4-2000

20th Annual Conference on Legal Issues for Financial Institutions

Office of Continuing Legal Education at the University of Kentucky College of Law

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20th Annual
Conference On
LEGAL ISSUES FOR FINANCIAL INSTITUTIONS
April 2000
Presented by the OFFICE OF CONTINUING LEGAL EDUCATION UNIVERSITY OF KENTUCKY COLLEGE OF LAW
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20th Annual Conference
LEGAL ISSUES FOR
FINANCIAL INSTITUTIONS

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FROM THE
2000 KENTUCKY GENERAL ASSEMBLY
CONCERNING FINANCIAL INSTITUTIONS

Debra K. Stamper
Kentucky Bankers Association
Louisville, Kentucky

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SECTION A
# LEGISLATIVE DEVELOPMENTS FROM THE 2000 KENTUCKY GENERAL ASSEMBLY CONCERNING FINANCIAL INSTITUTIONS

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**SECTION A**
I. **Introduction.** The materials included in this summary were accumulated as of March 29, 2000 and based upon bills introduced in the Kentucky 2000 General Session. The bills summarized here include issues of particular importance to financial institutions doing business in Kentucky. As these materials were compiled before the last day of session, it is subject to change. Updates will be provided at the seminar. More detailed information will be provided to financial institutions next month in a booklet produced by the Kentucky Bankers Association entitled *2000 Session in Summary.* Most of the bills summarized are included with these materials. Bills not included may be obtained through the LRC Website at www.lrc.state.ky.us/ or by contacting Debra Stamper at 502-582-2453.

II. **UCC amendments to Articles 5 and 9 and Central Filing (SB 11).** This bill and its changes will be covered in a separate section of the program.

III. **Lien Release (SB 44).** This bill amends KRS Section 382.365 to increase penalties for failure to timely release liens on real property. The statute now requires, rather than allows, for costs and attorneys fees. Additionally, it increases the penalty for failure to release a lien within 30 days. The penalty is now $100 per day beginning on the 15th day after notice is received of the failure. That fee increases to $500 per day beginning on the 45th day after notice is received of the failure to release. Further, the amendments require that state licensing agents be notified of these actions against lienholders.

IV. **Collateralization of City Accounts (SB 72).** This bill amends KRS Section 91A.060 to allow uninsured city deposits to be collateralized consistent with 12 U.S.C 1823 and surety bonds permitted by KRS Section 41.240(4).

V. **Chapter 287 “Super Parity” (SB 169).** This bill is the Department of Financial Institutions clean up bill for KRS Chapter 287. Most notably, this bill contains a new parity statute. This new section of Chapter 287 allows a state bank with a CAMEL rating of 1 or 2 to engage in any activity that a state or national bank or state of federal thrift of any state could engage. Before engaging in these activities, the state bank must obtain and retain a legal opinion specifying the authority under which the activity is permitted. It is not required that this opinion be submitted to the Department in advance or that any applications or notices be filed.

Additionally, changes made to Chapter 287 include:

- Allowing the Department to accept filings electronically.
- Removing the requirement for approval prior to acquiring real estate.
- Allowing for a state bank to own or operate a courier service in any county where it has a branch or main office.

VI. **Parity for Insurance Agents (SB 232).** This bill contains the first ripple of state legislation created directly in response to the new Financial Modernization Act. This bill essentially creates a new section of Subtitle 2 of KRS Chapter 304 which offers
insurers, agents and brokers the ability to engage in any insurance activity that financial institutions can.

VII. Limitation on Actions against Appraisers (SB 257). This bill amends KRS Section 413.140 to require that tort on contract actions against real estate appraisers be brought within one year from the date of the occurrence or when it was, or reasonably should have been, discovered.

VIII. Identity Theft (HB 4). The Attorney General's Office and Kentucky financial institutions have finally gotten an identity theft bill with some real merit. This bill creates new sections of Chapter 514 to provide that it is a Class D felony to use any identifying information of another for the purpose of various benefits including: obtaining property, entering into financial transactions, avoiding detection or receiving commercial or political benefit. It specifically excludes credit and debit card fraud which is covered in Chapter 434. This bill further provides that trafficking in stolen identities is a Class C felony.

IX. Manufactured Homes as Real Estate (HB 348). This provides a method by which manufactured homes permanently affixed to real property may be converted to real estate. It required the filing of an Affidavit of Conversion and surrender of the Kentucky certificate of title (free of all liens) with the county clerk's office.

X. Statewide Branching (HB 377). This bill removes the county restrictions on branching by banks and authorizes banks upon application and a showing of public need to branch statewide. Additionally, this bill removes the restriction on acquisition of banks less than 5 years old.

XI. Uniform Electronic Transactions Act (SB 571). This bill is the natural next step after the 1998 Electronic Signature bill. Although the bill is much too comprehensive to be covered in an overview section, it retains many of the same protections and goals of the prior bill. Most notably:

- Use of electronic transactions is voluntary.
- Some flexibility is allowed for changing technologies.
- Records, signatures or contracts may not be denied legal effect or enforceability merely because it is or was created in electronic form.
- Allows records required to be retained, to be retained in electronic form.
GENERAL ASSEMBLY
COMMONWEALTH OF KENTUCKY
2000 REGULAR SESSION

SENATE BILL 44
- Summary -

SB 44 (BR 382) - T. Buford

AN ACT relating to liens.
Amend KRS 382.365 to increase monetary penalties for not releasing satisfied liens on real property without good cause and to provide that other liens shall not be perfected while in violation.

SB 44 - AMENDMENTS

SCS - Amend to delete language in Section 1(8) that blocked perfection of security interest or lien if lienholder violated lien lease requirement.
SFA (1, T. Buford) - Amend to establish that beginning on the fifteenth day after receipt of the written notice by the lienholder, the penalty provisions for failure to release a lien will begin; amend to require the licensing agency of any lienholder to be notified of any actions brought against the lienholder under the penalty provisions.
SFA (2, T. Buford) - Amend to establish that beginning on the fifteenth day after receipt of the written notice by the lienholder, the penalty provisions for failure to release a lien will begin; amend to require the licensing agency of any lienholder to be notified of any action brought against the lienholder under the penalty provisions.
HCS - Add a provision specifying that the remedy provided by the statute is ancillary and supplemental to any other remedy provided by law.

Jan 4-introduced in Senate
Jan 6-to Banking and Insurance (S)
Jan 11-reported favorably, 1st reading, to Calendar with Committee Substitute
Jan 12-2nd reading, to Rules; posted for passage in the Regular Orders of the Day for Tuesday, January 18, 2000
Jan 13-floor amendment (1) filed
Jan 18-passed over and retained in the Orders of the Day; floor amendment (2) filed to Committee Substitute
Jan 19-3rd reading; floor amendment (1) withdrawn ; passed 38-0 with Committee Substitute, and floor amendment (2)
Substitute, and floor amendment (2)
Jan 20-received in House
Jan 21-to Judiciary (H)
Jan 24-posted in committee
Jan 27-reported favorably, 1st reading, to Calendar with Committee Substitute
Jan 28-2nd reading, to Rules
Feb 4-posted for passage in the Regular Orders of the Day for Monday, February 7, 2000
Mar 3-3rd reading, passed 97-0 with Committee Substitute
Mar 6-received in Senate
Mar 29-posted for passage for concurrence in House Committee Substitute ; Senate concurred in House Committee Substitute ; passed 30-0
AN ACT relating to liens.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

Section 1. KRS 382.365 is amended to read as follows:

(1) A holder of a lien on real property, including a lien provided for in KRS 376.010, shall release the lien in the county clerk's office where the lien is recorded within thirty (30) days from the date of satisfaction.

(2) A proceeding may be filed by any owner of real property or any party acquiring an interest in the real property in District Court or Circuit Court against a lienholder that violates subsection (1) of this section. A proceeding filed under this section shall be given precedence over other matters pending before the court.

(3) Upon proof to the court of the lien being satisfied, the court shall enter a judgment releasing the lien. The judgment shall include costs including a reasonable attorney's fee.

(4) A lienholder that continues to fail to release within thirty (30) days from the date of written notice of its failure to release and lack of good cause for not releasing the lien shall be liable to the owner of the real property in the amount of one hundred dollars ($100) per day for each day, beginning on the fifteenth day after receipt of the written notice, of the violation for which good cause did not exist.

(5) The former holder of a lien on real property shall send by regular mail a copy of the lien release to the property owner at his last known address within seven (7) days of the release. A former lienholder that violates this subsection shall be liable to the owner of the real property for fifty dollars ($50) and any actual expense incurred by the owner in obtaining documentation of the lien release.
(6) For the purposes of this section, "date of satisfaction" means that date of receipt by a holder of a lien on real property of a sum of money in the form of a certified check, cashier's check, wired transferred funds, or other form of payment satisfactory to the lienholder that is sufficient to pay the principal, interest, and other costs owing on the obligation that is secured by the lien on the property.

(7) The provisions of this section shall not apply when a lienholder is deceased and the estate of the lienholder has not been settled.

(8) The state licensing agency, if applicable, or any holder of a lien on real property shall be notified of the disposition of any actions brought under this section against the lienholder.

(9) The provisions of this Act shall be held and construed as ancillary and supplemental to any other remedy provided by law.
SENATE BILL 72
- Summary -

SB 72 (BR 1430) - D. Boswell

AN ACT relating to municipal finances.

Amend KRS 91A.060 to allow the amount of city funds in an official depository to be collateralized in accordance with 12 U.S.C. sec. 1823, to the extent it is uninsured, or by surety bond.

SB 72 - AMENDMENTS

HFA (1/Title, K. Upchurch) - Make title amendment.
HFA (2, K. Upchurch) - Create a new section of KRS Chapter 65 to suspend disbursal of funds from executive branch agencies to local governments that enact or enforce ordinances which exclude manufactured homes from siting in the jurisdiction of those local governments or which differentiate manufactured homes from other single-family dwellings.
HFA (3/P, K. Upchurch) - Amend KRS 100.111 to include the definitions of "mobile home," "qualified manufactured home," and "permanent foundation"; create a new section of KRS Chapter 100 to proscribe local governments from adopting and enforcing zoning or other land-use regulations which differentiate qualified manufactured homes from other single family residences while not applying the provisions to manufactured homes and also not affecting the adoption of residential housing regulations and ordinances, and affirm a local government's ability to adopt regulations concerning various aspects of a qualified manufactured home; amend KRS 100.203 to add manufactured homes to the content of zoning regulations without affecting, modifying, or abolishing certain legal instruments; create a new section of KRS Chapter 65 to suspend any funds from any executive branch agency payable to a city, county, urban-county government, or charter county government which adopts or enforces any ordinance which excludes from the locality or differentiates qualified manufactured homes from other single family residences.

Jan 10-introduced in Senate
Jan 12-to State and Local Government (S)
Feb 8-reported favorably, 1st reading, to Consent Calendar
Feb 9-2nd reading, to Rules
Feb 14-posted for passage in the Consent Orders of the Day for Wednesday, February 16, 2000
Feb 16-3rd reading, passed 37-0
Feb 17-received in House
Feb 18-to Local Government (H)
Mar 14-posted in committee
Mar 16-reported favorably, 1st reading, to Calendar
Mar 17-2nd reading, to Rules
Mar 20-posted for passage in the Regular Orders of the Day for Tuesday, March 21, 2000
Mar 22-floor amendments (1) (2) and (3) filed; 3rd reading, passed 95-0
Mar 23-received in Senate; enrolled, signed by each presiding officer, delivered to Governor
Mar 29-signed by Governor (Acts ch. 207)
AN ACT relating to municipal finances.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

Section 1. KRS 91A.060 is amended to read as follows:

(1) The executive authority shall designate as the city's official depositories one (1) or more banks, federally insured savings and loan companies or trust companies within the Commonwealth. The amount of funds on deposit in an official depository shall be fully insured by deposit insurance or collateralized in accordance with 12 U.S.C. sec. 1823, to the extent uninsured, by any obligations, including surety bonds permitted by KRS 41.240(4).

(2) All receipts from any source of city money or money for which the city is responsible, which has not been otherwise invested or deposited in a manner authorized by law, shall be deposited in official depositories. All city funds shall be disbursed by written authorization approved by the executive authority which shall state the name of the person to whom funds are payable, the purpose of the payment and the fund out of which the funds are payable. Each authorization shall be numbered and recorded.
GENERAL ASSEMBLY
COMMONWEALTH OF KENTUCKY
2000 REGULAR SESSION

SENATE BILL 169
- Summary -

SB 169 (BR 1831) - T. Buford

AN ACT relating to banks.
Create a new section of KRS Chapter 287 to permit state banks which receive a CAMEL rating of 1 or 2 to engage in certain banking activities under certain circumstances; amend KRS 287.011 to permit the department to accept required filings in electronic format or other technology; amend KRS 287.100 to permit a bank to own or operate a courier service under certain conditions; amend KRS 287.180 to permit a bank to establish a branch in a county in which its principal office or an existing branch is located, with permission of the commissioner; amend KRS 287.185 to permit a bank to move its principal office or a branch from one location to another with the permission of the commissioner; amend KRS 287.900 to prohibit a bank holding company from acquiring or controlling greater than fifty percent (50%) of voting securities; amend KRS 287.920 to establish that interstate merger transactions and the approval thereof will be determined in part from the most recent June 30 quarterly report.

SB 169 - AMENDMENTS

SCS - Amend to give state banks parity with national banks, and with banks in other states.

Feb 1-introduced in Senate
Feb 3-to Banking and Insurance (S)
Feb 8-reported favorably, 1st reading, to Consent Calendar with Committee Substitute
Feb 9-2nd reading, to Rules
Feb 14-moved from Consent; posted for passage in the Regular Orders of the Day for Wednesday, February 16, 2000
Feb 16-3rd reading, passed 37-0 with Committee Substitute
Feb 17-received in House
Feb 18-to Banking and Insurance (H)
Feb 25-posted in committee
Mar 9-reported favorably, 1st reading, to Calendar
Mar 10-2nd reading, to Rules
Mar 16-posted for passage in the Regular Orders of the Day for Friday, March 17, 2000
Mar 23-3rd reading, passed 96-0
Mar 24-received in Senate; enrolled, signed by each presiding officer, delivered to Governor
Mar 31-signed by Governor (Acts ch. 279)
AN ACT relating to banks.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 287 IS CREATED TO READ AS FOLLOWS:

(1) As used in this section, a CAMEL rating means a system of rating used by examiners of financial institutions to rate the institutions in five (5) categories: capital adequacy, asset quality, management effectiveness, quantity and quality of earnings, and liquidity.

(2) In addition to all other banking activities permitted by this chapter, a state bank receiving a CAMEL rating of 1 or 2 at its most recent state or federal bank regulatory examination may engage in any banking activity in which the bank could engage if:

(a) It was operating as a national bank in any state;
(b) It was operating as a state bank, state thrift, or state savings bank in any state; or
(c) It meets the qualified thrift lender test as determined by the Office of Thrift Supervision or its successor, or was operating as a federally chartered thrift or federal savings bank in any state.

(3) Before a state bank may engage in any of the banking activities permitted by subsection (1) of this section, the state bank shall obtain a legal opinion specifying the statutory or regulatory provisions that permit the activity in which the state bank intends to engage. This legal opinion shall be maintained by the bank and provided to the department upon request.
Section 2. KRS 287.011 is amended to read as follows:

(1) There is created a Department of Financial Institutions, which constitutes a department of the state government within the meaning of KRS Chapter 12. The department shall be headed by a commissioner of financial institutions, who shall be the executive head of the department and shall be charged with the administration of the department.

(2) The Department of Financial Institutions shall exercise all administrative functions of the state in relation to the regulation, supervision, chartering and licensing of banks, trust companies, savings and loan associations, consumer loan companies, investment and industrial loan companies, and credit unions, and in relation to the regulation of securities.

(3) There is established within the Department of Financial Institutions the following divisions and offices:
   (a) The Division of Financial Institutions, which shall be headed by a director appointed by the commissioner, subject to prior written approval of the Governor in accordance with KRS 12.050. The division shall consist of entities deemed appropriate by the commissioner;
   (b) The Division of Securities, which shall be headed by a director appointed by the commissioner in accordance with KRS 12.050. The division shall consist of entities deemed appropriate by the commissioner;
   (c) The Division of Administrative Services, which shall be headed by a director appointed by the commissioner in accordance with KRS 12.050. The division shall be composed of organizational entities deemed appropriate by the commissioner;
   (d) The Office of the Commissioner, which shall be composed of organizational entities deemed appropriate by the commissioner, and
   (e) The Office of General Counsel, which shall be headed by a general counsel appointed by the commissioner in accordance with KRS 12.050. The office shall be composed of organizational entities as deemed appropriate by the commissioner.

(4) The department may accept any application or other document required to be filed with the department in electronic format or in any other technology acceptable to the department.
Section 3. KRS 287.100 is amended to read as follows:

A bank may:

1. Hold personal property that has been transferred to it as collateral for the payment of any debt;

2. Acquire and hold title to real estate, provided:
   a. The real estate is necessary or appropriate for the transaction of legitimate business and the acquisition has been approved by the commissioner as required by KRS 287.103; and
   b. The cost of the real estate, including furniture and fixtures, shall not exceed forty percent (40%) of the total paid-in capital, unimpaired surplus and undivided profits (determined on accrual basis). The investment may exceed the bank's forty percent (40%) limit with prior written approval of the commissioner;

3. Acquire and hold for not longer than ten (10) years, any real estate conveyed to it in satisfaction of debts previously contracted in the course of its business, or that it may purchase under a judgment in its favor. A bank acquiring real estate in satisfaction of debts previously contracted in the course of business shall write down the acquisition at ten percent (10%) per year;

4. Invest in the bonds of any federal home loan bank;

5. Invest in obligations issued separately or collectively by or for federal land banks, federal intermediate credit banks and banks for cooperatives under the Act of Congress known as the Farm Credit Act of 1971, 85 Stat. 583, 12 U.S.C. sec. 2001 and amendments thereto;

6. Invest, subject to the approval of the commissioner, in the capital stock or bonds or both of any domestic realty corporation organized or existing for the sole purpose of acquiring and holding title to real property used by the bank, through lease or otherwise, for the transaction of the bank's legitimate business;

7. Purchase, hold, and convey the shares of any open end registered investment company registered under the Investment Company Act of 1940, or a series of the company, whose shares are registered under the Securities Act of 1933 and whose investments are limited to:
   a. Bonds or other interest-bearing obligations of the United States, or those for the payment of the principal and interest on which the faith and credit of the United States is pledged;
   b. Stocks, bonds, or other interest-bearing or dividend-yielding obligations issued or guaranteed as to the payment of principal and interest or dividend by any instrumentality presently or hereafter incorporated by authority of an Act of Congress;
   c. General obligation bonds or revenue bonds issued and guaranteed as to payment of principal and interest by any state, county, or municipal governments legally authorized to issue such instruments of indebtedness;
   d. Any other obligations in which national banking associations organized under the laws of the United States are permitted to invest in directly;

8. Purchase and hold shares of a bank service corporation as that term is used in the Bank Service Corporation Act (12 U.S.C. sec. 1861) and any amendments thereto;

9. Invest in:
   a. Bonds or other interest-bearing obligations of the United States, or those for the payment of the principal and interest on which the faith and credit of the United States is pledged;
   b. Stocks, bonds, or other interest-bearing or dividend-yielding obligations issued or guaranteed as to the payment of principal and interest or dividend by any instrumentality presently or hereafter incorporated by authority of an Act of Congress;
   c. General obligation bonds or revenue bonds issued and guaranteed as to payment of principal and interest by any state, county, or municipal governments legally authorized to issue such instruments of indebtedness;
(10) (a) Invest in other real estate in the bank's generally accepted banking market. For purposes of this section, "the bank's generally accepted banking market" means the geographic banking market at the time the investment is made as defined by the Federal Reserve Bank in the Federal Reserve District in which the bank is located. The investment shall not exceed ten percent (10%) of the bank's actual paid-in capital and surplus, calculated at the time the investment is made, for each real estate investment; and

(b) Investment in other real estate, not to exceed ten percent (10%) of the bank's actual paid-in capital and surplus, calculated at the time the investment is made, for each real estate investment, if the bank has acquired the real estate in satisfaction of a debt previously contracted and the investment is for the purpose of improving the real estate for sale. Any real estate acquired in satisfaction of a debt previously contracted and improved by the bank shall be disposed of within five (5) years of the date of acquisition, with the commissioner authorized to extend the disposition upon written request of the bank for good cause shown on a year-to-year basis not exceeding an additional five (5) years;

(11) Own or operate a discount brokerage service either through the bank or a bona fide subsidiary of the bank;

(12) Own or operate a travel agency either through the bank or a bona fide subsidiary of the bank;

(13) Invest, with the prior approval of the commissioner, in the capital stock or bonds of a trust company; and

(14) Own or operate a courier service, either through the bank or a bona fide subsidiary of the bank, in any county where the bank has its principal office or a branch.

Investments in accordance with subsections (7) and (9) of this section are subject to KRS 287.280 and 287.290. For purposes of computing the maximum investment of a bank in bonds, notes, and other investments, book value shall be used. For deep discount bonds or zero coupon bonds, accreted book value shall be used.

Section 4. KRS 287.180 is amended to read as follows:

(1) Banks authorized under the laws of this state may, except as provided in subsections (2) or (3) of this section, exercise, only at their principal office, powers necessary to carry on the business of banking by discounting and negotiating notes, drafts, bills of exchange and other evidences of debt, and by purchasing bonds, receiving deposits and allowing interest on these items, buying and selling exchange, coin, and bullion, and lending money on personal or real security.

(2) A bank may establish a branch in a county in which its principal office or an existing branch is located and may exercise all of the powers conferred in subsection (1) of this section at the branch. A bank, except for a bank that the commissioner may designate by the promulgation of administrative regulations, shall apply to the commissioner for permission to establish a branch. Any corporation presently or after July 13, 1990, engaged in the business of banking, and meeting the requirements of this subsection, may apply to the commissioner for permission to establish, within any county in which its principal office or an existing branch is located, a branch at which all of the powers conferred in subsection (1) of this section may be exercised. Before the commissioner shall approve or disapprove any application made under this subsection the commissioner shall ascertain and determine that the public convenience and advantage will be served and promoted and that there is reasonable probability of the successful operation of the branch based upon the financial and managerial impact of the branch on the bank establishing the branch. The following conditions shall apply to applications for branches:

(a) The permission to open a branch shall lapse one (1) year after the commissioner has rendered a final order as defined in KRS 13B.010, unless it shall have been opened and business actually begun in good faith. If, for reasons beyond the control of the applicant, the branch is not opened within this time period, permission to open the branch may, with the approval of the commissioner, be extended for any period of time the commissioner deems to be necessary; and
An application to establish a branch office shall be approved or disapproved by the commissioner based upon the facts existing at the date of filing of the application, except for the financial condition of the bank proposing to establish a branch office, which condition shall be subject to review until an order ruling on the application is made.

Any corporation which on January 1, 1966, was engaged in operating an agency or branch bank may continue to retain and operate the agency or branch bank under the general banking laws, and the requirements set forth in this section in respect to capital shall not apply to any existing agency or branch bank but only as to those agencies or branch banks which may be established in the future in accordance with the terms of this section.

The provisions of this section shall not be construed to prohibit the merger of banks in the same county and the operation by the merged corporation of the banks, nor to prohibit the sale of any bank to, and the purchase by, any other bank in the same county and the operation of the bank by the purchasing bank as a branch, provided the commissioner shall determine that the public convenience and necessity will be served by the operation, and provided further that, at the time of the merger or purchase, each of the banks involved shall have been in operation for a period of five (5) years or more. The bank which does not survive the merger shall surrender its charter.

Any national banking association or any state bank member of the Federal Reserve system whose principal office is located in this state may do all things and perform all acts which state banks are permitted to do or perform under this section, subject to the conditions and restrictions provided for banks as to exercise of these powers.

When a branch or agency bank has once been established any operation of the branch or agency bank shall not be discontinued, and the branch or agency bank shall not be closed until after ninety (90) days' notice in writing to the commissioner. In the discretion of the commissioner the branch or agency bank proposing to discontinue operation may be required to give notice of the date when its operation will cease.

Section 5. KRS 287.185 is amended to read as follows:

A bank may move its principal office or a branch from one location to another. A bank, except for a bank that the commissioner may designate through the promulgation of administrative regulations, shall apply to the commissioner for approval to relocate its principal office or a branch. No branch or principal office of any bank shall be moved from one location to another without the approval of the commissioner. Before the commissioner shall approve or disapprove any change of location he shall ascertain and determine that the public convenience and advantage will be served and promoted and that there is a reasonable probability of the successful operation of the branch or principal office at the new location.

Section 6. KRS 287.900 is amended to read as follows:

For purposes of this section and KRS 287.905:

(a) "Bank" means any institution organized under this chapter, the banking laws of another state, or the National Bank Act, as amended, to do a banking business. However, it shall not include an "interim bank" chartered solely for the purpose of facilitating the acquisition of an existing bank unless the existing bank has been in existence for less than five (5) years;

(b) "Bank holding company," "company," and "control" have the meanings accorded them in the Federal Bank Holding Company Act of 1956, as amended (12 U.S.C. secs. 1841 et seq.). "Control" may be acquired by acquisition of voting securities, by purchase of assets, by merger or consolidation, by contract, or otherwise;
(c) "Individual" means a natural person, partnership, association, business trust, voting trust, or similar organization. Individual does not include a corporation; and

(d) "Deposit" has the meaning accorded it in the Federal Deposit Insurance Act, as amended, and regulations promulgated thereunder; excluded, however, from deposits are all interbank deposits and all deposits in foreign branches and international banking facilities, as shown in the reports made by all federally-insured depository institutions to their respective supervisory authorities.

(2) Any individual, or any bank holding company having its principal place of business in this state, may acquire control of one (1) or more banks or bank holding companies wherever located, except that no individual, who on July 13, 1984, controls a bank or bank holding company wherever located, and no bank holding company wherever located, may acquire, directly or indirectly, control of greater than fifty percent (50%) of the voting securities of a bank having its principal place of business in this state if the bank was chartered after July 13, 1984, and if, at the time of the acquisition, the bank has been in existence less than five (5) years. The provisions of this subsection shall not prohibit the organization of a one (1) bank holding company for the purpose of acquiring control of a bank even if the bank was chartered after July 13, 1984, and has been in existence less than five (5) years at the time of the acquisition.

(3) No individual or bank holding company wherever located may acquire control of any bank or bank holding company if, upon the acquisition, the individual or bank holding company would control banks in this state holding more than fifteen percent (15%) of the total deposits and member accounts in the offices of all federally-insured depository institutions in this state as reported in the most recent June 30 quarterly reports made by the institutions to their respective supervisory authorities which are available at the time of the acquisition.

(4) The limitations set forth in this section or any other provision of this chapter or any administrative regulation promulgated thereunder, as now in effect or amended after July 13, 1984, shall not apply to the acquisition of a bank if, in his or her discretion, the commissioner, if the bank is organized under the laws of this state, or the comptroller of the currency, if the bank is a national bank, determines that an emergency exists and the acquisition is appropriate in order to prevent the probable failure of the bank which is closed or is in danger of closing.

(5) The provisions of this section shall not be construed to prohibit or restrict the merger or consolidation of banks or bank holding companies having their principal places of business in the same county and the operation by the merged or consolidated corporation of the banks, nor to prohibit the sale of any bank or bank holding company to, and the purchase thereof by, any other bank or bank holding company with its principal place of business in the same county and the operation of the bank as a branch so long as the provisions of KRS 287.180(4) have been satisfied.

Section 7. KRS 287.920 is amended to read as follows:

(1) As used in this section, unless the context requires otherwise:

(a) "Interstate merger transaction" means the merger or consolidation of banks with different home states, and the conversion of branches of any bank involved in the merger or consolidation into branches of the resulting bank; and

(b) "Resulting bank" means a bank that has resulted from an interstate merger transaction under this section.

(2) A Kentucky state bank may establish, maintain, and operate one (1) or more branches in a state other than Kentucky in accordance with an interstate merger transaction in which the Kentucky state bank is the resulting bank, or if the other state permits, by acquisition of a branch or branches in the other state. Not later than the date on which the required application for the interstate merger transaction or branch acquisition is filed with the responsible federal bank supervisory agency, the applicant shall file an application on a form prescribed by the commissioner and pay the fee prescribed by KRS 287.480. The applicant shall also comply with the applicable provisions of KRS...
287.180(2) and the commissioner shall base his or her approval or disapproval in the same manner as prescribed in KRS 287.180(2).

(3) An out-of-state state bank may establish, maintain, and operate one (1) or more branches in Kentucky in accordance with an interstate merger transaction in which the out-of-state state bank is the resulting bank. Not later than the date on which the required application for the interstate merger transaction is filed with the responsible federal bank supervisory agency, the applicant shall file an application on a form prescribed by the commissioner, pay the fee prescribed by KRS 287.480, and agree in writing to comply with the laws of this state applicable to its operation of branches in Kentucky. The applicant shall also comply with the applicable provisions of KRS 287.180(2) and the commissioner shall base his or her approval or disapproval in the same manner as prescribed in KRS 287.180(2).

(4) The bank to be acquired in an interstate merger transaction under the provisions of subsection (3) of this section shall have been involved in operation for a period of five (5) years or more. No interstate merger transaction under subsections (2) or (3) of this section shall be approved if the transaction would result in a bank holding company having control of banks or branches in this state holding more than fifteen percent (15%) of the total deposits and member accounts in the offices of all federally-insured depository institutions in this state as reported in the most recent June 30 quarterly report made by the institutions to their respective supervisory authorities which are available at the time of the transaction.

(5) An individual or bank holding company that controls two (2) or more banks may, from time to time, combine any or all of the commonly controlled banks in this Commonwealth into and with any one (1) of the banks, and thereafter the surviving bank shall continue to operate its principal office and may operate the other authorized offices of the banks so combined as branches of the surviving bank.

(6) A branch of an out-of-state state bank may conduct any activities that are authorized under the laws of this state for state banks. Additionally, the branch of an out-of-state state bank is authorized to conduct any activities relating to the administration of trusts that are authorized under the laws of its home state, if the activities are conducted in conformity with the laws of its home state.

(7) A branch of a Kentucky state bank located in a host state may conduct any activities that are:
   (a) Authorized under the laws of the host state for banks chartered by the host state; or
   (b) Authorized for branches of national banks located in the host state, but whose principal location is in a state other than the host state.
GENERAL ASSEMBLY
COMMONWEALTH OF KENTUCKY
2000 REGULAR SESSION

SENATE BILL 232
- Summary -

SB 232 (BR 2040) - D. Karem

AN ACT relating to insurance.
Create new sections of Subtitle 2 of KRS Chapter 304 to allow insurers and agents to engage in insurance activities granted to financial institutions by federal law; authorize the commissioner of insurance to enter into interstate compacts for issuing certificates of authority to insurers.

SB 232 - AMENDMENTS
HFA (1/P, M. Marzian) - Retain original provisions; attach provisions of HB 364 with the exception that the cap on the amount of drug assistance is limited to $500 instead of $700 and the funding is through the Kentucky Health Care Improvement Authority instead of using general funds; create a new section of KRS 205.510 to 205.630 to expand Medicaid coverage to low-income families up to 100% of the federal poverty level; require the Cabinet for Health Services to apply a resource limit of no less than $4,000 per household and exempt 2 cars for families with 2 parents and 1 car for families with 1 parent; require the Cabinet for Health Services to submit a waiver to the federal Health Care Financing Administration to exclude adults with employer-offered health benefit plans in which the total of employer-required premium shares is less than 10% of gross household income and to apply a copayment of $3 to physician office visits, laboratory services, radiology services, prescription drugs, hospital admissions, outpatient surgery, and nonemergency use of the emergency room for adults; require the cabinet to permit families to apply for coverage using the same application form used in determining eligibility for the Kentucky Children's Health Insurance Program; create a new section of KRS 17B of KRS Chapter 304 to establish the Kentucky Health Care Improvement Authority, designate 13 members and name the commissioner of the Department for Medicaid Services as the chair; provide that 70 percent of the moneys in the fund be used for Medicaid coverage for low-income families and the Kentucky Prescription Drug Assistance Program for the elderly, 20 percent be spent on collaborative partnerships between the University of Louisville and the University of Kentucky dedicated to lung cancer research, and 10 percent be spent to discourage the use of harmful substances by minors; appropriate $7,000,000 for fiscal year 2000-2001 and $7,000,000 for fiscal year 2001-2002 from the tobacco settlement to fund the Kentucky Prescription Drug Assistance Program for low-income elderly; appropriate $10,700,000 for fiscal year 2000-2001 and $14,300,000 for fiscal year 2001-2002 from the tobacco settlement to expand Medicaid to low-income parents; EMERGENCY.
HFA (2/Title, M. Marzian) - Make title amendment.

Feb 8-introduced in Senate
Feb 10-to Banking and Insurance (S)
Feb 15-reported favorably, 1st reading, to Consent Calendar
Feb 16-2nd reading, to Rules
Feb 18-posted for passage in the Consent Orders of the Day for Wednesday, February 23, 2000

Feb 23-3rd reading, passed 38-0
Feb 24-received in House
Feb 25-to Banking and Insurance (H)
Mar 1-posted in committee
Mar 9-reported favorably, 1st reading, to Calendar
Mar 10-2nd reading, to Rules
Mar 16-posted for passage in the Regular Orders of the Day for Friday, March 17, 2000
Mar 17-floor amendments (1) and (2-title) filed
Mar 21-floor amendments (1) and (2-title) withdrawn
Mar 22-3rd reading, passed 91-0
Mar 23-received in Senate; enrolled, signed by each presiding officer, delivered to Governor
Mar 31-signed by Governor (Acts ch. 254)

A - 17
AN ACT relating to insurance.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF SUBTITLE 2 OF KRS CHAPTER 304 IS CREATED TO READ AS FOLLOWS:
Notwithstanding any other provision of law, to the extent authorized by the commissioner by administrative regulation, a licensed agent, producer, broker, or insurer has the power to engage in any insurance activity that financial institutions chartered by or otherwise subject to the jurisdiction of the federal government are authorized to engage in according to federal law or regulation or by a court of competent jurisdiction.

SECTION 2. A NEW SECTION OF SUBTITLE 2 OF KRS CHAPTER 304 IS CREATED TO READ AS FOLLOWS:

(1) The commissioner may enter into interstate compacts for issuing certificates of authority to insurers if the commissioner determines that:
   (a) Each state participating in the compact has requirements for issuing certificates of authority that provide protections substantially similar to or greater than the requirements of this subtitle; or
   (b) The interstate compact contains requirements for issuing certificates of authority that provide protections substantially similar to or greater than the requirements of this subtitle.

(2) In lieu of the documents required in KRS 304.3-150(1) to (14) to be filed with an application for certificate of authority, the commissioner may accept documentation in accordance with the terms of the interstate compact.

(3) The commissioner may issue certificates of authority to insurers in accordance with the terms of the interstate compact.
SENATE BILL 257
- Summary -

HB 257 (BR 1305) - P. Marcotte, J. Reinhardt, C. Walton

AN ACT changing the classification of the City of Union, in Boone County. Reclassify the City of Union, population 1,199, from a city of the sixth class to a city of the fifth class. Section 156 of the Kentucky Constitution, now repealed, but not yet superseded, requires a population of 1,000 to 2,999 for a city of the fifth class.

Jan 5-introduced in House
Jan 6-to Local Government (H)
Jan 12-posted in committee
Jan 20-reported favorably, 1st reading, to Calendar
Jan 21-2nd reading, to Rules; posted for passage in the Regular Orders of the Day for Monday, January 24, 2000
Jan 24-3rd reading, passed 95-0
Jan 25-received in Senate
Jan 27-to State and Local Government (S)
Feb 8-reported favorably, 1st reading, to Consent Calendar
Feb 9-2nd reading, to Rules
Feb 14-posted for passage in the Consent Orders of the Day for Wednesday, February 16, 2000
Feb 16-3rd reading, passed 37-0
Feb 17-received in House; enrolled, signed by Speaker of the House
Feb 18-enrolled, signed by President of the Senate; delivered to Governor
Feb 22-signed by Governor (Acts ch. 24)
AN ACT relating to limitation of actions.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

Section 1. KRS 413.140 is amended to read as follows:

The following actions shall be commenced within one (1) year after the cause of action accrued:

(a) An action for an injury to the person of the plaintiff, or of her husband, his wife, child, ward, apprentice or servant.

(b) An action for injuries to persons, cattle or other livestock by railroads or other corporations, with the exception of hospitals licensed pursuant to KRS Chapter 216.

(c) An action for malicious prosecution, conspiracy, arrest, seduction, criminal conversation or breach of promise of marriage.

(d) An action for libel or slander.

(e) An action against a physician, surgeon, dentist or hospital licensed pursuant to KRS Chapter 216, for negligence or malpractice.

(f) A civil action, arising out of any act or omission in rendering, or failing to render, professional services for others, whether brought in tort or contract, against a real estate appraiser holding a certificate or license issued under KRS Chapter 324A.

(g) An action for the escape of a prisoner, arrested or imprisoned on civil process.

(h)(g) An action for the recovery of usury paid for the loan or forbearance of money or other thing, against the loaner or forbearer or assignee of either.

(h)(f) An action for the recovery of stolen property, by the owner thereof against any person having the same in his possession.

(i)(h) An action for the recovery of damages or the value of stolen property, against the thief or any accessory.

In respect to the action referred to in paragraph (e) of subsection (1) of this section, the cause of action shall be deemed to accrue at the time the injury is first discovered or in the exercise of reasonable care should have been discovered, provided that such action shall be commenced within five (5) years from the date on which the alleged negligent act or omission is said to have occurred.
(3) *In respect to the action referred to in paragraph (f) of subsection (1) of this section, the cause of action shall be deemed to accrue within one (1) year from the date of the occurrence or from the date when the cause of action was, or reasonably should have been, discovered by the party injured.*

(4) In respect to the action referred to in paragraph (f) of subsection (1) of this section, the cause of action shall be deemed to accrue at the time of payment. This limitation shall apply to all payments made on all demands, whether evidenced by writing or existing only in parol.

(5) In respect to the action referred to in paragraph (f) of subsection (1) of this section, the cause of action shall be deemed to accrue at the time the property is found by its owner.

(6) In respect to the action referred to in paragraph (f) of subsection (1) of this section, the cause of action shall be deemed to accrue at the time of discovery of the liability.
HB 4/FN/CI (BR 72) - J. Vincent, S. Baugh, J. Crenshaw, P. Marcotte, J. Reinhardt, C. Walton, R. Wilkey

AN ACT relating to identity theft.

Create a new section of KRS Chapter 514 to create the crime of theft of identity as a Class D felony for the first offense and Class C felony for subsequent offenses; create a new section of KRS Chapter 514 to create the crime of trafficking in stolen identities as a Class C felony for the first offense and Class B felony for subsequent offenses; create a new section of KRS Chapter 411 to create a civil cause of action for persons whose identity have been stolen against traffickers, provide for compensatory and punitive damages.

HB 4 - AMENDMENTS

HCS/FN/CI - Delete punishing second and subsequent identity theft offenses as Class C felonies; delete punishing second and subsequent trafficking in stolen identity offenses as Class B felonies; add the penalty of payment of restitution; permit the Attorney General to have concurrent jurisdiction with Commonwealth's attorneys and county attorneys for the prosecution of offenses under the Act.

SFA (1/P, R. Roeding) - Include in the crime of criminal homicide a criminal homicide committed against an unborn child; exempt certain physicians from being guilty of criminal homicide committed against an unborn child; exempt a mother from being guilty of criminal homicide committed against an unborn child.

SFA (2/Title, R. Roeding) - Make title amendment.

(Prefiled by the sponsor(s) indicated with recommendation for passage, and as amended by the Interim Joint Committee on Judiciary)

Jan 4-introduced in House; to Judiciary (H); posting waived
Jan 6-reported favorably, 1st reading, to Calendar with Committee Substitute
Jan 7-2nd reading, to Rules; recommitted to Appropriations and Revenue (H)
Feb 14-posted in committee
Feb 18-reported favorably, to Rules with original Committee Substitute
Feb 24-posted for passage in the Regular Orders of the Day for Friday, February 25, 2000
Feb 25-3rd reading, passed 92-0 with Committee Substitute
Feb 28-received in Senate
Mar 1-to Judiciary (S)
Mar 15-reported favorably, 1st reading, to Consent Calendar
Mar 16-2nd reading, to Rules; posted for passage in the Consent Orders of the Day for Friday, March 17, 2000; floor amendments (1) and (2-title) filed
Mar 17-taken from the Consent Orders of the Day, placed in the Regular Orders of the Day; 3rd reading; floor amendment (1) ruled not germane; passed 33-0
Mar 20-received in House; enrolled, signed by Speaker of the House
Mar 21-enrolled, signed by President of the Senate; delivered to Governor
Mar 28-signed by Governor (Acts ch. 174)
Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 514 IS CREATED TO READ AS FOLLOWS:

(1) A person is guilty of the theft of the identity of another when, without the other's consent, he or she knowingly possesses or uses any identifying information of the other person, such as one's name, Social Security number, birth date, personal identification number or code, which is kept in documents, photo or electrical copies, computer storage, or any other form of document retrieval and storage, and the theft is committed with the intent to represent that he or she is the other person for the purpose of:

(a) Depriving the other person of property;
(b) Obtaining benefits or property to which he or she would otherwise not be entitled;
(c) Making financial or credit transactions using the other person's identity;
(d) Avoiding detection; or
(e) Commercial or political benefit.

(2) Theft of identity is a Class D felony.

(3) This section shall not apply when a person obtains the identity of another to misrepresent his or her age for the purpose of obtaining alcoholic beverages, tobacco, or another privilege denied to minors.

(4) This section does not apply to credit or debit card fraud under KRS 434.550 to 434.730.

(5) Where the offense consists of theft by obtaining or trafficking in the personal identity of another person, the venue of the prosecution may be in either the county where the offense was committed or the county where the other person resides.

(6) A person found guilty of violating any provisions of this section shall forfeit any lawful claim to the identifying information, property, or other realized benefit of the other person as a result of such violation.

SECTION 2. A NEW SECTION OF KRS CHAPTER 514 IS CREATED TO READ AS FOLLOWS:

(1) A person is guilty of trafficking in stolen identities when without the other's consent, he manufactures, sells, transfers, purchases, or possesses with intent to manufacture, transfer, purchase, or sell the personal identity of another person for any purpose listed in subsection (1) of Section 1 of this Act. The personal identity of an individual includes any identifying information of that person, such as one's name, Social Security number, birth date, personal identification number or code, which is kept in documents, photo or electrical copies, computer storage, or any other form of document retrieval and storage.
Possession of five (5) or more separate identities shall be prima facie evidence that the identities are possessed for the purpose of trafficking.

(3) Trafficking in stolen identities is a Class C felony.

SECTION 3. A NEW SECTION OF KRS CHAPTER 411 IS CREATED TO READ AS FOLLOWS:

(1) Anyone who is a victim under Section 1 or Section 2 of this Act shall have a cause of action, either where the victim resides or the defendant resides, for compensatory and punitive damages against anyone who violates Section 1 or Section 2 of this Act.

(2) The statute of limitations for cases under the provisions of this section shall be five (5) years from the date of the discovery of the violation of Section 1 or Section 2 of this Act.

SECTION 4. A NEW SECTION OF KRS CHAPTER 532 IS CREATED TO READ AS FOLLOWS:

(1) A person found guilty of violating any provisions of Section 1 or Section 2 of this Act shall, in addition to any other punishment, be ordered to make restitution for financial loss sustained by a victim as a result of the violation. Financial loss may include any costs incurred by the victim in correcting the credit history of the victim or any costs incurred in connection with any civil or administrative proceeding to satisfy any debt or other obligation of such victim, including lost wages and attorney's fees.

(2) A person found guilty of violating any provisions of Section 1 or Section 2 of this Act shall pay restitution to the person or entity that suffers the financial loss. In addition to the financial loss detailed in subsection (1) of this section, the person or entity may include a financial institution, insurance company, or bonding association that suffers direct financial loss as a result of the violation.

SECTION 5. A NEW SECTION OF KRS CHAPTER 15 IS CREATED TO READ AS FOLLOWS:

The Attorney General shall have concurrent jurisdiction with Commonwealth's attorneys and county attorneys for the prosecution of offenses under and the enforcement of the provisions of Sections 1, 2, 3, and 4 of this Act.
GENERAL ASSEMBLY
COMMONWEALTH OF KENTUCKY
2000 REGULAR SESSION

HOUSE BILL 348
- Summary -


AN ACT relating to manufactured homes.
Create a new section of KRS 186A to establish a procedure by which manufactured homes may be converted to real estate; amend KRS 132.720 to define the term "manufactured home"; amend KRS 132.751 to include manufactured homes under the classification of real property.

HB 348 - AMENDMENTS

SCA (1, D. Kelly) - Make technical corrections.

Jan 13-introduced in House
Jan 14-to Local Government (H)
Jan 24-posted in committee
Feb 3-reported favorably, 1st reading, to Calendar
Feb 4-2nd reading, to Rules; posted for passage in the Regular Orders of the Day for Monday, February 7, 2000
Feb 7-3rd reading, passed 94-0
Feb 8-received in Senate
Feb 10-to Appropriations and Revenue (S)
Mar 2-reported favorably, 1st reading, to Consent Calendar with committee amendment (1)
Mar 3-2nd reading, to Rules
Mar 6-posted for passage in the Consent Orders of the Day for Thursday, March 9, 2000
Mar 9-3rd reading, passed 37-0 with committee amendment (1)
Mar 10-received in House; posted for passage for concurrence in Senate committee amendment (1)
Mar 21-House concurred in Senate committee amendment (1) ; passed 92-2
Mar 23-enrolled, signed by each presiding officer, delivered to Governor
Mar 28-signed by Governor (Acts ch. 166)
AN ACT relating to manufactured homes.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 186A IS CREATED TO READ AS FOLLOWS:

(1) When a manufactured home is or is to be permanently affixed to real estate, the owner may execute and file an Affidavit of Conversion to Real Estate with the county clerk of the county in which the real estate is located. The affidavit shall attest to the fact that the home has been or will be permanently affixed to the real estate and be accompanied by a surrender of the Kentucky certificate of title. The county clerk shall file the Affidavit of Conversion to Real Estate in the miscellaneous record book.

(2) A county clerk shall not accept a surrender of a Kentucky certificate of title which displays an unreleased lien unless it is accompanied by a release of the lien. When the county clerk files the Affidavit of Conversion to Real Estate, the county clerk shall furnish a copy to the property valuation administrator for inclusion in the real property tax rolls of the county. A filing of an Affidavit of Conversion to Real Estate and a surrender of a Kentucky certificate of title shall be deemed a conversion of the property as an improvement to the real estate upon which it is located.

Section 2. KRS 132.720 is amended to read as follows:

As used in KRS 132.260 and 132.751, unless the context otherwise requires:

(1) "Manufactured home" has the same meaning as in KRS 186.650.

(2) "Mobile home," "recreational vehicle," "mobile home park," and "recreational vehicle park" have the same meanings as in KRS 219.320.

(3) "Unit" means any single mobile home, manufactured home, or recreational vehicle.

(4) "Permanent, fixed foundation" means a foundation permanent in nature which is so constructed as to be fixed upon the surface of the land.

Section 3. KRS 132.751 is amended to read as follows:

(1) Mobile homes or manufactured homes not held for resale by a dealer shall be classified as real property for the purpose of the levy and assessment of ad valorem taxes, regardless of whether or not the wheels or mobile parts have been removed and whether or not the unit rests on a permanent, fixed foundation.

(2) Recreational vehicles shall be classified as real property if the wheels or mobile parts have been removed and the unit rests on a permanent, fixed foundation.

AN ACT relating to branching and acquisition of banks in Kentucky.
Amend KRS 287.180 to allow banks to establish branch banks within any state, the District of Columbia, or a territory of the United States; amend KRS 287.172 to remove the same county or city requirement regarding bank mergers; amend KRS 287.900 to remove the "interim bank" exception; amend KRS 287.915, 287.920, and 287.180 to conform.

HB 377 - AMENDMENTS

HCA (1, J. Bruce) - Make technical corrections.
HFA (1, P. Bather) - Amend to limit to four (4) the number of contiguous counties in which banks may establish branches.
HFA (2, P. Bather) - Amend to limit to four (4) the number of contiguous counties in which banks may establish branches, or banks may establish branches within seventy-five (75) miles of the county in which its principal office is located.
HFA (3, K. Upchurch) - Amend HFA2 to retain original provisions of amendment but permit branching within 100 miles of the county in which the principal office is located if that county is a border county.
HFA (4, K. Upchurch) - Delete provision that allows branching in any county and replace with permission to branch within home county, within up to four contiguous counties, within 75 miles of the county, or within 100 miles of the county if the county is on the border of the state.
HFA (5, J. Stacy) - Prohibit a bank whose principal office is located in a county with a population of 16,000 or fewer persons from opening a branch in any other county; prohibit a bank from opening a branch in a county, other than the county in which its principal office is located, with a population of 16,000 or fewer persons.
HFA (6, J. Stacy) - Require bank that opts to branch statewide to keep 50 percent of deposits at the branch within the county and require all investments and profits of bank to remain in the Commonwealth.
HFA (7, J. Stacy) - Remove authorization to branch in any county; allow branching in contiguous counties.
HFA (8, J. Stacy) - Require a bank that opts to branch statewide to reinvest within the county in which the branch is located at least 80 percent of deposits made at a branch.
HFA (9, J. Stacy) - Require a bank that opts to branch statewide to make available to the public its sources of income, including amount attributable to investments and service charges; require each service charge to be listed separately and the funds received from each separate charge.
Jan 18-introduced in House
Jan 19-to Banking and Insurance (H)
Jan 24-posted in committee
Jan 27-reported favorably, 1st reading, to Calendar with committee amendment (1)
Jan 28-2nd reading, to Rules
Feb 2-posted for passage in the Regular Orders of the Day for Thursday, February 3, 2000
Feb 7-floor amendments (1) and (2) filed
Feb 8-floor amendment (3) filed to House floor amendment (2); floor amendment (4) filed
Feb 9-floor amendments (5) (6) (7) (8) and (9) filed
Feb 10-3rd reading; floor amendments (2) and (5) defeated; passed 74-18 with committee amendment (1)
Feb 14-received in Senate
Feb 16-to Banking and Insurance (S)
Feb 29-reported favorably, 1st reading, to Calendar
Mar 1-2nd reading, to Rules
Mar 2-posted for passage in the Regular Orders of the Day for Friday, March 3, 2000
Mar 3-3rd reading, passed 26-10
Mar 6-received in House; enrolled, signed by Speaker of the House
Mar 6-received in House; enrolled, signed by Speaker of the House
Mar 7-enrolled, signed by President of the Senate; delivered to Governor
Mar 17-signed by Governor (Acts ch.135)
AN ACT relating to branching and acquisition of banks in Kentucky.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

Section 1. KRS 287.180 is amended to read as follows:

(1) Banks authorized under the laws of this state may, except as provided in subsections (2) or (3) of this section, exercise, only at their principal office, powers necessary to carry on the business of banking by discounting and negotiating notes, drafts, bills of exchange and other evidences of debt, and by purchasing bonds, receiving deposits and allowing interest on these items, buying and selling exchange, coin, and bullion, and lending money on personal or real security.

(2) Any corporation presently or after July 13, 1990, engaged in the business of banking, and meeting the requirements of this subsection, may apply to the commissioner for permission to establish, within any state, the District of Columbia, or a territory of the United States, a branch at which all of the powers conferred in subsection (1) of this section may be exercised. Before the commissioner shall approve or disapprove any application made under this subsection he shall ascertain and determine that the public convenience and advantage will be served and promoted and that there is reasonable probability of the successful operation of the branch based upon the financial and managerial impact of the branch on the bank establishing the branch. The following conditions shall apply to applications for branches:
(a) The permission to open a branch shall lapse one (1) year after the commissioner has rendered a final order as defined in KRS 13B.010, unless it shall have been opened and business actually begun in good faith. If, for reasons beyond the control of the applicant, the branch is not opened within this time period, permission to open the branch may, with the approval of the commissioner, be extended for any period of time he deems to be necessary; and

(b) An application to establish a branch office shall be approved or disapproved by the commissioner based upon the facts existing at the date of filing of the application, except for the financial condition of the bank proposing to establish a branch office, which condition shall be subject to review until an order ruling on the application is made.

(3) Any corporation which on January 1, 1966, was engaged in operating an agency or branch bank may continue to retain and operate the agency or branch bank under the general banking laws, and the requirements set forth in this section in respect to capital shall not apply to any existing agency or branch bank but only as to those agencies or branch banks which may be established in the future pursuant to the terms of this section.

(4) The provisions of this section shall not be construed to prohibit the merger of banks in the same county and the operation by the merged corporation of the banks, nor to prohibit the sale of any bank to, and the purchase by, any other bank in the same county and the operation of the bank by the purchasing bank as a branch, provided the commissioner shall determine that the public convenience and necessity will be served by the operation; and provided further that, at the time of the merger or purchase, each of the banks involved shall have been in operation for a period of five (5) years or more. The bank which does not survive the merger shall surrender its charter.

(5) Any national banking association or any state bank member of the Federal Reserve system whose principal office is located in this state may do all things and perform all acts which state banks are permitted to do or perform under this section, subject to the conditions and restrictions provided for banks as to exercise of these powers.

(6) When a branch or agency bank has once been established any operation of the branch or agency bank shall not be discontinued, and the branch or agency bank shall not be closed until after ninety (90) days' notice in writing to the commissioner. In the discretion of the commissioner the branch or agency bank proposing to discontinue operation may be required to give notice of the date when its operation will cease.

Section 2. KRS 287.172 is amended to read as follows:
(1) A national banking association may convert into or merge with a state bank under a state charter, provided that:
   (a) the action taken complies with federal law;
   (b) In the case of a merger, the institutions to be merged are located in the same city or county.

(2) In the case of each conversion, a written plan of conversion shall be submitted, in duplicate, to the commissioner. Such plan shall be in form satisfactory to the commissioner, shall prescribe the terms and conditions of the conversion and the mode of carrying it into effect, and shall have annexed thereto and forming a part thereof the proposed articles of incorporation of the state bank which is to result from the conversion. Such articles of incorporation shall be in the form prescribed by law for the organization of state banks, with such variations, if any, as shall be satisfactory to the commissioner. With such plan of conversion there shall be submitted, in duplicate, to the commissioner a certificate of the president, secretary or cashier of the national banking association certifying that all steps have been taken which are necessary under federal law to the consummation of the conversion. The commissioner shall approve or disapprove such plan of conversion within sixty (60) days of the submission thereof to him. In considering the approval or disapproval of the conversion plan the commissioner shall take into account:
   (a) Any pending administrative or judicial action to which the bank or any officer or director of the bank is a party;
   (b) The performance of the converting national bank for the five (5) years preceding the application for conversion as compared to similarly situated state-chartered banks; and
   (c) The proposed name of the bank after conversion which shall not be the same as or deceptively similar to any existing state-chartered bank.

If the commissioner shall approve such plan, he shall file one (1) duplicate thereof, together with one (1) duplicate of such certificate submitted therewith and the original of the approval of the commissioner, in the office of the commissioner, and the other duplicate of such plan, together with a duplicate of such certificate and a duplicate of the commissioner’s approval, shall be filed in the office of the clerk of the county in which the principal office of the state bank is to be located. After such filing in the office of the commission, the conversion shall become effective upon the filing and recording of the articles of incorporation as provided in KRS 287.050, unless a later date is specified in the plan, in which event the conversion shall become effective upon such later date. If the commissioner shall disapprove the conversion plan, he shall state his reasons for such disapproval in writing to which the converting national bank shall have the right of appeal as permitted by law.

(3) In the case of each merger, a written plan of merger shall be submitted, in duplicate, to the commissioner. Such plan shall be in form satisfactory to the commissioner and shall prescribe the terms and conditions of the merger and the mode of carrying it into effect. Such plan may provide the name to be borne by the state bank, as receiving corporation, if such name is to be changed. Such plan may also name the persons who shall constitute the first board of directors of the state bank after the merger shall have been accomplished, provided that the number and qualifications of such persons shall be in accordance with the provisions of KRS Chapter 287 relating to the number and qualifications of directors of a state bank; or such plan may provide for a meeting of the stockholders to elect a board of directors within sixty (60) days after such merger, and may make provision for conducting the affairs of the state bank meanwhile. With such plan of merger there shall be submitted, in duplicate, to the commissioner the following:
   (a) By the national banking association, a certificate of the president, secretary or cashier of such association certifying that all steps have been taken which are necessary under federal law to the consummation of their merger;
   (b) By the state bank, a certificate of the president, secretary or cashier certifying that such plan of merger has been approved by the board of directors of the state bank by a majority vote of all the members thereof, that
such plan has been submitted to the stockholders of the state bank at a meeting thereof held; upon notice of at least fifteen (15) days, specifying the time, and place and object of such meeting and addressed to each stockholder at the address appearing upon the books of the state bank and published pursuant to KRS Chapter 424, and that such plan of merger has been approved at such meeting by the vote of the stockholders owning at least two-thirds (2/3) in amount of the stock of the state bank.

(4) The commissioner shall approve or disapprove such plan of merger within sixty (60) days of such submission thereof to him. If the commissioner shall approve such plan, he shall file one (1) duplicate thereof, together with one (1) duplicate of each of such certificates and the original of the approval of the commissioner, in the office of the commissioner, and the other duplicate of such plan, together with a duplicate of each of such certificates and a duplicate of the commissioner's approval, shall be filed in the office of the clerk of the county in which the principal office of the state bank is to be located. Upon such filing in the office of the commissioner, the merger shall become effective, unless a later date is specified in the plan, in which event the merger shall become effective upon such later date.

(5) At the time when such conversion or merger becomes effective:

(a) The resulting state bank shall be considered the same business and corporate entity as the national banking association, although as to rights, powers and duties, the resulting bank is a state bank;

(b) All of the property, rights and powers and franchises of the national banking association shall vest in the resulting state bank and the resulting state bank shall be subject to and deemed to have assumed all of the debts, liabilities, obligations and duties of the national banking association and to have succeeded to all of its relationships, fiduciary or otherwise, as fully and to the same extent as if such property, rights, powers, franchises, debts, liabilities, obligations, duties and relationships had been originally acquired, incurred or entered into by the resulting state bank; provided, however, that the resulting state bank shall not, through such conversion or merger, acquire power to engage in any business or to exercise any right, privilege or franchise which is not conferred by the provisions of KRS Chapter 287 upon such resulting state bank;

(c) Any reference to the national banking association in any contract, will or document, whether executed or taking effect before or after the conversion or merger, shall be considered a reference to the resulting state bank if not inconsistent with the other provisions of the contract, will or document;

(d) A pending action or other judicial proceeding to which the national banking association is a party, shall not be deemed to have abated or to have discontinued by reason of the conversion or merger, but may be prosecuted to final judgment, order or decree in the same manner as if the conversion or merger had not been made; or the resulting state bank may be substituted as a party to such action or proceeding, and any judgment, order or decree may be rendered for or against it that might have been rendered for or against the national banking association if the conversion or merger had not occurred.

Section 3. KRS 287.900 is amended to read as follows:

(1) For purposes of this section and KRS 287.905:

(a) "Bank" means any institution organized under this chapter, the banking laws of another state, or the National Bank Act, as amended, to do a banking business; however, it shall not include an "interim bank" chartered solely for the purpose of facilitating the acquisition of an existing bank unless the existing bank has been in existence for less than five (5) years;

(b) "Bank holding company," "company," and "control" have the meanings accorded them in the Federal Bank Holding Company Act of 1956, as amended (12 U.S.C. secs. 1841 et seq.). "Control" may be acquired by acquisition of voting securities, by purchase of assets, by merger or consolidation, by contract, or otherwise;

(c) "Individual" means a natural person, partnership, association, business trust, voting trust, or similar
organization. Individual does not include a corporation; and

(d) "Deposit" has the meaning accorded it in the Federal Deposit Insurance Act, as amended, and regulations promulgated thereunder; excluded, however, from deposits are all interbank deposits and all deposits in foreign branches and international banking facilities, as shown in the reports made by all federally-insured depository institutions to their respective supervisory authorities.

(2) Any individual, or any bank holding company having its principal place of business in this state, may acquire control of one (1) or more banks or bank holding companies wherever located, except that no individual, who on July 13, 1984, controls a bank or bank holding company wherever located, and no bank holding company wherever located, may acquire, directly or indirectly, control of a bank having its principal place of business in this state if the bank was chartered after July 13, 1984, and if, at the time of the acquisition, the bank has been in existence less than five (5) years. The provisions of this subsection shall not prohibit the organization of a one (1) bank holding company for the purpose of acquiring control of a bank even if the bank was chartered after July 13, 1984, and has been in existence less than five (5) years at the time of the acquisition.

(3) No individual or bank holding company wherever located may acquire control of any bank or bank holding company if, upon the acquisition, the individual or bank holding company would control banks in this state holding more than fifteen percent (15%) of the total deposits and member accounts in the offices of all federally-insured depository institutions in this state as reported in the most recent year-end reports made by the institutions to their respective supervisory authorities which are available at the time of the acquisition.

(4) The limitations set forth in this section or any other provision of this chapter or any regulation promulgated thereunder, as now in effect or amended after July 13, 1984, shall not apply to the acquisition of a bank if, in his discretion, the commissioner, if the bank is organized under the laws of this state, or the comptroller of the currency, if the bank is a national bank, determines that an emergency exists and the acquisition is appropriate in order to prevent the probable failure of the bank which is closed or is in danger of closing.

(5) The provisions of this section shall not be construed to prohibit or restrict the merger or consolidation of banks or bank holding companies having their principal places of business in the same county and the operation by the merged or consolidated corporation of the banks, nor to prohibit the sale of any bank or bank holding company to, and the purchase thereof by, any other bank or bank holding company with its principal place of business in the same county and the operation of the bank as a branch so long as the provisions of KRS 287.180(4) have been satisfied.

Section 4. KRS 287.915 is amended to read as follows:

(1) Notwithstanding any other provision of KRS Chapter 287:

(a) An individual or bank holding company that controls two (2) or more banks having their principal offices in this Commonwealth may, from time to time, combine any or all of the commonly controlled banks in this Commonwealth into and with any one (1) of the banks, and thereafter the surviving bank, which shall have its principal office in this Commonwealth, shall continue to operate its principal office and may operate the other authorized offices of the banks so combined as branches of the surviving bank; and

(b) Any combination authorized by this section shall not require the approval of the commissioner of financial institutions, but on or before thirty (30) days prior to consummation of any combination, the proposed surviving bank shall notify the commissioner of the combination, and on the effective date of any such combination the charter of any combined bank organized under the laws of this Commonwealth shall be surrendered.

(2) Following any combination authorized by this section:

(a) The surviving bank may, subject to the approval of the commissioner as provided in KRS 287.180(2),
establish and operate additional branches in any county where any bank involved in the combination had established a branch or main office;

(b) Any combined bank which is being operated as a branch of the surviving bank shall have a board of directors, a majority of which shall be residents of the combined bank’s community, which shall meet not less often than quarterly to advise the branch in a nonfiduciary capacity with respect to the branch’s community activities and affairs, customer relations, and local charitable activities;

(c) The surviving bank shall maintain a record of the deposits in each of its offices resulting from such combination or thereafter established as provided in paragraph (a) of this subsection; and

(d) With the approval of the commissioner, all of a bank’s offices in a county may be transferred, by a purchase and assumption or other transaction, by the bank to a newly chartered bank having its principal office in the same county, or to an existing bank. [If transferred to a newly chartered bank, the years in existence of the newly chartered bank shall be deemed to be in excess of five (5) years.]

(3) For purposes of this section:

(a) The term "combine" or "combination" includes a merger or the acquisition of all or substantially all of the assets of a bank already controlled by an individual or bank holding company;

(b) An individual or bank holding company "controls" a bank if that individual or company, directly or indirectly, owns, controls, or has the power to vote at least eighty percent (80%) of the issued and outstanding voting securities of the bank;

(c) "Combined bank" means any bank participating in a combination authorized by this section other than the surviving bank;

(d) "Surviving bank" means a bank into which a combined bank has been combined;

(e) "Bank" includes a national bank, savings and loan association, and federal savings bank[but does not include a bank which has been in existence less than five (5) years]; and

(f) "Individual", "bank holding company" and "deposit" shall have the same meanings attributed to them in KRS 287.900(1).

Section 5. KRS 287.920 is amended to read as follows:

(1) As used in this section, unless the context requires otherwise:

(a) "Interstate merger transaction" means the merger or consolidation of banks with different home states, and the conversion of branches of any bank involved in the merger or consolidation into branches of the resulting bank; and

(b) "Resulting bank" means a bank that has resulted from an interstate merger transaction under this section.

(2) A Kentucky state bank may establish, maintain, and operate one (1) or more branches in a state other than Kentucky pursuant to an interstate merger transaction in which the Kentucky state bank is the resulting bank, or if the other state permits, by acquisition of a branch or branches in the other state. Not later than the date on which the required application for the interstate merger transaction or branch acquisition is filed with the responsible federal bank supervisory agency, the applicant shall file an application on a form prescribed by the commissioner and pay the fee prescribed by KRS 287.480. The applicant shall also comply with the applicable provisions of KRS 287.180(2) and the commissioner shall base his approval or disapproval in the same manner as prescribed in KRS 287.180(2).

(3) An out-of-state state bank may establish, maintain, and operate one (1) or more branches in Kentucky pursuant to an interstate merger transaction in which the out-of-state state bank is the resulting bank. Not later than the date on which the required application for the interstate merger transaction is filed with the responsible federal bank supervisory agency, the applicant shall file an application on a form prescribed by the commissioner, pay the fee prescribed by KRS 287.480, and agree in writing to comply with the laws of this state applicable to its operation of
branches in Kentucky. The applicant shall also comply with the applicable provisions of KRS 287.180(2) and the commissioner shall base his approval or disapproval in the same manner as prescribed in KRS 287.180(2).

(4) No interstate merger transaction under subsections (2) or (3) of this section shall be approved if the transaction would result in a bank holding company having control of banks or branches in this state holding more than fifteen percent (15%) of the total deposits and member accounts in the offices of all federally-insured depository institutions in this state as reported in the most recent year-end reports made by the institutions to their respective supervisory authorities which are available at the time of the transaction.

(5) An individual or bank holding company that controls two (2) or more banks may, from time to time, combine any or all of the commonly controlled banks in this Commonwealth into and with any one (1) of the banks, and thereafter the surviving bank shall continue to operate its principal office and may operate the other authorized offices of the banks so combined as branches of the surviving bank.

(6) A branch of an out-of-state state bank may conduct any activities that are authorized under the laws of this state for state banks. Additionally, the branch of an out-of-state state bank is authorized to conduct any activities relating to the administration of trusts that are authorized under the laws of its home state, if the activities are conducted in conformity with the laws of its home state.

(7) A branch of a Kentucky state bank located in a host state may conduct any activities that are:
(a) Authorized under the laws of the host state for banks chartered by the host state; or
(b) Authorized for branches of national banks located in the host state, but whose principal location is in a state other than the host state.
AN ACT adopting the Uniform Electronic Transactions Act, and making changes incidental thereto.

Create new section of KRS Chapter 369 to adopt the Uniform Electronic Transactions Act (UETA) drafted by the National Conference of Commissioners on Uniform State Laws to provide uniform rules to govern transactions in electronic commerce in every state; define "electronic signature" as an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record; define "transaction" as an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs; define various additional terms; direct that UETA apply to electronic records and electronic signatures relating to a transaction; provide exemptions; provide that UETA apply to electronic records or electronic signatures created, generated, sent, communicated, received, or stored on or after the effective date of this Act; direct that UETA does not require the creation or use of an electronic record or electronic signature; direct that UETA apply only to transactions in which each party has agreed by some means to conduct them electronically; allow a party who agrees to conduct a transaction by electronic means to refuse to conduct other transactions electronically; permit the provisions of UETA to be varied by agreement; describe how UETA is to be construed and applied; provide that a record or signature may not be denied legal effect or enforceability solely because it is in electronic form; provide that a contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation; direct that any law that requires a record to be in writing will be satisfied by an electronic record; direct that any signature requirement in the law will be satisfied by an electronic signature; describe the relationship between UETA and other law; prescribe attribution and effect of an electronic record or electronic signature; establish rules regarding errors and changes in messages; provide for notarization and acknowledgment by electronic signature under certain conditions; set forth rules for retention of electronic records; allow a governmental agency to specify additional requirements for record retention subject to the agency's jurisdiction; prohibit, in a proceeding, exclusion of evidence of a record or signature solely because it is in electronic form; prescribe rules for automated transactions; establish when and from what place information is legally sent or received in electronic form; prescribe rules for transferable records, as defined in the Uniform Commercial Code; direct each governmental agency to determine whether, and the extent to which it will create electronic records and direct the Department of Libraries and Archives to determine whether, and the extent to which, the Commonwealth will retain electronic records and convert written records to electronic records; allow each governmental agency, in compliance with standards established by the Governor's Office for Technology, to determine its use of sending and accepting electronic records; authorize the Governor's Office for Technology to specify the manner and format; authorize governmental agency to specify the type of electronic signature required, the manner and format in which it is affixed to a record, and the identity of, or criteria that must be met by, any third party used by a person filing a document; allow a governmental agency to specify any other required attributes for electronic records; direct that UETA does not require a governmental agency to use or permit the use of electronic records or electronic signatures; designate the Governor's Office for Technology to set standards for the use of electronic records and signatures that promote consistency and interoperability between governmental agencies; provide severability clause; direct that UETA applies to contracts created or renegotiated on and after the effective date of this Act; provide that contracts based on the repealed KRS 369.010 to 369.030 shall continue under their terms until those contracts expire or are renegotiated and direct that the application of the repealed electronic signature statutes to those contracts shall continue as if the specified statutes had not been repealed; make technical amendment; repeal KRS 369.010 (Legislative intent of KRS 369.010 to 369.030), 369.020 (Definitions for KRS 369.010 to 369.030), and 369.030 (Use of electronic record or electronic signature--Construction and scope of); establish August 1, 2000, as the effective date of this Act.
HB 571 - AMENDMENTS

SEA (1. W. Blevins) - Exempt certain consumer protection statutes from application of the Act; regarding consumer contracts entered for personal, family, or household reasons, establish circumstances by which an electronic agent provides an opportunity for the prevention or correction of an error; establish rules that apply to a transaction entered into by an individual for personal, family, or household purposes.

Feb 3-introduced in House
Feb 4-to State Government (H)
Feb 9-posted in committee
Feb 22-reported favorably, 1st reading, to Calendar
Feb 23-2nd reading, to Rules
Feb 25-recommitted to Appropriations and Revenue (H)
Mar 1-posted in committee
Mar 9-reported favorably, to Rules
Mar 13-3rd reading, passed 95-0
Mar 14-received in Senate
Mar 16-to Economic Development, Tourism & Labor (S)
Mar 20-reported favorably, 1st reading, to Calendar
Mar 21-2nd reading, to Rules; floor amendment (1) filed
Mar 24-3rd reading; floor amendment (1) withdrawn; passed 34-0
Mar 27-received in House; enrolled, signed by each presiding officer, delivered to Governor
Apr 3-signed by Governor (Acts ch. 301)
AN ACT adopting the Uniform Electronic Transactions Act, and making changes incidental thereto.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Sections 1 to 20 of this Act may be cited as the Uniform Electronic Transactions Act.

SECTION 2. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

As used in Sections 1 to 20 of this Act, unless the context requires otherwise:

1. "Agreement" means the bargain of the parties in fact, as found in their language or inferred from other circumstances and from rules, regulations, and procedures given the effect of agreements under laws otherwise applicable to a particular transaction;

2. "Automated transaction" means a transaction conducted or performed, in whole or in part, by electronic means or electronic records, in which the acts of records of one or both parties are not reviewed by an individual in the ordinary course in forming a contract, performing under an existing contract, or fulfilling an obligation required by the transaction;

3. "Computer program" means a set of statements or instructions to be used directly or indirectly in an information processing system in order to bring about a certain result;

4. "Contract" means the total legal obligation resulting from the parties' agreement as affected by Sections 1 to 20 of this Act and other applicable law;

5. "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities;

6. "Electronic agent" means a computer program or an electronic or other automated means used independently to initiate an action or respond to electronic records or performances in whole or in part, without review or action by an individual;
(7) "Electronic record" means a record created, generated, sent, communicated, received, or stored by electronic means;

(8) "Electronic signature" means an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record;

(9) "Governmental agency" means an executive, legislative, or judicial agency, department, board, commission, authority, institution, or instrumentality of the federal government or of a state or of a county, municipality, or other political subdivision of a state;

(10) "Information" means data, text, images, sounds, codes, computer programs, software, databases, or the like;

(11) "Information processing system" means an electronic system for creating, generating, sending, receiving, storing, displaying, or processing information;

(12) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, governmental agency, public corporation, or any other legal or commercial entity;

(13) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form;

(14) "Security procedure" means a procedure employed for the purpose of verifying that an electronic signature, record, or performance is that of a specific person or for detecting changes or errors in the information in an
electronic record. The term includes a procedure that requires the use of algorithms or other codes, identifying words or numbers, encryption, or callback or other acknowledgment procedures;

(15) "State" means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States. The term includes an Indian tribe or band, or Alaskan native village, which is recognized by federal law or formally acknowledged by a state; and

(16) "Transaction" means an action or set of actions occurring between two (2) or more persons relating to the conduct of business, commercial, or governmental affairs.

SECTION 3. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (2) of this section, Sections 1 to 20 of this Act applies to electronic records and electronic signatures relating to a transaction.

(2) Sections 1 to 20 of this Act does not apply to a transaction to the extent it is governed by:

(a) A law governing the creation and execution of wills, codicils, or testamentary trusts;

(b) KRS Chapter 355 other than KRS 355.1-107 and 355.1-206, and Articles 2 and 2A of KRS Chapter 355;

(c) A law governing the conveyance of any interest in real property; and

(d) A law governing the creation or transfer of any negotiable instrument or any instrument establishing title or an interest in title.

(3) Sections 1 to 20 of this Act applies to an electronic record or electronic signature otherwise excluded from the application of Sections 1 to 20 of this Act under subsection (2) of this section to the extent it is governed by a law other than those specified in subsection (2) of this section.

(4) A transaction subject to Sections 1 to 20 of this Act is also subject to other applicable substantive law.

SECTION 4. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Sections 1 to 20 of this Act applies to any electronic record or electronic signature created, generated, sent, communicated, received, or stored on or after the effective date of this Act.

SECTION 5. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) Sections 1 to 20 of this Act does not require a record or signature to be created, generated, sent, communicated, received, stored, or otherwise processed or used by electronic means or in electronic form.

(2) Sections 1 to 20 of this Act applies only to transactions between parties each of which has agreed to conduct transactions by electronic means. Whether the parties agree to conduct a transaction by electronic means is determined from the context and surrounding circumstances, including the parties' conduct.

(3) A party that agrees to conduct a transaction by electronic means may refuse to conduct other transactions by electronic means. The right granted by this subsection may not be waived by agreement.

(4) Except as otherwise provided in Sections 1 to 20 of this Act, the effect of any of its provisions may be varied by agreement. The presence in certain provisions of Sections 1 to 20 of this Act of the words "unless otherwise agreed," or words of similar import, does not imply that the effect of other provisions may not be varied by agreement.

(5) Whether an electronic record or electronic signature has legal consequences is determined by Sections 1 to 20 of this Act and other applicable law.
SECTION 6. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:
Sections 1 to 20 of this Act must be construed and applied:
(1) To facilitate electronic transactions consistent with other applicable law;
(2) To be consistent with reasonable practices concerning electronic transactions and with the continued expansion of those practices; and
(3) To effectuate its general purpose to make uniform the law with respect to the subject of Sections 1 to 20 of this Act among states enacting it.

SECTION 7. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:
(1) A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.
(2) A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.
(3) If a law requires a record to be in writing, an electronic record satisfies the law.
(4) If a law requires a signature, an electronic signature satisfies the law.

SECTION 8. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:
(1) If parties have agreed to conduct a transaction by electronic means and a law requires a person to provide, send, or deliver information in writing to another person, the requirement is satisfied if the information is provided, sent, or delivered, as the case may be, in an electronic record capable of retention by the recipient at the time of receipt. An electronic record is not capable of retention by the recipient if the sender or its information processing system inhibits the ability of the recipient to print or store the electronic record.
(2) If a law other than Sections 1 to 20 of this Act requires a record to be posted or displayed in a certain manner, to be sent, communicated, or transmitted by a specified method, or to contain information that is formatted in a certain manner, the following rules apply:
   (a) The record must be posted or displayed in the manner specified in the other law.
   (b) Except as otherwise provided in subsection (4)(b) of this section, the record must be sent, communicated, or transmitted by the method specified in the other law.
   (c) The record must contain the information formatted in the manner specified in the other law.
(3) If a sender inhibits the ability of a recipient to store or print an electronic record, the electronic record is not enforceable against the recipient.
(4) The requirements of this section may not be varied by agreement, but:
   (a) To the extent a law other than Sections 1 to 20 of this Act requires information to be provided, sent, or delivered in writing but permits that requirement to be varied by agreement, the requirement under subsection (1) of this section that the information be in the form of an electronic record capable of retention may also be varied by agreement; and
   (b) A requirement under a law other than Sections 1 to 20 of this Act to send, communicate, or transmit a record by United States mail may be varied by agreement to the extent permitted by the other law.

SECTION 9. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:
(1) An electronic record or electronic signature is attributable to a person if it was the act of the person. The act of the person may be shown in any manner, including a showing of the efficacy of any security procedure applied to
If a change or error in an electronic record occurs in a transmission between parties to a transaction, the following rules apply:

(1) If the parties have agreed to use a security procedure to detect changes or errors and one party has conformed to the procedure, but the other party has not, and the nonconforming party would have detected the change or error had that party also conformed, the conforming party may avoid the effect of the changed or erroneous electronic record.

(2) In an automated transaction involving an individual, the individual may avoid the effect of an electronic record that resulted from an error made by the individual in dealing with the electronic agent of another person if the electronic agent did not provide an opportunity for the prevention or correction of the error and, at the time the individual learns of the error, the individual:

(a) Promptly notifies the other person of the error and that the individual did not intend to be bound by the electronic record received by the other person;

(b) Takes reasonable steps, including steps that conform to the other person’s reasonable instructions, to return to the other person or, if instructed by the other person, to destroy the consideration received, if any, as a result of the erroneous electronic record; and

(c) Has not used or received any benefit or value from the consideration, if any, received from the other person.

(3) If neither subsection (1) of this section nor subsection (2) of this section applies, the change or error has the effect provided by other law, including the law of mistake, and the parties’ contract, if any.

(4) Subsections (2) and (3) of this section may not be varied by agreement.

SECTION 11. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

If a law requires a signature or record to be notarized, acknowledged, verified, or made under oath, the requirement is satisfied if the electronic signature of the person authorized to perform those acts, together with all other information required to be included by other applicable law, is attached to or logically associated with the signature or record.

SECTION 12. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) If a law requires that a record be retained, the requirement is satisfied by retaining an electronic record of the information in the record which:

(a) Accurately reflects the information set forth in the record after it was first generated in its final form as an electronic record or otherwise; and

(b) Remains accessible for later reference.

(2) A requirement to retain a record in accordance with subsection (1) of this section does not apply to any information the sole purpose of which is to enable the record to be sent, communicated, or received.

(3) A person may satisfy subsection (1) of this section by using the services of another person if the requirements of...
that subsection are satisfied.

(4) If a law requires a record to be presented or retained in its original form, or provides consequences if the record is not presented or retained in its original form, that law is satisfied by an electronic record retained in accordance with subsection (1) of this subsection.

(5) If a law requires retention of a check, that requirement is satisfied by retention of an electronic record of the information on the front and back of the check in accordance with subsection (1) of this subsection.

(6) A record retained as an electronic record in accordance with subsection (1) of this section satisfies a law requiring a person to retain a record for evidentiary, audit, or like purposes, unless a law enacted after the effective date of Sections 1 to 20 of this Act specifically prohibits the use of an electronic record for the specified purpose.

(7) This section does not preclude a governmental agency of this state from specifying additional requirements for the retention of a record subject to the agency's jurisdiction.

SECTION 13. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

In a proceeding, evidence of a record or signature may not be excluded solely because it is in electronic form.

SECTION 14. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

In an automated transaction, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents of the parties, even if no individual was aware of or reviewed the electronic agents' actions or the resulting terms and agreements.

(2) A contract may be formed by the interaction of an electronic agency and an individual, acting on the individual's own behalf or for another person, including by an interaction in which the individual performs actions that the individual is free to refuse to perform and which the individual knows or has reason to know will cause the electronic agent to complete the transaction or performance.

(3) The terms of the contract are determined by the substantive law applicable to it.

SECTION 15. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) Unless otherwise agreed between the sender and the recipient, an electronic record is sent when it:

   (a) Is addressed properly or otherwise directed properly to an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent and from which the recipient is able to retrieve the electronic record;

   (b) Is in a form capable of being processed by that system; and

   (c) Enters an information processing system outside the control of the sender or of a person that sent the electronic record on behalf of the sender or enters a region of the information processing system designated or used by the recipient which is under the control of the recipient.

(2) Unless otherwise agreed between a sender and the recipient, an electronic record is received when:

   (a) It enters an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent and from which the recipient is able to retrieve the electronic record; and

   (b) It is in a form capable of being processed by that system.

(3) Subsection (2) of this section applies even if the place the information processing system is located is different
from the place the electronic record is deemed to be received under subsection (4) of this section.

(4) Unless otherwise expressly provided in the electronic record or agreed between the sender and the recipient, an electronic record is deemed to be sent from the sender's place of business and to be received at the recipient's place of business. For purposes of this subsection, the following rules apply:

(a) If the sender or recipient has more than one (1) place of business, the place of business of that person is the place having the closest relationship to the underlying transaction.

(b) If the sender or the recipient does not have a place of business, the place of business is the sender's or recipient's residence, as the case may be.

(5) An electronic record is received under subsection (2) of this section even if no individual is aware of its receipt.

(6) Receipt of an electronic acknowledgment from an information processing system described in subsection (2) of this section establishes that a record was received but, by itself, does not establish that the content sent corresponds to the content received.

(7) If a person is aware than an electronic record purportedly sent under subsection (1) of this section, or purportedly received under subsection (2) of this section, was not actually sent or received, the legal effect of the sending or receipt is determined by other applicable law. Except to the extent permitted by the other law, the requirements of this subsection may not be varied by agreement.

SECTION 16. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) In this section, "transferable record" means an electronic record that:

(a) Would be a note under Article 3 of KRS Chapter 355 or a document under Article 7 of KRS Chapter 355 if the electronic record were in writing; and

(b) The issuer of the electronic record expressly has agreed is a transferable record.

(2) A person has control of a transferable record if a system employed for evidencing the transfer of interests in the transferable record reliably establishes that person as the person to which the transferable record was issued or transferred.

(3) A system satisfies subsection (2) of this section, and a person is deemed to have control of a transferable record, if the transferable record is created, stored, and assigned in such a manner that:

(a) A single authoritative copy of the transferable record exists which is unique, identifiable, and, except as otherwise provided in paragraphs (d), (e), and (f) of this subsection, unalterable;

(b) The authoritative copy identifies the person asserting control as:

1. The person to which the transferable record was issued; or

2. If the authoritative copy indicates that the transferable record has been transferred, the person to which the transferable record was most recently transferred;

(c) The authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

(d) Copies of revisions that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;

(e) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

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(f) Any revision of the authoritative copy is readily identifiable as authorized or unauthorized.

(4) Except as otherwise agreed, a person having control of a transferable record is the holder, as defined in KRS 355.1-201(20), of the transferable record and has the same rights and defenses as a holder of an equivalent record or writing under KRS Chapter 355, including, if the applicable statutory requirements under KRS 355.3-302(1), 355.7-501, or 355.9-308 are satisfied, the rights and defenses of a holder in due course, a holder to which a negotiable document of title has been duly negotiated, or a purchaser, respectively. Delivery, possession, and indorsement are not required to obtain or exercise any of the rights under this subsection.

(5) Except as otherwise agreed, an obligor under a transferable record has the same rights and defenses as an equivalent obligor under equivalent records or writing under KRS Chapter 355.

(6) If requested by a person against which enforcement is sought, the person seeking to enforce the transferable record shall provide reasonable proof that the person is in control of the transferable record. Proof may include access to the authoritative copy of the transferable record and related business records sufficient to review the terms of the transferable record and to establish the identity of the person having control of the transferable record.

SECTION 17. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Each governmental agency of this Commonwealth shall determine whether, and the extent to which it will create electronic records. The Kentucky Department of Libraries and Archives shall determine whether, and the extent to which, the Commonwealth will retain electronic records and convert written records to electronic records.

SECTION 18. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (6) of section 12 of this Act, each governmental agency of this state, in compliance with standards established by the Governor’s Office for Technology, shall determine whether, and the extent to which, it will send and accept electronic records and electronic signatures to and from other persons and otherwise create, generate, communicate, store, process, use, and rely upon electronic records and electronic signatures.

(2) To the extent that a governmental agency uses electronic records and electronic signatures under subsection (1) of this section:

(a) The Governor’s Office for Technology, giving due consideration to security, may specify the manner and format in which the electronic records must be created, generated, sent, communicated, received, and stored and the systems established for those purposes;

(b) If electronic records must be signed by electronic means, each governmental agency, giving due consideration to security, may specify the type of electronic signature required, the manner and format in which the electronic signature must be affixed to the electronic record, and the identity of, or criteria that must be met by, any third party used by a person filing a document to facilitate the process;

(c) The Governor’s Office for Technology and the Department for Libraries and Archives, giving due consideration to security, may specify control processes and procedures as appropriate to ensure adequate preservation, disposition, integrity, security, confidentiality, and auditability of electronic records; and

(d) Each governmental agency, giving due consideration to security, may specify any other required attributes for electronic records which are specified for corresponding nonelectronic records or reasonably
necessary under the circumstances.

(3) Except as otherwise provided in subsection (6) of Section 12 of this Act, Sections 1 to 20 of this Act does not require a governmental agency of this state to use or permit the use of electronic records or electronic signatures.

SECTION 19. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:
The Governor's Office for Technology which adopts standards pursuant to subsection (2)(a) of Section 18 of this Act may encourage and promote consistency and interoperability with similar requirements adopted by other governmental agencies of this and other states and the federal government and nongovernmental persons interacting with governmental agencies of this state. If appropriate, those standards may specify differing levels of standards from which governmental agencies of this state may choose in implementing the most appropriate standard for a particular application.

SECTION 20. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:
If any provision of Sections 1 to 20 of this Act or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of Sections 1 to 20 of this Act which can be given effect without the invalid provision or application, and to this end the provisions of Sections 1 to 20 of this Act are severable.

Section 21. The following KRS sections are repealed:
369.010 Legislative intent of KRS 369.010 to 369.030.
369.020 Definitions for KRS 369.010 to 369.030.
369.030 Use of electronic record or electronic signature -- Construction and scope of KRS 369.010 to 369.030.

Section 22. Sections 1 to 20 of this Act applies to contracts created or renegotiated on and after the effective date of this Act. To the extent that Sections 1 to 20 of this Act may be inconsistent, and notwithstanding the repeal of KRS 369.010 to 369.030 contained in Section 21 of this Act, contracts based on those statutes shall continue in force under their terms until they expire or are renegotiated, and the application of those statutes to such contracts shall continue as if the specified statutes had not been repealed.

Section 23. If the General Assembly enacts the revised version of Article 9 of the Uniform Commercial Code during this 2000 Regular Session and that legislation becomes law, the reference to KRS 355.9-308 in subsection (4) of Section 16 of this Act shall be changed to 355.9-330, as of the effective date of revised Article 9, to reflect the location of the relevant text in the revised Article 9.

Section 24. In the event that the Governor's Executive Order 99-1359, dated October 6, 1999, creating the Governor's Office for Technology, is not confirmed by the 2000 General Assembly, references in Sections 18 and 19 of this Act to the Governor's Office for Technology shall be deleted, and in codification the Chief Information Officer shall be inserted in lieu thereof.

Section 25. This Act shall take effect August 1, 2000.
THE FINANCIAL SERVICES MODERNIZATION ACT OF 1999

AN OVERVIEW

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THE FINANCIAL SERVICES MODERNIZATION ACT OF 1999  
— An Overview —  

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Financial Services Modernization
Act of 1999
(Gramm-Leach-Bliley Act)

by

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I. INTRODUCTION. The Gramm-Leach-Bliley Act of 1999 ("GLB Act"), a copy of which is contained in Exhibit A, was signed into law on November 12, 1999 and represents the most sweeping reform of financial services regulation since the Great Depression. The major aspects of the legislation are as follows:

• Removes the legal barriers to affiliation among banks, securities firms, insurance companies and other financial companies that were previously contained in the Glass-Steagall Act and the Bank Holding Company Act of 1956, as amended.

• Provides functional regulation of financial services activities.

• Requires financial institutions to establish and disclose their privacy policies and gives customers the right to block sharing of confidential data with non-affiliated third parties.

• Restricts nonfinancial companies from acquiring or forming unitary thrifts

• Expands the reach of the Community Reinvestment Act

• Requires banks to disclose ATM fees and surcharges in notices placed both on the ATM machine and on the ATM’s computer screen

• Reforms the Federal Home Loan Bank system.

• Requires a variety of agency studies and reports to Congress.

Many of the provisions of the GLB Act have delayed effectiveness and many of the enabling regulations have either just been released or are to be released in the future. An understanding of the regulations and interpretations promulgated pursuant to the GLB Act is critical to understanding the full impact of the legislation. This outline does not describe provisions in the GLB Act dealing with foreign banks.
II. OVERVIEW OF SELECT PORTIONS OF THE GRAMM-LEACH-BLILEY ACT

A. Title I – Facilitating Affiliation Among Banks, Securities Firms, and Insurance Companies (effective date is March 11, 2000).

1. **Cross-industry Affiliations.** Title I eliminates many of the restrictions that have prevented the affiliation of banks, securities firms and insurance companies by substantially amending the nonbanking provisions of the Bank Holding Company Act of 1956, as amended, and repealing Sections 20 and 32 of the Glass-Steagall Act. The GLB Act generally does not permit affiliation between financial institutions and non-financial commercial entities.

2. **Financial Holding Companies ("FHCs").** The GLB Act creates FHCs, a new form of bank holding companies, with greater powers than existing bank holding companies ("BHCs"). FHCs may engage in "financial activities" which exceed the types of financial activities presently permitted for BHCs and include, but are not limited to, insurance and securities underwriting, merchant banking and other activities that are determined by the regulators to be "financial in nature" or "incidental" thereto or "complimentary" to a financial activity. The activities permissible for BHCs, who do not elect FHC status, remain unchanged at this time and continue to be activities "closely related to banking."

3. **Qualifications for FHCs.** All “depository institutions” owned by an FHC must be:
   a. Well-capitalized (5% leverage ratio, 6% Tier 1, and 10% total risk based capital ratio).
   b. Well-managed (received a composite rating of “1” or “2” and a separate management rating of no less than satisfactory at the last bank regulatory examination).
   c. All insured depository institution subsidiaries must have a satisfactory or better rating under CRA at the last bank regulatory examination.

The statutory thresholds set out in the GLB Act are for depository institutions and not the FHC, itself. The GLB Act contains stringent requirements for any FHC that fails to maintain compliance with the well-managed and well-capitalized standards for its depository institution and further limits expansion by an FHC that has a depository institution that is determined to be less than satisfactory with respect to CRA compliance. Regulators indicate little flexibility in enforcing its provisions.

4. **Permissible FHC Activities.** FHCs may engage in various banking, securities, insurance activities, and other activities determined to be
financial in nature or incidental or complimentary to such financial activities. Among other things, the GLB Act authorizes FHCs to engage in:

a. Any activity determined by the Federal Reserve to be closely related to banking, such as lending or providing investment advisory services;

b. Any activity the Federal Reserve has determined to be usual in connection with transacting banking abroad, such as management consulting and travel agency activities;

c. Specific activities defined by the statute to be financial, such as securities and insurance underwriting and merchant banking; and

d. Any activity that is determined by the Federal Reserve in consultation with the Treasury to be financial in nature or incidental to a financial activity, or found by the Federal Reserve to be complimentary to a financial activity.

5. **Functional Regulation.** The business of banking will be supervised by the federal banking regulators; the holding company, either BHC or FHC, will be supervised by the Federal Reserve; the securities activities of banks will be overseen by the SEC; and the insurance activities will be supervised by state insurance regulators.

6. **Financial Subsidiaries of Banks.** As an alternative to FHCs, the GLB Act permits financial subsidiaries of banks to generally engage as principal in the same list of activities as permitted for FHCs, other than insurance underwriting, providing or issuing annuities, merchant banking (for five years), insurance portfolio investing and real estate development or investment which are not generally permitted for bank financial subsidiaries. Financial subsidiaries’ depository institutions must generally maintain the same qualifications as FHCs. However, a bank must deduct its investment in a financial subsidiary from the bank’s capital. A financial subsidiary for a bank is also subject to additional qualifications that FHCs are not subject to by the GLB Act. If it is a financial subsidiary for one of the 100 largest banks it must have a debt issue that is rated investment grade and for banks, its total investment in operating subsidiaries is limited to the lesser of 45% of the bank’s total assets or $50 billion. Financial subsidiaries are in general subjects to Sections 23A and 23B of the Federal Reserve Act; anti-tying restrictions; and other potential firewalls that regulators may impose.

7. **Bank Authority to Underwrite Industrial Revenue Bonds.** Banks are granted authority to underwrite industrial revenue bonds.
8. **Required Notifications.** A BHC that wants to convert to FHC status has to file a written declaration with the appropriate Federal Reserve Bank and furnish a copy to the Washington, D.C. office. The Fed then has 30 days to tell the BHC whether its declaration is effective. According to a recent supervisory letter, a copy of which is contained as *Exhibit B*, hereto, the declaration must include:

a. A statement that the BHC chooses or elects to be an FHC;

b. The name and head office address of the company and each depository institution controlled by the company;

c. A certification that all depository institutions controlled by the company are well-capitalized as of the date the company files its election;

d. The capital ratios for all relevant capital measures (as defined under Section 38 of the Federal Deposit Insurance Act) as of the close of the previous quarter for each depository institution controlled by the company on the date the company files its election; and

e. A certification that all depository institutions controlled by the company are well-managed as of the date the company files its election.

The GLB Act requires all of the FHC’s insured depository institutions to have a “satisfactory” or better rating under the Community Reinvestment Act at the time of the election. However, no CRA rating information is needed in the initial filing. Generally, an FHC does not need Federal Reserve approval prior to acquiring a company engaged in activities that are financial in nature, but an FHC must provide a notice to the Federal Reserve within 30 days of commencing the activity or acquiring the entity. Prior approval by the Federal Reserve is still required in order for an FHC to acquire control of a bank or savings and loan association or to engage in any complimentary activity.

9. **Preservation of Federal Trade Commission Authority.** The GLB Act requires in some instances for an FHC to file under the Hart-Scott Rodino Act with the Federal Trade Commission.

**B. Title II -- Functional Regulation for Securities Activities [effective as of May 12, 2001].**

1. **SEC Supervision for Bank Securities.** Bank securities activities are to become subject to SEC supervision by repealing the exclusion banks presently enjoy from being required to register as broker-dealers in the Securities Exchange Act of 1934.
2. **Limited Exceptions to SEC Supervision.** To avoid SEC broker-dealer registration requirements, banks must limit their activities to third party networking arrangements with registered broker-dealers; trust activities; traditional banking transactions such as commercial paper and exempt securities; safekeeping and custody activities; certain stock purchase plans; certain sweep accounts; certain private placements; certain identified banking products, including loan participations; municipal securities; swap agreements; and a de minimis exception involving not more than 500 transactions in any calendar year.

3. **Changes to the Investment Company Act of 1940 and the Investment Advisors Act of 1940.** Banks engaged in investment adviser services will no longer have an exclusion from regulation and will come under SEC scrutiny and the same regulatory scheme as other mutual fund advisers. Banks will be required to push out this activity to a separate subsidiary or conduct it in a separately identifiable department.

C. **Title III – Insurance [effective immediately].**

1. **Insurance Powers of Banks as Agents.** Both national banks and state bank powers previously granted to banks dealing with the sale of insurance as an agent continues unchanged by the GLB Act.

2. **Insurance Powers of Affiliates of Banks.** Banks and subsidiaries of banks cannot generally underwrite insurance.

3. **Insurance powers of FHC.** Qualified FHC affiliates, that are not banks, are generally permitted to engage in any type of insurance activity.

4. **Preemption of State Anti-affiliation Laws.** The GLB Act preempts state anti-affiliation laws that prevent affiliates of state banks from engaging in insurance activities and, further generally preempts any state law that significantly interferes with insurance sales, solicitation or cross-marketing activities of the FHC or a financial subsidiary.

5. **Antitying.** Bank regulators are required to regulate and prohibit banks from conditioning the making of loans on the purchase of insurance from an insurance affiliate.

D. **Title IV – Unitary Thrift Holding Company Provisions [effective November 12, 2000].**

Title IV closes the unitary thrift holding company loophole by prohibiting the future acquisition or creation of new unitary thrifts by commercial enterprises after May 4, 1999. Activities prior to May 4, 1999 are generally grandfathered. The GLB Act permits existing unitary savings and loan holding companies owned by general commercial companies to continue but restricts the transferability of the rights of such holding companies.
E. Title V -- Privacy (effective November 12, 2000).

1. **Privacy Policies.** The GLB Act requires a financial institution to establish privacy policies for protecting nonpublic personal information from third parties and disclose the policies to customers at the start of the relationship and annual thereafter during the life of the relationship. The definition of a “financial institution” is very broadly defined.

2. **“Opt-Out” Provisions by Customer.** Financial institutions must give customers a clear and conspicuous notice of their right to opt out of having information disclosed to nonaffiliated third parties except in limited circumstances.

3. **Account Numbers.** A financial institution is prohibited from disclosing “an account number or similar form of access number or access code” to unaffiliated third parties for use in marketing.

4. **Congressional Policy of Financial Privacy for Customers.** Congress has set forth a policy that every financial institution has a duty to respect the privacy of its customers and to protect.

5. **No Preemption of State Law.** The privacy provisions do not preempt state laws which provide greater protection to consumers with respect to sharing of information with nonaffiliated third parties.

6. **New Regulations Forthcoming.** The federal bank regulatory agencies, the Treasury, the SEC, and the FFC, in consultation with state insurance representatives, are each authorized to issue by May 12, 2000, necessary regulations to implement the privacy provisions of the GLB Act.

7. **Crime to Fraudulently Access Financial Information.** A new federal crime, punishable by up to five years in prison, to obtain or attempt to obtain private customer financial information from a financial institution through fraudulent or deceptive means.

F. Title VI -- Federal Home Loan Bank System Modernization (effective as of November 12, 2000). Membership in the Federal Home Loan Bank system is reformed to be voluntary and the FHLB will give small banks more access to funds for making loans to small businesses and small farmers by allowing these type loans as collateral for advances. The GLB Act further allows any depository institution with less than $500 million in total assets to become a member of the FHLB system without satisfying the QTL test.

G. Title VII -- Other Provisions.

1. **ATM Fee Notice.** Operators of ATM machines are required to post notices of fees imposed against the user on the ATM and on the ATM’s screen before a transaction is completed.
2. **CRA Provisions.** The GLB Act requires that each party to a CRA-related agreement fully disclose the agreement and its terms to the public and the appropriate bank regulator and report annually concerning the use of CRA money and resources for each year. The GLB Act also provides that depository institutions with $250 million or less in total deposits would be subject to routine CRA exams as follows:

a. On a 5-year cycle, if the depository institution receives an "outstanding" rating;

b. On a 4-year cycle, if the institution receives a "satisfactory" rating.

3. **Various Studies by Regulators.**

III. **FEDERAL RESERVE SR-00-1 (SVP), FEBRUARY 8, 2000 ON “PROCEDURES TO BECOME A FINANCIAL HOLDING COMPANY AND GUIDANCE REGARDING THE INITIAL MONITORING OF ACQUISITIONS AND THE COMMENCEMENT OF NEW ACTIVITIES BY FINANCIAL HOLDING COMPANIES” (attached hereto as Exhibit B).**

IV. **OCC FINAL RULE DEALING WITH FINANCIAL SUBSIDIARIES AND OPERATING SUBSIDIARIES (MARCH 10, 2000), Federal Register, Vol. 65, No. 48, pp. 12905 to 12916 (attached hereto as Exhibit C).**
THE FINANCIAL SERVICES MODERNIZATION ACT OF 1999
THE GRAMM-LEACH-BLILEY ACT
- S. 900 -

November 2, 1999
CONGRESSIONAL RECORD—HOUSE

CONFERENCE REPORT ON S. 900,
GRAMM-LEACH-BLILEY ACT

Mr. LEACH submitted the following conference report and statement on the Senate bill (S. 900) to enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial service providers, and for other purposes:

CONFERENCE REPORT (H. REPT. 106-434)
The committee of conference on the disagreeing votes of the two Houses on the amendments of the House to the bill (S. 900), to enhance competition in the financial services industry by providing a prudential framework for the affiliation of banks, securities firms, insurance companies, and other financial service providers, and for other
purposes, having met, after full and free con-
ference, have agreed to recommend and do
recommend to their respective Houses as fol-
lowing:

That the Senatecede from its disagree-
ment to the amendment of the House to the
text of the bill and agree to the same with an
amendment as follows:

In lieu of the matter proposed to be in-
serted by the House amendment, insert the
following:

SECTION 1. SHORT TITLE; TABLE OF CONTENTS

(A) SHORT TITLE—This Act may be cited as the
"Gramm-Leach-Bliley Act".

(B) TABLE OF CONTENTS—The table of con-
ents for this Act is as follows:

Sec. 1. Short title; table of contents.

TITLE I—REGULATING AFFILIATION
AMONG FINANCIAL INSTITUTIONS, INSURANCE
COMPANIES, AND OTHER ENTITIES

Subtitle A—Affiliations

Sec. 101. Glass-Steagall Act repealed.

Sec. 102. Activity restrictions applicable to bank
holding companies that are not fi-
nancial holding companies.

Sec. 103. Federal activities.

Sec. 104. Operation of State law.

Sec. 105. Mutual bank holding companies au-
dorsated.

Sec. 106. Prohibition on deposit production of

Sec. 107. Cross-marketing restriction; limited

purposes bank relief; divestiture.

Sec. 108. Use of subordinated debt to protect fi-
nancial system and deposit funds

from "too big to fail" Institutions.

Sec. 109. Study of financial modernization's ef-
fect on the accessibility of small

business and farm loans.

Subtitle B—Streamlining Supervision of Bank

Sec. 111. Streamlining bank holding company

superintendence.

Sec. 112. Authority of State insurance regulator

and Securities and Exchange

Commission.

Sec. 113. Role of the Board of Governors of the

Federal Reserve System.

Sec. 114. Procedural safeguards.

Sec. 115. Examination of investment companies.

Sec. 116. Elimination of application requirement

for financial holding companies.

Sec. 117. Preservation of the integrity of FDIC re-

sources.

Sec. 118. Repeal of savings bank provisions in the

Bank Holding Company Act of 1956.

Sec. 119. Technical amendment.

Subtitle C—Subsidaries of National Banks

Sec. 121. Subsidiaries of national banks.

Sec. 122. Consideration of merchant banking

activities by financial subsidi-
aries.

Subtitle D—Preservation of FTC Authority

Sec. 131. Amendment to the Bank Holding Com-
pany Act of 1933 to modify notifi-
cation and post-approval waiting per-
iod for section 3 transactions.

Sec. 132. Interagency data sharing.

Sec. 133. Clarification of status of subsidiaries and

affiliates.

Subtitle E—National Treatment

Sec. 141. Foreign banks that are financial hold-
ing companies.

Sec. 142. Representative offices.

Subtitle F—Direct Activities of Banks

Sec. 151. Authority of national banks to under-
write certain municipal bonds.

Subtitle G—Effective Date

Sec. 161. Effective date.

TITLE II—FUNCTIONAL REGULATION

Subtitle A—Brokers and Dealers

Sec. 201. Definition of broker.
November 2, 1999

CONGRESSIONAL RECORD—HOUSE

H 11257

Sec. 774. Control of bankers' banks.
Sec. 775. Provision of technical assistance to microenterprises.
Sec. 776. Federal Reserve audits.
Sec. 777. Authorization to release reports.
Sec. 778. General Accounting Office study of conflicts of interest.
Sec. 779. Study and report on adapting existing legislative requirements to online financial transactions (as the Committee on Government Reform and Oversight, the Committee on Government Reform, and the Financial Services Committee).
Sec. 780. Clarification of source of strength doctrine.
Sec. 781. Interstate rates and other charges at interstate branches.
Sec. 782. Interstate branches and agencies of foreign banks.
Sec. 783. Fair treatment of women by financial advisers.
Sec. 784. Membership of loan guarantee boards.
Sec. 785. Repeal of stock loan limit in Federal Reserve Act.
Sec. 786. Elimination of SAIF and DIF special reserves.
Sec. 787. Bank officers and directors as officers and directors of public utilities.
Sec. 788. Application for purchase of securities of United States.
Sec. 789. Optional conversion of Federal savings associations.
Sec. 790. Government indirectly owns.

TITLE I—FACILITATING AFFILIATION AMONG BANKS, SECURITIES FIRMS AND INSURANCE COMPANIES; AND INCENTIVES TO AFFILIATION

SEC. 101. GLASS-STEAGALL ACT REPEALS.
(a) SECTION 20 REPEALED.—Section 20 of the Banking Act of 1933 (12 U.S.C. 371) (commonly referred to as the "Glass-Steagall Act") is repealed.
(b) SECTION 32 REPEALED.—Section 32 of the Banking Act of 1933 (12 U.S.C. 378) is repealed.

SEC. 203. IRREGULARITIES AND INCENTIVES APPlicable TO BANK HOLDING COMPANIES AND NATIONAL FINANCIAL HOLDING COMPANIES.

(a) IN GENERAL.—Section 4(c)(8) of the Bank Holding Company Act of 1936 (12 U.S.C. 1841(c)(8)) is amended to read as follows:

"(8) shares of any company the activities of which had been determined by the Board by regulation or order as of the date of the enactment of the Gramm-Leach-Bliley Act, to be so closely related to banking or managing or controlling banks as to be a financial activity under this Act shall not be treated as being either (A) a financial activity for purposes of this Act."

(b) CONFORMING CHANGES TO OTHER STATUTES.—

(1) AMENDMENT TO THE BANK HOLDING COMPANY ACT AMENDMENTS OF 1970.—Section 105 of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 1841(f)) is amended by striking "so closely related to banking or managing or controlling banks as to be a financial activity under this Act.

(2) AMENDMENT TO THE BANK SERVICE COMPANY ACT.—Section 4(f) of the Bank Service Company Act (12 U.S.C. 1844(f)) is amended by inserting before the end of the following sentence of the enacting clause the following:

"as the date of the enactment of the Gramm-Leach-Bliley Act."

SEC. 103. FINANCIAL ACTIVITIES.

(a) IN GENERAL.—Section 4 of the Bank Holding Company Act of 1936 (12 U.S.C. 1844) is amended by adding at the end the following new sections:

"(1) ENGAGING IN ACTIVITIES THAT ARE FINANCIAL IN NATURE.—

(1) IN GENERAL.—Notwithstanding subsection (a), a bank holding company may engage in any activity, and may acquire and retain the shares of any company engaged in any activity, that the Board, in accordance with paragraph (2), determines is financial in nature—

(A) to be financial in nature or incidental to such financial activity; or

(B) is necessary for the ability of a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.

(2) CORDUROY OR OWNERSHIP INTERESTS.—(A) PROPOSALS RAISED BEFORE THE BOARD.—The Board shall notify the Secretary of the Treasury of, and consult with the Secretary of the Treasury concerning, any request, proposal, or application under this subsection for a determination of whether an activity is financial in nature or incidental to a financial activity.

(B) TREASURY VIEW.—The Board shall not determine that any activity is financial in nature or incidental to a financial activity under this subsection if the Secretary of the Treasury notifies the Board in writing, not later than 30 days after the date of receipt of the notice described in clause (1) (so much longer as the Board determines to be appropriate under the circumstances) that the Secretary of the Treasury believes that the activity is not financial in nature or incidental to a financial activity.

(3) TREASURY RECOMMENDATION.—The Treasury of the Treasury may, at any time, recommend in writing to the Board that an activity be financial in nature or incidental to a financial activity.

(4) THE PERIOD FOR BOARD ACTION.—Not later than 30 days after the date of receipt of a written recommendation from the Secretary of the Treasury under subsection (1) for such longer period as the Board determines to be appropriate under the circumstances, the Board shall determine whether to authorize that recommendation or to modify in a material way the recommendation as to the nature of the activity under subsection (1) of this section.

"(B) FACTORS TO BE CONSIDERED.—In determining whether an activity is financial in nature or incidental to a financial activity, the Board shall take into account—

(A) the purposes of this Act and the Gramm-Leach-Bliley Act;

(B) changes or reasonably expected changes in the marketplace in which financial holding companies compete on a national scale;

(C) changes or reasonably expected changes in the technology for delivering financial services; and

(D) whether such activity is necessary or appropriate to allow a financial holding company and the affiliates of a financial holding company to—

(i) compete effectively with any company seeking to provide financial services in the United States;

(ii) efficiently deliver information and services that are financial in nature through the use of technology or incidental to a financial activity for purposes of systems for the transmission of data or financial transactions;

(iii) offer customers any available or emerging technological means for using financial services by means of transmission of data;

"(IV) ACTIVITIES THAT ARE FINANCIAL IN NATURE.—For purposes of this subsection, the following activities shall be considered to be financial in nature:

(A) Lending, exchanging, transferring, investing for others, or safeguarding money or securities.

(B) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, whether or not in the ordinary course of business, and acting as principal, agent, or broker for purposes of the foregoing, in any State.

(C) Providing investment, economic or advisory services, including advising an investment company (as defined in section 3 of the Investment Company Act of 1940).

(D) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly, by pooling, commingling, dealing in, or making a market in securities.

(E) Engaging in any activity that the Board has determined, by order or regulation that is in effect on the date of the enactment of the Gramm-Leach-Bliley Act, to be so closely related to banking or managing or controlling banks as to be a proper investment. Whether, or not the same terms and conditions contained in such order or regulation, unless modified by the Board.

(G) Engaging, in the United States, in any activity that—

(i) a bank holding company may engage in outside of the United States; and

(ii) the Board has determined, under regulations or interpretations issued pursuant to subsection (c)(13) (as in effect on the day before the date of the enactment of the Gramm-Leach-Bliley Act) to be usual in connection with the transaction of banking or other financial operations abroad.

(H) Directly or indirectly acquiring or controlling, whether as principal, on behalf of 1 or more entities (including entities, other than a bank holding company, the bank holding company controls), or otherwise, shares, assets, or ownership interests (including debt or equity securities, partnership interests, trust certificates, or other instruments representing ownership) of a company or other entity, whether or not constituting control of such company or entity, engaged in any activity not authorized pursuant to this section if—

(i) the shares, assets, or ownership interests are not acquired or held by a depository institution or subsidiary of a depository institution;

(ii) such shares, assets, or ownership interests are acquired and held by—

(I) a securities affiliate of an affiliate thereof; or

(II) an affiliate of an insurance company described in subparagraph (D)(ii) that provides investment advice as part of a bona fide underwriting or merchant or investment banking activity, including investment banking activities engaged in as a result of appreciation and ultimate resale or disposition of the investment;

(iii) such shares, assets, or ownership interests are held for a period of time to enable the sale or disposition thereof on a reasonable basis consistent with the financial viability of the activities described in clause (1); and

(iv) during the period such shares, assets, or ownership interests are held, the bank holding company does not routinely manage or operate such company or entity except as may be necessary or required to obtain a reasonable return on investment upon resale or disposition.

(II) Directly or indirectly acquiring or controlling, whether as principal, on behalf of 1 or more entities (including entities, other than a depository institution or subsidiary of a depository institution, that the bank holding company controls), or otherwise, shares, assets, or ownership interests (including debt or equity securities, partnership interests, trust certificates, or other instruments representing ownership) of a company or other entity, whether or not constituting control of such company or entity, whether or not constituting control of such company or entity, engaged in any activity not authorized pursuant to this section if—

(II) the shares, assets, or ownership interests are not acquired or held by a bank holding company; or

(iii) such shares, assets, or ownership interests are held by the bank holding company if the board of directors of the bank holding company controls or otherwise, shares, assets, or ownership interests (including debt or equity securities, partnership interests, trust certificates, or other instruments representing ownership) of a company or other entity, whether or not constituting control of such company or entity, whether or not constituting control of such company or entity, engaged in any activity not authorized pursuant to this section if—

(iii) such shares, assets, or ownership interests are acquired and held by—

(I) a securities affiliate of an affiliate thereof; or

(II) an affiliate of an insurance company described in subparagraph (D)(ii) that provides investment advice as part of a bona fide underwriting or merchant or investment banking activity, including investment banking activities engaged in as a result of appreciation and ultimate resale or disposition of the investment.
and casualty insurance (other than credit-re­ insured) or providing and issuing annui­ ties:"

"(i) such shares, assets, or ownership inter­ ests represent an Investment made in the or­ dinary course of business of such insurance com­ pany in accordance with relevant State law gov­ erning such Investments; and

"(iv) during the period such shares, assets, or ownership Interests are held, the bank holding company is not required to exercise any control over such company except as may be necessary or re­ quired to obtain a reasonable return on invest­ ment.

"(5) ACTIONS REQUIRED.—

"(A) IN GENERAL.—The Board shall, by regu­ lation or order, define, consistent with the pur­ pose of this Act, the activities described in sub­ paragraph (B) as financial in nature, and the extent to which such activities are financial in nature or incidental to a financial activity.

"(B) ACTIVITIES.—The activities described in this subparagraph are as follows:

"(i) Arranging, effecting, or facilitating fi­ nancial transactions for the account of third par­ ties.

"(4) REQUIRED NOTIFICATION.—

"(A) IN GENERAL.—A financial holding com­ pany that acquires any company or commences any activity pursuant to this subsection shall provide written notice to the Board describing the activity commenced or conducted by the company acquired not later than 30 calendar days after commencing the activity or consum­ mating the acquisition, as the case may be.

"(B) APPROVAL NOT REQUIRED FOR CERTAIN FINANCIAL ACTIVITIES.—Except as provided in subsection (i) with regard to the acquisition of a savings association, a financial holding com­ pany may commence any activity, or acquire any company, pursuant to paragraph (i) or any regulation prescribed or order issued under paragraph (B), without prior approval of the Board.

"(6) MERCHANT BANKING ACTIVITIES.—

"(A) JOINT REGULATIONS.—The Board and the Secretary of the Treasury may issue such regu­ lations implementing paragraph (B)(ii), includ­ ing limitations on transactions between deposi­ tary institutions and merchant banks, controls pur­ suant to such paragraph, as the Board and the Secretary jointly deem appropriate to assure compliance with the purposes and prevent ev­ idence of this Act and the Gramm-Leach-Bliley Act and to protect depository institutions.

"(B) SUNSET OF RESTRICTIONS ON MERCHANT BANKING ACTIVITIES OF FINANCIAL SUBSIDI­ ARIES.—The restrictions contained in paragraph (B)(i) on the ownership and control of shares, assets, or ownership Interests by a subsidiary of a depository institution shall not apply to a financial subsidiary (as defined in subsection (a)(16) of the Federal Deposit Insurance Act) of an insured depository institution, to the extent such subsidiary is formed or acquired after enactment of this Act and the Gramm-Leach-Bliley Act.

"(C) CONDITIONS FOR ENGAGING IN EXPANDED FINANCIAL ACTIVITIES.—

"(1) IN GENERAL.—Notwithstanding subsection (k), (n), or (o), a bank holding company may acquire such financial activities, or directly or indirectly acquire or retain shares of any company engaged in any activity, under subsection (k), (n), or (o), other than activities permissible for any bank holding company under subsection (c)(8), unless—

"(A) all of the depository institution subsidi­ aries of the bank holding company are well capital­ ized; and

"(B) all of the depository institution subsidi­ aries of the bank holding company are well man­ aged; and

"(C) the bank holding company has filed with the Board—

"(i) a declaration that the company elects to be a financial holding company under this sub­ section; (ii) a certification that the company does not intend to engage in any activities or acquire and retain shares of a com­ pany that were not permissible for a bank hold­ ing company before the enactment of the Gramm­Leach-Bliley Act; and

"(ii) a certification that the company elects to be a financial holding company under this sub­ section; (ii) a certification that the company does not intend to engage in any activities or acquire and retain shares of a com­ pany that were not permissible for a bank hold­ ing company before the enactment of the Gramm­Leach-Bliley Act; and

"(2) BOARD MAY IMPOSE LIMITATIONS.—Until the conditions described in a notice to a financial holding company under subparagraph (A) are corrected, the Board may impose such limita­ tions on the conduct or activities of that finan­ cial holding company or any affiliate of that company as the Board determines to be appro­ priate under the circumstances and consistent with the purposes of this Act.

"(3) FAULTY NOTICE.—If the conditions described in a notice to a financial holding com­ pany under paragraph (1) are not corrected within 180 days after the date of receipt by the financial holding company of a notice under paragraph (1), the Board may direct the financial holding company, under such terms and conditions as may be imposed by the Board and consistent with the purposes of this Act, to divest control of any subsidiary depository institution or subsidiary of a depository institution that is not the Financial holding company and any insured depository institution.

"(B) AT THE ELECTION OF THE FINANCIAL HOLDING COMPANY — instead to cease to engage in any ac­ tivities, or acquire and retain shares of a com­ pany or its subsidiaries (other than a depository institution or a subsidiary of a depository insti­ tution that is not a financial holding company) that are not permissible for a bank holding company under subsection (c)(8).

"(2) CONSULTATION.—In taking any action under this subsection, the Board shall consult with all relevant Federal and State regulatory agencies and authorities.

"(4) AUTHORITY TO RETAIN LIMITED NON­ FINANCIAL ACTIVITIES AND AFFILIATIONS.—

"(A) IN GENERAL.—With respect to subsection (a), a company that is not a bank holding com­ pany or a financial holding company and becomes a financial holding company under the date of the enactment of the Gramm­Leach-Bliley Act may continue to engage in any ac­ tivities, or acquire and retain shares of a com­ pany or its subsidiaries (other than a depository institution or a subsidiary of a depository insti­ tution that is not a financial holding company) that are not permissible for a bank holding company under subsection (c)(8).

"(B) THE HOLDING COMPANY WAS ENGAGED IN THE ACTIVITY BEFORE SEPTEMBER 30, 1999.—If the holding company was not a bank holding company or a financial holding company under subsection (a), it may continue to engage in any activities, or acquire and retain shares of a company or its subsidiaries (other than a depository institution or a subsidiary of a depository insti­ tution that is not a financial holding company) that are not permissible for a bank holding company under subsection (c)(8).

"(C) FOREIGN HOLDING COMPANY.—If the holding company is a foreign holding company, it may continue to engage in any activities, or acquire and retain shares of a company or its subsidiaries (other than a depository institution or a subsidiary of a depository insti­ tution that is not a financial holding company) that are not permissible for a bank holding company under subsection (c)(8).

"(D) PREEMINENTLY FINANCIAL.—For pur­ poses of this subsection, a company is preem­ inently engaged in financial activities if the an­ nual gross revenues derived by the holding com­ pany and all subsidiaries of the holding com­ pany (excluding revenues derived from sub­ sidary depository institutions, on a consoli­ dated basis) from activities that are financial in nature are greater than the total annual gross revenues of the company.

"(E) NO EXPANSION OF GRANDFATHERED COM­ MERCIAL ACTIVITIES THROUGH MERGER, CONSOLI­ DATION.—A financial holding company that engages in activities or holds shares pursuant to this subsection, or a subsidiary of such financial holding company, may not acquire, in any merger, consolidation, or other type of business combination, assets of any other company that is engaged in any activity that the Board has deter­ mined to be financial in nature or incidental to a financial activity under subsection (b).

"(2) CONTINUING REVENUE LIMITATION ON GRANDFATHERED COMMERCIAL ACTIVITIES.—Nor­ mally, the revenue limitation under subsection (b) does not apply to activities engaged in by a bank holding company or a financial holding company since January 1, 1999, other than the activities permissible under subsection (c)(8).
such company does not exceed 15 percent of the consolidated annual gross revenues of the financial holding company or any other person engaged in any such activities as a subsidiary of a financial holding company.

(5) "Cross Marketing Restrictions Application of Subsection (b)"—In General.—A depository institution controlled by a financial holding company shall not:

(a) offer or market, directly or through any arrangement, any product or service of a company engaged in any such activities as a subsidiary of the holding company, or an affiliate of such subsidiary, that is not also offered or marketed by the financial holding company pursuant to this subsection or such arrangement, if the company, or such affiliate, is a subsidiary of a subsidiary of the financial holding company that is controlled by a financial holding company.

(b) permit any of its products or services to be offered or marketed, directly or through any arrangement, by any company described in clause (a).

(c) "Rule of Construction."—Paragraph (a) shall not be construed as prohibiting an arrangement between a depository institution and a company owned or controlled pursuant to subparagraph (a)(i) of subsection (b)(6)(D) for the marketing of products or services through statements or Internet websites if such arrangement does not violate subsection 106 of the Bank Holding Company Act Amendments of 1970; and

(d) "Limited Exclusions for Newly Acquired Insured Depository Institutions."—Any insured depository institution acquired by a financial holding company may not engage in a covered transaction (as defined in section 12119 of the Federal Reserve Act) with any affiliate controlled by the company pursuant to this subsection.

(e) "Significant Grandfather."—A financial holding company engaged in any activity, or retaining direct or indirect ownership or control of shares of a company, pursuant to this subsection, shall terminate such activity and divest ownership or control of the shares of such company before the end of the 10-year period beginning on the date of the enactment of the Gramm-Leach-Bliley Act. The Board may, upon application by a financial holding company, extend by a period not to exceed an additional 3 years if such extension would not be detrimental to the public interest.

(f) "General Note."—Notwithstanding subsection (a), a company that is not a bank holding company or a foreign bank (as defined in section 3(h) of the Federal Reserve Act) and becomes a financial holding company after the date of enactment of the Gramm-Leach-Bliley Act, may continue to engage in, or directly or indirectly own or control shares of a company engaged in, activities related to the trading, sale, or investment in commodities and underlying physical properties that were not permissible for bank holding companies to conduct in the United States as of September 30, 1997, if:

(1) the company, or any subsidiary of the holding company, lawfully was engaged, directly or indirectly, in any such activities as of September 30, 1997, in the United States;

(2) the parent holding company, or in the case of a company controlled by a financial holding company, the controlling company, or in the case of a company controlled by a company controlled by a financial holding company, the controlling company, are equal to or in excess of a percent of the total consolidated assets of the financial holding company, except that the Board may increase in the future the percent by which such amounts and under such circumstances as the Board considers appropriate, consistent with the purposes of this Act; and

(3) the company does not permit—

(a) any company, the shares of which it offers or markets, directly or through any arrangement, to be offered or marketed, by any financial holding company or such company's financial subsidiaries, as a subsidiary of a financial holding company, or a financial holding company that is controlled by a financial holding company, or by any credit association or any subsidiary of a financial holding company that is controlled by a financial holding company.

(b) any affiliate of such subsidiary that is engaged in any activity, or retaining direct or indirect ownership or control of shares of a company, pursuant to any such arrangement, to be offered or marketed, directly or through any arrangement, by any company described in clause (a).

(c) any person engaged in any such activity as a subsidiary of a financial holding company, or a financial holding company that is controlled by a financial holding company, or by any credit association or any subsidiary of a financial holding company that is controlled by a financial holding company, or by any credit association or any subsidiary of a financial holding company that is controlled by a financial holding company, or any other person engaged in such activities as a subsidiary of a financial holding company.

(6) "Financial Holding Company Requirement."—Section 200A of the Community Reinvestment Act of 1977 (11 U.S.C. 302) is amended by adding at the end the following new subsection:

(a) "Financial Holding Company Requirement.—"(b) In General.—An election by a bank holding company to become a financial holding company pursuant to section 4 of the Bank Holding Company Act of 1956, given during the 12-month period preceding the date the Board notifies the company of such finding before the end of the 30-day period beginning on such date.

(c) Limited Exclusions for Newly Acquired Insured Depository Institutions.—Any insured depository institution acquired by a bank holding company during the 12-month period preceding the date the Board notifies the company of such finding before the end of the 30-day period beginning on the date of such acquisition.

(d) Limited Exclusions for Newly Acquired Insured Depository Institutions.—An insured depository institution acquired by a bank holding company may not engage in a covered transaction (as defined in section 12119 of the Federal Reserve Act) with any affiliate controlled by the company pursuant to this subsection.

(e) Significant Grandfather.—A financial holding company engaged in any activity, or retaining direct or indirect ownership or control of shares of a company, pursuant to this subsection, shall terminate such activity and divest ownership or control of the shares of such company before the end of the 10-year period beginning on the date of the enactment of the Gramm-Leach-Bliley Act. The Board may, upon application by a financial holding company, extend by a period not to exceed an additional 3 years if such extension would not be detrimental to the public interest.

(f) General Note.—Notwithstanding subsection (a), a company that is not a bank holding company or a foreign bank (as defined in section 3(h) of the Federal Reserve Act) and becomes a financial holding company after the date of enactment of the Gramm-Leach-Bliley Act, may continue to engage in, or directly or indirectly own or control shares of a company engaged in, activities related to the trading, sale, or investment in commodities and underlying physical properties that were not permissible for bank holding companies to conduct in the United States as of September 30, 1997, if:

(1) the company, or any subsidiary of the holding company, lawfully was engaged, directly or indirectly, in any such activities as of September 30, 1997, in the United States;

(2) the parent holding company, or in the case of a company controlled by a financial holding company, the controlling company, or in the case of a company controlled by a company controlled by a financial holding company, the controlling company, are equal to or in excess of a percent of the total consolidated assets of the financial holding company, except that the Board may increase in the future the percent by which such amounts and under such circumstances as the Board considers appropriate, consistent with the purposes of this Act; and

(3) the company does not permit—

(a) any company, the shares of which it offers or markets, directly or through any arrangement, to be offered or marketed, by any financial holding company or such company's financial subsidiaries, as a subsidiary of a financial holding company, or a financial holding company that is controlled by a financial holding company, or by any credit association or any subsidiary of a financial holding company that is controlled by a financial holding company.

(b) any affiliate of such subsidiary that is engaged in any activity, or retaining direct or indirect ownership or control of shares of a company, pursuant to any such arrangement, to be offered or marketed, directly or through any arrangement, by any company described in clause (a).

(c) any person engaged in any such activity as a subsidiary of a financial holding company, or a financial holding company that is controlled by a financial holding company, or by any credit association or any subsidiary of a financial holding company that is controlled by a financial holding company, or by any credit association or any subsidiary of a financial holding company that is controlled by a financial holding company, or any other person engaged in such activities as a subsidiary of a financial holding company.

(7) "Insurance Company Requirement."—Section 163 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841) is amended by adding at the end the following new subsection:

(a) "Insurance Company Requirement.—"(b) In General.—An election by a bank holding company to become an insurance company, given during the 12-month period preceding the date the Board notifies the company of such finding before the end of the 30-day period beginning on such date.

(c) Limited Exclusions for Newly Acquired Insured De...
thereof, or against any other person based upon an association of such person with a depository institution.

(ii) Any State from requiring any person that is assuming control of an insured depository institution in that State to maintain or restore the capital requirements of that insurer to the level required under federal regulations that set forth or authorize capital requirements of general solvency in that State to avoid the requirement of preparing and filing with the insurance regulator of that State a plan to increase the capital of the insurer, except that any determination by the State insurance regulatory authority that such requirement must be made not less than 60 days after the date of notification under subparagraph (A); or

(iii) Any State from restricting a change in the ownership of stock in an insurer, or a company formed for the purpose of controlling such insurer, after the conversion of the insurer from mutual to stock form so long as such restriction does not have the effect of discriminating, intentionally or unintentionally, against a depository institution or an affiliate thereof, or against any other person based upon an association of such person with a depository institution.

(d) A soliciting or selling agent or broker that does not

(1) In General.—Except as provided in paragraph (B), and except with respect to insurance sales, solicitation, or cross-marketing activities, which shall be governed by paragraph (D), no State may, by statute, regulation, order, interpretation, or other action, prevent or significantly interfere with the ability of a depository institution, or an affiliate thereof, to engage, directly or indirectly, either by itself or in conjunction with an affiliate, or any other person, in any activity authorized or permitted under this Act and the amendments made by this Act.

(2) Insurance sales.—

(A) In General.—In accordance with the legal standards set forth in the Constitution of the United States in Barnett Bank of Marion County N.A. v. Nelson, 517 U.S. 26 (1996), no State may, by statute, regulation, order, interpretation, or other action, prevent or significantly interfere with the ability of a depository institution, or an affiliate thereof, to engage, directly or indirectly, either by itself or in conjunction with an affiliate or any other person, in any insurance sales, solicitation, or cross-marketing activity.

(B) Certain State laws preserved.—Notwithstanding subparagraph (A), a State may impose the following restrictions on restrictions that are substantially the same as but no more burdensome or restrictive than those in each of the following:

(i) Restrictions prohibiting the rejection of an insurance policy by a depository institution or an affiliate of a depository institution, solely because the policy has been issued or underwritten by any person who is not associated with such depository institution or affiliate when the insurance is required in connection with a loan or extension of credit.

(ii) Restrictions prohibiting a requirement for any debtor, insurer, or insurance agent or broker to pay a separate charge in connection with the handling of insurance that is required in connection with a loan or extension of credit or the provision of another traditional banking product by a depository institution, or an affiliate thereof, to any person if such charge would be required when the depository institution or affiliate is the licensed insurer providing the insurance.

(iii) Restrictions prohibiting the use of any advertisement or other insurance promotional material by a depository institution or affiliate of a depository institution that would cause a reasonable person to believe mistakenly that—

(I) a Federal Government or a State is responsible for the insurance sales activities of, or stands behind the credit of, the institution or affiliate; or

(II) a State, or the Federal Government guarantees any returns on insurance products, or is

a source of payment on any insurance obligation of or sold by the institution or affiliate;

(iv) Restrictions prohibiting the payment or receipt of any premium or service fee or other valuable consideration for services as an insurance agent or broker to or by any person, unless such person holds a valid State license regarding the writing of insurance for the time at which the services are performed, except that, in this clause, the term "services" as an insurance agent or broker includes the submission of an application for, or the placing of, a referral by an unlicensed person of a customer or potential customer to a licensed insurance agent or broker, or include a discussion of specific insurance policy terms and conditions.

(v) Restrictions prohibiting any compensation paid to or received by any individual who is not licensed to sell insurance, for the referral of a customer that seeks to purchase, or seeks an opinion or advice on, any insurance product to a person that sells or provides opinions or advice on such insurance to a customer on the purchase of insurance by the customer.

(vi) Restrictions prohibiting the release of the insurance information (as defined as information concerning the premiums, terms, and conditions of insurance coverage, including application information and insured claims of a customer contained in the records of the depository institution or an affiliate thereof) to any person, officer, director, employee, agent, or affiliate of a depository institution, for the purpose of soliciting or selling insurance, without the express consent of the customer, other than a provision that prohibits—

(I) a transfer of insurance information to an unaffiliated insurer in connection with transferring insurance in force on existing insureds of the depository institution or an affiliate thereof, or in connection with a merger with or acquisition of an unaffiliated insurer; or

(II) the release of insurance information as otherwise authorized by State or Federal law.

(vii) Restrictions prohibiting the use of health information obtained from the insurance records of a customer for any purpose, other than for its activities as a licensed agent or broker, without the express consent of the customer.

(viii) Restrictions prohibiting the extension of credit or any product or service that is equivalent to an extension of credit, lease or sale of property of any type, or any service or fixing or varying the consideration for any of the foregoing, on the condition or requirement that the purchase, acquisition, or extension of insurance from a depository institution or an affiliate of a depository institution, or a particular insurer, agent, or broker is conditioned in a way that would prevent any such depository institution or affiliate—

(I) from engaging in any activity described in this clause that would not violate section 106 of the Bank Holding Company Act Amendments of 1970, as interpreted by the Board of Governors of the Federal Reserve System; or

(II) from informing a customer or prospective customer that insurance is required in order to obtain a loan or credit, that loan or credit approval is contingent upon the purchase of the credit, and that insurance is available from the depository institution or an affiliate of the depository institution.

(ix) Restrictions prohibiting an application by a consumer for a loan or other extension of credit from a depository institution is pending, and the insurer acquiring the credit, and the consumer or is required in connection with the loan or extension of credit by the depository institution or any affiliate of the depository institution or any activity that is required to be provided to the consumer or prospective customer indicating that the consumer's choice of an insurance provider will not affect the credit or the credit terms.

(x) Restrictions prohibiting an application by a consumer for a loan or other extension of credit from a depository institution is pending, and the insurer acquiring the credit, and the consumer or is required in connection with the loan or extension of credit by the depository institution or any affiliate of the depository institution or any activity that is required to be provided to the consumer or prospective customer indicating that the customer's choice of an insurance provider will not affect the credit or the credit terms.

(e) Restrictions requiring clear and conspicuous disclosure, in writing, to the customer prior to the sale of any insurance policy that such policy—

(I) is not insured by the Federal Deposit Insurance Corporation;

(II) is not guaranteed by any depository institution or, if appropriate, an affiliate of any such institution or any person soliciting the sale of insurance on the premises thereof; and

(IV) where appropriate, involves investment risk and owning the policy will not affect the purchase of the insurance.

(f) Restrictions requiring that, when a customer obtains insurance (other than credit insurance or flood insurance) and credit from a depository institution, or an affiliate of such institution, or any person soliciting the purchase of insurance on the premises thereof, the credit and insurance transactions be completed through separate documents.

(g) Restrictions prohibiting, when a customer obtains insurance (other than credit insurance or flood insurance) and credit from a depository institution or an affiliate of such institution, or any person soliciting the purchase of insurance on the premises thereof, inclusion of the expense of insurance premiums in the primary rate or contract. (other than credit insurance or flood insurance)

(h) Restrictions requiring maintenance of separate and distinct books and records relating to insurance transactions, including all files relating to and reflecting consumer complaints, and requiring that such insurance books and records be made available to the appropriate State insurance regulator for inspection upon reasonable notice.

(C) LIMITATIONS.—

(i) OCC Reference.—Section 304(e) does not apply with respect to any State statute, regulation, order, interpretation, or other action regarding insurance sales, solicitation, or cross-marketing activities described in subparagraph (A) that was issued, adopted, or enacted before September 3, 1998, and that is not described in subparagraph (B).

(ii) Non-Discrimination.—Subsection (e) does not apply with respect to any State statute, regulation, order, interpretation, or other action regarding insurance sales, solicitation, or cross-marketing activities described in subparagraph (A) that was issued, adopted, or enacted before September 3, 1998, and that is not described in subparagraph (B).

(iii) CONSTRUCTION.—Nothing in this paragraph shall be construed—

(I) to limit the applicability of the decision in Barnett Bank of Marion County N.A. v. Nelson, 517 U.S. 25 (1996) with respect to any State statute, regulation, order, interpretation, or other action that is not referred to or described in subparagraph (B); or

(II) to create any inference with respect to any State statute, regulation, order, interpretation, or other action that is not described in this paragraph.

(2) INSURANCE ACTIVITIES OTHER THAN SALES.—State statutes, regulations, interpretations, orders, and other actions that are not described in subparagraph (I) or (II) and that are not exempted under paragraph (I) to the extent that they—

(A) relate to, or are issued, adopted, or enacted for the purpose of regulating the business of insurance in accordance with the Act entitled "An Act to provide for reference to the regulation of the business of insurance" and approved March 9, 1945 (15 U.S.C. 101 et seq. referred to as the "McCarran-Ferguson Act");

(B) apply only to persons that are not depository institutions, but that are directly engaged in the business of insurance (except that they may apply to depository institutions engaged in providing savings bank life insurance as principal, to the extent of regulating such insurance);
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(C) do not relate to or directly or indirectly regulate insurance sales, solicitations, or cross marketing activities covered under paragraph (D); and
(D) it—
(i) does not distinguish by its terms between depository institutions, or affiliates thereof, engaged in the activity at issue and other persons engaged in the same activity in a manner that is inconsistent with respect to the conduct of the activity by any such depository institution or affiliate engaged in the activity at issue;
(ii) as interpreted or applied, does not have, and will not have, an impact on depository institutions, or affiliates thereof, engaged in the activity at issue, or any person who has an association with such depository institution or affiliate, that is substantially more adverse than its impact on other persons engaged in the same activity that are not depository institutions or affiliates thereof, or persons who do not have an association with any such depository institution or affiliate;
(iii) does not effectively prevent a depository institution, or affiliate thereof, from engaging in activities authorized or permitted by this Act or any other provision of Federal law; and
(iv) does not conflict with the intent of this Act generally to permit affiliations that are authorized or permitted by Federal law.
(b) NONDISCRIMINATION.—Except as provided in any restrictions described in subsection (d)(2)(B), no State may, by statute, regulation, order, interpretation, or other action, regulate the extent to which, or permit affiliates of, a bank that is under common control with a bank in another State to engage in activities authorized or permitted under this Act or any other provision of Federal law of a depository institution, or affiliate thereof, that is substantially more adverse than its impact on other persons providing the same products or services engaged in the same activities that are not depository institutions, or affiliates thereof, or persons or entities affiliated therewith;
(2) distinguishes by its terms between depository institutions, or affiliates thereof, and other persons engaged in such activities, in a manner that is in any way adverse to any such depository institution, or affiliate thereof;
(I) as interpreted or applied, has or will have an impact on depository institutions, or affiliates thereof, that is substantially more adverse than its impact on other persons providing the same products or services engaged in the same activities that are not depository institutions, or affiliates thereof, or persons or entities affiliated therewith;
(3) effectively prevents a depository institution, or affiliate thereof, from engaging in insurance activities authorized or permitted by this Act or any other provision of Federal law; or
(4) is an exception to, or an attempt to frustrate, the intent of this Act generally to permit affiliations that are authorized or permitted by Federal law by depository institutions, or affiliates thereof, and persons engaged in the business of insurance.
(2) LIMITATION.—Subsections (c) and (d) shall not be construed to affect any of the provisions of the securities commission (or any agency or office performing like functions) of any State, under the laws of such State;
(A) to investigate and bring enforcement actions, consistent with section 18(c) of the Securities Act of 1933, with respect to fraud or deceit or unlawful conduct by any person, in connection with any securities transaction; or
(B) to require the registration of securities or the licensure or registration of brokers, dealers, or Investment Advisers (consists with section 203A of the Investment Advisers Act of 1940), or the associated persons of a broker, dealer, or Investment Adviser (consistent with such section 203A); or
(C) State laws, regulations, orders, Interpretations, or other actions of general applicability relating to the activities of banks, bank holding companies, bank holding companies, or such companies that are a part of such depository institutions, or affiliates thereof, or persons engaged in the business of insurance.
(d) DEFINITIONS.—For purposes of this section, the following definitions shall apply:
(1) AFFILIATE.—The term "affiliate" means any company that controls, is controlled by, or is under common control with another company. To "control" a company means to own more than a 5% interest in the voting securities or the nonvoting securities of such company, to possess direct or indirect power to direct the management and policies of such company.
(2) ANTITRUST LAW.—The term "antitrust laws" has the meaning given the term in subsection (a) of the first section of the Clayton Act (15 U.S.C. 2) and includes section 7 of the Federal Trade Commission Act (to the extent that such section 7 relates to unfair methods of competition).
(3) DEPOSITORY INSTITUTION.—The term "depository institution"—
(A) has the meaning given the term in section 3 of the Federal Deposit Insurance Act; and
(B) includes any foreign bank that maintains a branch, agency, or commercial lending company in the United States.
(4) INSURER.—The term "insurer" means any person engaged in the business of insurance.
(5) STATE.—The term "State" means any State of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, the Virgin Islands, and the Northern Mariana Islands.

SEC. 105. MUTUAL BANK HOLDING COMPANIES AUTHORIZED

Section 105 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(g)) is amended to read as follows:

"SEC. 105. MUTUAL BANK HOLDING COMPANIES AUTHORIZED.

Section 105 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (12 U.S.C. 183a(e)(4)(B)) is amended by inserting "and a branch of a bank controlled by an out-of-State bank holding company (as defined in section 203(f) of the Bank Holding Company Act of 1956) before the period.""

SEC. 106. PROHIBITION ON DEPOSIT PRODUCTION

Section 106 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (12 U.S.C. 183a(e)(4)(B)) is amended by inserting "and any branch of a bank controlled by an out-of-State bank holding company (as defined in section 203(f) of the Bank Holding Company Act of 1956) before the period.""

SEC. 107. CROSS MARKETING RESTRICTION: LIMITED PURPOSE BANK RELATES: DIVERSE

(a) CROSS MARKETING RESTRICTION.—Section 4(f) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(f)) is amended by striking paragraph (3).
(b) DAYCUT OVERDRAFTS.—Section 4(d) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(d)) is amended by inserting after paragraph (2) the following new paragraph:
"(3) PERMISSIBLE OVERDRAFTS DESCRIBED.—For purposes of paragraph (2)(C), an overdraft is described in the following manner:
(A) such overdraft results from an inadvertent computer or accounting error that is beyond the control of both the bank and the affiliate;
(B) such overdraft—"
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"(l) corrected the condition or ceased the ac-
vitiy that caused the company to fail to con-
tinue in operation."; and
"(ii) submitted a plan to the Board for ap-
proval to cease the activity or correct the con-
tdition or cease the activity in a manner which
shall not exceed 1 year; and
"(B) implemented procedures that are reason-
able to prevent the reoccurrence of such condi-
tion or activity.".

"(II) FOREIGN BANK SUBSIDIARIES OF LIMITED
PURCHASE DEPOSITORY INSTITUTIONS.—Subpara-
graph (A) of the Bank Holding Company Act of 1956
(12 U.S.C. 1841(l)) is amended by adding at the end
the following paragraph:

"(A) FOREIGN BANK SUBSIDIARIES OF LIMITED
PURPOSE CREDIT CARD BANKS.—
(A) IN GENERAL.—An institution described in
section 361(b)(1)(F) may control a foreign bank if—

the investment in the institution in the
foreign bank meets the requirements of section
25 or 25A of the Federal Reserve Act and the
foreign bank qualifies under such sections;

(ii) the foreign bank does not offer any prod-
 ducts or services in the United States; and

(iii) the activities of the foreign bank are per­
missible under applicable foreign laws.

(II) OTHER LIMITATIONS INAPPLICABLE.—
The limitations contained in any clause of section
361(b)(1)(F) shall not apply to a foreign bank de­
dcribed in subparagraph (A) that is controlled by
an institution described in such section.

SEC. 105. USE OF SUBORDINATED DEBT TO PRO-
TECT FINANCIAL SYSTEM AND ADVANCE THE
ESSENTIAL INTERESTS OF THE UNITED STATES FROM TOO BIG TO
FAIL.

(a) STUDY REQUIRED.—The Board of Gov-
ernors of the Federal Reserve System and the
Secretary of the Treasury shall conduct a study of—

(1) the feasibility and appropriateness of es-
 tablishing a depository institution holding the
business of a foreign bank and the benefits of
such an arrangement to the United States; and

(2) the manner in which such an arrangement
might be incorporated into existing capital
standards and other rules relating to the trans-

(a) REPORT.—Before the end of the 18-month
period beginning on the date of the enactment
of this Act, the Board of Governors of the Fed­
eral Reserve System and the Secretary of the
Treasury shall submit a report to the Congress
containing the findings and conclusions of the
Board and the Secretary in connection with the
study required under subsection (a), together with
a recommendation of any regulation or other
measures that the Board and the Secretary de-
termine to be appropriate.

(b) USE OF EXISTING REPORTS.—For purposes of subsection
(a), the following definitions shall apply:

(1) BANK HOLDING COMPANY.—The term "bank
holding company" means the meaning given the
term in section 3(c) of the Bank Holding Company
Act of 1956.

(2) INSURED DEPOSITORY INSTITUTION.—The
term "insured depository institution" has the
meaning given the term in section 3(c) of the
Federal Deposit Insurance Act.

(3) DEBT.—The term "subordi-
nated debt" means unsecured debt that—

(A) has an original weighted average maturity of
not less than 5 years;

(B) is subordinated as to payment of principal
and interest to all other indebtedness of the
bank, including deposits;

(C) is not supported by any form of credit en-
hancement, including a guarantee or standby
letter of credit; and

(D) is not held in whole or in part by any af-
filiate or institution-affiliated party of the in-
sured depository institution or bank holding
company.

SEC. 106. STUDY OF FINANCIAL MODERNIZATION
ACT OF 1999.

(a) STUDY.—The Secretary of the Treasury,
in consultation with the Federal banking agencies
(as defined in section 3(c) of the Federal Deposit
Insurance Act), shall conduct a study of the ef-
tect to which credit is being provided to and for
small businesses and farms, as a result of this Act
and the amendments made by this Act.

SEC. 107. FUTURE EXAMINATIONS AND
REGULATORY ACTIONS—

(a) PROHIBITION OF ACTIONS REQUIRING BANKS TO SUBMIT
DATA.—The Board of Governors of the Federal
Reserve System and the Federal Deposit Insurance
Corporation shall not require any bank holding
company, subsidiary of any bank holding company,
or any subsidiary of a bank holding company, to
submit any data to the Board, the Corporation or
any other Federal banking agency, that is not
required by Federal law or regulation.

(b) REPORT.—Before the end of the 3-year
period beginning on the date of the enactment
of this Act, the Board, in consultation with the
Federal banking agencies, shall submit a report to
the Congress on the findings and conclusions of the
study conducted pursuant to subsection (a) and
shall include such recommendations as determinates to be
appropriate for administrative and legislative
action.

Subtitle B—Streamlining Supervision of Bank
Holding Companies

SEC. 111. STREAMLINING BANK HOLDING
COMPANY SUPERVISION.

Section 3(c) of the Bank Holding Company Act
of 1956 (12 U.S.C. 1841(c)) is amended to read as
follows:

"(c) REPORTS AND EXAMINATIONS.—

(1) IN GENERAL.—The Board, on submis
sion of the first report, and on or before the end of
every 2 years thereafter, may require any bank
holding company, or any subsidiary of such company,
to submit a report to the Board with respect to
such holding company or subsidiary:

(a) the systems, policies, and procedures of
the company or subsidiary relating to the
management of risks (including credit, op-
eration, compliance, and liquidity risks);

(b) the risk management systems of the com-
pany or subsidiary, including any systems
used to identify, measure, monitor, and
control such risk;

(c) any other information that the Board
may require.

(2) REPORT Fresh.—Before the end of the
5-year period beginning on the date of the
enactment of this Act, the Board, in consultation
with the Federal banking agencies, shall submit a report
to the Congress on the findings and conclusions of
the study conducted pursuant to subsection (a) and
shall include such recommendations as determi
nates to be appropriate for administrative and legisla-
tive action.

Subtitle B—Streamlining Supervision of Bank
Holding Companies

SEC. 113. FOCUS ON EXAMINATIONS.—
The Board shall, to the fullest extent possible,
limited the focus and scope of any examination of a
bank holding company to—

(1) the bank holding company;

(2) any subsidiary of the bank holding
company that could have a materially adverse effect
on the safety and soundness of any depository
institution subsidiary of the holding company
due to—

(A) the size, condition, or activities of the
subsidiary; and

(B) the nature or size of transactions be-
 tween the subsidiary and any depository insti-
tution that is also a subsidiary of the bank
holding company.

SEC. 114. DEPENDENCE ON BANK EXAMINATIONS.—
The Board shall, to the fullest extent possible,
for the purposes of this section, use the re-
ports of examinations and related information to be
made by the appropriate Federal and State de-
pository institution supervisory authorities.

SEC. 115. ADMINISTRATIVE AND OTHER EXAMINATIONS.—
The Board shall, to the fullest extent possible,
forego an examination by the Board under this
paragraph and instead review the reports of ex-
aminations made of—

(1) any registered broker or dealer by or on
behalf of the Securities and Exchange Commis-
sion;

(2) any registered investment adviser prop-
erty registered by or on behalf of either the Se-
curities and Exchange Commission or any State;
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"(III) any licensed insurance company by or on behalf of any State regulatory authority responsible for the supervision of Insurance company activities;

(iv) any other subsidiary that the Board finds to be comprehensively supervised by a Federal or State authority.

(9) CAPITAL.—

(A) In GENERAL.—The Board may not, by rule, regulation, or, otherwise, prescribe or impose any capital or capital adequacy rules, guidelines, standards, or requirements on any Affiliate or regulated subsidiary of a bank holding company that—

(i) is not a depository institution; and

(ii) in compliance with the applicable capital requirements of its Federal regulatory authority (including the Securities and Exchange Commission) or State insurance authority;

(iii) properly registered as an investment adviser under the Investment Advisers Act of 1940, or with any State; or

(iv) is licensed as an insurance agent with the appropriate State insurance authority.

(B) RULE OF CONSTRUCTION.—Subparagraph (A) shall not be construed as preventing the Board from requiring capital or capital adequacy rules, guidelines, standards, or requirements with respect to—a registered investment adviser other than with respect to investment advisory activities or activities incidental to investment advisory activities; or

(ii) activities of a licensed insurance agent other than insurance agency activities or activities incidental to insurance agency activities.

(10) LIMITATIONS ON INDIRECT ACTION.—In developing, establishing, or assessing bank holding company capital or capital adequacy rules, guidelines, standards, or requirements, the Board shall not be required to consider—

(a) such funds or assets are to be provided by—

(i) a bank holding company that is an insurance company, a broker or dealer registered under the Securities Exchange Act of 1934, an investment company registered under the Investment Company Act of 1940, or an investment adviser registered by or on behalf of either the Securities and Exchange Commission or any State; or

(ii) an affiliate of the depository institution that is an insurance company or a broker or dealer registered under the Securities Exchange Act of 1934, an investment company registered under the Investment Company Act of 1940, or an investment adviser registered by or on behalf of either the Securities and Exchange Commission or any State; or

(b) the State insurance authority for the insurance company or the Securities and Exchange Commission for the registered broker, dealer, investment adviser (solely with respect to investment advisory activities incidental thereto), or investment company, as the case may be, in determining the net worth of the holding company that the holding company shall not provide such funds or assets because such action would have a material adverse impact on the condition of the insurance company or the broker, dealer, investment company, or investment adviser, as the case may be;

(12) NOTICE TO STATE INSURANCE AUTHORITY OR SEC REQUIRED.—If the Board requires a bank holding company, or an Affiliate of a bank holding company, that is an insurance company or a broker, dealer, investment company, or investment adviser described in paragraph (11)(A) to provide funds or assets to a depository institution subsidiary of the holding company pursuant to any regulation, order, or other action of the Board referred to in paragraph (1), the Board shall promptly notify the State insurance authority for the insurance company, the Securities and Exchange Commission, or the State securities regulator, as the case may be, of such requirement.

(13) DIVESTITUTE IN LIEU OF OTHER ACTION.—If the Board receives a notice described in paragraph (12) from a State insurance authority or the Securities and Exchange Commission with regard to a bank holding company or affiliate referred to in that paragraph, the Board may order the bank holding company to divest the depository institution subsidiary not later than 180 days after receiving the notice, or such longer period as the Board determines consistent with the safety and sound operation of the depository institution.

SEC. 112. AUTHORITY OF STATE INSURANCE REGULATOR AND THE SECURITIES AND EXCHANGE COMMISSION.

(a) BANK HOLDING COMPANIES.—Section 5 of the Bank Holding Company Act of 1956 (12 U.S.C. 1844) is amended by adding at the end the following new subsection:

(4) CONDITIONS BEFORE DIVESTITUTE.—During the period beginning on the date an order to divest is issued by the Board under paragraph (3) for a bank holding company to divest an depository institution subsidiary of the date the divestiture is completed, the Board may impose any conditions or restrictions on the bank holding company's ownership or operation of the depository institution, including restricting or prohibiting transactions between the depository institution and any affiliate of the institution as are appropriate under the circumstances.

(b) RULE OF CONSTRUCTION.—No provision of this subsection may be construed to prevent the Board or the State insurance authority, including the office of the insurance commissioner of any Federal agency or department with respect to any entity that is within the jurisdiction of an agency department.  (b) [Subparagraphs omitted.]

(10) SUBSIDIARIES OF DEPOSITORY INSTITUTIONS.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by adding at the end the following:

SEC. 43. AUTHORITY OF STATE INSURANCE REGULATOR AND THE SECURITIES AND EXCHANGE COMMISSION.

(a) IN GENERAL.—Notwithstanding any other provision of law, the provisions of—

(1) section 5(b) of the Bank Holding Company Act of 1956 that limit the authority of the Board of Governors of the Federal Reserve System to require reports from, to make examinations of, or to impose capital requirements on holding companies and their functionally regulated subsidiaries or that require deference to other regulators;

(2) section 5(g) of the Bank Holding Company Act of 1956 that limit the authority of the Board to require a functionally regulated subsidiary of a holding company to provide capital or other funds or assets to a depository institution subsidiary of the holding company and to take certain actions including requiring divestiture of the depository institution; and

(3) section 16A of the Bank Holding Company Act of 1956 that limit whatever authority the Board might otherwise have to take direct or indirect action with respect to holding companies and their functionally regulated subsidiaries;

shall also limit whatever authority that a Federal banking agency might otherwise have under any statute or regulation to require reports, make examinations, impose capital requirements, or take any other action in direct or indirect action with respect to any functionally regulated affiliate of a depository institution, subject to the same standards and requirements as are applicable to the Board under those provisions.

(b) CERTAIN EXEMPTION AUTHORIZED.—No provision of this section shall be construed as preventing the Corporation, if the Corporation finds it necessary to determine the condition of a depository institution for insurance purposes, from examining an affiliate of any depository institution, pursuant to section 1006(a), as may be necessary to disclose fully the relationship between the depository institution and the affiliate, and the extent of such relationship on the depository institution.

(c) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

(1) FUNCTIONALLY REGULATED SUBSIDIARY.—The term 'functionally regulated subsidiary' has the meaning given in the term in section 16A(3) of the Bank Holding Company Act of 1956.

(2) FUNCTIONALLY REGULATED AFFILIATE.—The term "functionally regulated affiliate'' means, with respect to any depository institution, any affiliate of such depository institution that is—

(A) not a depository institution holding company; and

(B) a company described in any clause of section 16A(3)(B) of the Bank Holding Company Act of 1956.

(3) SUBSIDIARY.—The term 'subsidiary' means—

(A) an Affiliate of a depository institution holding company; and

(B) a company described in any clause of section 16A(3)(B) of the Bank Holding Company Act of 1956.
**CONGRESSIONAL RECORD — HOUSE**

November 2, 1999

**SEC. 114. ROLE OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM**

The Bank Holding Company Act of 1956 (12 U.S.C. 1841 et seq.) is amended by inserting after section 10 the following new section:

"SEC. 10A. LIMITATION ON RULEMAKING, PRELIMINARY INVESTIGATION, AND ENFORCEMENT AUTHORITY OF THE BOARD.

(a) LIMITATION ON DIRECT ACTION.—The Board may not prescribe regulations, issue or seek entry of orders, impose restraints, restrictions, guidelines, requirements, safeguards, or standards, or otherwise take any action under or pursuant to any provision of this Act or section 8 of the Federal Deposit Insurance Act against or with respect to any member bank or any affiliate of such member bank, or against or with respect to any subsidiary of a bank holding company and any affiliate of such subsidiary if there is a pending examination by the Board of such member bank, such affiliate, such subsidiary, or such parent company.

(b) LIMITATION ON INDIRECT ACTION.—The Board may not prescribe regulations, issue or seek entry of orders, impose restraints, restrictions, guidelines, requirements, safeguards, or standards, or otherwise take any action under or pursuant to any provision of this Act or section 8 of the Federal Deposit Insurance Act against or with respect to any bank holding company that controls such member bank, such affiliate of such member bank, or such subsidiary of such member bank if there is a pending examination by the Board of such bank holding company, such affiliate of such member bank, or such subsidiary of such member bank.

(c) ACTIONS SPECIFICALLY AUTHORIZED. —Notwithstanding subsection (a) or (b), the Board may take action under this Act or section 8 of the Federal Deposit Insurance Act to enforce compliance by a functionally regulated subsidiary of a bank holding company with any Federal Reserve Board regulations or to take any action under or pursuant to any provision of this Act or section 8 of the Federal Deposit Insurance Act against or with respect to any bank holding company that is engaging in unsafe or unsound banking practices.

(d) FUNCTIONALLY REGULATED SUBSIDIARY Defined.—In this section, the term 'functionally regulated subsidiary' has the meaning given in section 5(c)(5).

(e) COMPTROLLER OF THE CURRENCY.—

(i) IN GENERAL.—The Comptroller of the Currency may, by regulation or order, impose restrictions or requirements on relationships between a national bank and a subsidiary of the national bank that the Comptroller finds:

(A) consistent with the purposes of this Act, title XXII of the Revised Statutes of the United States, and other Federal law applicable to national banks; and

(B) appropriate to avoid any significant risk to the safety and soundness of insured depository institutions or any Federal deposit insurance fund or other adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.

(ii) LIMITATION. —The Comptroller of the Currency shall regularly:

(A) review all restrictions or requirements established under paragraph (i) to determine whether there is a continuing need for any such restriction or requirement to carry out the purposes of the Act, including the avoidance of any adverse effect referred to in paragraph (i)(B); and

(B) modify or eliminate any such restriction or requirement the Comptroller finds is no longer required for such purposes.

(f) BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM.—

(1) IN GENERAL.—The Board of Governors of the Federal Reserve System, in accordance with the purposes and requirements of this Act, shall prescribe regulations, issue or seek entry of orders, impose restrictions or requirements on relationships or transactions between a branch, agency, or commercial lending company of a foreign bank in the United States and any affiliate of such foreign bank, an affiliate of such foreign bank that is a member of the Federal Reserve System, an affiliate of such foreign bank that is not a member of the Federal Reserve System, a domestic bank, a foreign bank, or any Federal Reserve System bank that is not a member of the Federal Reserve System.

(2) REVIEW.—The Federal Reserve Board shall review the Comptroller's regulations or orders and may modify or eliminate any such restriction or requirement the Comptroller finds is no longer required for such purposes.

SEC. 115. EXAMINATION OF INVESTMENT COMPANIES AND INVESTMENT ADVISORS

(a) EXCLUSIVE COMMISSION AUTHORITY. —Except as provided in subsection (c), a Federal Reserve Bank or branch shall not examine any registered investment company that is not a bank holding company or a savings and loan holding company.

(b) EXAMINATION RESULTS AND OTHER INFORMATION.—The Commission shall provide to any bank holding company or registered investment company that is not a Federal Reserve Bank or branch an examination report and any other information with respect to any registered investment company for the purposes of determining the regulatory responsibilities of the Federal Reserve System, the Comptroller of the Currency, and the Securities and Exchange Commission.

(c) DEFINITIONS.—For purposes of this section, the following definitions shall apply:

(i) BANK HOLDING COMPANY. —The term 'bank holding company' means the term 'bank holding company' as defined under the Federal Reserve Act.

(ii) FEDERAL BANKING AGENCY. —The term 'Federal banking agency' means the Federal Reserve System or any other Federal banking agency upon request.

(iii) REGISTERED INVESTMENT COMPANY. —The term 'registered investment company' means an investment company that is registered with the Commission under the Investment Company Act of 1940.

(iv) SAVINGS AND LOAN HOLDING COMPANY. —The term 'savings and loan holding company' has the meaning given in section 6(c)(1)(B) of the Federal Reserve Act.

SEC. 116. ELIMINATION OF APPLICATION REQUIREMENT FOR FINANCIAL HOLDING COMPANY

(a) PREVENTION OF DUPLICATIVE FILING.—Section 3(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1846(a)) is amended by adding at the end the following new sentence: "A declaration filed in accordance with section 401(c)(1) shall satisfy the requirements of this subsection with regard to the filing of an application to acquire a bank holding company but not any requirement to file an application to acquire a thrift institution or a registered investment company."
SEC. 111. PRESERVING THE INTEGRITY OF FDIC-INSURED INSTITUTIONS

Section 111(a)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1812(a)(1)(A)) is amended by striking "to benefit any shareholder of" and inserting "to benefit any shareholder or affiliate thereof or any other party with which the insured institution or any subsidiary thereof has a financial relationship that receives assistance in accordance with the provisions of this Act". 

SEC. 112. BANKING SERVICES TO SUBSIDIARIES OF THE NATIONAL BANKING SYSTEM

Section 3(h)(1)(A) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(h)(1)(A)) is amended by striking "section 38(b)" and inserting "section 38(c)".

Subtitle C—Subsidaries of National Banks

Section 38(c) of the Gramm-Leach-Bliley Act (12 U.S.C. 1841(c)) is amended by—

(1) redesignating subsection (a) as subsection (b); and

(2) inserting at the end of subsection (b) the following new subsection:

"(c) the national bank and each depository institution subsidiary shall be well capitalized and well managed;"

"(d) the aggregate consolidated total assets of all financial subsidiaries of the national bank do not exceed the lesser of—"

"(i) 45 percent of the consolidated total assets of the parent company; or"

"(ii) $50,000,000,000;"

"(e) except as provided in paragraph (f), the national bank shall maintain a tangible net worth of $50,000,000,000; or"

"(f) the national bank has received the approval of the Comptroller of the Currency for the financial subsidiary to engage in such activities, which approval shall be based solely upon the factors set forth in this section;

"(g) the national bank is not subject to subsection (d) of section 13 of the Federal Reserve Act, or"
(2) FINANCIAL STATEMENT DISCLOSURE OF CAPITAL DEDUCTION.—Any published financial statement of a national bank that controls a financial subsidiary, in addition to providing information prepared in accordance with generally accepted accounting principles, separately present financial information for any bank subsidiary provided in paragraph (1).

(3) SAFEGUARDS FOR THE BANK.—A national bank that establishes or maintains a financial subsidiary shall:

(a) the procedures of the national bank for identifying and managing financial and operational risks associated with the national bank and the financial subsidiary adequately protect the national bank from such risks;

(b) the national bank has, for the protection of the bank, reasonable policies and procedures to preserve the separate corporate identity and limited liability of the national bank and the financial subsidiaries of the national bank; and

(c) the national bank is in compliance with the requirements of section 23B.

(4) PROVISIONS APPLICABLE TO NATIONAL BANKS THAT FAIL TO CONTINUE TO MEET CERTAIN REQUIREMENTS.—

(a) IN GENERAL.—If a national bank or insured depository institution affiliate does not continue to meet the requirements of subsection (a)(2) or (3), the Comptroller shall promptly give notice to the national bank to that effect describing the conditions that govern the notice.

(b) AGREEMENT TO CORRECT CONDITIONS.—Not later than 45 days after the date of receipt by the national bank of a notice given under paragraph (a) for such additional period as the Comptroller of the Currency may permit, the national bank shall execute an agreement with the Comptroller of the Currency and any relevant insured depository institution affiliate that the national bank, with its appropriate Federal banking agency to comply with the requirements of subsection (a)(2) or (3).

(c) IMPOSITION OF CONDITIONS.—Until the conditions described in a notice under paragraph (a) are corrected:

(A) the Comptroller of the Currency may impose any such conditions on the conduct or activities of the national bank or any subsidiary of the national bank as the Comptroller of the Currency determines to be appropriate under the circumstances and consistent with the purposes of this part; and

(B) the appropriate Federal banking agency may impose any such conditions on the conduct or activities of any insured depository institution affiliate or any subsidiary of the institution as such agency determines to be appropriate under the circumstances and consistent with the purposes of this section.

(4) FAILURE TO CORRECT.—If the conditions described in a notice to a national bank under paragraph (a) are not corrected within 180 days after the date of receipt by the national bank of the notice, the Comptroller of the Currency may require the national bank, under such terms and conditions as may be imposed by the Comptroller and subject to such extension of time as may be granted by the Comptroller, to divest control of any financial subsidiary.

(5) CONSULTATION.—In taking any action under this subsection, the Comptroller shall consult with all relevant Federal and State regulatory agencies and authorities.

(6) RULES TO DETERMINE PUBLIC RATING OR MEET APPLICABLE CRITERIA.—

(a) IN GENERAL.—A national bank that does not meet all applicable criteria for any other requirement of subsection (a)(2)(E) after acquiring or establishing a financial subsidiary that is subject to a public rating, purchase or acquire any additional equity interest of any financial subsidiary until the bank meets such requirements.

(b) EQUITY CAPITAL.—For purposes of this subsection, the term 'equity capital' includes, in addition to any equity instrument, any debt instrument issued by a financial subsidiary, if the instrument qualifies as capital of the subsidiary under any State or Federal regulation, or interpretation applicable to the subsidiary.

(c) DEFINITIONS.—For purposes of this section, the following terms have the meanings given to them in section 23B:

(1) AFFILIATE, COMPANY, CONTROL, AND SUBSIDIARY.—The terms 'affiliate', 'company', 'control', and 'subsidiary' have the meanings given to them in section 23B of the Bank Holding Company Act of 1933.

(2) APPROPRIATE FEDERAL BANKING AGENCY, DEPOSITORY INSTITUTION, DEPOSITORY SUBSIDIARY, AND INSURED DEPOSITORY INSTITUTION.—The terms 'appropriate Federal banking agency', 'depository institution', 'depository subsidiary', and 'insured depository institution' have the meanings given to them in section 3 of the Federal Deposit Insurance Act.

(3) FINANCIAL SUBSIDIARY.—The term 'financial subsidiary' means any company that is controlled by a national bank or more insured depository institutions other than a subsidiary that:

(A) engages solely in activities that national banks are permitted to conduct directly and are conducted subject to the same terms and conditions that govern the conduct of such activities by national banks;

(B) a national bank is specifically authorized by the express terms of a Federal statute (other than section 1911 of title 12) or by implication or interpretation, to control, such as by section 25 or 31A of the Federal Reserve Act or the Bank Service Company Act.

(4) ELIGIBILITY.—The term 'eligible debt' means unsecured long-term debt that:

(A) is not supported by any form of credit enhancement, including a guarantee or standby letter of credit; and

(B) is not in whole or in any significant part by any affiliate, officer, director, principal shareholder, or employee of the bank or any other person acting on behalf of or with funds from the bank, on the bank, or any bank affiliate.

(5) WELL CAPITALIZED.—The term 'well capitalized' has the meaning given in the term in section 38 of the Federal Deposit Insurance Act.

(6) WELL MANAGED.—The term 'well managed' means:

(A) In the case of a depository institution that has been examined, unless otherwise determined in writing by the appropriate Federal banking agency,

(i) the achievement of a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (or an equivalent rating system) in connection with the most recent examination or subsequent review of the rating system of the depository institution and

(ii) at least a rating of 2 for management, if such rating is given;

(B) In the case of any depository institution that has not been examined, the existence and use of managerial resources that the appropriate Federal banking agency determines are satisfactory.

(7) SECTIONS 23A AND 23B OF THE FEDERAL RESERVE ACT.—

(a) LIMITING THE EXPOSURE OF A BANK TO A FINANCIAL SUBSIDIARY TO THE AMOUNT OF PERMISSIBLE EQUITY AND AFFILIATES.—Section 23A of the Federal Reserve Act (12 U.S.C. 310c) is amended —

(A) by redesignating subsection (e) as subsection (f); and

(B) by inserting after subsection (d), the following new subsection:

(8) RULES RELATING TO BANKS WITH FINANCIAL SUBSIDIARIES.—

(a) IN GENERAL.—For purposes of this section and section 23B, the term 'financial subsidiary' means any company that is a subsidiary of a bank that would be a financial subsidiary of a bank under section 5136A of the Revised Statutes of the United States.

(b) FINANCIAL SUBSIDIARY TREATED AS AN AFFILIATE.—For purposes of applying this section and section 23B, and notwithstanding subsection (b)(2) of this section or section 23B(b)(1), a financial subsidiary of a bank—

(A) shall not be deemed to be an affiliate of the bank; and

(B) shall not be deemed to be a subsidiary of the bank.

(9) EXCEPTIONS FOR TRANSACTIONS WITH FINANCIAL SUBSIDIARIES.—

(A) EXCEPTION LIMIT FROM COVERED TRANSACTIONS WITH ANY INDIVIDUAL FINANCIAL SUBSIDIARY.—Notwithstanding paragraph (2), any designating section contains any financial subsidiary, subsection (A)(1)(A) shall not apply with respect to covered transactions between a bank and any individual financial subsidiary.

(B) EXCEPTION FOR EARNINGS RETAINED BY FINANCIAL SUBSIDIARIES.—Notwithstanding paragraph (2) or subsection (b)(1), any investment in a financial subsidiary of the bank shall not include retained earnings of the financial subsidiary.

(10) ANTI-EVASION PROVISION.—For purposes of this section and section 23B—

(A) any purchase of, or investment in, the securities of a financial subsidiary of a bank by an affiliate of the bank shall be considered to be a purchase of or investment in such securities by the bank; and

(B) any extension of credit by an affiliate of a bank to a financial subsidiary of the bank shall be considered to be an extension of credit by the bank to the financial subsidiary if the Board determines that such treatment is necessary to prevent evasion of this Act and the Gramm-Leach-Bliley Act.

(11) REDEEMABLE PREJUSMPTION OF CONTROL OF PORTFOLIO COMPANIES.—In addition to paragraph (2) or subsection (b)(1), any investment in a financial subsidiary of the bank shall be presumed to control any other company if the company or shareholder, directly or indirectly, or acting through 1 or more other persons, owns or controls 15 percent or more of the equity capital of the other company pursuant to subparagraph (B) of section 430(c)(1) of the Bank Holding Company Act of 1956 or rules adopted under section 132 of the Gramm-Leach-Bliley Act.

(12) RULEMAKING REQUIRED CONCERNING DERIVATIVE TRANSACTIONS AND INTRADAY CREDIT.—

(A) IN GENERAL.—Not later than 18 months after the date of the enactment of the Gramm-Leach-Bliley Act, the Board shall adopt final rules under this section to address as covered transactions credit exposure arising out of derivative transactions between member banks and their affiliates and intraday extensions of credit by member banks to their affiliates.

(B) EFFECTIVE DATE.—The effective date of any final rule adopted by the Board pursuant to paragraph (A) shall be delayed for such pe­

(C) ACCEPTING.—Section 106(a) of the Bank Holding Company Act Amendments of 1970 (12 U.S.C. 330c) is amended by inserting at the end the following new section:

(13) EFFECTIVE DATE.—The effective date of any final rule adopted by the Board pursuant to paragraph (A) shall be delayed for such pe­

(14) ADDITIONAL RULEMAKING.—For purposes of this section, any rule or regulation of the Federal Reserve System or the Board of Governors of the Federal Reserve System that is more restrictive than a rule or regulation of any other Federal banking agency may be adopted by the Board.
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(1) FEDERAL DEPOSIT INSURANCE ACT.—The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) or any Federal banking law, or any final rule or regula-
tion issued thereunder. In construing any
section of the Federal Deposit Insurance Act and
is not itself a bank or savings association shall
do not be deemed to be a bank or savings associa-
tion for purposes of any provisions applied by
the Federal Trade Commission under the

(2) BANKING HOLDING COMPANIES.—The provision of this section shall be construed as restricting the au-
thority of any Federal banking agency (as de-
fined in section 3 of the Federal Deposit Insur-
ance Act) under any Federal banking law,
including section 4 of the Federal Deposit
Insurance Act.

(2) BANKING HOLDING COMPANIES.—Section 23B of the Clayton Act (15 U.S.C. 16(2)(B)) is amended by inserting after the semicolon at the end of the following paragraph: 

except that a portion of a transaction is not exempt under this paragraph if such portion of the
transaction (A) is subject to section 4(b) of the Bank Holding Company Act of 1956; and (B) does not require agency approval under section 13 of the Bank Holding Company Act of 1956.

Subtitle D.—Preservation of FTC Authority

SEC. 113. AMENDMENT TO THE BANK HOLDING COMPANY ACT OF 1956—WITHDRAWAL OF CONSENT AND POST-APPROVAL DISCLOSURE REQUIREMENTS

Section 11(b)(1) of the Bank Holding Company Act of 1956 (12 U.S.C. 1649(b)(1)) is amended by inserting “and” after the term “section” in section 4(b)(1), (2), or (3) of the Bank Holding Company Act of 1956, section 16(c) of the Federal Deposit Insurance Act, the National Bank Consolidation and Merger Act, and section 10 of the Home Owners’ Loan Act, or the antitrust laws.

SEC. 114. CONSENT AND DISCLOSURE REQUIREMENTS

(a) Subsection (a) of section 4(b)(1), (2), or (3) of the Bank Holding Company Act of 1956, the National Bank Consolidation and Merger Act, and the Home Owners’ Loan Act shall be treated as if they were section 4(b)(1), (2), or (3) of the Bank Holding Company Act of 1956, as amended.

(b) The provisions of subsection (a) are hereby amended by inserting “and” at the end of the following: “or the antitrust laws.”

(c) The provisions of subsection (a) are hereby amended by inserting “and” at the end of the following: “or the antitrust laws.”

(d) The provisions of subsection (a) are hereby amended by inserting “and” at the end of the following: “or the antitrust laws.”

(2) Other Privileges Not Waived by Disclosure

SEC. 115. REPRESENTATIVE OFFICES

(a) Definition.—Section 16(b)(13) of the International Banking Act of 1978 (12 U.S.C. 3101(13)) is amended by striking “State agency, or subsidiary of a foreign bank” and inserting “or subsidiary of a foreign bank.”

(b) Examinations.—Section 10(e) of the International Banking Act of 1978 (12 U.S.C. 3107(c)) is amended by adding at the end of the following: “The Board may also make ex-
aminations of any affiliate of a foreign bank conducting business in any State if the Board...

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REINVESTMENT PLANS. - The permissible delivery of securities in connection with the plan or program in connection with a brokerage arrangement, except that the bank employees may receive compensation for the referral of any customer if the compensation is based on the cash fee, the amount paid and the payment of the fee is not contingent on whether the referral results in a transaction, and:

(vii) such services are provided by the broker or dealer on a basis in which all customers that receive any services are fully disclosed to the broker or dealer:

(VIII) the bank does not carry a securities position, other than by advertising that it effects transactions in securities in conjunction with advertising its other trust activities.

(V) PERMISSIBLE SECURITIES TRANSACTIONS. - The bank effects transactions in securities authorized under subsection (d) of section 193 of the Federal Deposit Insurance Act.

(II) trust beneficiaries, the issuer or the bank):

(III) the bank effect a transaction in a trust account, or effects transactions in a fiduciary capacity in its trust department or in any other capacity that is regularly examined by bank examiners for compliance with fiduciary principles and standards, and:

(i) is compensated in any manner by the person performing the brokerage services;

(ii) the broker or dealer offers brokerage services in an area that is clearly marked and, to the extent practicable, physically separate from the routine deposit-taking activities of the bank:

(iii) any materials used by the bank to advertise or promote generally the availability of brokerage services do not clearly indicate that the brokerage services are being provided by the broker or dealer and not by the bank:

(IV) any materials used by the bank to advertise or promote generally the availability of brokerage services, in an area that is clearly marked and, to the extent practicable, physically separate from the routine deposit-taking activities of the bank:

(III) exempted securities: (iii) qualified Canadian government obligations as defined in subsection (c) of the Bank Holding Company Act, 1956, of the United States:

(ii) any standardized, credit enhanced debt security issued to a retirement plan pursuant to the March 30, 1983 plan of then Secretary of the Treasury Brady, used by such foreign government to retire outstanding commercial bank loans:

(iv) certain stock purchase plans. - The bank effects transactions, as part of its transfer agency activities, in the securities of an issuer as part of a plan or program for the purchase or sale of such securities by broker or dealer:

(III) ISSUER PLANS. - The bank effects transactions as part of its transfer agency activities, in the securities of an issuer as part of a plan or program for the purchase or sale of securities in connection with the plan or program, and:

(aa) the bank does not solicit transactions or provide investment advice with respect to the purchase or sale of securities in connection with the plan or program:

(bb) the bank does not net shareholders' buy and sell orders, other than for programs for odd-lot holders or plans registered with the Commission.

(IV) PERMISSIBLE DELIVERY OF MATERIALS. - The exception to being considered a broker for a bank engaged in activities described in sub-clauses (i), (ii), and (iii) will not be affected by delivery of written or electronic material of the act by a bank to employees of the issuer, shareholders of the issuer, or members of affinity groups of the issuer, as long as such materials are:

(aa) comparable in scope or nature to that permitted by the Commission at the date of the enactment of the Gramm-Leach-Bliley Act:

(bb) otherwise permitted by the Commission.

(V) SWEEP ACCOUNTS. - The bank effects transactions as part of a program for the investment of cash balances that do not exceed $100,000 per account:

(bb) the bank is a registered broker or dealer:

(bb) the bank is an affiliate that is engaged in merchant banking, as described in section 4(5)(V)(G) of the Bank Holding Company Act of 1956:

(VI) PRIVATE SECURITIES OFFERINGS. - The bank:

(i) effects sales as part of a primary offering of securities not involving a public offering, pursuant to section 3(b), (d), or (f) of the Securities Act of 1933 or the rules and regulations issued thereunder:

(ii) at any time after the date that is 1 year after the date of the enactment of the Gramm-Leach-Bliley Act, is not affiliated with a broker or dealer that has been registered for more than 1 year in accordance with this Act, and engages in dealing in market making in underwriting activities, other than with respect to exempted securities:

(iii) the bank is not affiliated with a broker or dealer, does not effect any primary offering described in subclause (i) the aggregate amount of which exceeds 5 percent of the capital of the bank, except that the limitation of this subclause shall not apply with respect to any sale of government securities or municipal securities:

(VII) SAFEGUARD AND CUSTODY ACTIVITIES. -

(II) IN GENERAL. - The bank, as part of custodial banking activities:

(a) provides safekeeping or custody services with respect to securities, including the exercise of warrants and other rights on behalf of customers:

(bb) facilitates the transfer of funds or securities, as a custodian or a clearing agency, in connection with the clearance and settlement of its customers' transactions in securities:

(bc) effects securities lending or borrowing transactions with or without the delivery of securities as part of services provided to customers pursuant to division (aa) or (bb) or invest cash collateral pledged in connection with such transactions:

(III) DIVIDEND REINVESTMENT PLANS. - The bank effect transactions, as part of its transfer agency activities, in the securities of an issuer as part of that issuer's dividend reinvestment plan, if:

(aa) the bank does not solicit transactions or provide investment advice with respect to the purchase or sale of securities in connection with the plan:

(bb) the bank does not net shareholders' buy and sell orders, other than for programs for odd-lot holders or plans registered with the Commission.
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under applicable law, if the bank maintains records reasonably identifying the securities and the customer; or

"(ee) serves as a custodian or provider of other fiduciary services to any individual retirement account, pension, retirement, profit sharing, bonus, thrift savings, incentive, or other similar benefit plan.

SEC. 204. REDEFINING BROKER ACTIVITIES.—The exception to being considered a broker for a bank engaged in activities described in clause (I) of this subsection shall not apply if the bank in connection with such activities, acts in the United States as a carrying broker (as such term, and different formulations thereof, are used in section 15(c)(3) of this title and the rules and regulations thereunder) for any broker or dealer, unless such carrying broker activities are engaged in with respect to government securities (as defined in paragraph (42) of this subsection).

"(4x) IDENTIFIED BANKING PRODUCTS.—The bank effects transactions in identified banking products as defined in section 206 of the Gramm-Leach-Bliley Act.

"(5) SEC. 10Z. DEFINITION OF BUSINESS OF BANKING.—The bank effects transactions in municipal securities.

"(6) SE. MINIMUM EXCEPTION.—The bank effects transactions in transactions referred to in paragraphs (I) through (x), not more than 50 transactions in securities in any calendar year, and such securities are not owned, within the capacity of employee of the bank who is also an employee of a broker or dealer.

"(7) BROKER OR DEALER.—The exception to being considered a broker for a bank engaged in activities described in clauses (I), (ii), and (viii) of subparagraph (B) shall not apply to the activities described in such provisions result in the trade in the United States of any security that is publicly traded security in the United States, unless:

"(I) the bank directs such trade to a registered broker or dealer for execution;

"(ii) the trade is a cross trade or other substantially similar trade of a security that—

"(I) is made by the bank or between the bank and an affiliated fiduciary; and

"(II) is not in contravention of fiduciary principles established under applicable Federal or State law; or

"(iii) the trade is conducted in some other manner permitted under rules, regulations, or orders as the Commission may prescribe or issue."

"(8) VALUES OF Debt SECURITY.—For purposes of subparagraph (B)(ii), the term 'fiduciary capacity' means:

"in the capacity as trustee, executor, administrator, registrar of stocks and bonds, transfer agent, guardian, assignee, or custodian under a uniform gift to minor act, or as an investment adviser if the bank receives a fee for its investment advice;

"(ii) in any capacity in which the bank possesses investment discretion on behalf of another; or

"(iii) in any other similar capacity.

"EXCEPTION FOR ENTITIES SUBJECT TO SECTION 15(e).—The term 'broker' does not include a bank that—

"(I) on the day before the date of enactment of the Gramm-Leach-Bliley Act, subject to section 15(e); and

"(ii) is subject to such restrictions and requirements as the Commission considers appropriate."

SEC. 205. DEFINITION OF DEALER.—The term 'Dealer' means any person engaged in the business of buying and selling securities for such person's own account.

"(A) IN GENERAL.—The term 'dealer' means any person engaged in the business of buying and selling securities for such person's own account.

"(B) EXCEPTION FOR PERSON NOT ENGAGED IN THE BUSINESS OF DEALING.—The term 'dealer' does not include a person that buys or sells securities for such person's own account, either individually or in a group of securities whose aggregate market capacity, but not as part of a regular business.

"(C) EXCEPTION FOR CERTAIN BANK ACTIVITIES.—A bank may be considered to be a dealer because the bank engages in any of the following activities under the conditions described:

"(I) PERMISSIBLE SECURITIES TRANSACTIONS.—The bank buys or sells—

"(i) commercial paper, bankers acceptances, or commercial loans; and

"(II) exempted securities;

"(III) qualified Canadian government obligations as defined in section 512 of the Revised Statutes of the United States, in conformity with section 15C of this title and the rules and regulations thereunder; or obligations of the North American Development Bank; or

"(IV) any standardized, credit enhanced debt security issued by a foreign government pursuant to the March 1989 plan of then Secretary of the Treasury Braddy, used by such foreign government to retire outstanding commercial bank loans.

"(II) INVESTMENT, TRUSTEE, AND FIDUCIARY TRANSACTIONS.—The bank buys or sells securities for investment purposes—

"(I) for the bank; or

"(II) for accounts for which the bank acts as a trustee or custodian.

"(III) ASSET-BACKED TRANSACTIONS.—The bank engages in the issuance or sale to qualified investors, a trust, or other separate entity, of securities backed by or representing an interest in notes, drafts, acceptances, loans, leases, receivables, other obligations, or securities of which the bank is not the issuer), or pools of any such obligations predominantly originated by—

"(I) the bank;

"(II) an affiliate of any such bank other than a broker or dealer; or

"(III) a syndicate of banks of which the bank is a member, if the obligations or pool of obligations consists of mortgage obligations or consumer-related receivables.

"(IV) IDENTIFIED BANKING PRODUCTS.—The bank buys or sells identified banking products, as defined in section 206 of the Gramm-Leach-Bliley Act.

"(R) REGISTRATION FOR SALES OF PRIVATE SECURITIES OFFERINGS.—Section unless prohibited by the Commission in accordance with section 365(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s-3) is amended by inserting after subsection (I) the following new subsection:

"(II) REGISTRATION FOR SALES OF PRIVATE SECURITIES OFFERINGS.—A registered securities association shall create a limited qualification category for any associated person of a member who effects sales as part of a primary offering of securities not involving a public offering, pursuant to section 3(1), (2), or (3) of the Securities Act of 1933 and the rules and regulations thereunder, and shall deem qualified in such limited qualification category, without testing, any bank employee who, in the six month period preceding the date of the enactment of the Gramm-Leach-Bliley Act, engaged in effecting such sales.

SEC. 206. REGISTRATION AND REVIEW.—Section 18 of the Federal Deposit Insurance Act is amended to read as follows:

"(8) FILING FOR PETITION FOR REVIEW.—The Board may obtain review of any final regulation described in paragraph (1) in the United States Court of Appeals for the Federal Circuit by filing in such court, not later than 60 days after the date of publication of the final regulation, a written petition requesting that the regulation be set aside. Any proceeding to challenge any such rule shall be expedited by the Court of Appeals.

"(B) TRANSMITTAL OF PETITION AND RECORD.—A copy of a petition described in subparagraph (A) shall be transmitted as soon as
(B) DEFINITION OF SWAP AGREEMENT.—For purposes of this subparagraph, the term "swap agreement" means any individually negotiated contract, agreement, warrant, note, or option that is based, in whole or in part, on the value or performance of a financial index or commodity or on the occurrence of any event relating to, one or more commodities, securities, currencies, interests or other assets, but does not include any other identified banking product, as defined in paragraphs (I) through (J) of subsection (a). (2) AUTHORITY.—Classification of a particular product as an identified banking product pursuant to paragraph (a) shall not be construed as finding or implying that such product is or is not a security for any purpose under the securities laws or is or is not an account, agreement, contract, or transaction for any purpose under the Commodity Exchange Act.

SEC. 207. ADDITIONAL DEFINITIONS.—Section 3(a) of the Commodity Exchange Act of 1934 is amended by adding at the end the following new paragraph:

"(AA) QUALIFIED INVESTOR.—(A) DEFINITION.—Except as provided in subparagraph (B), for purposes of this title, the term "qualified investor" means—(i) any investment company registered with the Commission under section 8 of the Investment Company Act of 1940; (ii) any issuer eligible for an exclusion from the definition of investment company pursuant to section 3(c)(7) of the Investment Company Act of 1940; (iii) any bank (as defined in paragraph (B) of this subsection), savings association (as defined in section 3(b)(5) of the Federal Deposit Insurance Act), broker, dealer, insurance company (as defined in section 2(a)(13) of the Securities Act of 1933), or business association company (as defined in section 10(a)(4) of the Investment Company Act of 1940); (iv) any small business investment company licensed by the United States Small Business Administration under section 301(c) or (d) of the Small Business Investment Act of 1958; (v) any State-sponsored employee benefit plan, or any other employee benefit plan, within the meaning of the Employee Retirement Income Security Act of 1974, other than an individual retirement account, if the investment decisions are made by a plan fiduciary, as defined in section 3(21) of that Act, which is either a bank, savings and loan association, insurance company, or registered investment adviser; (vi) any trust whose purchases of securities are directed by a person described in clauses (I) through (V) of this subparagraph; (vii) any market intermediary exempt under section 3(c)(2) of the Investment Company Act of 1940; (viii) any association of persons who is or is not a natural person; (ix) any foreign bank (as defined in section 306(a)(7) of the International Banking Act of 1978); (x) the government of any foreign country; (xi) any person who is or is not a partnership that owns and invests on a discretionary basis, not less than $25,000,000 in investments; (xii) any government or political subdivision, agency, or instrumentality of a government who owns and invests on a discretionary basis not less than $25,000,000 in investments; (xiii) any other government or political subdivision, agency, or instrumentality of a government who owns and invests on a discretionary basis not less than $50,000,000 in investments; (xiv) any multinational or subnational entity or any agency or instrumentality thereof.

"(C) ALTERED THRESHOLDS FOR ASSET-BACK SECURITIES AND LOAN PARTICIPATIONS.—For purposes sections 4(a)(5)(C)(ii) of this title and section 306(a)(7) of the International Banking Act of 1978, the term "qualified investor" has the meaning given such term by subparagraph (A) of this paragraph except that clauses (i) and (ii) shall be applied by substituting "$150,000,000 for "$25,000,000," "$350,000,000 for "$50,000,000," and "$550,000,000 for "$100,000,000."
SEC. 215. DEFINITION OF BROKER UNDER THE INVESTMENT COMPANY ACT OF 1940.

Section 215(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(6)) as amended—

(1) by striking clause (v) and inserting the following new clause:

"(v) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has loaned money or other property to—

(a) another investment company; or

(b) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(c) any account for which the investment company's investment adviser has brokerage placement discretion;"

(2) by redesignating clause (vi) as clause (vii); and

(3) by inserting after clause (v) the following new clause:

"(vi) any person or any affiliated person of a person (other than a registered investment company) that, at any time during the 6-month period preceding the date of the determination of whether that person or affiliated person is an interested person, has loaned money or other property to—

(a) another investment company; or

(b) any other investment company having the same investment adviser as such investment company or holding itself out to investors as a related company for purposes of investment or investor services; or

(c) any account for which the investment company's investment adviser has brokerage placement discretion;"

SEC. 216. DEFINITION OF DEALER UNDER THE INVESTMENT COMPANY ACT OF 1940.

Section 216(a) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(7)) is amended to read as follows:

"(1) The term 'dealer' has the same meaning as given in section 3 of the Securities Exchange Act of 1934."
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SEC. 221. CONFORMING CHANGE IN DEFINITION.

Section 1(a)(3) of the Investment Company Act of 1940 (15 U.S.C. 80a-6(a)(3)) is amended by striking "(a)" a banking institution organized under the laws of the United States and insert­
ing "(A) a depository institution as defined in section 3 of the Federal Deposit Insurance Act") or a branch or agency of a foreign bank (as such terms are defined in section 1(b)(6) of the International Banking Act of 1978)."

SEC. 222. EFFECTIVE DATE.

Section 202 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2) is amended by adding at the end the following:

"(e) CONSIDERATION OF PROMOTION OF EFFI­
CIENCY, COMPETITION, AND CAPITAL FORMA­
TION.—Without affecting the meaning of this title the Commission is engaged in rulemaking and is re­
qued to consider or determine whether an ac­
tion is necessary or appropriate to public in­
terest, the Commission shall also consider, in addition to the protection of investors, whether the action would further efficiency, competition, and capital formation."

SEC. 223. EFFECTIVE DATE.

This subtitle shall take effect 18 months after the date of the enactment of this Act.

Subtitle C—Securities and Exchange Commission Supervision of Investment Bank Holding Companies

SEC. 224. AMENDMENT.

Section 7 of the Securities Exchange Act of 1934 (15 U.S.C. 7b) is amended—

(1) by redesignating subsection (I) as subsection (A); and

(2) by inserting after subsection (I) the fol­
lowing new subsections:

"(II) INVESTMENT BANK HOLDING COMPANIES.—

"(I) ELECTIVE SUPERVISION OF AN INVEST­
MENT BANK HOLDING COMPANY NOT HAVING A BANK OR SAVINGS ASSOCIATION AFFILIATE.—

"(A) IN GENERAL.—An investment bank hold­
ing company that is not—

"(I) an affiliate of an insured bank (other than an institution described in subparagraph (D), (F), or (G)) of section 201(d)(2), or held under section 201(d)(2) of the Bank Holding Company Act of 1956), or a savings association;

"(II) a foreign bank, foreign company, or com­
pany that is an affiliate of a foreign bank, foreign company, or company that is a bank under section 13(a) of the International Banking Act of 1978; or

"(III) a foreign bank that controls, directly or indi­
rectly, a savings association under section 25(a) of the Federal Reserve Act,

shall be subject to supervision by filing with the Commission a notice of intention to become super­
vized, pursuant to subparagraph (B) of this paragraph. Any investment bank holding company filing such a notice shall be supervised in accordance with this section and comply with the rules promulgated by the Commission appli­
cable to supervised investment bank holding companies.

"(B) NOTIFICATION OF STATUS AS A SUPER­
VISED INVESTMENT BANK HOLDING COMPANY.—An investment bank holding company that elects under subparagraph (A) to become supervised by the Commission shall file with the Commis­sion a written notice of intention to become super­
vized by the Commission in such form and containing such information and documents concerning such investment bank holding company as the Commission, by rule, may prescribe as necessary or appropriate in furtherance of the purposes of this section. Unless the Commis­sion finds that such supervision is not necessary or appropriate in furtherance of the purposes of this section, such notice shall become effec­tive 45 days after the date at which the Commission, by rule or order, shall become effective.

"(C) ELECTION NOT TO BE SUPERVISED BY THE COMMIS­sION AS AN INVESTMENT BANK HOLDING COMPANY.—

"(A) VOLUNTARY WITHDRAWAL.—A supervised investment bank holding company that is super­
vized pursuant to paragraph (I) may, upon such terms and conditions as the Commission deems reasonable, elect not to continue to be super­
vized by the Commission by filing a written notice of withdrawal from Commission supervision. Such notice must be filed not later than 1 year after receipt of the Commission, or such shorter or longer period as the Commission may determine.

"(B) DISCONTINUATION OF COMMISSION SUPER­
VISION.—If the Commission finds that any su­
pervised investment bank holding company that is supervised pursuant to paragraph (I) is no longer in existence or has ceased to be an investment bank holding company, or if the Commis­sion finds that continued supervision of such a supervised investment bank holding company is not consistent with the purposes of this section, the Commission may terminate the supervision pursuant to a rule or order, if any, promulgated by the Commission under this section.

"(C) SUPERVISION OF INVESTMENT BANK HOLD­
ING COMPANIES.—

"(A) RECORDKEEPING AND REPORTING.—The Commis­sion may request that an investment bank holding company and each affiliate thereof make and keep for prescribed peri­
s periods such records, furnish copies thereof, and make such reports, as the Commission may re­quire by rule, in order to keep the Commission informed as to—

"(I) the company’s or affiliate’s activities, fi­
nancial condition, policies, systems for moni­toring and controlling financial and operational risks, and transactions and activities be­tween any broker or dealer affiliate of the sup­
ervised investment bank holding company, and

"(II) the extent to which the company or affili­
ate has complied with the provisions of this Act and regulations prescribed and orders issued under this Act.

"(B) FORM AND CONTENTS.—Such records and reports shall be prepared in such form and ac­
cording to such specifications (including certifi­
cation by an independent public accountant), as the Commission may require and shall be pro­
vided promptly at any time upon request by the Commis­sion. Such records and reports may include—

"(I) a balance sheet and income statement;

"(II) an assessment of the capital stock and total of the supervised investment bank holding com­
pany;

"(III) an independent auditor’s report attest­ing to the supervised investment bank holding company’s compliance with its internal risk man­
agement and internal control objectives;

and

"(IV) reports concerning the extent to which the company or affiliate has complied with the pro­
visions of this title and any regulations pre­
scribed and orders issued under this title.

"(B) USE OF EXISTING REPORTS.—

"(A) IN GENERAL.—The Commission shall, to the fullest extent possible, accept reports in ful­
fillment of the requirements under this para­
graph from the supervisory authority of the financial institution or investment bank holding com­
pany or its affiliates that have been required to provide to another appropriate regulatory agency regulating such financial institution that is super­
vized by the financial institution or investment bank holding company or its affiliates have been required to provide to another appropriate regulatory agency regulating such financial institution that is super­
vized by the financial institution or investment bank holding company or its affiliates have been required to provide to another appropriate regulatory agency regulating such financial institution that is super­
vized by the financial institution or investment bank holding company or its affiliates.

"(C) AVAILABILITY.—A supervised investment bank holding company or an affiliate of such a company shall provide copies of such a report to the require­
ment of the Commission, any report referred to in clause (I).

"(1) EXAMINATION AUTHORITY.—The Commis­sion may make examinations of any super­
vized investment bank holding company and any affiliate of such a company.

"(2) FOCUS OF EXAMINATION AUTHORITY.—The Commis­sion shall provide, in such a manner as it determines, the reasons for conducting such an exam­
ination and any other information that it determines to be necessary.

(3) AUTHORITY OF EXAMINATION.—The Commis­sion may conduct examinations of any sup­
ervised investment bank holding company and any affiliate of such a company.
November 2, 1999

CONGRESSIONAL RECORD—HOUSE

H11273

TITLE III—INSURANCE

Subtitle A—State Regulation of Insurance

SEC. 301. FUNCTIONAL REGULATION OF INSURANCE

The insurance activities of any person (including a national bank exercising its power to act as agent under the provisions of section 21 of the Federal Reserve Act) shall be functionally regulated by the States, subject to section 104.

SEC. 302. INSURANCE UNDERWRITING IN NATIONAL BANKS

(a) In GENERAL.—Except as provided in section 303, a national bank and the subsidiaries of a national bank may not provide insurance in a State as principal except that this prohibition shall not apply to authorized products.

(b) AUTHORIZED PRODUCTS.—For the purposes of this section, a product is authorized if—

(1) as of January 1, 1999, the Comptroller of the Currency had determined that national banks may provide such product as principal, or national banks were in fact lawfully engaged in providing such product;

(2) no court of relevant jurisdiction had, by final judgment, overturned a determination of the Comptroller of the Currency that national banks may provide such product as principal;

(3) the product is not title insurance, or an annuity contract the income of which is subject to tax treatment under section 72 of the Internal Revenue Code of 1986;

(c) DEFINITION.—For purposes of this section, the term "insurance" means—

(i) any product regulated as insurance as of January 1, 1999, in accordance with the relevant State insurance law, in the State in which the product is provided;

(ii) any product first offered after January 1, 1999, which—

(A) a State insurance regulator determines shall be regulated as insurance in the State in which the product is provided because the product insures, guarantees, or indemnifies against liability, loss of life, loss of health, or losses through damage to or destruction of property, including, but not limited to, surety bonds, life insurance, health insurance, title insurance, and property and casualty insurance such as private passenger or commercial automobile, homeowners, mortgage, commercial multi-peril, and workers' compensation, fire and allied lines, farm owners multiperil, aircraft, fidelity, surety, medical malpractice, errors and omissions, professional liability, health-care providers' compensation, marine, and boiler and machinery insurance; and

(B) is not a product or service of a bank that is—

(i) a deposit product;

(ii) a loan, discount, letter of credit, or other extension of credit;

(iii) a trust or other fiduciary service;

(iv) a qualified financial contract (as defined in section 3a(a)(10)(A) of the Federal Deposit Insurance Act); or

(v) a financial guaranty, except that this subparagraph shall not apply to such contracts that includes an insurance component such that if the product is offered or proposed to be offered by the Comptroller of the Currency, it would be treated as a life insurance contract under section 7702 of the Internal Revenue Code of 1986;

(3) in the event that the product is not a letter of credit or other similar extension of credit, a qualified financial contract, or a financial guaranty, and the guarantor of the product is insured for losses incurred with respect to such product under section 622(15) of the Internal Revenue Code of 1986, if the bank were an insurance company under section 621 of that Code; or

(i) an annuity contract, the income on which is subject to tax treatment under section 72 of the Internal Revenue Code of 1986.

Subtitle D—Banks and Bank Holding Companies

SEC. 341. CONSIDERATION

(a) In GENERAL.—The Securities and Exchange Commission shall consult and coordinate comments with the appropriate Federal banking agency before taking any action with respect to the manner in which any insured depository institution or depository institution holding company reports annual, semiannual, or quarterly financial information, including the amount of any such loan loss reserve.

(b) DEFINITIONS.—For purposes of subsection (a), the terms "insured depository institution", "depository institution holding company"; and "appropriate Federal banking agency" have the same meaning as in section 3 of the Federal Deposit Insurance Act.
Section 205. Title Insurance Activities of National Banks and Their Affiliates

(a) General Prohibition.—No national bank may engage in any activity involving the underwriting or sale of title insurance.

(b) Discrimination Parity Exception.—

(1) In General.—Notwithstanding any other provision of law (including Section 104 of this Act), in the case of any State in which banks organized under the laws of such State are authorized to sell title insurance as agent, a national bank may sell title insurance as agent in such State, but only in the same manner, to the same extent, and under the same restrictions as such State banks are authorized to sell title insurance as agent in such State.

(2) Coordination with "Wildcard" Provision.—A State law which authorizes State banks to engage in any activities in such State in which a national bank may engage shall not be construed to mean that any such State law shall be treated as a law which authorizes State banks to sell title insurance as agent, for purposes of paragraph (1).

(c) Grandfathering with Consistent Regulation.—

(1) In General.—Except as provided in paragraphs (a) and (b), a national bank, and a subsidiary of a national bank, may conduct title insurance activities in such State, if such national bank or subsidiary was actively and lawfully conducting such activities before the date of the enactment of this Act.

(2) Affiliate.—In the case of a national bank which has an affiliate which provides insurance as principal and is not a subsidiary of the bank, the national bank and any subsidiary of the national bank may not engage in the underwriting of title insurance pursuant to paragraph (1).

(d) Insurance Subsidiary.—In the case of a national bank which has a subsidiary which provides insurance as principal and has no affiliate other than a subsidiary which provides insurance as principal, the national bank may not directly engage in any activity involving the underwriting of title insurance.

(e) "Affiliate" and "Subsidiary" Defined.—For purposes of this section, the terms "affiliate" and "subsidiary" have the same meanings as in Section 2 of the Bank Holding Company Act of 1956.

(f) Rule of Construction.—No provision of this Act or any other Federal law shall be construed as superseding or affecting a State law which was in effect before the date of the enactment of this Act and which prohibits title insurance from being offered, provided, or sold in such State, or as being underwritten with respect to real property in such State, by any person whatever.

Section 206. Restricted and Equalized Resolution for Federal Regulation

(a) Filing in Court of Appeals.—In the case of a regulatory conflict between a State insurance regulator and a Federal regulator regarding insurance activities, including whether a State law, rule, regulation, order, or interpretation regarding any insurance sales or solicitation activities is applicable, any insurer under a Federal law, the Federal or State regulator may seek expedited judicial review of such determination in the appropriate United States Court of Appeals for the circuit in which the State is located or in the United States Court of Appeals for the District of Columbia Circuit by filing a petition for review.

(b) Expedited Review.—The United States Court of Appeals in which a petition for review is filed in accordance with subsection (a) shall complete all section on such petition, including rendering a judgment, before the end of the 60-day period following on which such petition is filed, unless all parties to such proceeding agree to any extension of such period.

(c) Supreme Court Review.—Any petition for certiorari to the Supreme Court of the United States of any judgment of a United States Court of Appeals with respect to a proceeding under this section shall be filed with the Supreme Court of the United States as soon as practicable after such judgment is issued.

(d) Statute of Limitations.—No petition may be filed under this section challenging an order, ruling, determination, or other action of a Federal regulator or State insurance regulator after the later of—

(1) the end of the 18-month period beginning on the date on which the first public notice is made of such order, ruling, determination or other action in its final form; or

(2) the end of the 6-month period beginning on the date on which such order, ruling, determination, or other action takes effect.

(e) Standard of Review.—The court shall decide a petition filed under this section based on its review of the merits of all questions presented under State law, including the nature of the product or activity and the history and purpose of its regulation under State and Federal law, without unequal treatment.

Section 207. Insurance Customer Protections

The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by inserting after section 41, as added by section 121(d) of this Act, the following new section:

"Section 41. Insurance Customer Protections.

(a) Regulation.—

(1) In General.—The regulations prescribed pursuant to paragraph (f) shall be consistent with the requirements of this Act and provide such additional protections for customers as the Office of Thrift Supervision may prescribe for insurance activities, including such solicitation and advertising, or offers are directed.

(2) Applicability to Subsidiaries.—The regulations prescribed pursuant to paragraph (f) shall extend such protections to any subsidiary of a depository institution, as deemed appropriate by the regulations referred to in paragraph (1), where such extension is determined to be necessary to ensure the consumer protections provided by this section.

(b) Consultation and Joint Regulations.—The Federal banking agencies shall consult with each other and develop regulations pursuant to paragraph (f), after consultation with the State insurance regulators, as appropriate.

(c) Sales Practices.—The regulations prescribed pursuant to subsection (a) shall include antifraud and anticoercion rules applicable to the sale of insurance products that prohibit a depository institution or any affiliated enterprise of such institution from engaging in any practice that would be considered unfair in violation of section 5 (15 U.S.C. 1659) of the Federal Trade Commission Act Amendments of 1970, as current at the date of application for such regulation under this Act.

(1) The purchase of an insurance product from the institution or any subsidiary; or

(2) Any agreement by the consumer not to obtain, or a prohibition on the consumer from obtaining, an insurance product from an unaffiliated entity.

(d) Disclosures and Advertising.—The regulations prescribed pursuant to subsection (a) shall include the following provisions relating to disclosures and advertising in connection with the initial purchase of an insurance product:

(1) Disclosures.—

(A) In General.—Requirements that the following disclosures be made before the completion of the initial sale and, in the case of clause (iii), at the time of application for an extension of coverage, including:

(i) uninsured status, as appropriate, the product is not insured by the Federal Deposit Insurance Corporation, the surety, or the depository institution.

(B) Investment Risk.—In the case of a variable annuity or other insurance product which involves an investment risk, that there is an investment risk associated with the product, including possible loss of value.

(C) Approval of an extension of credit may not be conditioned on—

(1) the purchase of an insurance product from the institution in which the application for credit is pending or any affiliate of the institution.

(D) Any agreement by the consumer not to obtain, or a prohibition on the consumer from obtaining, an insurance product from an unaffiliated entity.

(2) Making Disclosure Readily Understandable.—Regulations prescribed under subparagraph (A) shall encourage the use of disclosure that is conspicuous, simple, direct, and readily understandable, such as the following:

"(A) NOT FDIC-INSURED.

(B) NOT GUARANTEED BY THE BANK.

(C) MAY GO DOWN IN VALUE.

(D) NOT INSURED BY ANY GOVERNMENT AGENCY."

(E) Limitation.—Nothing in this paragraph requires the inclusion of limitations as in advertisements of a general nature describing or listing the services or products offered by the institution or its representative states that disclosures required by this subsection were available to the customer in printed material available for distribution, where such printed material is not provided and such information is not orally disclosed to the customer.

(f) Adjustments for Alternative Methods of Purchase.—In prescribing the requirements under subparagraphs (A) and (F), necessary adjustments shall be made to account for purchase through telephone, or by electronic media to provide for the most appropriate and complete form of disclosure and acknowledgment.

(g) Consumer Acknowledgment.—A requirement that a depository institution shall require any person selling an insurance product at any office of, or on behalf of, the institution to obtain, at the time a consumer receives the disclosure required under this paragraph or at the time of the initial purchase by the consumer of such product, an acknowledgment by such consumer of the receipt of the disclosure required under this subsection with respect to such product.

(h) Prohibition on Misrepresentations.—A prohibition on any practice, or any advertising, at any office of, or on behalf of, the depository institution, or any subsidiary, as appropriate, that is misleading or otherwise unfair is necessary to prevent a reasonable person to reach an erroneous belief with respect to—

(1) the assumed nature of any insurance product sold, or offered for sale, by the institution or any subsidiary of the institution;

(2) the nature of any insurance or insurance product that involves an investment risk, the investment risk associated with any such product; or

(3) the case in the institution or subsidiary at which insurance products are sold or offered for sale, the fact that—..."
(i) the approval of an extension of credit to a customer by the institution or subsidiary may not be conditioned on the purchase of an insurance product by such customer from the institution or subsidiary; and
(ii) the insurer is free to purchase the insurance product from another source.

(i) SEPARATION OF BANKING AND NON-BANKING ACTIVITIES.

(ii) REGULATIONS REQUIRED.—The regulations prescribed pursuant to subsection (a) shall be designed to assure that the Federal banking agencies consider appropriate to ensure that the routine acceptance of deposits is kept, to the extent practicable, separate and distinctly segregated from insurance product activity.

(ii) REQUIREMENTS.—Regulations prescribed pursuant to paragraph (i) shall include the following requirements:

(A) SEPARATE SETTING.—A clear delineation of the section in which, and the circumstances under which, transactions involving insurance products should be conducted in a location physically segregated from an area where retail deposits are processed.

(B) REFERRALS.—Standards that permit any person accepting deposits from the public in an area where no transactions are routinely conducted in a depository institution to refer a customer who seeks to purchase any insurance product to a person who is not part of the same institution, only if the person making the referral receives no more than a one-time nominal fee of a fixed dollar amount for each referral that does not depend on whether the referral results in a transaction.

(C) QUALIFICATION AND LICENSING REQUIREMENTS.—Standards prohibiting any depository institution from permitting any person to sell or offer for sale any insurance product in any part of the office of the institution, or on behalf of the institution, unless such person is appropriately qualified and licensed.

(D) DOMESTIC VIOLENCE DISCRIMINATION PROHIBITION.—

(I) IN GENERAL.—In the case of an applicant for, or an insured under, any insurance product described in paragraph (B), the status of the applicant or insured as a victim of domestic violence, or as a provider of services to victims of domestic violence, shall not be considered as a criterion in any decision with regard to insurance underwriting, pricing, renewal, or scope of coverage, contract exclusions, or payment of insurance claims, except as required or expressly permitted under State law.

(II) DEFINITION OF DOMESTIC VIOLENCE.—The prohibition contained in paragraph (I) shall apply to any life or health insurance product which is sold or offered for sale, as principal, agent, or broker, by any depository institution or any person who is engaged in such activities at an office of the institution or on behalf of the institution.

(III) DOMESTIC VIOLENCE DEFINED.—For purposes of this subsection, the term ‘domestic violence’ means the occurrence of any of the following acts by a current or former family member, household member, intimate partner, or caretaker:

(A) Attempting to cause or causing or threatening another person physical harm, severe emotional distress, psychological trauma, rape, or sexual abuse.

(B) Engaging in a course of conduct or repeatedly committing acts toward another person by which the reasonable person would feel fear or threat of harm, including fear or threat of harm by a person with authority, under circumstances that place the person in reasonable fear of bodily injury.

(C) Subjecting another person to false imprisonment.

(III) FEDERAL PREEMPTION AND ABILITY OF STATES TO OVERRIDE FEDERAL PREEMPTION.—If the Federal agencies referred to in clause (I) jointly determine that any provision of the regulations prescribed under this section affords greater protection for customers than a comparable State law, rule, regulation, order, or interpretation, those agencies shall send a written preemption notice to the appropriate State regulatory authority to notify the State that the Federal provision will preempt the State provision and will become applicable, unless not later than 3 years after the date of such notice any person engaged in insurance sales or solicitations that is not affiliated with a depository institution.

(i) NON-DISCRIMINATION AGAINST NON-AFFILIATED AGENTS.—The Federal banking agencies shall ensure that the regulations prescribed pursuant to subsection (a) shall not have the effect of discriminating, either intentionally or unintentionally, against any person engaged in insurance sales or solicitations that is not affiliated with a depository institution.

(II) CONSIDERATIONS.—Before making a final determination under clause (I), the Federal agencies referred to in clause (I) shall give appropriate consideration to comments submitted by the appropriate State regulatory authorities relating to the level of protection afforded to consumers under State law.

(III) FEDERAL PREEMPTION AND ABILITY OF STATES TO OVERRIDE FEDERAL PREEMPTION.—If the Federal agencies referred to in clause (I) jointly determine that any provision of the regulations prescribed under this section affords greater protections for customers than a comparable State law, rule, regulation, order, or interpretation, those agencies shall send a written preemption notice to the appropriate State regulatory authority to notify the State that the Federal provision will preempt the State provision and will become applicable, unless not later than 3 years after the date of such notice any person engaged in insurance sales or solicitations that is not affiliated with a depository institution.

(III) FEDERAL PREEMPTION AND ABILITY OF STATES TO OVERRIDE FEDERAL PREEMPTION.—If the Federal agencies referred to in clause (I) jointly determine that any provision of the regulations prescribed under this section affords greater protections for customers than a comparable State law, rule, regulation, order, or interpretation, those agencies shall send a written preemption notice to the appropriate State regulatory authority to notify the State that the Federal provision will preempt the State provision and will become applicable, unless not later than 3 years after the date of such notice any person engaged in insurance sales or solicitations that is not affiliated with a depository institution.

(II) CONSIDERATIONS.—Before making a final determination under clause (I), the Federal agencies referred to in clause (I) shall give appropriate consideration to comments submitted by the appropriate State regulatory authorities relating to the level of protection afforded to consumers under State law.

(IV) FEDERAL PREEMPTION AND ABILITY OF STATES TO OVERRIDE FEDERAL PREEMPTION.—If the Federal agencies referred to in clause (I) jointly determine that any provision of the regulations prescribed under this section affords greater protections for customers than a comparable State law, rule, regulation, order, or interpretation, those agencies shall send a written preemption notice to the appropriate State regulatory authority to notify the State that the Federal provision will preempt the State provision and will become applicable, unless not later than 3 years after the date of such notice any person engaged in insurance sales or solicitations that is not affiliated with a depository institution.

(II) CONSIDERATIONS.—Before making a final determination under clause (I), the Federal agencies referred to in clause (I) shall give appropriate consideration to comments submitted by the appropriate State regulatory authorities relating to the level of protection afforded to consumers under State law.

(IV) FEDERAL PREEMPTION AND ABILITY OF STATES TO OVERRIDE FEDERAL PREEMPTION.—If the Federal agencies referred to in clause (I) jointly determine that any provision of the regulations prescribed under this section affords greater protections for customers than a comparable State law, rule, regulation, order, or interpretation, those agencies shall send a written preemption notice to the appropriate State regulatory authority to notify the State that the Federal provision will preempt the State provision and will become applicable, unless not later than 3 years after the date of such notice any person engaged in insurance sales or solicitations that is not affiliated with a depository institution.

(II) CONSIDERATIONS.—Before making a final determination under clause (I), the Federal agencies referred to in clause (I) shall give appropriate consideration to comments submitted by the appropriate State regulatory authorities relating to the level of protection afforded to consumers under State law.
by such Federal banking agency and any affiliated company that is engaged in insurance activities regulated by such State insurance regulator. The appropriate Federal banking agency believes is necessary or appropriate to permit the State insurance regulator to administer and enforce applicable State insurance laws.

(3) STATE INSURANCE REGULATOR INFORMATION.—Upon the request of the appropriate Federal banking agency, a State insurance regulator may provide any information or data to which such insurance regulator has access with respect to a company which—

(A) is engaged in insurance activities and regulated by such State insurance regulator; or

(B) is an affiliate of a depository institution or financial holding company.

(4) PROCEDURAL REQUIREMENTS.—No mutual insurer shall constitute, in whole or in part, a transference domicile with respect to a transferor pursuant to this section, the continuing affiliation of which is not domiciled in any State, and then only in the case of outstanding policies and contracts whose owners reside in such licensed State.

22 SEC. 311. REDOMESTICATION OF MUTUAL INSURERS

(a) REDOMESTICATION.—A mutual insurer organized under the laws of any State may transfer its domicile as a step in a reorganization in which, pursuant to the laws of the transferee domicile and consistent with the standards of the State, the mutual insurer transfers to a stock insurer that is a direct or indirect subsidiary of a mutual holding company.

(b) RESULTING DOMICILE.—Upon complying with the applicable law of the transferee domicile governing transfers of domicile and completion of a transfer pursuant to this section, the mutual insurer shall cease to be a domestic insurer in the transferee domicile and, as a continuation of its corporate existence, shall be a domestic insurer of the transferee domicile.

(c) LICENSES RESERVED.—The certificate of authority, agents' appointments and licenses, rates, approvals and other items that a licensed State allows and that are in existence immediately prior to the redomestication of the mutual insurer transfers its domicile pursuant to this subsection shall continue in full force and effect upon the transfer. The insurer shall be duly qualified to transact the business of insurance in such licensed State.

23 SEC. 312. EFFECT ON STATE LAWS RESTRICTING REDOMESTICATION

(a) IN GENERAL.—Unless otherwise provided by the State insurance regulator of the transferee domicile, the law of the transferee domicile that conflict with the purposes and intent of this subsection is preempted. Including but not limited to—

(i) any law that has the purpose or effect of interfering with the activities of, taking action against, or imposing any provision of law or regulation to the extent that such insurer because that insurer or any affiliate plans to redomesticate, or has redomesticated, pursuant to this subsection;

(ii) any law that has the purpose or effect of interfering with the activities of, taking action against, or imposing any provision of law or regulation to the extent that such insurer because that insurer or any affiliate plans to redomesticate, or has redomesticated, pursuant to this subsection; and

(iii) any law that has the purpose or effect of terminating, because of the redomestication of a mutual insurer pursuant to this subtitle, any certificate of authority, agent appointment or license, rate approval, or other approval, of any State insurance regulator or other State authority in existence immediately prior to the redomestication in any State other than the transferee domicile.

(b) DIFFERENTIAL TREATMENT PROHIBITED.—No State law, regulation, interpretation, or functional equivalent thereof, of a State other than a transferee domicile may apply to a redomesticating or redomesticated insurer or any affiliate thereof any differently than an insurer operating in that State that is not a redomesticating or redomesticated insurer.

(c) LAWS PROHIBITING OPERATIONS.—If any licenses the State fails to issue or, seeks to revoke an original or renewal certificate of authority of a redomesticated insurer promptly for policies in effect in that State that are not redomesticated, or for policies in a stock holding company, the offer or sale of any such certificate of authority to foreign insurers that are not redomesticating, such insurer shall be exempt from any State law of the licensed State to the extent that such State law or the operation of such State law would
(b) JUDICIAL REVIEW.—The appropriate United States district court shall have exclusive jurisdiction over litigation arising under this section involving any redomesticed or re­domesticated insurer.

(2) SEVERABILITY.—If any provision of this section, or the application thereof to any person or circumstances, is held invalid, the remainder of the section, and the application of such provision to other persons or circumstances, shall not be affected thereby.

SEC. 315. DEFINITIONS

For purposes of this subtitle, the following definitions shall apply:

(1) COURT OF COMPETENT JURISDICTION.—The term "court of competent jurisdiction" means a court authorized pursuant to section 319(a) to adjudicate litigation arising under this subtitle.

(2) TRANSFEREE DOMICILE.—The term "transfer­ee domicile" means the States from which a mutual insurer is redomesticating pursuant to this subtitle.

(3) TRANSFEROR DOMICILE.—The term "transfer­or domicile" means the State from which a mutual insurer is redomesticating pursuant to this subtitle.

(4) INSTITUTION.—The term "institution" means a corporation, joint stock company, limited liability company, limited partnership, association, trust, partnership, or any similar entity.

(5) LICENSED STATE.—The term "licensed State" means any State, the District of Colum­bia, any territory of the United States, Puerto Rico, Guam, American Samoa, the Trust Terri­tory of the Pacific Islands, the Virgin Islands, and the Northern Mariana Islands in which the redomesticated Insurer has a certificate of authority in effect immediately prior to the redomestication.

(6) MUTUAL INSURER.—The term "mutual insurer" means a mutual insurer organized under the laws of any State.

(7) PERSON.—The term "person" means an indi­vidual, institution, government or government­al agency, State or political subdivision of a State, public authority, association, trust, estate, trustee, or fiduciary, or other similar enti­ty.

(8) POLICYHOLDER.—The term "policyholder" means the owner of a policy issued by a mutual insurer, except that, with respect to voting rights, the term means a member of a mutual in­sur­er or mutual holding company granted the right to vote, as determined under applicable State law.

(9) REDOMESTICATED INSURER.—The term "redomesticated insurer" means a mutual insurer that has redomesticated pursuant to this subtitle.

(10) REDOMESTICATING INSURER.—The term "redomesticating insurer" means a mutual insurer that is redomesticating pursuant to this subtitle.

(11) DOMESTICATION OR TRANSFER.—The term "domestication or "transfer" means the transfer of the domicile of a mutual insurer from one State to another State pursuant to this subtitle.

(12) STATE INSURANCE REGULATOR.—The term "State insurance regulator" means the principal Insurance regulatory authority of a State, the National Association of Insurance Commissioners (hereafter referred to as the "NAIC") in consultation with the insurance commissioners or chief insurance regulatory officials of the States, or any other entity designated pursuant to paragraphs (b)(1) and (2) of section 319.

(13) STATE LAW.—The term "State law" means the statutes of any State, the District of Colum­bia, any territory of the United States, Puerto Rico, Guam, American Samoa, the Trust Territory of the Pacific Islands, the Virgin Islands, and the Northern Mariana Islands.

(14) TRANSFEREE INSURANCE LICENSE.—The term "transfer­ee insurance license" means a license to do business as a nonresident insurer issued by a court of competent jurisdiction or by a court of record in the home State of a transfer­ee domicile.

(15) TRANSFEROR INSURANCE LICENSE.—The term "transfer­or insurance license" means a license to do business as a nonresident insurer issued by a court of competent jurisdiction or by a court of record in the home State of a transfer­or domicile.

(16) UNIFORM CONTINUING EDUCATION REQUIREMENTS.—The term "uniform continuing education requirements" means the requirements for continuing education for licensed insurers prescribed under the laws of the home State of a transfer­or domicile.

SEC. 316. EFFECTIVE DATE

This subtitle shall take effect on the date of the enactment of this Act.

Subtitle C—National Association of Registered Agents and Brokers

SEC. 321. STATE FLEXIBILITY IN MULTISTATE LIFE INSURANCE

(a) IN GENERAL.—The provisions of this sub­title shall take effect unless, not later than 3 years after the date of the enactment of this Act, at least a majority of the States bind that they have enacted laws and regulations governing the licensure of individual and corpo­rate producers that meet the requirements for the sale or solicitation of insurance within the State or States; that do not exceed the requirements for the sale or solicitation of insurance within the States specified by subsection (b); and are substantially uniform to the extent prescribed by subsection (c).

(b) REQUIREMENTS.—The requirements under subsection (a) shall be met with respect to a State if the State has enacted laws and regulations governing the licensure of individual and corporate producers that (1) do not exceed the requirements for the sale or solicitation of insurance within the States specified by subsection (b); and (2) are substantially uniform to the extent prescribed by subsection (c).

(c) LIMITATIONS.—(1) The guarantees required under subsection (a)(1) shall not apply to States that have enacted laws and regulations that meet the requirements of subsection (b) unless, not later than 1 year after the date of the enactment of this Act, the States have enacted laws and regulations that meet the requirements of subsection (b).
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SECTION 321. PURPOSE.
The purpose of the Association shall be to provide a mechanism through which uniform licensing, appointment, continuing education, and other insurance producer sales qualification requirements and conditions can be adopted and applied on a multi-state basis, while preserving the right of States to license, supervise, and discipline producers and to protect the public and enforce laws and regulations with regard to insurance-related consumer protection and unfair trade practices.

SECTION 322. RELATIONSHIP TO THE FEDERAL GOVERNMENT.
The Association shall be subject to the supervision and oversight of the NAIC.

SECTION 323. MEMBERSHIP.
(a) ELIGIBILITY.—
(1) In general.—Any State-licensed insurance producer shall be eligible to become a member in the Association.
(2) Ineligibility for suspension or revocation of license.—Notwithstanding paragraph (1), a State-licensed insurance producer shall not be eligible to become a member if a State insurance regulator has suspended or revoked such producer's license for a period of more than 2 years preceding the date on which such producer applies for membership.
(b) Suspension or revocation.—Paraphrase.
(3) Suspension or revocation is subsequently overturned.
(b) AUTHORITY TO ESTABLISH MEMBERSHIP CRITERIA.—The Board shall have the authority to establish membership criteria that—
(1) bear a reasonable relationship to the purpose for which the Association was established; and
(2) do not unfairly limit the access of smaller agencies to the group home practice.
(c) ESTABLISHMENT OF CLASSES AND CATEGORIES.—
(1) CLASSES OF MEMBERSHIP.—The Association may establish separate classes of membership, with separate criteria, if the Association reasonably determines that different kinds of agencies or producers require different levels of education, training, or experience.
(2) CATEGORIES OF MEMBERSHIP.—The Association may establish separate categories of membership for individuals and for other persons. The establishment of any such categories of membership shall be established by the Board in its licensing categories that exist under State laws or on the aggregate amount of business handled by an insurance producer. No special categories of membership, and no distinct membership criteria, shall be established for members which are dependent institutions or for their employees, agents, or affiliates.
(d) MEMBERSHIP CRITERIA.—
(1) In general.—The Association may establish criteria for membership which shall include standards for integrity, personal qualifications, education, training, and experience.
(2) MINIMUM STANDARD.—In establishing criteria under paragraph (1), the Association shall consider the standards of the insurance producer qualifications established under the licensing laws of the States.
(e) EXCLUSION OF MEMBERSHIP.—Membership in the Association shall entitle the member to license in each State for which the member pays the requisite fees, including licensing fees and, where applicable, bonding requirements, set by such State.
(f) ANNUAL RENEWAL.—Membership in the Association shall be based on an annual basis.
(g) CONTINUING EDUCATION.—The Association shall establish, as a condition of membership, continuing education requirements which shall be comparable to or greater than the continuing education requirements under the licensing laws of a majority of the States.
(h) SUSPENSION AND REVOCATION.—The Association may—
(1) inspect and examine the records and offices of the members of the Association to determine compliance with the criteria for membership established by the Association; and
(2) suspend or revoke the membership of an insurance producer if—
(A) the producer fails to meet the applicable membership criteria of the Association; or
(B) the producer shall have been subject to disciplinary action pursuant to a final adjudication by virtue of the rules of a State insurance regulator, and the Association concludes that retention of membership in the Association would not be in the public interest.
(i) OFFICE OF CONSUMER COMPLAINTS.—
(1) In general.—The Association shall establish an office of consumer complaints that shall—
(A) receive and investigate complaints from both consumers and State insurance regulators related to members of the Association; and
(B) recommend to the Association any disciplinary actions that it considers appropriate, to the extent that any such recommendation is not inconsistent with State law.
(2) RECORDS AND REFERRALS.—The office of consumer complaints of the Association shall—
(A) maintain records of all complaints received in accordance with paragraph (1) and make such records available to the NAIC and to each State insurance regulator for the State of residence of the consumer who filed the complaint; and
(B) refer, when appropriate, any such complaint to any appropriate State insurance regulator.
(j) TELEPHONE AND OTHER ACCESS.—The office of consumer complaints shall maintain a toll-free telephone number for the purpose of this subsection and, as practicable, other alternative means of communication with consumers, such as a fax and email.

SECTION 324. BOARD OF DIRECTORS.
(a) ESTABLISHMENT.—There is established the Board of Directors of the Association, which shall consist of 12 persons appointed by the NAIC.
(b) POWERS.—The Board shall have such powers and authority as may be specified in the bylaws of the Association.
(c) COMPOSITION.—
(1) MEMBERS.—The Board shall be composed of 7 members appointed by the NAIC.
(2) REQUIREMENT.—At least 4 of the members of the Association shall have significant experience with the regulation of commercial lines of insurance in at least 1 of the 20 States in which the greatest total dollar amount of commercial lines insurance is placed in the United States.
(d) INITIAL BOARD MEMBERS.—
(A) IN GENERAL.—If, by the end of the 2-year period beginning on the date of the enactment of this Act, the NAIC has not appointed the initial 7 members of the Board, the initial 7 Board members shall be appointed by the NAIC and the insurance regulators of the 7 States with the greatest total dollar amount of commercial lines insurance in place as determined by the NAIC as of the end of such period.
(B) ALTERNATE COMPOSITION.—If any of the insurance regulators described in subparagraph (A) declines to serve on the Board, the Insurers' Security Fund with the next greatest total dollar amount of commercial lines insurance in place, as determined by the NAIC as of the end of such period, shall appoint the alternate member of the Board.
(e) INOPERABILITY.—If fewer than 7 State insurance regulators accept appointment to the Board, the Association shall be established without NAIC oversight pursuant to section 321.
(f) TERMS.—The term of each director shall, after the initial appointment of the members of the Board, be for 3 years, with one-third of the directors to be appointed each year.
(g) BOARD VACANCIES.—A vacancy on the Board shall be filled in the same manner as the original appointment of the initial Board for the remainder of the term of the vacant member.
(h) MEETINGS.—The Board shall meet at the call of the chairman or, otherwise provided by the bylaws of the Association.

SECTION 325. OFFICERS.
(a) IN GENERAL.—
(1) Officers of the Association shall consist of a chairperson and a vice chairperson of the Board, a president, secretary, and treasurer.
(2) In general.—Each person appointed as an officer shall serve as an officer of the Association or, if otherwise provided by the bylaws, as an officer of the NAIC.
(3) Offenses.—An officer of the Association shall be subject to all rules and regulations of the NAIC.
(b) CRITERIA FOR CHAIRPERSON.—Only individuals who are members of the NAIC shall be eligible to serve as the chairperson of the board of directors.

SECTION 326. BYLAWS, RULES, AND DISCIPLINARY ACTION.
(a) ADOPTION AND AMENDMENT OF BYLAWS.—
(1) COPY REQUIRED TO BE FILED WITH THE NAIC.—The board of directors of the Association shall file with the NAIC a copy of the proposed bylaws or any proposed amendment to the bylaws, accompanied by a concise general statement of the basis and purpose of such proposal.
(2) EFFECTIVE DATE.—Except as provided in paragraph (1), any proposed bylaw or proposed amendment shall take effect—
(A) 30 days after the date of the filing of a copy with the NAIC; or
(B) upon such later date as the Association may designate; or
(C) upon such earlier date as the NAIC may determine.
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(3) DISAPPROVAL BY THE NAIC.—Notwithstanding any provision of this subsection other than subparagraph (b), a proposed rule or amendment relating to the administration or organization of the Association shall be disapproved if—

(i) upon the date of filing with the NAIC, if such proposed rule or amendment is designated by the Association as applicable to matters which the NAIC, consistent with the public interest and the purposes of this subsection, determines are inapplicable by reason of circumstances set forth in this paragraph; or

(ii) upon such date as the NAIC shall for good cause determine that the action should be taken;

(b) affirm, modify, or rescind the disciplinary action upon which the Association acted under section (d).

(6) DISMISSAL OF PROCEEDING.—The NAIC may dismiss a proceeding to review disciplinary action if the NAIC finds that—

(A) the proposed grounds on which the action is based exist in fact;

(B) the action is in accordance with applicable rules and regulations;

(C) such rules and regulations are, and were, applied in a manner consistent with the purposes of this subsection.

SEC. 332. FUNCTIONS OF THE NAIC.

(a) ADMINISTRATIVE PROCEDURES.—Determinations of the NAIC, for purposes of making rules pursuant to section 328, shall be made after appropriate notice and opportunity for hearing, and submission of a report to any interested persons.

(b) EXAMINATIONS AND REPORTS.—No examinations may be made by the NAIC or its agents or employees, upon any insurer or insurance producer, whether member or nonmember thereof as the NAIC determines to be appropriate.

(c) DISCIPLINARY ACTION.—In any proceeding to determine whether membership shall be denied, suspended, revoked, or not renewed (hereafter in this section referred to as a "disciplinary action"), the Association shall bring specific charges, notify each member of such charges, give the member an opportunity to defend against the charges, and keep a record.

(d) SUPPORTING STATEMENT.—A determination to take disciplinary action shall be supported by a statement setting forth—

(I) any act or acts of the grounds for disapproval under consideration;

(II) the specific provision of the NAIC statute, rule or regulation applicable to the NAIC proceeding instituted by the NAIC with respect to a proposed rule or amendment pursuant to paragraph (2) shall—

(A) by order approve such proposed rule or amendment;

(B) institute proceedings to determine whether such proposed rule or amendment should be modified or disapproved.

(II) NAIC PROCEEDINGS.—

(A) IN GENERAL.—Proceedings instituted by the NAIC with respect to a proposed rule or amendment pursuant to paragraph (2) shall—

(i) not more than 60 days if the NAIC finds good cause for such extension and sets forth its reasons for so finding; or

(ii) such longer period as to which the Association consents.

(B) STANDARDS FOR REVIEW.—

(A) GROUNDS FOR APPROVAL.—The NAIC shall approve a proposed rule or amendment if the NAIC finds that the rule or amendment is in the public interest and is consistent with the purposes of this Act.

(B) APPROVAL BEFORE END OF NOTICE PERIOD.—In any proceeding under subparagraph (A), the NAIC shall, by order, approve or disapprove the proposed rule or amendment.

(C) EXTENSION OF TIME FOR CONSIDERATION.—

The NAIC may extend the time for considering any proceeding under subparagraph (A), the NAIC shall, by order, approve or disapprove the proposed rule or amendment.

(3) DISMISSAL OF PROCEEDING.—At the conclusion of any proceeding under subparagraph (A), the NAIC shall, by order, approve or disapprove the proposed rule or amendment.

(4) STANDARDS FOR REVIEW.—

(A) GROUNDS FOR APPROVAL.—The NAIC shall approve a proposed rule or amendment if the NAIC finds that such rule or amendment is in the public interest and is consistent with the purposes of this Act.

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(C) EXTENSION OF TIME FOR CONSIDERATION.—The NAIC may extend the time for considering any proceeding under subparagraph (A), the NAIC shall, by order, approve or disapprove the proposed rule or amendment.
States commercial-lines insurance premiums have not satisfied the uniformity or reciprocity requirements of subsections (a), (b), and (c) of section 9.22.

(2) The NAIC has not approved the Association's bylaws as required by section 328 or is unable and as a result, supervise the Association, or the Association is not conducting its activities as required under this Act.

(3) APPOINTMENTS.-If the repeals required by subsection (a) are implemented, the following shall apply:

(A) INITIAL APPOINTMENT POWER.-The President, with the advice and consent of the Senate, shall appoint the members of the State Board established under section 328 from lists of candidates recommended to the President by the NAIC.

(2) PROCEDURE FOR OBTAINING NAIC APPOINTMENTS.-

(A) INITIAL DETERMINATION AND RECOMMENDATIONS.-After the date on which the provisions of subsection (a) become effective, the NAIC shall, not later than 60 days thereafter, provide a list of proposed candidates to the President. If the NAIC fails to provide a list by that date, or if any list that is provided does not include at least 12 recommended candidates or comply with the requirements of section 328(d), the President shall, with the advice and consent of the Senate, make the requisite appointments without consulting the views of the Senate.

(B) SUBSEQUENT APPOINTMENTS.-After the initial appointments, the NAIC shall provide a list of at least six recommended candidates for the Board to the President by January 15 of each subsequent year. If the NAIC fails to provide a list by that date, or if any list that is provided does not include at least six recommended candidates or comply with the requirements of section 328(c), the President, with the advice and consent of the Senate, shall make the requisite appointments without considering the views of the NAIC.

(C) PRESIDENTIAL OVERSIGHT.-

(I) REMOVAL.-If the President determines that the Association is not acting in the interests of the public, the President may remove the entire existing Board for the remainder of the term to which the members of the Board were appointed and appoint, with the advice and consent of the Senate, new members to fill the vacancies on the Board for the remainder of such terms.

(II) SUSPENSION OF RULES OR ACTIONS.-The President, or a person designated by the President for such purpose, may suspend the effectiveness and validity of any rule or order or prohibit any action which the Association which the President or the designee determines is contrary to the public interest.

(3) ANNUAL REPORT.-As soon as practicable after the close of each fiscal year, the Association shall submit to the President and to the Congress a written report relative to the conduct of its business, and the exercise of the other rights and powers granted by this subtitle, during such fiscal year and the contained financial statements setting forth the financial position of the Association at the end of such fiscal year and the results of operations (including the source and application of its funds) for such fiscal year.

SEC. 332. RELATIONSHIP TO STATE LAW;

(A) PREEMPTION OF STATE LAWS.-State laws, regulations, provisions, or other actions purporting to regulate insurance producers shall be preempted by section 328.

(B) PROHIBITED ACTIONS.-No State shall:

(I) Impose any requirement upon a member of the Association that it pay dues or provides for disciplinary action against, or any insurance producer because that insurance producer or any affiliate plans to become, is a member of the Association;

(II) Impose any requirement upon a member of the Association that it pay dues or provides for disciplinary action against, or any insurance producer because that insurance producer or any affiliate plans to become, is a member of the Association.

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States commercial-lines insurance premiums have not satisfied the uniformity or reciprocity requirements of subsections (a), (b), and (c) of section 9.22.

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(3) ANNUAL REPORT.-As soon as practicable after the close of each fiscal year, the Association shall submit to the President and to the Congress a written report relative to the conduct of its business, and the exercise of the other rights and powers granted by this subtitle, during such fiscal year and the contained financial statements setting forth the financial position of the Association at the end of such fiscal year and the results of operations (including the source and application of its funds) for such fiscal year.

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(I) Impose any requirement upon a member of the Association that it pay dues or provides for disciplinary action against, or any insurance producer because that insurance producer or any affiliate plans to become, is a member of the Association;

(II) Impose any requirement upon a member of the Association that it pay dues or provides for disciplinary action against, or any insurance producer because that insurance producer or any affiliate plans to become, is a member of the Association.
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"(l) under paragraph (1)(C) or (2) of this subsection;

(ii) for financial holding companies under section 10 of the Bank Holding Company Act of 1935;

(iii) prevent new commercial affiliations.

(1) PREVENTION OF NEW COMMERCIAL AFFILIATIONS.—(A) In general.—Subparagraph (2), no savings and loan holding company may engage directly or indirectly (including through a subsidiary association) in any activity other than as described in clauses (i) and (ii) of subparagraph (A).

(2) AUTHORITY TO PREVENT NEW UNAFFILIATED HOLDING COMPANIES.—Subparagraphs (A) and (B) do not apply with respect to a savings and loan holding company on May 4, 1999, or that becomes a savings and loan holding company pursuant to an application pending before the Office on or before that date, and that—

(i) meets and continues to meet the requirements of paragraph (B) at

(ii) continues to control not fewer than 1 savings association that it controlled on May 4, 1999, or that it acquired pursuant to an application pending before the Office on or before that date, or the successor to such savings association.

(3) CORPORATE REORGANIZATIONS PERMITTED.—This paragraph does not prevent a transaction that—

(i) involves solely a company under common control with a savings and loan holding company, directly or indirectly, of control of the savings and loan holding company or any savings association that is already a subsidiary of the savings and loan holding company;

(ii) involves a merger, consolidation, or other type of business combination as a result of which a company under common control with the savings and loan holding company acquires, directly or indirectly, control of the savings and loan holding company or any savings association that is already a subsidiary of the savings and loan holding company.

(4) AUTHORITY TO PREVENT EVASIONS.—The Director may issue interpretations, regulations, or orders that the Director determines necessary to administer and carry out the purpose and prevent evasions of this paragraph, including a determination that, notwithstanding the form of transaction, the transaction would in all respects reasonably result in the same control of a savings association.

(5) PRESERVATION OF AUTHORITY FOR FAMILY TRUSTS.—Subparagraphs (A) and (B) do not apply with respect to any trust that becomes a savings and loan holding company with respect to a savings association if—

(i) not less than 85 percent of the beneficial ownership interests in the trust are continuously owned, directly or indirectly, by or for the benefit of members of the same family, or their spouses, who are lineal descendants of common ancestors who controlled, directly or indirectly, such savings association on May 4, 1999, or a subsequent date, pursuant to an application pending before the Office on or before May 4, 1999, and

(ii) at the time at which such trust becomes a savings and loan holding company, such ancestors or lineal descendants, or spouses of such descendants, have directly or indirectly controlled such association continuously since May 4, 1999, or a subsequent date, pursuant to an application pending before the Office on or before May 4, 1999.

1. CONFORMING AMENDMENT.—Section 100(g)(5)(E) of the Home Owners’ Loan Act (12 U.S.C. 1474a(g)(5)(E)) is amended by striking "", except subparagraph (B) "" and inserting ""c)(9)(A)(1)"".

2. RULE OF CONSTRUCTION FOR CERTAIN APPLICATIONS.—(1) In general.—In the case of a company that

(A) submits an application with the Director of the Office of Thrift Supervision before the date of the enactment of this Act to convert a State-chartered trust company controlled by such company on May 4, 1999, to a savings association; and

(B) controlled a subsidiary on May 4, 1999, that had submitted an application to the Director on or before March 26, 1993, to the company (including any subsidiary controlled by such company as of such date of enrollment) as having filed such conversion application with the Director before May 4, 1999, for purposes of section 5(c)(6)(B)(C) of the Home Owners’ Loan Act (as added by subsection (a)).

(2) DEFINITIONS.—For purposes of paragraph (1), the terms "company," "control," "savings association," and "subsidiary" have the meanings given those terms in section 10 of the Home Owners’ Loan Act.

VII—PRIVACY

Subtitle A—Disclosure of Nonpublic Personal Information

SEC. 201. PROTECTION OF NONPUBLIC PERSONAL INFORMATION

(a) PRIVACY OBLIGATION POLICY.—It is the policy of the Congress that each financial institution has an affirmative and continuing obligation to its customers to respect their privacy by not disclosing such customers’ nonpublic personal information to nonaffiliated third parties except as provided in this section.

(b) INFORMATION TO CUSTOMERS.—Each financial institution shall annually disclose to each customer to whom the financial institution has provided financial services during the previous year the Privacy Policy Statement of the financial institution and any amendment to the Privacy Policy Statement since the date of the previous disclosure. The financial institution shall keep a written record of the delivery of the Privacy Policy Statement to the customer and the date and manner of delivery.

(c) NOTICE REQUIREMENTS.—Except as otherwise provided in this subtitle, a financial institution may not disclose any nonpublic personal information to nonaffiliated third parties except as specified in this section, and the financial institution agrees to the following:

(1) provide notice to each customer to whom nonpublic personal information pertains, at least annually, that their personal information may be disclosed to nonaffiliated third parties unless the financial institution provides the customer with an opportunity to opt out of such disclosure;

(2) protect against any anticipated threats or hazards to the security or integrity of such records and

(3) protect against unauthorized access to or use of such records or information which could result in substantial harm or inconvenience to any customer.

(d) OPT OUT.—(1) In general.—A financial institution may not disclose nonpublic personal information to a nonaffiliated third party unless—

(A) such financial institution clearly and conspicuously discloses to the consumer, in writing or in electronic form or other form permitted by the regulations prescribed under section 504, that such information may be disclosed to such third party;

(B) the consumer is given the opportunity, before the time that such information is initially disclosed, to direct that such information not be disclosed to such third party; and

(C) the consumer is given an explanation of how the consumer can exercise that nondisclosure option.

(2) Exception.—This subsection shall not prevent a financial institution from providing nonpublic personal information to a nonaffiliated third party that engages in any one or more of the following activities on behalf of the financial institution, including marketing of the financial institution’s own benefit:

(i) products or services offered pursuant to joint agreements between two or more financial institutions that comply with the requirements imposed by the regulations prescribed under section 504, if the financial institution fully discloses the providing of such information and enters into a contractual agreement with the third party that requires the third party to maintain the confidentiality of such information.

(c) LIMITS ON USE OF INFORMATION.—Except as otherwise provided in this subtitle, a financial institution may not disclose any nonpublic personal information under this section unless the financial institution discloses such information only to a nonaffiliated third party, unless disclosure would be lawful if made directly to such person by the financial institution.

(d) LIMITATIONS ON THE SHARING OF ACCOUNT NUMBER INFORMATION FOR MARKETING PURPOSES.—A financial institution shall not disclose, other than to a consumer requesting information, an account number or similar form of access code for a credit card account, deposit account, or transaction account to any nonaffiliated third party for use in telemarketing, direct mail marketing, or other marketing through electronic mail to the consumer.

(e) GENERAL EXCEPTIONS.—Subsections (a) and (d) shall not prohibit the disclosure of nonpublic personal information:

(1) to a customer that has provided notice in writing or otherwise as required by subsection (a) for any entity other than a financial institution; or

(2) in connection with a transaction requested by or for the customer.

(f) MAINTAINING THE SECURITY OF FINANCIAL INFORMATION.—Each financial institution shall, to the extent practicable, protect the confidentiality and security of financial information of customers and noncustomers by safeguarding those records or other information against any anticipated threats or hazards to the security or integrity of such records and are susceptible to unauthorized access, either through electronic mail or otherwise.

(g) DIRECT MAIL MARKETING, TELEMARKETING, AND OTHER MARKETING THROUGH ELECTRONIC MAIL OR TELEMARKETING.—Each financial institution shall, to the extent practicable, protect the confidentiality and security of financial information of customers and noncustomers by safeguarding those records or other information against any anticipated threats or hazards to the security or integrity of such records and are susceptible to unauthorized access, either through electronic mail or otherwise.

(h) AUDIT AND REPORTING.—For purposes of this section, each financial institution shall, at the request of the Director, provide an audit and report to the Director on the financial institution’s procedures to protect the confidentiality and security of financial information of customers and noncustomers.

(i) REQUIREMENTS TO BE FOLLOWED.—Each financial institution shall follow the requirements established by the Director of the Office of Thrift Supervision.

(j) DEFINITIONS.—For purposes of this section:

(i) consumer—means a person who holds an account with a financial institution.

(ii) financial institution—means a bank, savings and loan association, credit union, or their subsidiaries.

(iii) financial information—means nonpublic personal information of customers and noncustomers.

(iv) nonpublic personal information—means personal information concerning the financial affairs or activities of a customer or noncustomer that are not publicly available.

(v) personal information—means information about a consumer’s financial affairs or activities that is not publicly available.

(vi) protected classes—means racial or national origin, or any other characteristic made unlawful by title VII of the Civil Rights Act of 1964, as amended.

(vii) related persons—means any person who is related to a consumer by blood, marriage, or adoption.

(k) ENFORCEMENT.—The Director of the Office of Thrift Supervision shall enforce this section through the use of such tools as audits, examinations, and other enforcement actions.
(l) to comply with Federal, State, or local laws, rules, and other applicable legal requirements; to comply with a properly authorized civil, criminal, or regulatory investigation or proceeding, whether conducted by Federal, State, or local authorities; or to respond to judicial process or government regulatory authorities having jurisdiction over such Federal, State, or local authorities; and (d) to disclose to any other person engaged in providing insurance, investment companies, and investment advisers, as described in paragraphs (a) through (c) of section 46(b) as are deemed consistent with the purposes of this subtitle.

SEC. 594. RULEMAKING.
(a) REGULATORY AUTHORITY.—
(1) Rulemaking.—The Federal banking agencies, the National Credit Union Administration, the Secretary of the Treasury, the Securities and Exchange Commission, and the Federal Trade Commission shall each prescribe, after consultation as appropriate with representatives of State insurance, securities, and credit agencies, the National Association of Insurance Commissioners, such regulations as may be necessary to carry out the purposes of this subtitle with respect to the financial institutions subject to their jurisdictions under section 505.
(2) COORDINATION, CONSISTENCY, AND COMPLIANCE.—Each of the agencies and authorities required under paragraph (1) to prescribe regulations shall consult and coordinate with the other authorities and authorities having jurisdiction over such financial institutions, and shall be consistent with the regulations prescribed by the other such agencies and authorities.
(b) EFFECTIVE DATE AND DEADLINE.—Such regulations shall be prescribed in accordance with applicable requirements of title 5, United States Code, and shall be issued in final form not later than 6 months after the date of the enactment of this Act.

(2) EXCEPTION.—The agencies and authorities described in paragraphs (1), (4), (5), (6), and (7) of subsection (a) shall implement the standards and rules prescribed under section 505(b) by rule with respect to the financial institutions and other persons subject to their respective jurisdictions under subsection (a).

SEC. 595. PROTECTION OF FAIR CREDIT REPORTING ACT.
(a) AMENDMENT.—Section 621 of the Fair Credit Reporting Act (15 U.S.C. 1681n) is amended—
(1) in subsection (d), by striking everything following the period at the end of the sentence; and
(2) by striking subsection (e) and inserting the following:
(3) "(d) REGULATORY AUTHORITY.—
(1) The Federal banking agencies referred to in paragraphs (1) and (2) of subsection (b) shall jointly prescribe such regulations as necessary to carry out the purposes of this Act with respect to any persons identified under paragraphs (1) and (2) of subsection (b), and the Board of Governors of the Federal Reserve System shall have authority to prescribe regulations consistent with such joint regulations with respect to any bank holding company (other than depository institutions and consumer reporting agencies) of such holding company.
(2) The Board of the National Credit Union Administration shall prescribe such regulations as necessary to carry out the purposes of this Act with respect to any persons identified under paragraph (3) of subsection (b)."
(b) CONFORMING AMENDMENT.—Section 621(a) of the Fair Credit Reporting Act (15 U.S.C. 1681n(a)) is amended by striking paragraph (4).
(c) RELATION TO OTHER PROVISIONS.—Except for the amendments made by subsections (a) and (b), nothing in this title shall modify, limit, or supersede the operation of the Fair Credit Reporting Act, and no inference shall be drawn from the omission of any part of this title regarding whether information is transaction or experience information under section 603 of such Act.

SEC. 597. RELATION TO STATE LAWS.
(a) IN GENERAL.—This subtitle and the amendments made by this subtitle shall not be construed as superseding, altering, or affecting any statute, regulation, order, or interpretation in effect in any State, except to the extent that such statute, regulation, order, or interpretation is inconsistent with the provisions of this subtitle, and then only to the extent of the inconsistency.
(b) GREATER PROTECTION UNDER STATE LAW.—For purposes of this section, a State statute, regulation, order, or interpretation is not inconsistent with the provisions of this subtitle if the protection such statute, regulation, order, or interpretation affords any person is greater than the protection provided under this title and the amendments made by this subtitle, as determined by the Federal Trade Commission, after consultation with the affected State banking authority and the affected State insurance commissioner and department.
November 2, 1999

CONGRESSIONAL RECORD—HOUSE

H11283

SEC. 508. STUDY OF INFORMATION SHARING

PRactices AMONG financial institutions

(a) IN GENERAL.—The Secretary of the Treas-

ury, in conjunction with the Federal functional

regulators and the Federal Trade Commission,

shall conduct a study of information sharing

practices among financial institutions and their

affiliates. Such study shall include—

(1) the purposes for the sharing of confiden-
tial customer information with affiliates or with

nonaffiliated third parties;

(2) the adequacy of security precautions for

such information;

(3) the potential risks for customer privacy

of such sharing of information;

(4) the potential benefits for financial institu-
tions and affiliates of such sharing of informa-
tion;

(5) the potential benefits for customers of

such sharing of information;

(6) the adequacy of existing laws to protect

customer privacy;

(7) the feasibility of different approaches, in-
cluding opt out and opt in, to permit customers
to direct that confidential information not be
shared with affiliates and nonaffiliated third par-
ties;

(8) the feasibility of restricting sharing of

information for specific uses or of permitting cus-
tomers to direct the uses for which information
may be shared.

(b) CONSULTATION.—The Secretary shall con-
sult with representatives of State insurance au-
thorities designated by the National Association
of Insurance Commissioners, and also with finan-
cial services industry, consumer organiza-
tions and privacy groups, and other repre-
sentatives of the general public, in formulating
and conducting the study required by subsection
(a).

(c) REPORT.—Not later than January 1, 2002, the
Secretary shall submit a report to the Con-
gress containing the findings and conclusions of
the study required under subsection (a), to-
gether with such recommendations for legis-

tative or administrative action as may be appro-

priate.

SEC. 509. DEFINITIONS

As used in this subtitle:

(1) FINANCIAL INSURANCE AUTHORITY.—The

term "Federal banking agency" has the same mean-
ing as given in section 3 of the Federal Deposit

Insurance Act.

(2) FEDERAL FUNCTIONAL REGULATOR.—The

term "Federal functional regulator" means—

(A) the Board of Governors of the Federal Re-

cerves System;

(B) the Office of the Comptroller of the Curr-

ecy;

(C) the Board of Directors of the Federal De-

posit Insurance Corporation;

(D) the Director of the Office of Thrift Super-

vision;

(E) the National Credit Union Administration

Board; and

(F) the Securities and Exchange Commission.

(3) FINANCIAL INSTITUTION.—

(A) IN GENERAL.—The term "financial institu-
tion" means any institution the business of which
is engaged in financial activities as de-

scribed in section 4(k) of the Bank Holding


(B) PERSONS SUBJECT TO CFTC REGULATION.—

Notwithstanding subparagraph (A), the term

"financial institution" does not include any per-
son or entity with respect to any financial

activity that is subject to the jurisdiction of the

Commodity Futures Trading Commission under

the Commodity Exchange Act.

(C) FARM CREDIT INSTITUTIONS.—Notwith-

standing subparagraph (A), the term "financial

institution" does not include the Federal Agri-
tural Mortgage Corporation or any entity char-

tered and operating under the Farm Credit


(D) OTHER SECONDARY MARKET INSTI-

TUTIONS.—Notwithstanding subparagraph (A), the
(I) testing the security procedures or systems of such institution for maintaining the confidentiality of customer information;

(II) Inquiring about or obtaining information of the financial institution which was obtained or received by any person in another manner described in (I) or (II) or (III);

III) Nonapplicability to certain types of customer information of financial institutions.—No provision of this section shall be construed to prevent any State-licensed private investigator, or any officer, employee, or agent of such private investigator, from obtaining customer information of a financial institution to the extent reasonably necessary to perform a credit investigation for a person to whom such information is not available under the Federal Fair Credit Reporting Act.

IV) Nonapplicability to collection of consumer support judgments.—No provision of this section shall be construed to prevent any State-licensed private investigator, or any officer, employee, or agent of such private investigator, from obtaining customer information of a financial institution, to the extent reasonably necessary to perform a credit investigation for a person to whom such information is not available under the Federal Fair Credit Reporting Act.

V) Nonapplicability to exclusion of financial institutions.—The term "financial institution," as defined in section 1939k(b)(1) of the Federal Reserve Act of 1933, includes any bank, savings association, State-chartered bank, savings and loan association, or credit union, as well as any person or entity that is treated as a financial institution for purposes of that provision.

VI) Nonapplicability to enforcement of financial institution laws.—No provision of this section shall be construed to prevent any State-enforced consumer protection law from applying to any financial institution.

VII) Nonapplicability to enforcement of financial institution regulations.—No provision of this section shall be construed to prevent any State-enforced consumer protection regulation from applying to any financial institution.

VIII) Nonapplicability to enforcement of financial institution statutes.—No provision of this section shall be construed to prevent any State-enforced consumer protection statute from applying to any financial institution.

IX) Nonapplicability to enforcement of financial institution orders.—No provision of this section shall be construed to prevent any State-enforced consumer protection order from applying to any financial institution.

X) Nonapplicability to enforcement of financial institution judgments.—No provision of this section shall be construed to prevent any State-enforced consumer protection judgment from applying to any financial institution.

XI) Nonapplicability to enforcement of financial institution agencies.—No provision of this section shall be construed to prevent any State-enforced consumer protection agency from applying to any financial institution.

XII) Nonapplicability to enforcement of financial institution systems.—No provision of this section shall be construed to prevent any State-enforced consumer protection system from applying to any financial institution.

XIII) Nonapplicability to enforcement of financial institution activities.—No provision of this section shall be construed to prevent any State-enforced consumer protection activity from applying to any financial institution.

XIV) Nonapplicability to enforcement of financial institution services.—No provision of this section shall be construed to prevent any State-enforced consumer protection service from applying to any financial institution.

XV) Nonapplicability to enforcement of financial institution products.—No provision of this section shall be construed to prevent any State-enforced consumer protection product from applying to any financial institution.

XVI) Nonapplicability to enforcement of financial institution records.—No provision of this section shall be construed to prevent any State-enforced consumer protection record from applying to any financial institution.

XVII) Nonapplicability to enforcement of financial institution transactions.—No provision of this section shall be construed to prevent any State-enforced consumer protection transaction from applying to any financial institution.

XVIII) Nonapplicability to enforcement of financial institution agreements.—No provision of this section shall be construed to prevent any State-enforced consumer protection agreement from applying to any financial institution.

XIX) Nonapplicability to enforcement of financial institution contracts.—No provision of this section shall be construed to prevent any State-enforced consumer protection contract from applying to any financial institution.

XX) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXI) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXII) Nonapplicability to enforcement of financial institution approvals.—No provision of this section shall be construed to prevent any State-enforced consumer protection approval from applying to any financial institution.

XXIII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXIV) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXV) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXVI) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXVII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXVIII) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXIX) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXX) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXXI) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXXII) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXXIII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXXIV) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXXV) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXXVI) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXXVII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XXXVIII) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XXXIX) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XL) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XLI) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XLII) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XLIII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XLIV) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XLV) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XLVI) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XLVII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

XLVIII) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

XLIX) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

L) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

LI) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

LII) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

LIII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

LIV) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

LV) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

LVI) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

LVII) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

LVIII) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

LIX) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.

LX) Nonapplicability to enforcement of financial institution licenses.—No provision of this section shall be construed to prevent any State-enforced consumer protection license from applying to any financial institution.

LXI) Nonapplicability to enforcement of financial institution certifications.—No provision of this section shall be construed to prevent any State-enforced consumer protection certification from applying to any financial institution.
United States Virgin Islands, American Samoa, and the Commonwealth of the Northern Mariana Islands. (l) by adding at the end the following new paragraph:

"(b) DEFINITIONS.—For purposes of this subsection, the terms "small business," "agriculture," "small farm," and "small agri-business" shall have the meanings given by regulations of the Federal Home Loan Bank.");

(b) CLERICAL AMENDMENT.—The section heading for section 10 of the Federal Home Loan Bank Act (12 U.S.C. 1430) is amended to read as follows:

"SEC. 10. ADVANCES TO MEMBERS.—

(a) ADDITIONAL RESTRICTIONS EFFECTIVE AFTER 1993.—Beginning 3 years after the date on which a savings association should have become a qualified thrift lender, or the Federal Home Loan Bank System ceases to be a qualified thrift lender, as applicable, the savings association shall not retain any investment (including an investment in any subsidiary) or engage, directly or indirectly, in any activity, unless that investment or activity—

(i) would be permissible for the savings association if it were a national bank; and

(ii) is permissible for the savings association as a savings association.

SEC. 11. ELIGIBILITY CRITERIA.—

Section 11 of the Federal Home Loan Bank Act (12 U.S.C. 1430a) is amended—

(C) by striking "An Insured" and inserting the following:

"(D) by striking "An Insured" and inserting the following:

SEC. 2. ADJUSTMENTS TO MEMBERS; COLLATERAL.—

(a) in general.—Section 2 of the Federal Home Loan Bank Act (12 U.S.C. 1431) is amended—

(1) by striking paragraph (1) of the section and inserting the following:

"(2) PURCHASES OF ADVANCES.—A long-term advance may only be made for the purposes of—

(A) providing funds to any member for residential housing finance; and

(B) providing funds to any community financial institution for small businesses, small farms, and community housing programs;

(2) by striking "A Bank" and inserting the following:

SEC. 3. ELIGIBILITY CRITERIA.—

Section 3 of the Federal Home Loan Bank Act (12 U.S.C. 1432) is amended—

(a) by striking paragraphs (2) and (3) of the section and inserting the following:

"(b) CERTAIN INSTITUTIONS.—

(1) by striking "An Insured" and inserting the following:

SEC. 4. MANAGEMENT OF BANKS.—

(a) by striking paragraph (d) of the section and inserting the following:

"(1) in subsection (a), by striking "and, by its Board of directors, of any Federal home loan bank in connection with service on the Board";

(b) by striking paragraph (e) of the section and inserting the following:

"(C) by striking "Board of directors" where such term appears in the penultimate sentence and inserting "board of directors"; and

"(D) by striking "boards of directors" where such term appears in the penultimate sentence and inserting "boards of directors".

SEC. 5. ISSUANCE OF NOTICES OF VIOLATIONS.—

Section 5 of the Federal Home Loan Bank Act (12 U.S.C. 1435) is amended—

"(1) by striking "loans banks" and inserting "loan banks".

(c) POWERS AND DUTIES OF FEDERAL HOUSING FINANCE BOARD.—

(2) by striking paragraph (3) of the section and inserting the following:

"(3) by striking paragraph (4) of the section and inserting the following:

(h) CHAIRPERSON AND VICE CHAIRPERSON.—

(1) ELECTION.—The Chairperson and Vice Chairperson of the Board of directors of each Federal home loan bank shall be elected by a majority of all the directors of such bank from among the directors of the bank.

(2) ACTING CHAIRPERSON.—In the event of a vacancy in the position of Chairperson of the board of directors due to death, resignation, or disability of the Chairperson, the Vice Chairperson shall act as Chairperson.
by any executive officer or director of a Federal home loan bank if, in the determination of the Federal Housing Enterprise Oversight, the executive officer or director is engaging or has engaged in, or the Finance Board has reasonable cause to believe that the executive officer or director is about to engage in an unsafe or unsound practice in conducting the business of the bank, or any executive officer or director has violated any provision of this Act or any law, order, rule, or regulation or any condition imposed in writing by the Finance Board in connection with the granting of any application or other request by the bank, or any written agreement entered into by the bank with the procedures provided in subsection (c) or (f) of section 1317 of the Federal Housing Enterprises Financial and Soundness Act of 1982, such authority includes the same authority to issue an order requiring a party to take affirmative action to correct conditions resulting from violations or practices or to limit activities of a Bank or any executive officer or director of a Bank as appropriate Federal lending agencies have to take with respect to insured depository institutions under paragraphs (8) and (7) of section 11(e) of the Federal Deposit Insurance Act, and to prevent its liquidation, suspension of payment, or other action or measure by the Finance Board to enforce this Act with respect to the Federal home loan banks and their executive officers and directors as the Office of Federal Housing Enterprise Oversight has to enforce the Federal Housing Enterprises Financial and Soundness Act of 1982, the Federal National Mortgage Association Charter Act, or the Federal Home Loan Mortgage Corporation Act with respect to the Federal housing enterprises under that subtitle C (other than section 1317) of the Federal Housing Enterprises Financial and Soundness Act of 1982.

(ii) To address any insufficiencies in capital levels resulting from the application of section 501 of the Home Owners’ Loan Act.

(iii) To act in its own name and through its own attorneys—

(A) in enforcing any provision of this Act or any regulation promulgated under this Act; or

(B) in any action, suit, or proceeding to which it is a party, whenever the action, suit, or proceeding involves the Board’s regulation or supervision of any Federal home loan bank.

ASSESSMENT.—Section 111 of Public Law 93-445 (12 U.S.C. 250) is amended by striking “Federal Home Loan Bank Board,” and inserting at the end “the Office of Federal Housing Enterprise Oversight, the Federal Housing Finance Board.”

ELIGIBILITY TO SECURE ADVANCES.—

(I) SECTION 5—Section 9 of the Federal Home Loan Bank Act (12 U.S.C. 1439) is amended—

(A) in the second sentence, by striking “with the approval of the Board”;

and

(B) in the third sentence, by striking ", subject to the approval of the Board,”;

(II) SECTION 11—Section 10 of the Federal Home Loan Bank Act (12 U.S.C. 1439) is amended—

(A) in subsection (c)—

(i) in first sentence, by striking “Board” and inserting “Federal home loan bank”;

(ii) by striking the second sentence; and

(B) in subsection (d)—

(i) in the first sentence, by striking “and the approval of the Board”;

(ii) by striking subject to the approval of the Board,” and inserting “Board,” any”; and

(iii) by striking ", subject to the approval of the Board,” and inserting “Board.”

(III) SECTION 16A—Section 16A of the Federal Home Loan Bank Act (12 U.S.C. 1439(a)) is amended—

(A) in subsection (c)—

(i) by striking ", inserting “previOUS retained earnings or current net earnings,” and

(ii) by striking “, and then only with the approval of the Federal Housing Finance Board”;

and

(B) by striking the fourth sentence.

SECTION 18.—Section 18(b) of the Federal Home Loan Bank Act (12 U.S.C. 1439(b)) is amended by adding at the end the following new paragraphs:

“(A) REGULATIONS.—

(I) CAPITAL STANDARDS.—Not later than 1 year after the date of the enactment of the Federal Home Loan Bank System Modernization Act of 1989, the Finance Board shall issue regulations prescribing capital standards applicable to each Federal home loan bank, which shall require each such bank to meet—

(A) the leverage requirement specified in paragraph (2); and

(B) the risk-based capital requirements, in accordance with paragraph (2).

(II) DEFINITIONS OF CAPITAL.—For purposes of determining compliance with the capital standards established under this subsection—

(A) permanent capital of a Federal home loan bank shall include—

(I) the amounts paid for the Class B stock;

and

(II) the retained earnings of the bank (as determined in accordance with generally accepted accounting principles); and

(B) total capital of a Federal home loan bank shall include—

(I) permanent capital;

(II) the amounts paid for the Class A stock;

the amount included in any and all accounting principles, and subject to the regulations of the Finance Board, a general allowance

and
for losses, which may not include any reserves or allowances made or held against specific assets. 

"(iv) any other amounts from sources available to absorb losses incurred by the bank that the member provides by regulation to be appropriate to include in determining total capital."

2. TRANSITION PERIOD. Notwithstanding any other provision of this Act, the requirements relating to purchase and retention of capital stock of a Federal home loan bank shall not become effective until the day that is 30 days prior to the date on which the member complies with any adjustment to the required minimum investment.

3. VOLUNTARY WITHDRAWAL. Any member may withdraw from a Federal home loan bank if such withdrawal is approved by the Board of Directors of the bank of its own accord or on the request of any other member. The Board of Directors may not refuse the request for withdrawal of any member. The provisions of this section shall not be the subject of any action in any court, provided that the bank, with which the request was made, will not cause the Federal Home Loan Bank System to fail to meet its obligations under section 212(b)(2)(C) to contribute to the debt service fund of the Federal Home Loan Bank System and to provide any other financial support needed.

4. VOLUNTARY WITHDRAWAL. Any member may withdraw from a Federal home loan bank only with the written consent of all members of the bank. The written consent of all members shall be deemed to have been given at the request of any member. The written consent of all members shall be given in writing and shall be effective as follows:

(a) A voluntary withdrawal shall be effective as of the date of written notice to the member, forthwith and in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal.

(b) A voluntary withdrawal shall be effective as of the date of written notice to the member, forthwith and in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal.

(c) A voluntary withdrawal shall be effective as of the date of written notice to the member, forthwith and in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal. The member bank, upon written notice to the Federal Home Loan Bank System, may, at any time, withdraw from its member bank in accordance with the requirements of the member bank that has approved the withdrawal.
 "(f) IMPAIRMENT OF CAPITAL.—If the Finance Board or the board of directors of a Federal home loan bank determines that the impairment has incurred or is likely to incur losses that result in or are expected to result in charges against the capital of the bank, the bank shall not redeem or retire any shares of Federal home loan bank stock until after the prior approval of the Finance Board. The Finance Board shall not in any event allow the prior approval to include an amendment of a member stock constitutes a major portion of its capital stock. A member bank shall not be required to redeem or retire any share of its capital stock if, following the redemption, the bank would fail to satisfy any applicable capital requirement.

"(g) READING AFTER DIVESTITUTE OF ALL SHARES.—

"(1) IN GENERAL.—Except as provided in paragraph (2), notwithstanding any other provision of this Act, an institution that disposes all shares of stock in a Federal home loan bank may, after such divestiture, acquire shares of any Federal home loan bank before the end of the 5-year period beginning on the date of the completion of such divestiture, unless the divestiture is a consequence of a transfer of membership on an uninterrupted basis between banks.

"(2) TREATMENT FOR WITHDRAWALS FROM MEMBERSHIP BEFORE 1984.—Any Institution that withdrew from membership in any Federal home loan bank on or before December 31, 1986, and is required to divest all shares of a Federal home loan bank at any time after that date, subject to the approval of the Finance Board, shall be required to divest all shares of the Federal home loan bank on or after that date, subject to the approval of the Finance Board.

"(h) TREATMENT OF RETAINED EARNINGS.—

"(1) IN GENERAL.—The holders of the Class B stock of any Federal home loan bank shall own the retained earnings, surplus, undivided profits, and equity reserves, if any, of the bank. Except as provided in this section or through the declaration of a dividend or a capital distribution by a Federal home loan bank, or in the event of liquidation of the bank, a member shall have no right to withdraw or otherwise receive distribution of any portion of the retained earnings of the bank.

"(2) LIMITATION.—A Federal home loan bank may not make any distribution of its retained earnings unless, following such distribution, the bank would continue to meet all applicable capital requirements.

TITLE VII—OTHER PROVISIONS

Subtitle A— ATM Fee Reform

SEC. 701. SHORT TITLE.

This subtitle may be cited as the "ATM Fee Reform Act of 1999.

SEC. 702. ELECTRONIC FUND TRANSFER FEE DISCLOSURES AT ANY HOST ATM.

Section 904(d) of the Electronic Fund Transfer Act (15 U.S.C. 1693(b)) is amended by adding at the end the following new paragraph: "(O) FEE DISCLOSURES AT AUTOMATED TELLER MACHINES.—

"(A) IN GENERAL.—The regulations prescribed under paragraph (1) shall require any automated teller machine operator who imposes a fee on any consumer for providing host transfer services to such consumer to provide notice in accordance with subparagraph (B) to the consumer (at the time the service is provided) of—

"(i) the fact that a fee is imposed by such operator for providing the service; and

"(ii) the amount of any such fee;

"(B) NOTICE REQUIREMENTS.—

"(i) ON THE MACHINE.—The notice required under subparagraph (A) with respect to any fee described in such subparagraph shall be posted in a prominent and conspicuous location at the automated teller machine at which the electronic fund transfer is initiated by the consumer.

"(ii) ON THE SCREEN.—The notice required under clauses (i) and (ii) of subparagraph (A) with respect to any fee described in such subparagraph shall be posted in a prominent and conspicuous location at the automated teller machine on or on a paper notice issued from such machine, after the transaction is initiated and before the consumer is irrevocably committed to completing the transaction, except that during the period beginning on the date of the enactment of the Gram-Leach-Bliley Act and ending on December 31, 2004, this clause shall not apply to any automated teller machine that lacks the technical capability to disclose the notice on the transaction screen or to issue a paper notice after the transaction is initiated and before the consumer is irrevocably committed to completing the transaction by depositing or withdrawing funds.

"(C) PROHIBITION ON FEES NOT PROPERLY DISCLOSED OR EXPLICITLY ASSUMED BY CONSUMER.—No fee for any automated teller machine operator in connection with an electronic fund transfer initiated by a machine operator in connection with a transaction is required under subparagraph (A), unless—

"(i) the consumer receives such notice in accordance with subparagraph (B); and

"(ii) the consumer elects to complete the transaction in the manner necessary to effect the transaction after receiving such notice.

"(D) DEFINITIONS.—For purposes of this paragraph, the following definitions shall apply:

"(F) AUTOMATED TELLER MACHINE OPERATOR.—The term 'automated teller machine operator' means any person who—

"(I) operates an automated teller machine at which consumers initiate electronic fund transfers; and

"(II) is not the financial institution that holds the account of such consumer from which the transfer is made.

"(E) ELECTRONIC FUND TRANSFER.—The term 'electronic fund transfer' includes a transfer or any balance inquiry that involves a balance inquiry initiated by a consumer in the same manner as an electronic fund transfer, and that the consumer initiates a transfer of funds in the course of the transaction.

"(F) HOST TRANSFER SERVICES.—The term 'host transfer services' means any electronic fund transfer made by an automated teller machine operator that is not initiated by a consumer at an automated teller machine operated by such operator.

"SEC. 703. DISCLOSURE AND BILLING FEES TO CUSTOMERS WHEN ATM CARD IS ISSUED.

Section 904(b)(6) of the Electronic Fund Transfer Act (15 U.S.C. 1693(b)(6)) is amended—

"(1) by striking "and" at the end of paragraph (8); and

"(2) by inserting at the end of paragraph (8), and inserting "; and"; and

"(3) by inserting after paragraph (9) the following new paragraph:

"(t) a notice to the consumer that a fee may be imposed by—

"(I) an automated teller machine operator (as defined in section 904(d)(3)(D)(i)) if the consumer initiates a transfer from an automated teller machine that is not operated by the person issuing the card or other means of access; and

"(II) any national, regional, or local network utilized to effect the transaction.

"SEC. 704. FEASIBILITY STUDY.

(a) IN GENERAL.—The Comptroller General of the United States shall conduct a study of the feasibility of requiring, in connection with any electronic fund transfer initiated by a consumer through the use of an automated teller machine—

"(1) a notice to be provided to the consumer before the consumer is irrevocably committed to completing the transaction, which clearly states the amount of any fee that will be imposed upon the consummation of the transaction by—

"(I) an automated teller machine operator (as defined in section 904(d)(3)(D)(i) of the Electronic Fund Transfer Act) involved in the transaction;

"(II) the financial institution holding the account of the consumer; and

"(II) any other party involved in the transfer; and

"(b) any party to the agreement described in this section shall be entitled to a hearing before the Comptroller General, and the Comptroller General shall consider the following factors:

"(i) the availability of electronic fund transfer technology,

"(ii) the implementation and operating costs,

"(iii) the competitive impact any such notice requirement would have on the size and types of institutions, if implemented,

"(iv) the period of time that would be reasonable for implementing any such notice requirement,

"(v) the extent to which consumers would benefit from such a notice requirement,

"(vi) any other factor the Comptroller General determines to be appropriate in analyzing the feasibility under this section for failure to comply with section 904(d)(D)(B)(i)."

Subtitle B—Community Reinvestment

SEC. 705. CBA SUNSHINE REQUIREMENTS.

The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by adding after section 47, as added by section 305 of this Act, the following new section:

"SEC. 705. CBA SUNSHINE REQUIREMENTS.

(a) PUBLIC DISCLOSURE OF AGREEMENTS.—

Any agreement (as defined in subsection (b) of section 701 of the Community Reinvestment Act of 1977) in connection with the Community Reinvestment Act of 1977 involving funds or other resources of such insured depository institution or its subsidiaries shall be in its entirety fully disclosed, and the full text thereof made available to the appropriate Federal banking agency with supervisory responsibility over the insured depository institution and to the public by each party to the agreement; and

(b) ANNUAL REPORT OF ACTIVITY BY INSURED DEPOSITORY INSTITUTION.—Each insured depository institution or insured depository institution or affiliate that is a party to an agreement described in subsection (a) shall report to the appropriate Federal banking agency with supervisory responsibility over the insured depository institution, not less frequently than once per year, such information about the insured depository institution as the Federal banking agency may by rule require relating to the following actions taken by the party pursuant to the agreement during the preceding 12-month period:

"(1) Payments, fees, or loans made to any party to the agreement or received from any party to the agreement.
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party to the agreement and the terms and conditions were

(2) Aggregate data on loans, investments,
and services provided by each party in its com-

(3) Such other pertinent matters as deter-
mine the extent to which the appropriate Federal
banking agency with supervisory responsibility
over the insured depository institution.

1. SUMMARY REPORT OF ACTIVITY BY NON-

GOVERNMENTAL ENTITIES.

(1) IN GENERAL.—Each nongovernmental en-
tity or person that is not an affiliate of an in-
sured depository institution and that is a party to
an agreement described in subsection (a) shall
report to the appropriate Federal banking agen-
cy with supervisory responsibility over the in-
sured depository institution that is a party to
such agreement, not less frequently than once
each year, an accounting of the use of funds re-
cieved pursuant to such agreement during the
preceding 12-month period.

2. FACILITIES.—A nongovernmental entity
or person referred to in paragraph (1) may comply
with the reporting requirements in this sub-
paragraph by transmitting the report to the insured
depository institution that is a party to the agree-
ment, and such insured depository Institu-
tion shall forward such report to the appropriate
Federal banking agency with supervisory
authority over the insured depository in-
stitution.

3. INFORMATION TO BE INCLUDED.—The ac-
counting referred to in paragraph (1) shall in-
clude a detailed, itemized list of the uses to
which such funds have been made, including
compensation, administrative expenses, travel,
entertainment, consulting and professional fees
paid, and such other categories, as determined
by regulation by the appropriate Federal bank-
ing agency, with supervisory responsibility
over the insured depository institution.

4. APPLICABILITY.—Subsections (b) and (c)
shall not apply with respect to any agreement
entered into before the end of the 6-month pe-
riod beginning on the date of the enactment
of the Gramm-Leach-Bliley Act.

5. DEFINITION.—For purposes of this sec-
tion and subsection (a), "agreement" means

(i) any written contract, written arrange-
ment, or other written understanding that pro-
vides for an insured depository institution to
make a loan or extension of credit, in a
principal amount of $10,000 or more, and for
which the aggregate amount of principal of
such loans or extensions of credit is an
aggregate amount of principal in excess of
$500,000 annually;

(ii) a group of substantially related contracts
with an aggregate value of cash advances
or other consideration in excess of
$10,000, or with an aggregate amount of loan
principal in excess of $50,000; or

(iii) a group of individually nonrelated con-
tacts with an aggregate amount of cash ad-
vances, grants, or other consideration in excess of
$10,000, or with an aggregate amount of loan
principal in excess of $50,000; or

(2) COORDINATION, CONSISTENCY, AND COM-
PARABILITY.—In carrying out paragraph (1), each
appropriate Federal banking agency shall
consult and coordinate with the other such
agencies, and in the orderly and timely process of
assuring, to the ex-
tent possible, that the regulation prescribed by
each such agency is consistent and comparable
with the regulations prescribed by the other
such agencies.

SEC. 112. SMALL BANK REGULATORY RELIEF.
The Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.) is amended by adding at
the end the following new section:

SEC. 109. SMALL BANK REGULATORY RELIEF.
(a) In general.—Except as provided in subs-
sections (b) and (c), any regulated financial in-
stitution with aggregate assets of not more than
$250,000,000 shall be subject to routine examina-
tion under this title:

(2) not more than once every 60 months for
an institution that has received a rating of 'outstanding' on the Board of meeting community credit
needs at its most recent examination under sec-
tion 84;

(3) not more than once every 48 months for
an institution that has received a rating of less than
'satisfactory record of meeting community credit
needs' at its most recent examination under sec-
tion 84;

(b) No exception from CRA examinations in connection with applications for de-
faulted facilities.—A regulated financial institu-
tion described in subsection (a) shall remain subject to examination under this title in con-
nection with an application for a deposit facility.

(c) Discretion.—A regulated financial institu-
tion described in subsection (a) may be subject
to more frequent or less frequent examinations for reasonable cause under such circumstances
as may be determined by the appropriate Fed-
eral financial supervisory agency.

SEC. 113. FEDERAL RESERVE BOARD STUDY OF
CRA LENDING.
The Board of Governors of the Federal Re-
serve System shall conduct a comprehensive
study, in consultation with the Chairman and
an undersigned of the Federal Reserve Sys-

7IS.

Nothing in this Act shall be construed to re-
peal any provision of the Community Reinvest-
ment Act of 1977.

SEC. 115. RESPONSIVENESS TO COMMUNITY
NEEDS FOR FINANCIAL SERVICES

(a) Study.—The Secretary of the Treasury,
in consultation with the Federal banking agencies
(as defined in section 1(2) of the Federal Deposit
Insurance Act), shall conduct a study of insti-
tutional arrangements that which adequate services are being pro-
vided as intended by the Community Reinvest-
ment Act of 1977, including services in low-
and moderate income neighborhoods, as a means
of assessing the extent to which credit is being
provided at reasonable terms and conditions in
modest means, as a result of the enactment of
this Act.

(b) Reports.—
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(1) IN GENERAL.—The Secretary of the Treasury shall:
(a) before March 15, 2000, submit a baseline report to the Congress on the study conducted pursuant to subsection (a); and
(b) before the end of the 2-year period beginning on the date of the enactment of this Act, in consultation with the Federal banking agencies, submit a study to the Congress on the study conducted pursuant to subsection (a).

(2) RECOMMENDATIONS.—The final report submitted under paragraph (1)(B) shall include such recommendations as the Secretary determines to be appropriate for administrative and legislative actions with respect to institutions covered under the Community Reinvestment Act of 1977.

Subsection C—Other Regulatory Improvements

SEC. TII. Extent of Assistance to Microenterprise Technical Assistance and Capacity Building Programs

(a) STUDY.—The Comptroller General of the United States shall conduct a study of:
(1) possible modifications to the rules governing S corporations, including—
(A) increasing the permissible number of shareholders;
(B) permitting shares of such corporations to be held in individual retirement accounts;
(C) increasing the investment held for safety, soundness, and liquidity purposes should not be considered to be passive income;
(D) discontinuation of the treatment of stock held by bank directors as a disqualifying personal social class of stock for such corporations; and
(E) Improving Federal tax treatment of bad debt and interest deductions; and
(2) what impact such revisions might have on community banks.

(b) REPORT TO THE CONGRESS.—Not later than 6 months after the date of the enactment of this Act, the Comptroller General of the United States shall submit a report to the Congress on the results of the study conducted under subsection (a).

(2) DEFINITION.—For purposes of this section, the term “S corporation” has the meaning given in section 1361(a)(1) of the Internal Revenue Code of 1986.

SEC. TII. Plain Language Requirement for Federal saving institution

(a) IN GENERAL.—Each Federal banking agency shall use plain language in all proposed and final rulemakings published by the agency in the Federal Register after May 1, 1996.

(b) REPORT.—Not later than March 1, 2001, each Federal banking agency shall submit to the Congress a report that describes how the agency has complied with subsection (a).

(c) DEFINITION.—For purposes of this section, the term “Federal banking agency” has the meaning given in section 3 of the Federal Deposit Insurance Act.
"(a) LIMITATION.—No more than 10 percent of the total funds made available from the Administrator in any fiscal year to carry out this subsection shall be used for matching requirements of subsection (a), as authorized by paragraph (1) of this subsection.

"SEC. 179. RECORDKEEPING.—The requirements of section 115 shall apply to the Federal Reserve System, including such requirements as may be necessary to carry out this title.

"SEC. 180. AUTHORIZATION.—In addition to funds otherwise authorized to be appropriated to the Fund to carry out this title, there are authorized to be appropriated to the Administrator to carry out this title—

"(1) $15,000,000 for fiscal year 2021;

"(2) $15,000,000 for fiscal year 2022;

"(3) $15,000,000 for fiscal year 2023.

"SEC. 181. IMPLEMENTATION.—The Administrator shall, by regulation, establish procedures as may be necessary to carry out this title.

"SEC. 178. FEDERAL RESERVE BANKS and BOARD.—The Federal Reserve Act (12 U.S.C. 221 et seq.) is amended by inserting after section 711 a new section:

"SEC. 118. ANNUAL INDEPENDENT AUDITS OF FEDERAL RESERVE BANKS and BOARD.—The Board shall order an annual independent audit of the financial statements of each Federal reserve bank and the Board.

"SEC. 177. MATCHING REQUIREMENTS.—In general.—Financial assistance under this subsection shall be made available only with funds from sources other than the Federal Government on the basis of not less than 30 percent of each dollar provided by the Administrator.

"SEC. 178. GENERAL ACCOUNTING OFFICE STUDY OF CONSTRUCTION OF INTEREST.—(a) STUDY REQUIRED.—The Comptroller General shall cause the Auditor to disclose the nature of interest faced by the Board of Governors of the Federal Reserve System in its role as a financial services intermediary for the depository and financial services industry.

"(b) SPECIFIC CONFLICT REQUIRED TO BE ADRESSED.—In the course of the study required under subsection (a), the Comptroller General shall address the conflict of interest faced by the Board of Governors of the Federal Reserve System in its role as a financial services intermediary.

"(c) REPORT TO THE CONGRESS.—Before the end of the 1-year period beginning on the date of the enactment of this Act, the Comptroller General shall submit a report to the Congress containing the findings and conclusions of the Comptroller General in connection with the study required under this section, together with such recommendations for legislation or administrative actions as the General may determine to be appropriate, including recommendations for resolving any such conflict of interest.

"SEC. 179. STUDY AND REPORT ON ADAPTING EXISTING LEGISLATIVE REQUIREMENTS TO CONSUMER BANKING AND LENDING.—(a) STUDY REQUIRED.—The Federal banking agencies shall conduct a study of banking regulations regarding the delivery of financial services, including those regulations that may assume that there is a consumer transaction during the course of a financial services transaction, and report their recommendations on adapting those existing requirements to online banking and lending.

"(b) REPORT REQUIRED.—Before the end of the 2-year period beginning on the date of the enactment of this Act, the Federal banking agencies shall submit a report to the Congress on the findings and conclusions of the agencies with respect to the study required under subsection (a), together with such recommendations for legislative or regulatory action as the agencies may determine to be appropriate.

"(c) DEFINITION.—For purposes of this section, the term "Federal banking agencies" means each Federal banking agency (as defined in section 3(f) of the Federal Deposit Insurance Act).

"SEC. 180. CLARIFICATION OF DEFINITION OF "INSURED DEPOSITORY INSTITUTION".—Section 18(b) of the Federal Deposit Insurance Act (12 U.S.C. 1818a) is amended by inserting after the period the following new subsection:

"(d) DEFINITION.—For purposes of this section, the term "insured depository institution" means any depository institution which, as an insured depository institution, is defined in section 3(a)(19) of the Federal Deposit Insurance Act (12 U.S.C. 1813a).

"SEC. 181. RULE OF CONSTRUCTION.—No provision of this subsection shall be construed as superseding any law not in force at the time of the enactment of this Act.
SEC. 713. INTERSTATE BRANCHES AND AGENCIES OF FOREIGN BANKS.

Section 4(a)(7) of the International Banking Act of 1978 (12 U.S.C. 3103(a)(7)) is amended to read as follows:

"(7) ADDITIONAL AUTHORITY FOR INTERSTATE BRANCHES AND AGENCIES OF FOREIGN BANKS, UPGRADING OF THE FOREIGN BANK ACCOUNT RESERVE.

Section 11(a)(6) of the Federal Deposit Insurance Act of 1991 (12 U.S.C. 1813n(a)(6)) as amended by striking subparagraph (A) and inserting the following:

"(A) [Repealed]."

(b) DIF SPECIAL RESERVE.—Section 204(b) of the Federal Deposit Insurance Act of 1991 (12 U.S.C. 1331 note) is amended—

(1) by striking subsection (b); and

(2) in subsection (c), by striking paragraph (4) and inserting the following:

"(4) by designating paragraph (3) as paragraph (4) ."

(c) EFFECTIVE DATE.—This section and the amendments made by this section shall become effective on the date of the enactment of this Act.

SEC. 714. BANK OFFICERS AND DIRECTORS AS OFFICERS AND DIRECTORS OF PUBLIC UTILITIES.

Section 30(b) of the Federal Power Act (16 U.S.C. 796(b)) is amended—

(1) by striking "(b) After six months and inserting the following:

"(b) "Interim Designated Directors.—"

(2) by striking subparagraph (2) and inserting the following:

"(2) by designating subparagraph (1) as paragraph (2) ."

SEC. 715. FAIR TREATMENT OF WOMEN BY FINANCIAL ADVISERS.

It is the sense of the Congress that individuals offering financial advice and products should offer such services and products in a non-discriminatory, nongender-specific manner.

SEC. 716. MEMBERSHIP OF LOAN GUARANTEE BOARD.

(a) EMERGENCY STEEL LOAN GUARANTEE BOARD.—Section 101(e) of the Emergency Steel Loan Guaranty Act of 1993 is amended—

(1) by inserting "(a)" before "(e)"; and

(2) by striking through paragraph (a) and substituting the following:

"(a) In subparagraph (b), by inserting "(a)" before "(b)"; and

(b) by striking "(b) After six months and inserting the following:

"(b) "Interim Designated Directors.—"

(c) by striking "(3) and inserting "(3) ."

SEC. 717. REPEAL OF STOCK LOAN LIMIT IN FEDERAL RESERVE ACT.

Section 11(b) of the Federal Reserve Act (12 U.S.C. 248) is amended by striking the paragraph designated as "(m)" and inserting "(m) [Repealed]."

SEC. 718. ELIMINATION OF SAIF AND DIF SPECIAL RESERVES.

(a) SAIF SPECIAL RESERVE.—Section 11(a)(6) of the Federal Deposit Insurance Act of 1991 (12 U.S.C. 1813n(a)(6)) is amended by striking subparagraph (2).

(b) DIF SPECIAL RESERVE.—Section 204(b) of the Federal Deposit Insurance Act of 1991 (12 U.S.C. 1331 note) is amended—

(1) by striking subsection (b); and

(2) in subsection (c), by striking paragraph (4) and inserting the following:

"(4) by designating paragraph (3) as paragraph (4) ."

(c) EFFECTIVE DATE.—This section and the amendments made by this section shall become effective on the date of the enactment of this Act.

SEC. 719. GRAND JURY PROCEEDINGS.

Section 332(b) of title 18, United States Code, is amended—

(1) in paragraph (1), by inserting "Federal or State" before "financial institution"; and

(2) in paragraph (2), by inserting "at any time during or after the completion of the Investigation of the grand jury" before "upon".

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de date of enactment in 1 or more States, may convert, at its option, with the approval of the Comptroller of the Currency or the appropriate State bank supervisor, into 1 or more national or State banks, each of which may encompass 1 or more of the branches of the Federal savings association in operation before such date of enactment in 1 or more States, but only if such resulting national or State bank will meet all financial, management, and capital requirements applicable to the resulting national or State bank.

(8) DEFINITIONS.—For purposes of this paragraph, the term 'State bank' and 'State bank supervisor' have the meanings given those terms in section 3 of the Federal Deposit Insurance Act .
Board of Governors of the Federal Reserve System
Washington, D.C. 20551

Division of Banking Supervision and Regulation
SR 00-1 (SUP)
February 9, 2000

To the Officer in Charge of Supervision and Appropriate Supervisory and Examination Staff at Each Federal Reserve Bank

Subject: Procedures to Become a Financial Holding Company and Guidance Regarding the Initial Monitoring of Acquisitions and the Commencement of New Activities by Financial Holding Companies

Title I of the Gramm-Leach-Bliley Act ("GLB Act") will become effective on March 11, 2000. On January 19, 2000, the Board publicly released its interim rule implementing the new banking law. The GLB Act and the Board's rule establish conditions that must be met for a bank holding company or a foreign bank to be deemed a "financial holding company" and to engage in expanded activities. This SR letter describes (1) how a bank holding company or a foreign bank that is subject to the Bank Holding Company Act may elect to become a financial holding company by filing a declaration, (2) the procedures to be followed by Reserve Bank and Board staff upon receipt of a declaration to become a financial holding company, and (3) how new acquisitions or activities of financial holding companies will be initially monitored.

The Board has invited public comment on its interim rule. This SR letter explains the procedures the System will follow on an interim basis. The procedures described below may change in light of the comments the Board receives. If there are any changes in the procedures, the Reserve Banks will be advised.

Domestic Bank Holding Companies

In order to become a financial holding company, a domestic bank holding company must file with the appropriate Reserve Bank a written declaration that contains the following information:

1. a statement that the bank holding company elects to be a financial holding company,
2. the name and head office address of the company and of each depository institution controlled by the company,
3. a certification that all depository institutions controlled by the company are well capitalized as of the date the company files its election, and
4. the capital ratios for all relevant capital measures (as defined in section 38 of the Federal Deposit Insurance Act) as of the close of the previous quarter for each depository institution controlled by the company on the date the company files its election,

5. a certification that all depository institutions controlled by the company are well managed as of the date the company files its election.2

The GLB Act also requires that all of the insured depository institutions controlled by the company at the time of the election must be rated satisfactory or better under the Community Reinvestment Act.3 CRA rating information should be reviewed by the Reserve Bank after receipt of a declaration; it is not required to be submitted directly by the bank holding company.

The bank holding company should file its declaration with the responsible Reserve Bank, with a copy sent to Board staff to the attention of Betsy Cross, Assistant Director, Division of Banking Supervision and Regulation. In order to ensure that staff of the responsible Reserve Bank and the Board are both receiving all declarations, each Monday the Reserve Banks should email to the Board Applications section (Betsy Cross and Melissa Clark, Manager, Global/International Applications) a list of all companies that submitted declarations the previous week.

The Federal Reserve has 30 days in which to inform the domestic bank holding company whether its declaration is ineffective. A declaration to become a financial holding company will be deemed effective on the 31st day after the date the declaration was received by the responsible Reserve Bank unless the Board has notified the bank holding company prior to that time that the declaration is ineffective. The date of receipt of the declaration by the Reserve Bank should be considered the first day of the 30-day period. The Federal Reserve may affirmatively notify a company that its election to become a financial holding company is effective prior to the expiration of the 30-day review period.

Within three business days after receiving a declaration, the Reserve Bank should send an acknowledgement letter (Attachment I) to the domestic bank holding company indicating the date on which the declaration was received by the Reserve Bank and the date of expiration of the 30-day review period.4 By the 5th business day following receipt of a declaration, the Reserve Bank must complete Attachment II and forward it to Board Applications staff (Melissa Clark). The Reserve Bank will be expected to verify the information submitted in the declarations filed by domestic bank holding companies. If the Reserve Bank identifies a potential issue or problem with a declaration, the Reserve Bank should immediately inform Board Applications staff (Betsy Cross or Melissa Clark). Unless issues or problems arise in the review of a declaration filed by a domestic bank holding company, it is not expected that Board staff will conduct a simultaneous review of the declaration.

Under the Board's interim rule, bank holding companies may begin filing declarations to become financial holding companies at any time. The Board will try to act on all declarations that are filed prior to February 15, 2000 by March 13, 2000 (the first business day following the effective date of the GLB Act). An Order would likely be issued at that time.
listing the bank holding companies whose declarations were determined to be effective. Any declarations filed prior to March 11, 2000 would not become effective in the absence of System action prior to April 10, 2000. Over time, responsibility for notifying domestic bank holding companies that their elections are effective may be transferred to the Reserve Banks. All determinations that a declaration is not effective will be made by the Board.

Foreign Banks

For foreign banks whose only U.S. banking presence is through the ownership or control of a U.S. bank(s), the only issue is whether the U.S. depository institution(s) meets the well capitalized, well managed, and CRA requirements applicable to U.S. depository institutions. The foreign bank in such case should follow the procedures outlined above for domestic bank holding companies.

In order for a foreign bank that operates a branch, agency, or commercial lending company in the United States, or any company that owns such foreign bank, to be treated as a financial holding company, the Board must find that the foreign bank meets the applicable standards for "well capitalized" and "well managed" in accordance with capital and management standards that are comparable to those required of U.S. banks. This requirement applies to foreign banks with U.S. branches, agencies, or commercial lending companies whether or not the foreign bank owns a bank in the United States.

Foreign banks that operate in the United States through subsidiary bank(s) and branches, agencies, or commercial lending companies must provide items (2) through (4) below, in addition to the items provided by domestic bank holding companies. Those foreign banks operating only through U.S. branches, agencies, or commercial lending subsidiaries should provide only items (1) through (4) below.

1. a statement that the foreign bank or company elects to be treated as a financial holding company,
2. the risk-based and leverage capital ratios of the foreign bank as of the close of the most recent quarter and as of the close of the most recent audited reporting period,
3. a certification that the foreign bank meets the standards of well capitalized set out in section 225.90(b)(1)(i), (ii), and (iii) or section 225.90(b)(2) of Regulation Y as of the date the foreign bank or company files its election, and
4. a certification that the foreign bank is well managed as defined in section 225.90(c)(1) and (2) of Regulation Y as of the date the foreign bank or company files its election.

The well capitalized and well managed tests apply to each foreign bank that has U.S. operations in the form of a branch, agency or commercial lending company subsidiary and that is part of a foreign banking organization seeking certification as a financial holding company.

For those foreign banks whose home country supervisors have adopted risk-based capital standards consistent with the Basel Accord, such banks' tier I and total risk-based capital ratios, as calculated under the home country standard, must be at least 6 percent and 10 percent, respectively. In addition, the foreign bank's ratio of tier I capital to total assets (the leverage ratio) must be at least 3 percent. The Board will then determine the comparability of the foreign bank's capital. For those foreign banks whose home country supervisors have not adopted the Basel Accord and any other foreign banking organizations that otherwise do not meet the capital standards noted above, the foreign bank may be considered well capitalized by obtaining from the Board a prior determination that its capital is otherwise comparable to the capital that would be required of a U.S. banking organization in order to become a financial holding company.

A foreign bank will be considered well managed if (1) each of the U.S. banking offices (depository institutions, branches, agencies, and commercial lending subsidiaries) of the foreign bank has received at least a satisfactory composite rating at its most recent examination, (2) the home country supervisor of the foreign bank considers the overall operations of the foreign bank to be satisfactory or better, and (3) the Board determines that the management of the foreign bank meets standards comparable to those required of a U.S. bank owned by a financial holding company.

In determining whether a foreign bank is well capitalized and well managed in accordance with comparable capital and management standards, the Board may consider such factors as the composition of capital, accounting standards, long term debt ratings, reliance on government support to meet capital requirements, the extent to which the foreign bank is subject to comprehensive consolidated supervision, and other factors that may affect the analysis of capital and management. The home country supervisor of the foreign bank also will be consulted as appropriate.

As in the case of domestic bank holding companies, all of the U.S. insured depository institutions controlled by the foreign bank or company must be rated satisfactory or better under the CRA. In addition, if the foreign bank operates a U.S. branch that is FDIC insured, the branch must be rated satisfactory or better under the CRA.

Prior to filing a formal declaration to become a financial holding company, a foreign bank may choose to utilize a pre-clearance process provided by the regulation, and file a request for review of its qualifications to be treated as a financial holding company. The Board will try to make a determination on such requests within 30 days of receipt.

An election by a foreign bank or company to be treated as a financial holding company will not become effective until the Board has notified the foreign bank or company that the Board has determined that it meets the applicable standards. Every effort will be made to notify the foreign bank or company of the Board's determination within 30 days of the filing of the declaration.

A foreign bank or company should file the declaration (or pre-clearance request) with the responsible Reserve Bank, with a copy sent to Board staff to the attention of Betsy Cross, Assistant Director. Foreign bank declarations and pre-clearance requests also should be included in the list of domestic company declarations that is sent to Board Applications staff each Monday. Within three business days after receiving a declaration, the Reserve Bank should send an acknowledgement letter (Attachment III) indicating the date on which the declaration was received by the Reserve Bank and that the declaration will not be deemed effective until the Federal Reserve notifies the
foreign bank or company that it meets the applicable standards. It is not necessary to send an acknowledgement letter for a pre-clearance request.

By the 10th business day following receipt of a declaration filed by foreign banks and companies, the Reserve Bank should complete Attachment IV and forward it to Board Applications staff (Melissa Clark). As noted above, a determination must be made that the foreign bank is well capitalized and well managed in accordance with comparable capital and management standards. Given the additional factors that may need to be considered in order to make this determination, Board applications staff will simultaneously review all declarations and pre-clearance requests filed by foreign banks.

Supervisory Concerns

There may be instances where a U.S. bank holding company or a foreign bank meets the statutory requirements to be a financial holding company, but its capital strength and managerial resources are less than satisfactory on a consolidated basis. In such a situation, the Federal Reserve may have supervisory concerns about the consolidated entity although it technically qualifies as a financial holding company. The Federal Reserve, in the exercise of its supervisory authority, restrict or limit the conduct of new activities or future acquisitions of a financial holding company, or take other appropriate action, if the Board finds that the financial holding company does not have the financial or managerial resources to conduct the activity or make the acquisition. This supervisory action could be based, for example, on a determination that the company does not have adequate capital or risk management systems to conduct a specific activity in a safe and sound manner and may involve the issuance of cease and desist orders, the execution of written agreements, or other appropriate supervisory action.

Initial Monitoring of Acquisitions and the Commencement of New Activities

The GLB Act requires that a financial holding company that engages in an activity, or acquires control or shares of a company engaged in an activity, under section 4(k) of the Bank Holding Company Act provide written notice to the appropriate Reserve Bank. The notice must be filed within 30 calendar days of commencement of the activities or the acquisition, and should describe the activity commenced, or identify the name of the company acquired and describe its activities. The manner in which such information should be submitted to the Federal Reserve is currently under review and additional guidance will be forthcoming.

A new field is being added to the National Information Center to identify a bank holding company as a financial holding company once a declaration is effective. It will be the responsibility of each Reserve Bank to ensure that this information is entered into the NIC in a timely manner.

Attachments V and VI are letters that can be sent by the Reserve Banks to those U.S. bank holding companies and foreign banking organizations with U.S. operations inquiring about the certification process. The letters outline the procedures for making a declaration to elect to become a financial holding company.

If you have any questions regarding the foregoing, please contact Betsy Cross, Assistant Director, Division of Banking Supervision and Regulation, at (202) 452-2574; Thomas M. Corsi, Managing Senior Counsel, Legal Division, at (202) 452-3275; can be contacted concerning domestic bank holding companies, and Ann E. Misback, Managing Senior Counsel, Legal Division, at (202) 452-3788, can be contacted concerning foreign banks.

Richard Spillenkothen
Director

Notes:

1 For purposes of the election process for both domestic bank holding companies and foreign banks, a "depository institution" means any national bank, state chartered bank, Federal branch of a foreign bank, insured branch of a foreign bank, savings association, savings bank, and industrial bank. It also includes any trust company that engages in the business of receiving deposits other than trust funds. See 12 USC § 1813. A depository institution does not have to have FDIC insurance.

2 A depository institution is well managed if, at its most recent examination or subsequent review by the appropriate Federal banking agency for the institution, the institution received (1) at least a satisfactory composite rating, and (2) at least a satisfactory rating for management and for compliance, if such a rating is given. In the case of a depository institution that has not received an examination rating, the Board may determine, after a review of managerial and other resources of the depository institution and after consulting with other regulators, that the company or depository institution is well managed. In addition, a depository institution that results from the merger of two or more depository institutions that are well managed will be considered to be well managed unless the Board determines otherwise after consulting with other regulators.

3 When determining whether the insured depository institutions controlled by a bank holding company meet the CRA requirement, the Federal Reserve may exclude an institution that was acquired during the 12 months preceding the date the company filed its declaration, provided that the company has submitted an affirmative correction plan to the appropriate Federal banking agency and the agency has accepted the plan.

4 In acknowledging receipt of declarations filed prior to the effective date of the GLB Act, the 31st day would be April 10, 2000 (31 days from the effective date of the GLB Act, counting the effective date as Day 1).

5 Under the GLB Act, the Board must apply to such foreign banking
organizations that elect to become financial holding companies capital and management standards that are comparable to those applied to domestic institutions, giving due regard to the principle of national treatment and equality of competitive opportunity.

6. The Board has requested comment from the public on the imposition of a leverage ratio requirement with respect to foreign banks.

7. For example, other factors could include asset quality and earnings performance.
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The OCC received 11 comments on the proposal. The commenters generally supported the availability of alternative procedures citing the flexibility they will afford National Banks so that they can conduct additional expanded financial activities through financial subsidiaries. Some commenters noted that the OCC revise the proposed procedures to require a national bank to provide notice to the OCC at least five business days prior to commencing any new subsidiary or commencing the new expanded financial activity in an existing financial subsidiary, and that this type of notice would combine the information required in the agency order or notice described above, and should be labeled "Initial and continuing affiliation with a financial subsidiary." The OCC revised the notice procedures to include this information.

Final rule also clarifies that the notice provision relating to actions by National Banks in their capacity as an investment adviser (5.34(a)(3)(v)) includes actions as an investment adviser with discretion and review the provision on checking services and verification services to clarify that it includes payment services. Finally, the final rule clarifies that real estate appraisers for the subsidiary, bank or any subsidiary, may not conduct any other activities that the OCC has found to be incidental to the business of banking in its role as a bank holding company for an existing operating subsidiary. Second, the OCC may even extend the period of time for the notice to be filed if the OCC determines that the notice or the notice procedures may be well capitalized and well managed as defined in 5.34(e)(5)(vi). The final rule makes several changes to the list of activities eligible for an expanded notice filing. The OCC has added a new category for bank holding companies to file a notice for the expanded notice filing procedure, and defined as a "digital certification authority" to be used when the OCC has been notified of a national bank's intent to conduct activities as an insurance company or as a fund manager.

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**Federal Register**

**Vol. 65, No. 48/Friday, March 10, 2000/Rules and Regulations**

**12097**

**Failure To Continue To Meet Certain Requirements (5.393)**

The OCC believes that a national bank and its affiliated depository institutions are required to continue to meet the requirements of section 307(c) of GLBA, the OCC agrees with the suggestion and the final rule adds a new section 5.34(e), which provides that a financial subsidiary is subject to examination by the OCC in accordance with the Federal Deposit Insurance Act (12 U.S.C. 1811) and section 115 of the GLBA (12 U.S.C. 1828).

**Operating Subsidiaries (rev. 5.34)**

Proposed 5.34 authorizes national banks to conduct a new expanded financial activity through a financial subsidiary in any activity that is not part of its activities as a savings or time deposit insurance corporation for the activity, i.e. where the financial subsidiary is engaged in activities other than solely in an agency capacity, and with respect to additional equity capital of such an expanded subsidiary.

Finally, one commenter requested that the OCC provide forms to those banks that seek to establish a new subsidiary to an existing bank seeks this subsidiary subject to examination by the OCC. Moreover, the OCC has expanded the GLBA provisions relating to the financial requirements of certain types of bank subsidiaries. The OCC agrees with this suggestion and the final rule adds a new section 5.34(e), which provides that a financial subsidiary is subject to examination by the OCC, subject to the limitations and requirements of section 45 of the Federal Deposit Insurance Act (12 U.S.C. 1811) and section 115 of the GLBA (12 U.S.C. 1828).

The OCC also has the revised notice provisions relating to underwriting credit life-insurance to include other types of credit-related insurance the OCC has approved. Thus, the final rule clarifies that underwriting credit-related insurance is the extent consistent with section 302 of GLBA. The final rule also clarifies that the notice provisions relating to actions by National Banks in their capacity as an investment adviser (5.34(a)(3)(v)) includes actions as an investment adviser with discretion and review the provision on checking services and verification services to clarify that it includes payment services. Finally, the final rule clarifies that real estate appraisers for the subsidiary, bank or any subsidiary, may not conduct any other activities that the OCC has found to be incidental to the business of banking in its role as a bank holding company for an existing operating subsidiary. Second, the OCC may even extend the period of time for the notice to be filed if the OCC determines that the notice or the notice procedures may be well capitalized and well managed as defined in 5.34(e)(5)(vi). The final rule makes several changes to the list of activities eligible for an expanded notice filing. The OCC has added a new category for bank holding companies to file a notice for the expanded notice filing procedure, and defined as a "digital certification authority" to be used when the OCC has been notified of a national bank's intent to conduct activities as an insurance company or as a fund manager.

**Certification** with the OCC listing the bank's depository institution affiliates and subsidiaries to which the bank's policy applies, and each of those affiliates is well-capitalized and well-managed. The OCC, in an interest in a new subsidiary, or commences an additional expanded financial activity or an existing financial subsidiary, the bank must file a written certification with the OCC. The written notice must state that the bank's certification remains valid, and describe the activity or activities to be performed in the financial subsidiary as well as cite the specific authority permitting the expanded financial activity to be conducted by a financial subsidiary. (Where the authority relied on in an agency order or interpretation under section 4(c)(8) or 4(c)(13), respectively, on the BHCA, a copy of the order or interpretation should be attached.) The written notice must also state that the aggregate consolidated total assets of all financial subsidiaries of the national bank do not exceed the lesser of $1 billion or 10% of the bank's total equity capital as of the most recent examination or notice as described above, and should be labeled "Initial and continuing affiliation with a financial subsidiary." The OCC revised the notice procedures to include this information.

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The proposal also clarifies that authorized products referenced in the GLBA. However, an operating subsidiary under § 3.4. The final rule adopts the language in the original proposal.

The proposal also revises § 3.24 to eliminate the reference to non-controlling investments under the GLBA. First, the OCC proposed to remove the language from § 3.24(e)(2)(B). The GLBA makes clear that an operating subsidiary may engage only in activities that are entered in the bank's notice to engage in direct. The final rule makes clear that an operating subsidiary conducts its activities subject to the same authority, terms, and conditions that apply to the conduct of those activities by the national bank. Second, the proposal removes the former statement that "each operating subsidiary is subject to examination and supervision by the OCC." and clarifies that the OCC has the authority to examine and take action against certain subsidiaries is subject to the limitations and requirements of the OCC. The OCC did not remove this requirement and provided that OCC's power to limit subsidiaries' activities is not limited to those activities covered by the notice to engage in those activities.

Conforming Technical Changes

Finally, the final rule makes conforming technical changes to §§ 3.24 and 3.25. These changes clarify that separate notices under § 3.25 to acquire control of, or in an interest in, a financial subsidiary are not required where information is supplied in connection with the conversion or merger application. In addition, the final rule revises § 3.25, the OCC rule relating to bank service companies, to remove the provisions in that section relating to expedited application filings. This change was intended to conform to similar changes made in § 3.24. Section 3.25(f) provides that a bank must have made a good faith effort to acquire control of or in an interest in, a financial subsidiary, and the OCC has the ability to withdraw the permission.

Effective Date

The final rule is effective 30 days after publication in the Federal Register. If the final rule is not made effective for 30 days after publication, the rule will be published in the Federal Register. The OCC will publish a notice in the Federal Register if the rule is not made effective within 30 days after publication.

Executive Order 13806 Determinations

The Executive Order requires that the final rule does not "entail a significant regulatory action" for purposes of Executive Order 13563. This requires that the final rule be reviewed by the Office of Management and Budget (OMB) to determine whether it involves a significant regulatory action. The final rule was reviewed by the OMB and determined not to involve a significant regulatory action.
Not applicable or notice required.

A national bank may act as a real estate mortgage investment conduit without filing an application or providing notice to the OCC, if the bank is well capitalized and the
new subsidiary is limited to those activities previously reported by the OCC as permissible subject to the
limitations and requirements of section 43 of the Federal Deposit Insurance Act (12 U.S.C. 1831p) and
section 115 of the Graham-Leach-Bliley Act (12 U.S.C. 1820a).}

1. Notice process only for certain activities. A national bank that is "well
capitalized" as defined in § 3.24(d) may invest in a bank service company, or performs a new
activity, in the bank service company, by providing the appropriate district office with a written notice within 10
days after the investment. If the bank service company has both national and state bank shareholders or
members, the activities conducted in such company must also be permissible for the state bank shareholders
or members.

3. Section 3.36 is amended by:

(a) Repealing paragraphs (c), (d), and (e) and
(b) Revising paragraphs (f)(1)(b) (called "E") and
(f)(2) (called "F").

4. In addition to the requirements described in paragraph (c), a state bank
shall also have the following definitions and standards:

(a) Bank service company means any company, partnership, or corporation
that is engaged solely in activities that are not permitted to be conducted
by a national bank or its subsidiary, but that are authorized by law to
engage in the activities described in paragraph (c).

(b) Financial subsidiary means any company that is controlled by one or
more insured depository institutions, other than a subsidiary that:

(i) Engages solely in activities that are not permitted to be conducted
by a national bank or its subsidiary, but that are authorized by law to
engage in the activities described in paragraph (c).

(c) Non-controlling investment means an investment in an entity that is not a
subsidiary of a national bank or its subsidiary, and that is not directly or
indirectly controlled by a national bank or its subsidiary.

5. Section 3.36 is amended by:

(a) Repealing paragraphs (c), (d), and (e) and
(b) Revising paragraphs (f)(1)(b) (called "E") and
(f)(2) (called "F").

6. In addition to the requirements described in paragraph (c), a state bank
shall also have the following definitions and standards:

(a) Bank service company means any company, partnership, or corporation
that is engaged solely in activities that are not permitted to be conducted
by a national bank or its subsidiary, but that are authorized by law to
engage in the activities described in paragraph (c).

(b) Financial subsidiary means any company that is controlled by one or
more insured depository institutions, other than a subsidiary that:

(i) Engages solely in activities that are not permitted to be conducted
by a national bank or its subsidiary, but that are authorized by law to
engage in the activities described in paragraph (c).

(c) Non-controlling investment means an investment in an entity that is not a
subsidiary of a national bank or its subsidiary, and that is not directly or
indirectly controlled by a national bank or its subsidiary.

7. A new § 3.39 is added to subpart C to read as follows:

§ 3.39 — Bank service companies.

(a) Standards and requirements. A national bank may invest in a bank service
company, or perform an activity in an existing bank service company, without filing an application or
providing notice to the OCC, if the bank is well capitalized and the
new subsidiary is limited to those activities previously reported by the OCC as permissible subject to the
limitations and requirements of section 43 of the Federal Deposit Insurance Act (12 U.S.C. 1831p) and

(b) Examination and supervision. Each bank service company in which a
national bank is the principal investor is subject to examination and supervision by the OCC in the same
manner as an existing bank service company, and to the same extent as that national bank.

(c) Examination and supervision. Each bank service company in which a
national bank is the principal investor is subject to examination and supervision by the OCC in the same
manner as an existing bank service company, and to the same extent as that national bank.

(d) Examination and supervision. Each bank service company in which a
national bank is the principal investor is subject to examination and supervision by the OCC in the same
manner as an existing bank service company, and to the same extent as that national bank.

(e) Examination and supervision. Each bank service company in which a
national bank is the principal investor is subject to examination and supervision by the OCC in the same
manner as an existing bank service company, and to the same extent as that national bank.

(f) Examination and supervision. Each bank service company in which a
national bank is the principal investor is subject to examination and supervision by the OCC in the same
manner as an existing bank service company, and to the same extent as that national bank.
(iii) The OCC may impose limitations on the conduct of activities of the national bank or any subsidiary of the national bank as the OCC determines appropriate under the circumstances and consistent with the purposes of section 5136A of the Revised Statutes; and
(iv) The OCC may require a national bank to divest control of a financial subsidiary if the national bank does not correct the conditions giving rise to the notice within 180 days after receipt of the notice provided under paragraph (ii)(1)(B) of this section.

(4) Eligible debt ratios

(a) A national bank that does not consolidate or record nonfinancial subsidiaries with the domestic bank must have capital of an amount equal to or greater than the capital required for a national bank by section 5113 of the Revised Statutes (12 U.S.C. 26a), or directly or indirectly acquire control of a company engaged in any such activity, if the bank or any of its insured depositary institution affiliates received a CRA rating of less than "satisfactory" record of meeting community credit needs on its most recent CRA examination prior to when the bank would file a notice under this section.

(b) Failure to continue to meet certain capital adequacy requirements (Qualifications and penalties). If an insured depositary institution, which is a subsidiary of a national bank, fails to meet any capital adequacy requirement set forth in paragraphs (g)(1) and (2) and 10 of this section and the applicable Federal Reserve Board regulation, or does not certify by the end of the first full calendar quarter following the first calendar quarter in which such failure occurred that it will meet the capital adequacy requirement set forth in paragraphs (g)(1) and (2) and 10 of this section, the OCC may take appropriate action to prevent the failure of such institution.

(c) Federal Reserve System determination

(i) In determining any capital adequacy requirement under section 12(a)(1)(A) of the Revised Statutes (12 U.S.C. 371(d)) apply to a national bank that has acquired a corporation or other subsidiary to which a bank's consolidated financial and operating data are required to be reported by the Board of Governors of the Federal Reserve System, such subsidiary's examination and supervision by the Federal Reserve System is not, on a continuing basis, adequate to reasonably and effectively ensure that the consolidated financial and operating data of the Acquiring Corporation or other subsidiary is true, complete, and accurate. The OCC may take appropriate action to prevent the failure of such institution.

(ii) The OCC shall give notice to any bank that the capital adequacy requirements of paragraphs (g)(1) and (2) and 10 of this section, or any Federal Reserve Board requirement applicable to the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section, fail to be met. The OCC may, at its discretion, require the bank to meet the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section within a reasonable time after receipt of notice and, if the bank fails to meet such capital adequacy requirements within such time period, take appropriate action to prevent the failure of such institution.

(d) Examination and supervision.

(i) The OCC shall give notice to any national bank and, in the case of an insured bank, to its Federal Reserve Deposit insurance Corporation, or other subsidiary to which a bank's consolidated financial and operating data are required to be reported, of its determination that the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section, or any Federal Reserve Board requirement applicable to the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section, fail to be met. The OCC may, at its discretion, require the bank to meet the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section within a reasonable time after receipt of notice and, if the bank fails to meet such capital adequacy requirements within such time period, take appropriate action to prevent the failure of such institution.

(ii) The OCC shall give notice to any national bank and, in the case of an insured bank, to its Federal Reserve Deposit insurance Corporation, or other subsidiary to which a bank's consolidated financial and operating data are required to be reported, of its determination that the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section, or any Federal Reserve Board requirement applicable to the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section, fail to be met. The OCC may, at its discretion, require the bank to meet the capital adequacy requirements set forth in paragraphs (g)(1) and (2) and 10 of this section within a reasonable time after receipt of notice and, if the bank fails to meet such capital adequacy requirements within such time period, take appropriate action to prevent the failure of such institution.
FINANCIAL INSTITUTION PRIVACY ISSUES

Changes Under The Gramm-Leach-Bliley Act

Martha Andes Ziskind
PNC Bank, N. A.
Louisville, Kentucky

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# FINANCIAL INSTITUTION PRIVACY ISSUES

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SECTION C
Introduction

Confidentiality and security of customer information are increasingly major consumer issues. There is a newspaper or magazine article on consumer privacy or a TV program on the subject almost every month, and financial and medical information privacy are the two areas of greatest concern. It’s appropriate for us to take stock of where we are today and what we can anticipate in the near future.

The major privacy event for financial institutions in the last year was the inclusion in the Gramm-Leach-Bliley Act of Title V on Privacy, codified at 15 U.S.C. Sections 6801-6827. Subtitle A established rules for disclosure of nonpublic personal information by financial institutions, and Subtitle B made it a federal offense to obtain (or try to obtain) customer information from a financial institution by false pretenses. We will look at the provisions of Title V and the proposed implementing regulations in detail.

Title V specifically provides that there will be no federal preemption of state laws providing greater consumer protections, and there are currently a number of bills before state legislatures that deal with consumer privacy. These “privacy” bills are in addition to bills that regulate or limit telemarketing.

Washington State’s House Bill 2489 is considered by some privacy writers a bell-weather bill that could influence state legislatures across the country. The bill’s provisions apply to all “information custodians” that collect and disclose “personal” or “sensitive” information of consumers who (1) are or have been disclosed to be residents of the state of Washington and (2) purchase or contract for consumer products or services within the state of Washington or from an entity at its Washington locations. The bill has disclosure requirements that differ from and are intended to be in addition to the disclosure requirements under Title V. Further, it creates a statutory right of access to information held by an information custodian and a statutory right to be excluded from all marketing solicitations, even from solicitations by an entity with which a consumer has an existing business relationship.

Privacy initiatives have been undertaken by state attorneys general, most notably Mike Hatch of Minnesota and Eliot Spitzer in New York. Hatch sued U.S. Bancorp, alleging that its disclosure of customer information to third party telemarketers violated U.S. Bancorp’s own privacy policies. The litigation was settled after a great deal of publicity. A copy of the complaint is included with these materials. Spitzer negotiated an agreement with Chase Manhattan Bank USA, N.A. whereby Chase agreed not to provide any customer information to unaffiliated third party vendors except name, address and telephone number. A copy of the Chase Assurance of Discontinue is included with these materials.

There is privacy activity on the federal front as well. Title V did not go far enough in its restrictions on customer information disclosure to satisfy a number of Congressmen. For example, Title V does not limit sharing of customer information among affiliated companies beyond what is provided in the Fair Credit Reporting Act. Affiliated financial institutions may share customer transaction information without limitation and may share “other information,”
such as application data, financial statements, and credit reports so long as the consumer is given prior notice of such sharing and the opportunity to opt out. Bills in Congress and in some state legislatures would require customer opt in to all affiliate sharing. Title V permits disclosure of customer information to other financial institutions that are joint marketing partners. Some bills would subject all information sharing for marketing purposes to a customer opt in. The Clinton administration has made it known that it would not oppose further limits on information sharing by financial institutions. Interest in expanding consumer privacy protection cuts across party lines. In February, Representatives Edward Markey (D., Mass.) and Joe Barton (R., Texas) joined with Senators Richard Shelby (R., Alabama) and Richard Bryan (R., Nevada) to form the Congressional Privacy Caucus. Representatives Asa Hutchinson (R., Arkansas) and Jim Moran (D., Virginia) have introduced a bill to create a 17-member national privacy commission to study internet privacy, identity theft, and protections for medical and financial privacy. The commission would report in 18 months.

The federal bank regulatory agencies all have customer privacy high on their agenda list. Title V authorizes the regulatory agencies to write regulations to implement FCRA, an authority they did not have previously. On March 23, 2000 the FDIC held an open forum on financial privacy. Representative statements are included in these materials.

Finally, the “online privacy” debate continues. Last year, Congress passed the Children’s Online Privacy Act, ("COPPA") which becomes effective on April 21, 2000. COPPA may be the model for legislation to protect all consumers who provide personal information online. Included with your materials is the FTC’s guide to complying with COPPA, OCC Bulletin 2000-2 reminding national banks that COPPA and the FTC’s implementing rule apply to national banks, and OCC NR 99-40, guidance on effective web privacy practices.

Stay tuned.

The Gramm-Leach Bliley Act

Title V, Subtitle A, of the Gramm-Leach-Bliley Act ("Act") imposes on financial institutions a federal obligation to respect customer privacy and protect the security and confidentiality of customer "nonpublic personal financial information." "Financial institutions" are defined by the Act as businesses engaged in financial activities permissible for bank holding companies under Section 4k of the Bank Holding Company Act (12 U.S.C. 1843(e)), ("BHCA"), including insurance, brokerage, and underwriting. "Nonpublic personal financial information" includes all personally identifiable financial information, whether provided by a consumer to a financial institution, resulting from any transaction with the consumer or service performed for the consumer, or "otherwise" obtained by the financial institution.

Scope of the Act

The Act establishes federal (i) privacy policy disclosure requirements; (ii) notice and opt out rights when nonpublic personal financial information is shared with unaffiliated third parties, subject to certain statutory exceptions; (iii) a prohibition on disclosing the account numbers of consumer deposit, credit card, and transaction accounts to unaffiliated third parties for marketing purposes; and (iv) enforcement policies. The Act specifically provides that state laws granting greater consumer protections are not preempted. Lack of a federal preemption will pose a number of issues for multi-state financial institutions.

Effective Date and Enforcement

The Act directs the appropriate federal regulatory agencies to produce implementing regulations within six months of the passage of the Act (November 12, 1999). Title V becomes effective six months thereafter, unless a later date is provided for by regulation. Enforcement is by federal functional regulator and state insurance authorities with respect to financial institutions under their jurisdiction.

Fair Credit Reporting Act

The Act is intended to supplement, not supersede, the Fair Credit Reporting Act ("FCRA"). The FCRA is still relevant for determining the ability of affiliates to share transaction and experience information, and the notice and opt out requirements applicable to sharing other information, such as applications, financial statements and credit reports. The Act also grants immediate regulatory authority to the appropriate federal regulator to issue regulations implementing the FCRA and to examine for FCRA compliance.
• Proposed Implementing Regulations

The federal financial regulatory agencies ("Agencies") have issued for comment proposed regulations ("Proposal") to implement Title V of the Gramm-Leach-Bliley Act ("Act"). A copy of the Proposal is included with these materials.

The Proposals issued by the federal bank regulators (OCC, FRB, FDIC and OTS) were substantially similar. The SEC issued proposed regulations for entities subject to its jurisdiction, as did the FTC.

One interesting difference among the Agencies is in their definition of "financial institutions" subject to the Act. The federal banking regulators define financial institution to mean "any institution the business of which is engaging in activities that are financial in nature or incidental to such financial activities as described in Section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k))" Proposal 3(j). The SEC Proposal is the same. (Section 248.3(m)(1)). The FTC however, restricts the coverage of the Act by providing in its Proposal that an entity is a financial institution "if it is significantly (emphasis added) engaged in financial activities, such as a retailer that extends credit by issuing its own credit card directly to consumers." (Section 313.3(j)(2)). Further, the FTC points out that many entities that come within the broad statutory definition of financial institution won't be covered by the Act because they do not deal with "consumers." For example, management consulting, data processing, and courier services are financial activities under the BHCA, but most of these businesses deal only with other businesses, not with consumers purchasing services "for personal, family, or household purposes." (See, FTC Proposal, Section-by-Section Analysis, discussion of section 313.3(j)).

One business that has provoked discussion among financial institutions is that of aggregator. With the consumer’s consent, aggregators use a consumer’s account numbers and passwords to pull the consumer’s account information from web sites of multiple financial institutions. This "screen scraping" occurs without knowledge of the financial institutions and may create privacy and security risks.

Comments on the Agencies’ proposals were due March 31, 2000, and we expect a final regulation by the end of May.

The Act established and the Proposal elaborates on three main requirements:

(1) An initial and annual notice of a financial institution’s policies and procedures with respect to the collection and disclosure of “nonpublic personal financial information” to affiliated and unaffiliated third parties.

(2) A notice and opt out when nonpublic personal financial information may be shared with unaffiliated third parties, subject to certain statutory exceptions.

(3) A prohibition on disclosing account numbers for marketing purposes.
The Proposal defines terms such as "consumer," "customer" and "nonpublic personal financial information," sometimes by way of example, and prescribes the acceptable means of disclosure and exercise of opt out rights. The proposal distinguishes between "consumers", generally persons who may apply for or receive isolated products or services, and "customers" persons with whom financial institutions have a continuing relationship. A financial institution is not required to provide notices to "consumers" unless it intends to share nonpublic personal information about them with unaffiliated third parties.

The following analysis explains the major topics covered by the Proposal and highlights "Issues" either posed for comment by the Agencies or identified as concerns by financial institution commenters. These industry concerns may be with the language of the Proposal or with implementation challenges.
Analysis of the Bank Regulatory Agency Proposals

I. Definitions

The Act’s notice and opt out requirements pertain to “nonpublic personal financial information” of “consumers.” Individual “consumers” have certain rights depending on whether or not they are “customers.” All notices must be “clear and conspicuous.”

A. “Clear and Conspicuous” - The Proposal defines “clear and conspicuous” disclosure as readily understandable and designed to call attention to the nature and significance of the information contained in the notice. There are no established print size requirements but suggested means of compliance are using a plain-language caption, in a typeset easily seen, and designed to call attention to the information contained in the notice. The Proposal recommends using common every day words and active voice. The clear and conspicuous requirement applies to privacy policy disclosures and to the third party notice and opt out.

Issues: Some commentators are concerned that compliance issues (and possibly litigation) may result because this clear and conspicuous requirement is different from that contained in the Truth-in-Lending Act and other federal consumer disclosure laws.

B. “Consumer” - The Proposal defines “consumer” as an individual who obtains, from a “financial institution” financial products and services used primarily for personal family or household purposes, as well as the person’s legal representative. A “consumer” is entitled to a privacy disclosure and opt out notice only if the financial institution intends to disclose nonpublic personal financial information about the consumer to an unaffiliated third party. Although the Act and the Proposal define a consumer as a person who obtains a financial product or service, the Proposal includes examples where the person is either applying or otherwise requesting information such as a determination of whether he or she qualifies for a particular type of account. Examples are: consumer credit or mortgage applicants, whether or not credit is extended; an individual who provides information in connection with investment advisory services, regardless of whether the bank establishes an ongoing relationship; and a consumer in a workout situation, even if the bank did not originally make the loan.

Note: An FCRA affiliate sharing notice is required if a financial institution wishes to share applicant consumer non-transaction information, such as credit reports, with affiliates, even if it is not required to provide a full privacy disclosure because it does not share applicant information with unaffiliated third parties.

An individual is not a consumer solely because the bank processes information about him/her on behalf of a financial institution that extended a loan to the individual.
Issues:

- Are there instances where your bank discloses nonpublic personal information about persons who never become your customers?

- If so, would it be possible to give the required disclosures in a timely manner to such persons?

- When does a person become a “consumer” when access is through a loan broker who is making available the consumer’s inquiry or request for an account to several financial institutions at the same time?

- When is a person a “consumer” if such person is at an auto-dealer purchasing a car, and the dealer sends the application to a number of financial institutions, only one of which will buy the dealer paper?

C. “Customer” / “customer relationship” - This is a critical definition because “customers” are entitled to both an initial and an annual privacy disclosure and opt out notices. The Proposal defines a “customer” as a consumer who has a “continuing customer relationship” with a financial institution.

The Proposal provides the following examples of how a customer relationship may be established or retained:

- purchase of an insurance policy
- execution of account documents for a deposit, loan, trust, or investment account or personal property lease
- purchase of an investment product through the financial institution
- has a loan that the bank services, where the bank owns the servicing rights

Examples of where a consumer is not a customer:

- consumer uses bank’s ATM, cashes checks at a bank, or purchases cashier checks at a bank but has no accounts at the bank
- the bank sells the consumer’s loan without retaining servicing rights
- the bank sells the consumer airline tickets, travel insurance or traveler’s checks

For purposes of receiving annual disclosures, a consumer is no longer a “customer” when:

- for a closed end loan, the financial institution charges off the consumer’s loan or sells the consumer’s loan without retaining servicing rights (although the individual is still the bank’s consumer) or the consumer pays off the loan
- for an open-end credit relationship, the bank no longer provides statements or notices or the bank sells the credit card receivables without retaining servicing rights
- the consumer’s account becomes dormant under the bank’s internal rules
- in other cases, where the financial institution has not communicated with the consumer for 12 consecutive months
Issues:

• Are the examples adequate and appropriate to determine when an account relationship has been terminated?

• Should the dormancy standard be the institution’s policies or applicable state law? Financial institutions commenting on the Proposal have recommended the institution’s dormancy or “inactive account” standards.

• What if a financial institution services loans for a third party which is also a financial institution? Should the term “servicing rights” be defined to exclude certain circumstances, i.e. where the servicer is under a contractual commitment that precludes use of the customer information for any purpose other than servicing the account? Wouldn’t it be confusing to a customer to receive a privacy notice from a financial institution servicer under these circumstances?

• The mortgage banking industry and financial institutions that provide back office services for mutual funds and brokerage firms commented extensively on this issue.

D. “Nonpublic personal information” - The Act has a very broad definition of non public personal information as “personally identifiable financial information (i) provided by a consumer to a financial institution; (ii) resulting from any transaction with the consumer or any service performed for the consumer; or (iii) otherwise obtained by the financial institution.” Nonpublic personal information does not include “publicly available information.” The Proposal’s definitions evoked extensive industry comment.

• The Proposal offers alternative definitions of nonpublic personal information. Both Alternative A and Alternative B define “nonpublic personal information as:

   (i) personally identifiable financial information; and
   (ii) any list, description or other grouping of consumers (and publicly available information pertaining to them) that is derived using any personally identifiable information.

Both Alternative A and Alternative B define “publicly available information” as information lawfully made available to the general public that is obtained from:

(i) federal, state or local government records;
(ii) widely distributed media; or
(iii) disclosures to the general public required by law

Examples are:

• government real estate security interest filings
• telephone books, newspapers, TV or radio
The difference is in the definitions of "personally identifiable financial information" and the exclusions from "nonpublic personal information." In Alternative A, in order for information to be publicly available, the financial institution must have obtained the information from public records. "Availability" of the information from public records is not sufficient. Alternative A defines personally identifiable financial information as any information:

(i) provided by a consumer to a financial institution to obtain a financial product or service
(ii) resulting from any transaction involving a financial product or service between a financial institution and a consumer; or
(iii) the financial institution otherwise obtains about a consumer in connection with providing a financial product or service to that consumer, other than "publicly available information."

Examples are:
- any information on an application for a financial service
- account balance and transaction information, including debit/credit card purchase information
- the fact that an individual is or was a customer, unless that information is derived only from publicly available records
- other information if disclosed in a manner that indicates someone is or has been a "consumer"
- any information provided by a consumer in connection with collecting or servicing a loan
- information from a consumer report

Alternative B defines "personally identifiable financial information" in almost exactly the same way as Alternative A as any information:

(i) provided by a consumer to a financial institution to obtain a financial product or service;
(ii) about a consumer resulting from any transaction involving a financial product or service between a financial institution and a consumer; or
(iii) the financial institution otherwise obtains about a consumer in connection with providing a financial product or service to that consumer.

Examples are:
- any information on an application for a financial service
- account balance and transaction information, including debit/credit card purchase information
• the fact that an individual is or has been a customer, unless derived only from publicly available information
• other information if disclosed in a manner that indicates someone is or has been a "consumer"
• any information provided by a consumer or otherwise obtained in connection with collecting or servicing a loan
• information from a consumer report

Alternative A excludes from nonpublic personal information "any list, description or other grouping of consumers (and publicly available information pertaining to them) that is derived without using any personally identifiable financial information." Under Alternative A, a list of street addresses and phone numbers would be nonpublic personal information if the information came from customer applications.

Alternative B excludes from "nonpublic personal information" any

(i) publicly available information, except for a list of consumers derived using personally identifiable information; or
(ii) any list, description or other grouping of consumers (and publicly available information pertaining to them) that is derived without using any personally identifiable financial information.

Under Alternative B, if information is available to the public, and is not part of list of consumers derived using personally identifiable information, the information is public information.

Both Alternatives were criticized by financial institution commenters because the personal information subject to disclosure restrictions was not limited to "financial information," as they argued Congress intended.

As a practical matter, both Alternatives would require a notice and opt out before a financial institution may disclose customer lists to an unaffiliated third party or even acknowledge that a consumer was or had been a customer. Alternative B (favored by the Fed) would permit disclosure without notice and opt out of information about a single customer if the information was available from public records and did not indicate that the person was or had been a customer.

**Issues:**

• Which Alternative definition of nonpublic personal information and publicly available information is preferable? Are both inconsistent with the Act's protection of financial information?
• Would either definition of nonpublic personal information cover disclosure of information non-identifiable to a particular consumer, for example, the provision of aggregate loan data to a nonaffiliated third party for market studies?

• What information is appropriately considered publicly available, especially in the context of information available over the internet?

• Do both Alternatives put a financial institution at a competitive disadvantage with others who are not financial institutions and may have the same information for marketing purposes?
II. Initial Notice of Privacy Policies and Practices

Section 503 of the Act requires financial institutions to disclose their privacy policies and practices to their consumer customers “at the time the customer relationship is established and annually thereafter.”

A. Timing of Notice

- Generally, the Proposal requires a financial institution to provide a notice of its privacy policies and practices to a “customer” prior to “establishing a customer relationship” (see definition section) and to a “consumer” who does not become a customer, prior to disclosing nonpublic personal information about the consumer to a nonaffiliated third party. No notice is required to “consumers” if the financial institution does not intend to share information about them with unaffiliated third parties.

- The financial institution may provide the notice within a reasonable time after it establishes a customer relationship where:
  (i) the financial institution purchases a loan or assumes a deposit liability and the customer has no choice about the purchase or assumption.
  (ii) the customer relationship is established orally (e.g., through a call center)

Issues:

- Should the Proposal require disclosure “prior to” establishing the customer relationship when the Act requires disclosure “at the time” the relationship is established?

- What are other situations for which a timing exemption is necessary?

- Student loans?

- Indirect lending?

- Change of mortgage servicer in a transaction covered by RESPA?

B. Format of Initial Notice and Manner of Delivery

- The Proposal requires that the notice be “clear and conspicuous” and accurately reflect the financial institution’s practices. The financial institution must provide the notice “so that each consumer can reasonably be expected to receive the notice in writing or if the consumer agrees, in electronic form.”

- The initial privacy disclosures may not be given orally.

- Posting in the branch is not sufficient.
• Electronic disclosure is permitted only if customer agrees.

Examples of acceptable delivery:
• hand delivery to the consumer
• mailing a copy to consumer’s last known address
• electronic delivery in the form of e-mail for a customer who has agreed to accept electronic disclosures or provided on a web page which a consumer must access to obtain the product or service.
• for an isolated transaction, such as at an ATM, posting notice on the screen and requiring the consumer to acknowledge receipt

• Financial institution customers must be able to retain a copy of the privacy disclosure or obtain a copy at a later time electronically, if the customer agrees.

Examples of appropriate retention or access:
• hand delivery of a printed copy
• mailing of a printed copy to last known address upon request by customer
• maintaining notice on website (or link to another website) for web customer who agrees to receive notice electronically

• The Section-by-Section analysis provides that financial institutions may choose whether to provide a common notice of privacy policies for all their companies or they may establish different policies for different categories of consumers, customers or products. The Proposal does not contain this option.

• If the financial institution changes its policies and procedures in a way that makes the initial notice inaccurate, the financial institution must redisclose its polices and provide new opt outs.

Issues:

• Financial burden of providing initial notices. Is this in your budget for 2000?

• How should a financial institution deal with a situation where customer has requested “no contact” as is the case in some private banking relationships?

• Who should get notice when there is more than one party to an account?

• If one owner on a joint account elects to receive notice by e-mail, and the notice must go to all joint owners of an account, can a financial institution require all joint owners to receive notice by e-mail at a single e-mail address?
• How should fiduciary accounts be handled? Should they be exempt altogether? What about employee benefit accounts subject to ERISA?

C. Content of Initial Notice

(1) "Categories" of nonpublic personal information a financial institution may "collect."

• Categories may be explained by using the source of the information.

Examples are:
  • application information
  • transaction information
  • credit reports

Issues:

• Is this an appropriate way to describe categories?

• Are financial institutions required to identify other sources of information, such as information from marketing data bases?

(2) "Categories" of nonpublic personal information a financial institution may disclose to either affiliates or nonaffiliated third parties.

• "Categories" of information disclosed may be explained by source of information and illustrative examples. General terms, such as transaction information, without examples, is not acceptable.

Examples are:
  • application information (such as assets and income)
  • identifying information (such as name, address, social security number)
  • transaction information (such as account balance, payment history, parties to a transaction, and credit card usage)
  • information from consumer reports (such as credit history)

Issues:

• Is this disclosure too detailed?

• Should disclosure to affiliates be more than what is required by FCRA?
(3) **Categories of affiliates and nonaffiliated third parties to whom a financial institution discloses nonpublic personal information.**

- "Categories" of third parties to which disclosure may be made may be explained by identifying the types of business in which they engage.

- General descriptions such as "financial services" may be used only if illustrative examples of significant lines of business are provided.

Examples are:
  - financial services such as retail banking, mortgage lending, life insurance, or securities brokerage.

**Note:** The Act does not require a financial institution to list the categories of persons to whom information may be disclosed pursuant to one of the exceptions to the notice requirements. The Proposal requires that consumers be informed that the financial institution makes other disclosures "as permitted by law".

**Issues:**

- Is this requirement too detailed?
- Why disclose categories of affiliates?

(4) **Disclosure of information about former customers to affiliates and nonaffiliated third parties.**

- Financial institutions must disclose their policies and practices with respect to disclosing information about former customers to both affiliates and nonaffiliated companies.

- Disclosures included in statutory exceptions, such as fraud or to protect the institution may be made without notice.

**Issues:**

- What is your policy about disclosing information about former customers to affiliates or nonaffiliated parties?

(5) **Disclosure of information to service providers.**

- The Act permits a financial institution to disclose nonpublic personal information about a consumer to a nonaffiliated third party for the purpose of the third party
performing services for the institution, including marketing of the financial institution’s own products or financial products or services under a joint agreement between the financial institution and at least one other financial institution. In this case, a consumer has no right to opt out, but the financial institution must “fully disclose” the practice unless the service falls within one of the other statutory exceptions.

• The Proposal interprets “fully disclose” to mean that if a financial institution’s disclosure of nonpublic personal information to a service provider or joint financial institution marketing partner is not otherwise covered by a statutory exception, the financial institution must have a separate disclosure that describes the categories of information the institution discloses and the categories of third parties with whom the institution has contracts that involve disclosure.

• The Proposal does not list examples of service providers whose activities must be disclosed. They probably include market research companies, marketing agents, and third party telemarketing agents.

• The disclosure (but not opt out) is also required for nonaffiliated financial institutions with which a financial institution has joint marketing agreements to jointly offer, endorse, or sponsor a financial product or service. This exception applies only if there is a joint marketing agreement.

• A consumer may NOT opt out of disclosure to a service provider or to a financial institution joint marketing partner so long as:
  (i) the fact of the disclosure is included in the privacy disclosure notice
  (ii) the financial institution has a contractual agreement with the third party that:
    • requires the third party to maintain the confidentiality of the information at least to the standards established in the Proposal
    • limits third party’s use of the information to the purposes of which it was disclosed (subject to the statutory exceptions)

• An opt out would be required if the joint marketing agreement were with a company that was not a “financial institution.”

Issues:

• Should there be a “full disclosure” requirement for service providers that provide marketing services while disclosures to other service providers are exempt from even the notice requirement?

• Where financial institutions contract with credit scoring vendors to evaluate borrower credit worthiness, would the information use limits prohibit the vendor from using personally unidentifiable information to revalidate the underlying model? Would using the information in this manner be beyond the lender’s immediate purpose of determining credit worthiness?
• The Agencies have asked if a financial institution be required to assure itself that the product being jointly marketed and the other participants in the joint marketing arrangement do not present "undue risks for the institution" by, for example, making the financial institution's sponsorship very clear?

• Review all third parties to whom you disclose customer information. Are they covered by the service provider or financial institution joint marketing exceptions?

• If not, are they covered by any of the other statutory exceptions?

(6) Explanation of the consumer's third party opt out right and manner of exercise.

• The financial institution must include in its privacy disclosure notice an explanation of a consumer's right to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties and an explanation of how to exercise this right.

• The explanation in the privacy disclosure is in addition to the opt out notice itself although the opt out notice may be attached to or provided at the same time as the initial and annual privacy notices.

The Opt Out Notice

• All "consumers" are entitled to an opt out notice if the financial institution intends to disclose their information to unaffiliated third parties and the disclosure is not covered by a statutory exception.

• The opt out notice must be "clear and conspicuous"

• The opt out notice must:
  (i) inform the consumer that the institution may disclose nonpublic personal information (by category of information) to nonaffiliated third parties (by category of third party)
  (ii) state that the consumer has a right to opt out
  (iii) provide a reasonable means to opt out

• The opt out notice must be delivered in the same manner as the initial disclosure: by person, by mail, or electronically, if the consumer agrees.

• The consumer must have a "reasonable" way to exercise the opt out. The Proposal says the financial institution provides a reasonable means if it:
  • designates check-off boxes in a prominent position on the relevant forms with the opt out notice
• includes a detachable pre-addressed stamped reply form together with the opt out notice; or
• provides an electronic means such as an e-mail form or website process

• An oral opt out notice is not acceptable, nor is it acceptable to require the customer to write his or her own opt out letter to the financial institution.

• If a customer relationship is established orally, e.g., through a call center, the institution may provide the opt out notice “within a reasonable time” after the relationship is established, but only if the consumer agrees.

• The consumer must have a reasonable time to exercise the opt out (30 days when the opt out notice is mailed; at the time of the transaction for a single transaction, such as purchase of cashier checks).

• The Proposal does NOT set a fixed time for the processing of the opt out but requires only that disclosures stop as soon as “reasonably practical.”

• If the opt out notice is sent after the privacy disclosure, the financial institution must include a copy of the disclosure with the opt out notice.

• The consumer may opt out at any time.

• The opt out continues until the consumer revokes it in writing or, if the consumer has agreed, electronically.

• A financial institution may offer a partial opt out:
  (i) limited to certain information, or
  (ii) limited to certain nonaffiliated third parties

• If the financial institution changes its third party disclosure policies, it must provide a revised disclosure notice, a new opt out notice, and give the consumer a reasonable opportunity to opt out. The change in terms must be provided in the same manner as the original disclosure.

Examples of change in terms:
  • disclosure of a new category of information
  • disclosure to a new category of third party

Issues:

• Most industry commenters said that the opt out procedure was too costly.

• How should the opt out apply in the case of joint accounts? All parties on account be required to opt out before opt out becomes effective? If only one party
needs to opt out, should it apply to that party’s information or to information about all parties on account?

- How should opt out apply to commingled trust accounts where a trustee manages a single account on behalf of multiple beneficiaries?

- Is thirty days a reasonable time to exercise opt out where opt out notice is mailed?

- How should opt out work when an account is opened through a call center or online?

- Since the FCRA affiliate sharing opt out does not require a return receipt check off notice, will your procedure for FCRA change?

(7) FCRA affiliate sharing disclosures and opt out.

- No change in right to share information with affiliates provided the FCRA notice is included in privacy disclosure.


- The FCRA notice and opt out must be part of the initial and annual disclosures even if we make the disclosure in other documents.

Issues:

- Since the FCRA affiliate sharing disclosure and opt out must now be included in a privacy disclosure that must be in writing, may a financial institution continue to provide the affiliate sharing notice and opt out verbally and immediately share application information in a cross-sell program? Would verbal customer consent to affiliate sharing be sufficient?

(8) Confidentiality, security and integrity.

- Disclosure of practices with respect to confidentiality and security is adequate if financial institution explains who has access to the information and the circumstances under which information may be accessed.

- Disclosure with respect to protecting integrity is adequate if the financial institution explains the measures it takes to protect against “reasonably anticipated threats or hazards.”

- Technical information about safeguards is NOT required.
Issues:

- Since the regulatory standards relating to administrative, technical and physical safeguards will not be in place until the time of issuance of the final privacy rules (late May), will there be sufficient time to develop the systems and operational policies to comply?

- How detailed must the explanation of who has access to information be? Does it mean that a financial institution must identify every line of business that has access to information as well as the occasions when a financial institution would find it necessary to access information?
III. Annual Notice

- Financial institutions must provide a clear and conspicuous notice of their privacy policies and practices \textit{then in effect} at least once during any period of 12 consecutive months.

- Only customers with a continuing account relationship are entitled to an annual notice.

- Content and manner of delivery are the same as for the initial notices.

\textit{Issues:}

- Regulatory burden of providing annual notice and methods financial institutions anticipate to provide the notices.

- Who is entitled to the annual notice in a multiparty account?
IV. Statutory Exceptions to the Notice and Opt Out

Section 502(e) of the Act created a number of statutory exceptions to both the disclosure requirements and opt out exercise. The 502(e) exceptions are listed at the end of this outline. The Proposal divides these exceptions into two general categories:

(i) Administering, enforcing, processing, and servicing of a financial transaction requested or authorized by a consumer and the sale of a consumer’s account.

- The Proposal explains that a disclosure “necessary to effect, administer, or enforce a transaction” is one that is required, usual, or appropriate to enforce the financial institution’s or another person’s rights.

Some examples are:
- completing a transaction or recording, servicing, or maintaining the consumer’s account
- administering or servicing benefits or claims
- providing confirmations, statements, valuations to the consumer or the consumer’s broker
- accruing or recognizing incentives or bonuses
- underwriting and processing insurance
- settling a transaction

(ii) Other disclosures as required or permitted by law.

- A financial institution is not required to list the 502(e) exceptions in its disclosures but may use a general term such as “as permitted by law.”
V. Customer Consent

One of the statutory exceptions is customer consent.

- A financial institution may disclose nonpublic personal financial information with the consent or at the direction of the consumer, provided that the consumer has not revoked the consent to direction.

- Neither the Act nor the Proposal specifies how consent may be given or revoked although a consumer may revoke consent by a subsequent exercise of the opt out right.

- The Proposal gives only one example of consent. A consumer may specifically consent to a bank’s disclosure to a nonaffiliated insurance company of the fact that the consumer has applied for a mortgage so that the insurance company can offer homeowners insurance to the consumer.

- The regulators caution that disclosure must not exceed the purpose for which consent is given.

Issues:

- The regulators are clearly concerned about the issue of consumer consent.

- The regulators invited comment on whether safeguards should be added to the consent exception “in order to minimize customer confusion.” These additional safeguards could include a requirement for written consent, consent on a separate line on a document, or on a distinct web page.

- Most industry commenters argued against requiring separate written consent.

- Many industry commenters pointed to cobranded products, such as credit cards that offer frequent flyer miles, as examples of implicit consent.
VI. Limits on Redisclosure and Reuse of Information

- Section 502(c) of the Act provides that any nonaffiliated third party that receives nonpublic personal information from a financial institution may not make a further disclosure unless otherwise permitted under the Act, and the information received may be used only for the purposes disclosed. The Proposal imposes similar restrictions on a financial institution that receives information from another unaffiliated financial institution.

Issues:

- The Agencies asked if the regulation should require a financial institution that discloses nonpublic personal information to an unaffiliated third party to develop policies and procedures to ensure that the third party complies with the limits on redisclosure.

- The industry generally responded that contract limitations were sufficient, and that financial institutions should not be auditors or guarantors of third party activity.
VII. Prohibition Against Disclosure of Consumer Credit Card, Deposit Account, or Transaction Account Number or Access Code for Marketing Purposes

- Section 502(d) of the Act prohibits a financial institution from disclosing a consumer credit card, deposit account, or "transaction" account number or access code to any nonaffiliated third party for use in telemarketing, direct mail marketing or e-mail marketing. The only exception is disclosure to a consumer reporting agency. Although the Conference Report Statement of Managers authorized federal functional regulators to permit encrypted disclosure of account numbers "where the disclosure is expressly authorized by the customer and is necessary to service or process a transaction expressly requested or authorized by the customer," they have not chosen to do so because of the "risks associated with third parties' direct access to a consumer's account."

Issues:

- Industry commenters argued that exceptions to the 502(d) prohibition were appropriate, especially where disclosure was to an institution's service provider. Other areas of concern were disclosures to insurance providers.

- Commenters stated that a flat prohibition would unintentionally disrupt routine practices, such as disclosure to a service provider who prepares monthly statements where the institution or the service provider to include product information in the statement.

- Commenters thought that consumers should be able to consent to disclosure either implicitly or explicitly. Disclosure should be permitted at the "fulfillment" stage.

- The industry recommended that the Proposal clarify that Section 502(d) of the Act does not prohibit disclosure to a marketing firm of encrypted account numbers if the marketer is not given the key to decrypt the account numbers.
VIII. Implementation Schedules

- The Proposal sets the effective date as November 13, 2000.
- Disclosures to existing customers must be made within thirty days of the effective date. They may be sent separately or included with customers statements.

Issues:

- Most financial institutions have commented that six months after the rules are prescribed is not sufficient time for compliance.
- Most have argued against disclosure of privacy principles to existing customers within thirty days of effective date (November 13, 2000) because disclosure would come in the middle of holiday mailings, printers might not be available. Average consumer households could receive more than six disclosures.
Enforcement and Other Regulatory Matters

Multiple Enforcement Authorities

Section 505 of the Act provides that Title V, Subtitle A and the implementing regulations are to be enforced by the federal functional regulators, state insurance authorities and the FTC with respect to financial institutions subject to their respective jurisdiction. Thus, financial institutions engaging in insurance will be subject to the applicable state insurance authority of the state where the entity is domiciled.1

Issues:

• Each bank holding company affiliate, depending on its functional regulator, could be subject to separate Title V regulations and enforcement procedures.

• State insurance laws could limit marketing arrangements for insurance.

No Federal Preemption

The Act specifically provides that state laws granting greater consumer protection are not preempted. The FTC, in consultation with the appropriate functional regulator, is authorized to determine whether a state law is more protective of consumer privacy and, therefore, not inconsistent with the Act.

Issues:

• Financial institutions must be alert to state privacy laws and develop a strategy for multi-state activities.

• Secretary of Treasury, in conjunction with federal functional regulators and FTC, is directed to study information sharing practices of financial institutions and their affiliates.

Section 508 provides that on or before January 1, 2002, the Secretary of the Treasury is to report to Congress on financial institution information sharing practices with respect to affiliates and unaffiliated third parties. In preparing the report, the Secretary is to consult with state insurance

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1 Title I, Section 104, "Operation of State Law" of the Act, expressly provides in subsection (d)(2)(B)(vi) that with respect to insurance sales by a depository institution or its affiliate, either by itself or in conjunction with an affiliate or any other person, a state may impose restrictions prohibiting the release of insurance information of a customer (defined as information concerning the premiums, terms and conditions of insurance coverage, including expiration dates and rates, and insurance claims of the customer contained in the records of the depository institution or an affiliate thereof) to any person other than an officer, director, employee, agent, or affiliate, for the purpose of soliciting or selling insurance, without the express consent of the customer.
authorities, consumer organizations, privacy groups, the financial services industry, and the
general public. The study is to consider, inter alia, the rules and benefits of sharing, adequacy of
existing laws to protect customer privacy, and feasibility of "opt in" or "opt out" approaches to
both affiliate and third party sharing. Additionally, the study is to consider the "feasibility of
restricting sharing of information for specific uses or of permitting customers to direct the uses for
which information may be shared."

**Issues:**

- The privacy debate is just beginning. Privacy advocates will not be satisfied until there
  is at least an opt out on all affiliate sharing and possibly an opt in on third party
  sharing. Financial Institutions must remain alert to federal and state legislative and
  regulatory initiatives, comment on any proposed implementing regulations, and
  continue to participate in trade association activities.

- Fraudulently obtaining or attempting to obtain customer information from a financial
  institution is made a federal offense.

Subtitle B of Title V makes it a criminal offense subject to fine and/or imprisonment for not more
than five years to fraudulently obtain or attempt to obtain customer information from a financial
institution by making false statements, or providing fictitious documents.

**Issues:**

- Alert security department of new law.

- Reinforce employee awareness of activities of information brokers and the importance
  of following your bank's policies on disclosure of customer information.
• Statutory Exceptions to Notice and Opt Out for Disclosure to Unaffiliated Third Parties

1. As necessary to effect, administer or enforce transaction authorized* by consumer;

2. In connection with servicing or processing financial service requested* or authorized* by consumer;

3. In connection with maintaining or servicing consumer's account with financial institution or with another entity as part of a private label credit card program, or other lending program, on behalf of such entity;

4. In connection with a proposed or actual securitization, secondary market sale (including sale of servicing rights) or similar transaction;

5. With consent or at direction of consumer*;

6. To protect the confidentiality or security of the financial institution's records pertaining to the consumer;

7. To protect financial institution against fraud or prevent actual or potential fraud, unauthorized transactions, claims, or other liability;

8. Required institutional risk control;

9. Resolving customer disputes or inquiries;

10. To persons holding legal or a beneficial interest relating to consumer;

11. To person acting in fiduciary or representative capacity on behalf of consumer;

12. To provide information to insurance rate advisory organizations, guaranty funds or organizations, financial institution rating agencies, entities assessing compliance with industry standards, and the institution's attorneys, accountants, and auditors;

13. To the extent specifically permitted or required under other provisions of law and in accordance with Right to Financial Privacy Act, to law enforcement agency (including a federal functional regulator), self-regulating organization (e.g., NASD), Secretary of Treasury for BSA purposes, state insurance authority, FTC, or for an investigation on a matter related to public safety;

14. To a consumer reporting agency in accordance with FCRA or from a consumer report reported by a consumer reporting agency;
15. In connection with a proposed or actual sale, merger, transfer, or exchange of all or part of a business or operating unit if disclosure concerns solely consumers of such business units; or

16. To comply with federal, state or local laws, rules, or other applicable legal requirements; to comply with properly authorized subpoena or summons by federal, state or local authorities, to respond to judicial civil, criminal or regulatory investigation or process, or to government regulatory authorities for examination, compliance, or "other purposes as authorized by law".

* form of request, authorization or consent not specified in statute.
COMPLAINT IN HATCH v. U.S. BANCORP
REGARDING DISCLOSURE OF CUSTOMER INFORMATION TO THIRD PARTY
TELEMARKETERS U.S. District Court for the District of Minnesota, 1999

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA

MIKE HATCH, ATTORNEY GENERAL
FOR THE STATE OF MINNESOTA

Plaintiff,

VS

US BANK NATIONAL ASSOCIATION
f/k/a FIRST BANK OF SOUTH DAKOTA
(NATIONAL ASSOCIATION), US BANCORP
INSURANCE SERVICES, INC. and
US BANCORP f/k/a FIRST BANK
SYSTEMS, INC.

Defendants.

COMPLAINT
JURY TRIAL REQUESTED

PRELIMINARY STATEMENT


2. Defendants US Bank National Association ND and its parent holding company, US Bancorp, have sold their customers' private, confidential information to MemberWorks, Inc., a telemarketing company, for $4 million dollars plus commissions of 22 percent of net revenue on sales made by MemberWorks.

3. Using the personal, confidential information provided by Defendants, MemberWorks markets membership service programs to Minnesota consumers. These programs have membership fees payable monthly or annually depending on the program, ranging from approximately $50 per year to approximately $120 per year. MemberWorks refuses to provide written information about its programs until after the consumer actually enrolls in the program. Consumers generally receive a trial 30 day membership. If the membership is not canceled during the trial period, the consumer is automatically charged the annual membership fee. The fee is charged to the consumer's US Bank checking or credit card account.

4. Defendants have told their customers that all information provided to or obtained by Defendant banks will be kept confidential and will only be released in certain circumstances. Among other things, Defendants have told their customers that:

"US Bancorp and its family of financial service providers understands that confidentiality is important to you and essential in our business. It is our policy that all personal information you supply to us will be considered confidential. This policy holds true no matter how we receive your personal information; over the phone, at our branches, through our ATMs or on-line at this Web site."


Defendants have not advised their depositors and/or credit card customers the extent and types of information they are providing to telemarketers like MemberWorks.

5. Defendants have retained contractual rights to review and approve all programs and scripts used by MemberWorks. Defendants have approved the use of false, deceptive and misleading marketing scripts that are used by MemberWorks. For example, Defendants routinely transmit checking account and credit card account numbers to MemberWorks. If, however, consumers ask MemberWorks' personnel whether they already have the customer's checking account or credit card account numbers, MemberWorks' scripts instruct their telephone personnel falsely to tell consumers that MemberWorks does not have the numbers when, in fact, it does.

JURISDICTION, VENUE & PARTIES

6. The Minnesota Attorney General as Chief Law Enforcement Officer of the State of Minnesota is authorized to bring an action pursuant to 15 U.S.C. § 1681s (c). The State of Minnesota has authority to bring an action to enjoin violations of the FCRA in the appropriate United States District Court and to recover on behalf of the residents of Minnesota damages under 15 U.S.C. §§ 1681n and 1681o of the FCRA. Defendants are also liable pursuant to laws of the State of Minnesota, which claims may be brought under the pendant jurisdiction of this Court. Minnesota law governs contracts of national banks unless it expressly conflicts with federal banking laws. Minn. Stat. §§ 325F.69, 325F.67, and 325D.44 (1998). The pendant claims in this action are premised on violation of Minnesota laws that do not expressly conflict with federal banking laws.


8. US Bancorp Insurance Services, Inc. is a subsidiary of US Bancorp.


10. MemberWorks Incorporated (MemberWorks), not a Defendant in this case, is a publicly
traded telemarketing company based in Stamford, Connecticut. MemberWorks is not affiliated with any of the Defendants.

11. This Court has jurisdiction over this matter based upon 28 U.S.C. § 1331, in that this dispute involves predominant issues of federal law. Defendants are liable pursuant to provisions of the FCRA, 15 U.S.C. § 1681, et seq. Defendants are also liable pursuant to the laws of Minnesota which claims may be brought under the pendant jurisdiction of this Court.

TRIAL BY JURY


REQUEST FOR EXEMPLARY/PUNITIVE DAMAGES

13. The State of Minnesota respectfully requests that this Court instruct the jury, as the trier of facts, that in addition to actual or compensatory damages, punitive or exemplary damages may be awarded against Defendants under federal and state laws.

GENERAL FACTUAL BASIS FOR COMPLAINT

Contracts with MemberWorks

14. On or about November 1, 1996 First Bank entered into an agreement with MemberWorks, a telemarketing company based in Stamford, Connecticut, to provide MemberWorks with confidential information about the bank's consumer depositors and credit cardholders for telemarketing purposes. Appendix 1. The agreement was amended on April 12, 1999 to reflect the name change of First Bank to US Bank. Appendix 2. A second marketing agreement between US Bancorp Insurance Services, Inc., a subsidiary of US Bancorp, and Coverdell & Company, a subsidiary of MemberWorks, was made on June 30, 1998. Appendix 3.

15. These agreements permit and require Defendants to transmit confidential, personal information about their customers which the Defendants have assembled on their own and from other sources to MemberWorks. According to US Bank, this information includes but is not limited to:

- a. name, address and telephone numbers of primary and secondary customers
- b. checking account numbers
- c. credit card numbers
- d. social security numbers
- e. date of birth
- f. account status and frequency of use
- g. gender
- h. marital status
- i. homeowner
- j. occupation
- k. date account was opened
- l. average account balance
- m. year-to-date finance charges for credit card accounts
- n. behavior score
- o. bankruptcy score
- p. credit insurance status
- q. last credit card purchase information


16. In its answers to CID Interrogatories, MemberWorks states that it receives the following confidential, personal information from US Bank about its customers:

- a. cardholder names
- b. cardholder address
- c. cardholder phone number?
- d. cardholder account number (scrambled)
- e. last date of purchase information
- f. account open date
- g. account balance
- h. credit limit
- i. credit insurance status
- j. social security number
- k. year-to-date finance charge
- l. ATD transaction count
- m. card type (classic or gold)
- n. brand (US Bank, Express line Rocky MT)
- o. number of plastics (number of cards)
- p. date of birth
- q. cash advance amount
- r. behavior score
- s. bankruptcy score
- t. date of last payment
- u. amount of last payment
- v. date of last statement
- w. statement balance

MemberWorks Answer to CID Interrogatory No. 5, Appendix 7. On information and belief additional information pertaining to Defendants checking account customers was also transmitted to MemberWorks.

17. US Bank and US Bancorp were guaranteed a minimum payment of $4,025,000 by MemberWorks for the provision of confidential bank customer information. Appendix 1, Appendix 3, Schedule A.

18. In return for providing personal, confidential customer information, MemberWorks also pays Defendants commissions equal to 22% of net membership revenue from sales to Defendants’ customers. Appendix 2, Attachment 1 to Amendment No. 1.

19. The information provided by Defendants to MemberWorks includes information, such as the bankruptcy score, behavior score and various account data, including last purchase date on credit card transactions, that is at least in part based on information Defendants received from sources other than Defendants’ first-hand experience with their customers. US Bank’s
Appendix 5.

§ 205, set forth the requirements for the pre-authorized electronic funds transfer. In fact, Defendants have specifically contracted with applicable federal law. 12 C.F.R. § 205 (b).

25. Minnesota customers who are telemarketed by MemberWorks and its agents are unaware at the time of the solicitation that their credit card numbers and/or checking account numbers are already in the telemarketers' possession. Affidavit of Catherine Welsh, Appendix 6.

26. The telemarketing scripts used by MemberWorks and approved for use by Defendants direct telemarketing representatives who are asked by bank customers during the telephone call if MemberWorks already has the consumer's credit card account or checking account number to respond as follows:

5. “Do you have my CLIENT NAME account number?”

No, I personally do not have your account number. However, if you decide to continue your membership after the 30-day trial, then our system will automatically bill the $79.95 annual membership fee to your CLIENT NAME Visa/MasterCard account provided to CountryWide Dental by CLIENT NAME (Return to point of interruption) (or) OK!!

Appendix 10, page 13.

27. Under the terms of the contracts between Defendants and MemberWorks, any membership fee will either be billed to the customer's US Bancorp credit card account or be paid through electronic transfer or draft of personal funds from a consumer's US Bank account to MemberWorks. US Bank's Response to Interrogatory No. 15, Appendix 5.

Electronic Fund Transfers

28. Under the terms of the contracts and as practiced, MemberWorks is required to obtain only verbal authorization from consumers before it sets up an automatic debit for the monthly installment of the MemberWorks' fee from the consumer's checking account at US Bank. No written authorization is ever obtained from the consumer. Appendix 1, Attachment II 2.a.


30. The transfers set up by MemberWorks are pre-authorized transfers as that term is defined by applicable federal law. 12 C.F.R. § 205.10 (a).

31. MemberWorks routinely and repeatedly debits Minnesota consumers' checking accounts electronically. Affidavit of Catherine Welsh and attached Exhibit, Appendix 6.

32. The Electronic Fund Transfer Act and Reg. E prohibit the electronic transfer of funds from a checking account without the prior written authorization of the consumer. 12 C.F.R. § 205 (b).

33. On information and belief, US Bank has agreed to abide by the rules of the National Automated Clearing House Association (NACHA) regarding the handling and processing nationwide electronic payments systems.

34. NACHA Rules require that debit entries to consumers' accounts must have been authorized in writing, signed or similarly authenticated by the consumers. As used by NACHA, the term "similarly authenticated" includes the use of a digital signature or other code. To meet the requirement that an authorization be in writing, an electronic authorization must be able to be displayed on a computer screen or other visual display that enables the consumers to read the communication. NACHA Rules, Article Two Subsection 2.1.2.

35. Defendants do not require MemberWorks to comply with the written authorization requirements for electronic funds transfer. In fact, Defendants have specifically contracted and/or established the practice of requiring only verbal authorization in order to approve the electronic funds transfer. This violates both federal law and NACHA Rules that protect consumers from unauthorized electronic fund transfers.

Responses to Interrogatories and Document Requests Interrogatory No. 3, Appendix 5.

20. Since January 1, 1996 US Bancorp and its companies have provided MemberWorks with information relating to 600,000 checking account customers from Midwestern and Western states. Defendants are unable to identify how many of these 600,000 customers are from Minnesota. US Bank's Response to Interrogatory No. 7, Appendix 5.

21. Since January 1, 1996 US Bancorp and its companies have provided MemberWorks with information on approximately 330,000 of its US Bank Minnesota credit card customers. US Bank's Response to Interrogatory No. 7, Appendix 5.

22. Using the private, confidential information provided by Defendants, MemberWorks and/or its agents conduct telephone and direct mail solicitations of customers of US Bancorp and its companies. MemberWorks hires telemarketing vendors to conduct the telemarketing solicitations. These vendors, in turn, are also provided with personal, confidential information that Defendants provide to MemberWorks. Appendix 1, Attachment II, I.a.

23. Under the terms of the contracts, Defendants review and approve the telephone solicitation scripts in advance of telemarketing solicitations. Appendix 1, Attachment II, I.a. (2).

24. The telemarketing scripts used by MemberWorks and approved for use by Defendants direct telemarketing representatives to enroll customers in MemberWorks' programs before any literature about programs can be sent to the consumers. MemberWorks explicitly prohibits its telemarketing representatives from sending information to customers without their initial enrollment.

1. ‘Send me literature’

Mr(s) , I'm unable to send any information without an enrollment. That's why we've arranged to send the information out and provide you with the 30-day trial membership. If you feel the service is not for you, simply call us before the end of your 30-day trial and you won't be billed, OK!!!


25. Minnesota customers who are telemarketed by MemberWorks and its agents are unaware at the time of the solicitation that their credit card numbers and/or checking account numbers are already in the telemarketers' possession. Affidavit of Catherine Welsh, Appendix 6.

26. The telemarketing scripts used by MemberWorks and approved for use by Defendants direct telemarketing representatives who are asked by bank customers during the telephone call if MemberWorks already has the consumer's credit card account or checking account number to respond as follows:

5. “Do you have my CLIENT NAME account number?”

No, I personally do not have your account number. However, if you decide to continue your membership after the 30-day trial, then our system will automatically bill the $79.95 annual membership fee to your CLIENT NAME Visa/MasterCard account provided to CountryWide Dental by CLIENT NAME (Return to point of interruption) (or) OK!!
Consumer Representations

36. US Bank and US Bancorp informed consumers through advertising that the information the consumers provide Defendants will be considered confidential. Appendix 12.

37. Defendants have informed customers that they will only disclose information in certain circumstances:

Disclosure of Account Information
Information concerning your account and your account transactions, including electronic banking transactions, may be released to third parties only under the following circumstances:

- in connection with an examination by government regulators or external auditors;
- to comply with a request for information from a party to whom you have given our name as a reference or a party to whom you have written a check or otherwise agreed to make payment from your account;
- to report to (a) a credit bureau about the existence or condition of your account or (b) an information clearinghouse if we close your account due to excessive overdrafts or other irregular activity by you;
- to any person to whom you have given information about your account (such as your account number and personal identification number) that is enough to permit them to pose as you;
- to comply with a subpoena or any other legitimate request under state or federal law;
- when we need to in order to complete transactions, including electronic banking transactions;
- when we conclude that disclosure is necessary to protect you, your account or our interests; or
- if you give your written permission.

38. US Bank and US Bancorp do not disclose to their customers that they routinely provide and transmit confidential information, such as the customer's average account balance, marital status, gender, social security numbers and bankruptcy score, to third parties.

39. Defendants have created an expectation that its Minnesota consumers have a right to financial privacy.

40. Defendants do not disclose to their checking account customers that confidential information is being sold.

41. Defendants' only disclosure pertaining to the sale of information obtained from credit card customers is made in a paragraph in the credit card agreement titled "Affiliate Sharing". US Bank Answers to CID Interrogatory No. 4, Appendix 5. The Affiliate Sharing section of the credit card agreement reads as follows:

Affiliate Sharing. We offer our customers the full resources of our banking insurance and investment capabilities. You agree that a consumer credit report may be requested periodically from one or more consumer reporting agencies (credit bureaus) and used in connection with your application and any update, renewal or extension of credit. We share customer information within our organization so that your accounts are properly serviced and to better meet your needs. If you prefer that we not provide this information (exception for information about our experiences with you) to other legal entities that are part of our corporate family, please write us at: Customer Information (CIS), Mail Code SPPN 0803, 336 North Robert Street, St. Paul, MN 55101.

Periodically we may share our cardholder lists with companies that supply products and services that we feel our customers will value. We carefully review these offers to insure that they meet our standards. You may request that your name and information not be given to these companies by writing us at US Bank National Association ND, P.O. Box 6345, Fargo, ND 58125-6345.

See Also Credit Card Agreement, Appendix 15.

42. Defendants have told their customers that:

"US Bancorp and its family of financial service providers understands that confidentiality is important to you and essential in our business. It is our policy that all personal information you supply to us will be considered confidential. This policy holds true no matter how we receive your personal information, over the phone, at our branches, through our ATMs or on-line at this Web site." www.usbank.com/privacy (May 25, 1999).

43. MemberWorks is not an affiliate of either US Bancorp or US Bank.

44. Once Defendants transfer the personal, confidential customer data to MemberWorks, it is used to target consumers for credit transactions, create bulk mail and telemarketing solicitations to Minnesota customers.

45. MemberWorks sells the membership program Countrywide Dental and Health service for an introductory price of $39.95 per year and an annual renewal price of $99.95 per year, payable in monthly renewals of $8.95. The program promises free or nominal charge for X-ray and oral exams, discount pricing for dental work and access to a network of participating dentists along other benefits. This program was marketed to US Bank customers.

46. MemberWorks sells its membership programs for various prices which are set forth in the Membership Program. Appendix 9.

47. MemberWorks' programs are set up to offer either periodic monthly payment of fees or annual payment of fees. Appendix 9.

48. MemberWorks markets its program offering the customer a 30-day trial period. In its initial contact with Defendants' customers, MemberWorks asserts that it obtains verbal authorization to make a monthly deduction from the customer's checking account or a billing to the customer's US Bancorp credit card. Appendix 10, page 5.

49. Notice that MemberWorks will begin automatically deducting fees from the customer's
checking account or billing the credit card is sent to Minnesota customers on a postcard. A copy of this postcard is attached as Appendix 8.

50. Neither MemberWorks nor Defendants obtain written authorization for electronic deductions from consumers' checking accounts.

51. Defendants' contracts with MemberWorks require Defendants to refer all consumer complaints to MemberWorks.

COUNT I

VIOLATION OF FAIR CREDIT REPORTING ACT

52. Plaintiff incorporates and realleges paragraphs 1-50.

53. By assembling and transmitting consumer reports (15 U.S.C. § 1681a(d)(1)) that is at least in part obtained from other sources, Defendants are a "credit reporting agency" as that term is defined by the FCRA. 15 U.S.C. § 1681t(f).

54. In the course of its actions, Defendants have willfully and/or negligently violated the provisions of the FCRA in the following respects:
   a. By willfully and/or negligently failing to provide consumer reports for a permissible purpose as required by § 1681b of the FCRA.
   b. By willfully and/or negligently failing to maintain reasonable procedures to ensure proper disclosure of information to third parties as required by §1681e.
   c. By willfully and/or negligently failing to maintain reasonable procedures to ensure compliance with consumer disclosure obligation as required by §1681g.
   d. By willfully and/or negligently failing to respond to consumer disputes by § 1681c.

55. Alternatively, Defendants obtain credit reports about their customers from credit reporting agencies. These credit reports consist of credit scores, such as behavior and bankruptcy scores and other information provided by the credit reporting agency.

56. Defendants, as users of credit reports, are required by the FCRA to certify the purposes for which information is obtained from credit reporting agencies. 15 U.S.C. § 1681e (a).

57. Defendants' failure to certify the uses of credit reporting information by its subsequent sale to MemberWorks violates the FCRA. 15. U.S.C. 16813(a).

58. In addition to actual or compensatory damages, US Bank and US Bancorp are liable to the State of Minnesota on behalf of residents for damages resulting from violations of sections 1681n and 1681o of the FCRA.

COUNT II

PREVENTION OF CONSUMER FRAUD

59. Plaintiff incorporates and realleges paragraphs 1-58.

60. Minnesota Statutes § 325F.69, subd. 1 (1998) provides:

   The act, use or employment by any persons of any fraud, false promise, misrepresentation, misleading statement or deceptive practice, with the intent that others rely thereon in connection with the sale of any merchandise, whether or not any person has in fact been misled, deceived, or damaged thereby, is enjoynable as provided herein.

61. The privacy statement provided at Defendants' Web site does not advise customers that Defendants will sell their confidential information to third parties outside of its family of financial service providers.

62. The privacy statement provided at Defendants' Web site does not advise customers of whether or how they may opt-in or opt-out of the sale of their personal financial information to third parties by Defendants.

63. The privacy statement provided at Defendant's Web site does not provide the customer with any option as to how the Defendants choose to use the customer's personal, confidential information.

64. US Bank's Customer Agreement pertaining to checking accounts contains no information advising customers about the sale of confidential information to third parties or the nature and scope of the information being sold. Appendix 14.

65. The credit card agreement only contains US Bank information about the sale of confidential information in a paragraph titled "Affiliate Sharing" (i.e. other legal entities that are part of Defendants' corporate family). By titling the paragraph "Affiliate Sharing," consumers are deceived and/or misled regarding the sale of information to unrelated, non-affiliated entities. Appendix 15.

66. Defendants' failure to require or obtain written authorization prior to electronic transfer of funds violates both the Electronic Funds Transfer Act, Reg. E and NACHA Operating Rules and is thus a violation of Minnesota's Prevention of Consumer Fraud Act.

67. Defendants approved the use of deceptive and misleading telemarketing practices, including the refusal to provide literature to consumers without a prior sale and misrepresentations about the transfer of account numbers of bank customers to MemberWorks by Defendants.

68. Defendants' sale of personal, confidential information obtained from consumers in the course of a banking relationship violates Minnesota consumers' common law right to privacy and is a deceptive and misleading act. Lake v Wal-Mart Stores, Inc., 582 N.W. 2d 231 (Minn. 1998).

69. The Defendants' intentional intrusion upon the private affairs or concerns through the sale of confidential information is highly offensive to a reasonable person.

70. Defendants' appropriation of its customers' personal and confidential information for its own use or benefit violates the common law right to privacy.
71. Defendants’ publication of Minnesota consumers’ private facts to third parties is highly offensive to a reasonable person. The publication of these private facts concerns matters which are not of legitimate concern to the public.

72. The privacy interests of Minnesota consumers in the confidentiality of their personal financial information affects the economic health and well-being of Minnesota residents.

73. Defendants’ conduct has adversely affected hundreds of thousands of Minnesota citizens living in every county in the State of Minnesota.

74. The systematic violation of Minnesota consumers’ common law right of privacy is a violation of Minnesota’s Prevention of Consumer Fraud Act and Deceptive Trade Practices Act.

75. Defendants’ conduct described in the above paragraphs 1-74 constitutes multiple, separate violations of Minn. Stat. § 325F.69, subd. 1 (1998).

COUNT III
VIOLATIONS OF MINN. STAT. § 325F.67 (1998)
FALSE ADVERTISING

76. Plaintiff realleges the allegations contained in paragraphs 1-75.

77. Minnesota Statutes § 325F.67 (1998) provides in pertinent part:

Any person, firm, corporation, or association who, with intent to sell or in anywise dispose of merchandise, securities, service, or anything offered by such person, firm, corporation, or association, directly or indirectly, to the public, for sale or distribution, or with intent to increase the consumption thereof, or to induce the public in any manner to enter into any obligation relating thereto, or to acquire title thereto, or any interest therein, makes, publishes, disseminates, circulates, or places before the public, or causes, directly or indirectly, to be made, published, disseminated, circulated, or placed before the public, in this state, in a newspaper or other publication, or in the form of a book, notice, handbill, poster, bill, label, price tag, circular, pamphlet, program, or letter, or over any radio or television station, or in anything so offered to the public, for use, consumption, purchase, or sale, which advertisement contains any material assertion, representation, or statement of fact which advertisement contains any material assertion, representation, or statement of fact which is untrue, deceptive, or misleading, shall, whether or not pecuniary or other specific damage to any person occurs as a direct result thereof, be guilty of a misdemeanor, and any such act is declared to be a public nuisance and may be enjoined as such.

78. Defendants’ advertising, such as the privacy notice posted on Defendants’ Web site and in the credit card agreement, contains false, misleading and untrue information regarding the lack of confidentiality Defendants provide for the personal information they obtain from Minnesota consumers.


COUNT IV
VIOLATIONS OF MINN. STAT. § 325D.44 (1998)
DECEPTIVE TRADE PRACTICES

80. Plaintiff realleges the allegations contained in paragraphs 1-79 above.

81. Minn. Stat. § 325D.44 subd. (5) and (13), provides in pertinent part as follows:

Subdivision 1. A person engages in a deceptive trade practice when, in the course of business, vocation, or occupation, the person:

. . . . (5) represents that goods or services have sponsorship, approval, characteristics, ingredients, uses, benefits, or quantities that they do not have or that a person has a sponsorship, approval, status, affiliation, or connection that the person does not have;

. . . . (13) engages in any other conduct which similarly creates a likelihood of confusion or of misunderstanding.

82. Defendants’ approval of telemarketing scripts that fail to accurately convey the data Defendants have sold to MemberWorks deceives Minnesota consumers and creates significant confusion and misunderstanding.

83. Defendants’ failure to require or obtain written authorization prior to electronic transfer of funds violates both the Electronic Funds Transfer Act, Reg. E and NACHA Operating Rules, and is thus a violation of Minnesota’s Deceptive Trade Practice Act.

84. Defendants’ sale of personal, confidential information obtained from consumers in the course of a banking relationship violates Minnesota consumers’ common law right to privacy, and it is a deceptive trade practice. Lake v Wal-Mart Stores, Inc., 582 N.W.2d 231 (Minn. 1998).

85. Defendants’ conduct as described in the above paragraphs 1-84 constitutes multiple, separate violations of Minn. Stat. § 325D.44, subd. 1 (5) and (13) (1998).

RELIEF
WHEREFORE, Plaintiff, the State of Minnesota, by its Attorney General, Mike Hatch, respectfully asks the Court to award judgment against Defendants:

1. Declaring that Defendants’ acts and practices described in this complaint constitute multiple, separate violations of the Fair Credit Reporting Act, 15 U.S.C. § 1681 et seq.
2. Declare that Defendants’ acts and practices described in this complaint constitute multiple, separate violations of Minnesota’s Prevention of Consumer Fraud Act, Minn. Stat. § 325F.69.
5. Enjoining, via the entry of a preliminary and permanent injunction, Defendants from engaging in the practices alleged in this Complaint and violating the above statutes. 15 U.S.C. § 1681.
6. Awarding damages on behalf of the residents of the State of Minnesota as the result of willful and negligent violations of the FCRA §§ 1681n and 1681o.
7. Requiring Defendants make restitution in an amount to be determined by the Court and awarding judgment against Defendants for such amount.
8. Ordering Defendants to take such remedial measures as the Court deems appropriate.
10. Awarding Plaintiff its costs, including costs of investigation and reasonable attorney fees, as authorized by Minn. Stat. § 8.31, subd. 3(a)(1998) and the FCRA.
11. Granting such further legal or equitable relief as the Court deems appropriate and just.

Respectfully submitted,

MIKE HATCH
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State of Minnesota

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ATTORNEYS FOR PLAINTIFF
ASSURANCE OF DISCONTINUANCE REGARDING
PROVISION OF CUSTOMER INFORMATION TO UNAFFILIATED THIRD PARTY
VENDORS
CHASE MANHATTAN BANK USA, N.A.
Attorney General of the State of New York, January 2000

THE ATTORNEY GENERAL OF THE STATE OF NEW YORK
BUREAU OF CONSUMER FRAUDS AND PROTECTION

ASSURANCE OF DISCONTINUANCE
PURSUANT TO EXECUTIVE LAW §63(15)

Pursuant to the provisions of Article 22-A of the General Business Law
("GBL") and Section 63(12) of the Executive Law, Eliot Spitzer, Attorney General of the
State of New York State, caused an inquiry to be made into certain marketing practices of
Chase Manhattan Bank USA, N.A. Based upon this inquiry, the Attorney General makes the
following findings:

FINDINGS OF FACTS

1. Chase Manhattan Bank USA, N.A. is a subsidiary of The Chase Manhattan
Corporation. Its principal place of business is located at 802 Delaware Avenue, Wilmington,
Delaware 19801. Chase Manhattan Bank USA, N.A. and The Chase Manhattan Corporation are
herein referred to as "Chase".

2. Chase is a credit card issuer and has approximately 20 million accounts
nationwide. Chase also holds a substantial number of residential mortgages.

3. Chase has engaged in marketing programs with major nonaffiliated telemarketing
and direct mail entities for the purpose of offering consumer products and services to its
cardholders and mortgagors. The products and services offered to consumers included
memberships in discount shoppers' clubs, emergency road service plans, dental and legal
services plans, travel clubs, home and garden supply clubs and credit card registration and
magazine subscription services.

4. In connection with those marketing programs, Chase provided information to
nonaffiliated third party vendors in computer readable form including a list of names, addresses,
phone numbers and encrypted account numbers (or, in the case of Chase's mortgage business,
loan numbers) of Chase customers and, in the case of Chase customers having credit cards,
certain other information that related to the extent and timing of customer usage of Chase's credit
cards over time (including, for example, credit line, credit balance, the period of time the
customer has had the card and the date of the customer's last transaction) to enable the
nonaffiliated third party vendor to conduct computerized analyses (the "computer tapes") to
create a list of Chase customers who were likely to have an interest in purchasing the products or
services of the nonaffiliated third party vendor. According to Chase, the computer tapes were
provided to the nonaffiliated third party vendors under agreements which provided that the
information be kept confidential.

5. The nonaffiliated third party vendors with whom Chase established marketing
programs entered into agreements with Chase pursuant to which they paid Chase a fee in the
event that a Chase customer purchased the product or service offered by the nonaffiliated third
party vendor.

6. Once the nonaffiliated third party vendor conducted the computerized analysis of
the computer tapes and generated the list of Chase customers who were likely to purchase the

EXHIBIT B
particular product or service to be offered, the nonaffiliated third party vendor arranged for
telemarketing or direct mail representatives to have access to the list of cardholder names,
addresses and telephone numbers of those specific Chase customers in order to conduct
telephone and/or direct mail solicitations.

7. Chase customers who were contacted by nonaffiliated third party vendors and/or
their agents had not been advised of the specific types of information that had been in the
possession of the nonaffiliated third party vendor.

8. On or about July 1, 1999, Chase voluntarily imposed a moratorium on such
marketing efforts.

9. At the time of the opening of a credit card account and periodically thereafter,
Chase provided its cardholders with a copy of its “Customer Information Principles” which set
forth its policies for protecting the privacy and confidentiality of customer information. Chase
informed customers, inter alia, that it does not share information about its customers with
unrelated companies except in certain limited circumstances, including making available special
offers of products and services that it felt may be of interest to Chase customers. Chase
provided a similar statement of its “Customer Information Principles” in its initial welcome kit
for Chase customers who had obtained mortgages from Chase.

10. Chase did not include information on how to opt-out in its initial notice to
mortgagors and did not include information on opting-out on its website or identify in its opt-out
notice to credit card holders an 800 number by which consumers can opt-out.

11. The Attorney General believes that Chase has not fully and adequately disclosed
to Chase customers that specific types of information on the computer tapes were provided to
nonaffiliated third party vendors for the purpose of offering Chase customers products and
services other than Chase’s own products and services. The Attorney General further believes
that Chase also failed to fully and adequately provide Chase customers with notice of the
opportunity not to have that information shared with nonaffiliated third party vendors or of the
means to exercise that opt-out. The Attorney General further believes that, as a result of such
inadequate disclosure, Chase customers were unable to make a fully informed decision as to
whether to have the information on the computer tapes provided to nonaffiliated third party
vendors.

12. The Attorney General believes that Chase’s practice of providing this information
regarding Chase customers to nonaffiliated third party vendors without more detailed and more
conspicuous disclosure of those practices and without a more convenient means to opt-out was
contrary to the consumer protection statutes of the State and to consumers’ expectations of
privacy with respect to financial information provided to or acquired by Chase.

13. The Attorney General further believes that Chase’s practice of failing to provide
more detailed and conspicuous disclosure to Chase customers regarding its policy of information
sharing and the means to opt-out constituted conduct violative of GBL Article 22-A and
Executive Law §63(12).

CHASE STATEMENT

Chase has expressly denied that any of its actions described above violates the consumer
protection laws of the State of New York including GBL Article 22-A and Executive Law
§63(12). Chase has further asserted that its policy with respect to the use of information
regarding Chase customers has been properly disclosed in its customer information principles
and in subsequent disclosures to Chase customers and was consistent with its stated intention to
make available products and services that Chase believed would be of interest to Chase
customers and that information about Chase customers was appropriately protected by the terms
of its confidentiality agreements with the nonaffiliated third party vendors. Chase provided
additional information regarding information sharing when it notified customers with Chase
credit card accounts that the customers could inform Chase that they did not want to receive
telemarketing calls or direct mail solicitations. A welcome kit informed Chase credit card
customers that they could opt-out at any time by contacting Chase at a specified 800 number.
Chase also published its customer information principles online at its website at www.chase.com.
Chase has further stated that information about Chase customers was not provided to
nonaffiliated third party vendors if the Chase customers had exercised their opportunity to opt-
out and that the opportunity to opt-out was clear, the means to do so was easily accessible to
customers and the opt-out was, in fact, exercised by Chase customers. Chase further states that
the identity of the stores or other providers at which cards were used and the specific purchases
made were not disclosed to the nonaffiliated third party vendor and that the individuals making
telemarketing calls to Chase customers did not have access to information regarding the credit
balance or credit line, or regarding the extent or timing of the Chase customers’ use of their
credit cards or the identity of the stores or other providers at which cards were used or the
specific purchases made.

IT NOW APPEARS that Chase is willing to enter into this Assurance without
admitting that it has violated any law, or that it otherwise committed any wrongful or improper
act and further without admitting that the alleged practices violate New York state consumer
protection laws, and the Attorney General is willing to accept this Assurance in lieu of
commencing a statutory proceeding.

IT IS HEREBY AGREED by Chase, its agents, affiliates, subsidiaries, and
assigns that:

1. Except as set forth herein, Chase shall not provide any information regarding a
Chase customer other than name, address and phone number to nonaffiliated third party vendors
for the purpose of allowing those vendors to market to Chase customers products or services of
the nonaffiliated third party vendors. For the purposes of this Assurance, the term “nonaffiliated
third party vendor” shall mean any entity that is not an affiliate of, related by common ownership
or affiliated by corporate control with Chase but does not include a joint employee of Chase, and
the term “customer” shall mean an individual Chase customer who has provided Chase with a
mailing address in the state of New York.

2. Chase may furnish a list of names, addresses and telephone numbers of Chase
customers to nonaffiliated third party vendors provided that (a) the nonaffiliated third party
vendor cannot identify other specific financial information such as credit line or credit balance
regarding the Chase customer derived solely from information provided by Chase and (b) Chase
provides to each of its cardholders and mortgagors within a reasonable time from the date of
establishing a cardholder or mortgage relationship, as applicable, (or in the case of customer
relationships existing on the date of this Assurance, at any time prior to the initial release of the
customer's name, address and telephone number to the nonaffiliated third party vendor after the
execution of this Assurance), and not less than annually during the continuation of such
relationship, a disclosure which clearly and conspicuously (i) sets forth Chase’s customer
information principles, including a description of the types of entities to which the Chase
customer’s name, address and telephone number is provided and a notice that such information
may be shared for the purpose of telemarketing and/or direct mail solicitations unless the
customer directs that such information not be disclosed to such nonaffiliated third party vendors,
and (ii) gives the customer notice that the customer may direct Chase not to disclose his/her
name, address and phone number to nonaffiliated third party vendors by writing to Chase at a
designated address or by calling Chase at a specified toll-free number ("Opt-Out Notice"). The
Opt-Out Notice shall be set apart from the text of the customer information principles, shall be
headed Opt-Out Notice, or words of similar import and meaning, such heading to be in at least
12 point bold type and the body of the Notice shall be in at least 9.5 point type. Chase shall
further publish its customer information principles and method for opting-out on its website.

3. This Assurance shall not apply, either before or after the effective date of the Gramm-
Leach-Bliley Act signed into law by the President on November 12, 1999, to the disclosure of
customer information in accordance with the provisions of Sections 502(b)(2), 502(e) or 504(b)
of the Gramm-Leach-Bliley Act, as originally enacted or as it may later be amended, or in
accordance with any regulations which may from time to time be promulgated thereunder;
except that, notwithstanding the foregoing, this Assurance shall apply (i) to any marketing
program that was in existence on June 15, 1999 and was on the list of programs supplied to the
New York Attorney General's office by Chase, or (ii) to any similar program involving the
sharing of customer information with a nonaffiliated third party vendor that is not a financial
institution (as that term is defined in the Gramm-Leach-Bliley Act) for the purpose of marketing
such vendor's products. However, Chase may continue to provide customer information to those
entities whose names and/or marks appear on the face of Chase credit cards unless prohibited by
regulations issued pursuant of the Gramm-Leach-Bliley Act.

4. Chase shall not furnish to a nonaffiliated third party vendor a cardholder's account
number until and unless Chase is assured that the customer has accepted the products or services
and with the cardholder's consent has either recorded, or if the cardholders refuses to be
recorded, confirmed with a supervisory employee of the telemarketing company, the
cardholder's agreement to charge the products or services to a Chase credit card account.

5. Chase shall take steps to retrieve or direct to be destroyed all personal identifiable
account information retained by nonaffiliated third party vendors within the last two years,
except that, in the case of completed sales, the nonaffiliated third party vendor may retain such
information as is necessary for future billing or servicing purposes.

6. In the event that the regulations issued pursuant to the Gramm-Leach-Bliley Act
differ from the requirements of this Assurance as to the disclosures required with respect to the
form, content and timing of Chase's customer information principles and Opt-Out Notice, Chase
may, upon 15 days notice, to the Attorney General's office elect to comply with the federal
regulations and such compliance shall be deemed compliance with the terms of this Assurance.
The provisions of this Assurance shall remain in effect for a period of five (5) years from the date
of its execution.

7. In the event that New York enacts legislation that affords consumers greater
protections than the specific protections provided under this Assurance, such law shall govern
Chase's obligations under any statute to which this Assurance relates.

8. Chase shall file a report with the Attorney General within 90 days after the date on
which Chase must comply with regulations adopted pursuant to the Gramm-Leach-Bliley Act indicating the manner and extent of its compliance with this Assurance of Discontinuance and shall annex thereto copies of its revised customer information principles and Opt-Out Notices to customers.

9. Nothing contained herein shall be construed as to deprive any individual of any private right of action under the law. This Assurance shall not confer on any person any rights as a third party beneficiary or otherwise against Chase.

10. Chase shall pay to the Attorney General within 10 days of the execution of this Assurance the sum of $101,500 as costs of this investigation pursuant to Executive Law §63(15).

11. Pursuant to Executive Law §63(15), evidence of a violation of this Assurance shall constitute prima facie proof of a violation of the applicable statutes in any civil action or proceeding hereafter commenced by the Attorney General.

WHEREFORE, the following signatures are affixed hereto this ___ day of January, 2000.

CHASE MANHATTAN BANK USA, N.A.

ELIOT SPITZER
Attorney General of the State of New York
120 Broadway
New York, New York 10271-0332
(212) 416-8323

BUREAU OF CONSUMER FRAUDS AND PROTECTION

By:
THOMAS CONWAY
Assistant Attorney General in Charge

STEPHEN MINDELL
JANE M. AZIA
SHIRLEY STARK
Assistant Attorneys General
CORPORATE ACKNOWLEDGMENT

STATE OF DELAWARE
COUNTY OF

being duly sworn, deposes and says:

I am a corporate officer of Chase Manhattan Bank USA, N.A., the entity described in
and which executed the foregoing Assurance of Discontinuance. I have executed the aforesaid
instrument with the consent and authority of Chase Manhattan Bank USA, N.A. and those
responsible for the acts of said entity and duly acknowledge same.

Sworn to before me this
day of January, 2000

Notary Public
PART 332—PRIVACY OF CONSUMER FINANCIAL INFORMATION

Sec. 332.1 Purpose and scope.
332.2 Rule of construction.
332.3 Definitions.
332.4 Initial notice to customers of privacy policies and practices required.
332.5 Annual notice to customers required.
332.6 Information to be included in initial and annual notices of privacy policies and practices.
332.7 Limitations on disclosure of nonpublic personal information about customers to nonaffiliated third parties.
332.8 Exceptions to opt-out notice requirements for service providers and joint marketing.
332.9 Exceptions to notice and opt-out requirements for consumer-initiated servicing transactions.
332.10 Other exceptions to notice and opt-out requirements.
332.11 Limits on disclosure and reuse of information.
332.12 Limits on sharing of account number information for marketing purposes.
332.13 Protection of customer information.
332.14 Relation to State laws.
332.15 Effective date; transition rules.

Authority: 12 U.S.C. 1819 (Seventh and Tenth); 15 U.S.C. 68 et seq.

§332.1 Purpose and scope.

(a) Purpose. This part governs the treatment of nonpublic personal information about consumers by the financial institutions listed in paragraph (b) of this section.

(1) Requires a financial institution to provide notice of its privacy policies and practices;

(2) Describes the conditions under which a financial institution may disclose nonpublic personal information about consumers to nonaffiliated third parties; and

(3) Provides a method for consumers to prevent a financial institution from disclosing that information to certain nonaffiliated third parties by "opting out" of that disclosure, subject to the exceptions in §§332.9, 332.10, and 332.11.

(b) Scope. The rules established by this part apply only to nonpublic personal information about individuals who obtain financial products or services for personal, family, or household purposes from the institutions listed in this paragraph (b).

This part does not apply to information about companies or about individuals who obtain financial products or services for business purposes. This part applies to entities for which the Federal Deposit Insurance Corporation has primary supervisory authority. They are referred to in this part as "you." These rules are intended by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System, insured state branches of foreign banks, and any subsidiaries of such entities, except a broker or dealer that is registered under the Securities Exchange Act of 1934, a registered investment adviser (with respect to the investment advisory activities of the adviser and activities incidental to those investment advisory activities), an investment company registered under the Investment Company Act of 1940, an insurance company that is subject to supervision by a state insurance regulator (with respect to insurance activities of the company and activities incidental to those insurance activities), and an entity that is subject to regulation by the Commodity Futures Trading Commission.

§332.2 Rule of construction.

The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

§332.3 Definitions.

As used in this part, unless the context requires otherwise:

(a) Affiliate means any company that controls, is controlled by, or is under common control with another company.

(b1) Clear and conspicuous means that a notice is reasonably understandable and designed to call attention to the nature and significance of the information contained in the notice.

(b2) Consumer means an individual who has obtained or has obtained a financial product or service from you that is to be used primarily for personal, family, or household purposes.

(c) Financial institutions means any company that obtains personal financial information to determine whether the loan is extended to you or to another financial institution.

(d) Information means any form or medium of communication from which facts can be ascertain, including oral communications, electronic communications, and other written forms.

(e) Marketing means any communication that promotes or offers to sell a financial product or service to you for personal, family, or household purposes, whether or not the communication is directed to you in a particular context.

(f) Notice means any communication to you, whether or not directed to you in a particular context, that describes the nature and purpose of a consumer's financial records, the types of records kept by an institution, and the potential uses of such records.

(g) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(h) Personal financial information means any nonpublic information about a consumer obtained in connection with a consumer's financial records, the types of records kept by an institution, and the potential uses of such records.

(i) Consumer relationship means a continuing relationship between a consumer and you under which you provide one or more financial products or services to the consumer that are to be used primarily for personal, family, or household purposes.

(j) Example means an example that is intended to illustrate a section of this part.

(k) opt-out notice means any notice that requires a consumer to take action in order to prevent you from disclosing nonaffiliated third parties with whom you do not otherwise maintain a consumer relationship.

(l) Opt-out notice means any notice that requires a consumer to take action in order to prevent you from disclosing nonaffiliated third parties with whom you do not otherwise maintain a consumer relationship.

(m) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(n) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(o) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(p) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(q) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(r) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(s) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(t) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(u) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(v) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(w) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(x) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(y) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

(z) Privacy notice means any communication to you that describes the institution's privacy policies and practices with respect to nonaffiliated third parties and the conditions under which such disclosures may be made.

[A] Avoid multiple negatives;
1. Financial product or service means any product or service that a financial institution could offer by engaging in an activity that is financial in nature or incidental to such financial activities as described in section 4(i)(3) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)(3)).

2. Financial institution does not include:

(a) A person or entity with respect to any financial activity that is subject to the jurisdiction of the Commodity Futures Trading Commission under the Commodity Exchange Act (7 U.S.C. 1 et seq.);

(b) The Federal Agricultural Mortgage Corporation or any entity chartered and operating under the Farm Credit Act of 1919 (12 U.S.C. 2001 et seq.);

(c) Institutions chartered by Congress specifically to engage in activities secondary to the institution's primary purpose;

(d) An individual who becomes your consumer in connection with a request or an application for a financial product or service and (ii) A customer relationship, or

(e) You otherwise obtain about a consumer in connection with a request or an application for a financial product or service.

3. Financial product or service means any product or service that a financial institution could offer by engaging in an activity that is financial in nature or incidental to such financial activities as described in section 4(i)(3) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)(3)).

4. Financial service includes your evaluation, performance, or provision of information that you collect in connection with a request or an application for a financial product or service.

5. General rule. You may provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

6. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

7. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

8. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

9. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

10. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

11. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

12. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

13. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

14. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

15. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

16. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.

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37. General rule. You must provide the privacy notices required by paragraph (a) of this section so that each customer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, in electronic form.
(C) For the consumer who conducts transactions electronically, post the notice on the electronic screen and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining a particular financial product or service.

(D) For an isolated transaction with the consumer, such as an ATM transaction, you must display the notice on the ATM screen and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining a particular financial product or service.

(ii) You may not, however, reasonably expect that a consumer will receive actual notice of your privacy policies and practices if you:

(A) Only post a sign in your branch or office or generally publish advertisements of your privacy policies and practices; or

(B) Send the notice via electronic mail to a consumer who obtains a financial product or service from you in person or through the mail and who does not agree to receive the notice electronically.

(iii) You provide the initial privacy notice to the consumer so that it can be retained or obtained at a later time if necessary:

(A) Hand-deliver a printed copy of the notice to the customer;

(B) Include a printed copy of the notice to the last known address of the consumer if you are not in a continuing relationship with the consumer; or

(C) Maintain the notice on a website (or a link to another web site) for the consumer who obtains a financial product or service from you in person or through the mail and who agrees to receive the notice electronically.

§ 322.5 Annual notice to customers

General rule. You must provide a clear and conspicuous notice to customers that adequately describes your privacy policies and practices not less than once in each year or such more frequent intervals that relationship exists.

(1) In order to provide notice. You must provide the annual notice required by paragraph (a)(1) of this section to a customer who obtains a financial product or service from you in person or through the mail and who agrees to receive the notice electronically.

(2) Termination of customer relationship. A consumer who sufficiently refrains from utilizing your privacy policies and practices not less than annually during the continuation of the customer relationship. Annually means at least once in any period of 12 months not shorter than which relationship exists.

(3) In order to provide notice. You must provide the annual notice required by paragraph (a)(1) of this section to a customer who obtains a financial product or service from you in person or through the mail and who agrees to receive the notice electronically.

§ 322.6 Form and method of providing opt out notices to consumers.

(1) Form of opt out notice. You must provide a clear and conspicuous notice to each of your consumers that describes your policies and procedures for the consumer to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including:

(A) The method by which you make disclosures of nonpublic personal information to nonaffiliated third parties;

(B) The categories of nonpublic personal information you disclose to nonaffiliated third parties;

(C) The categories of nonaffiliated third parties to whom you disclose nonpublic personal information;

(D) The purpose for which you disclose the information;

(E) That the consumer does not have to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties.

(2) Notice required under § 322.4 (d).

(3) Notice required under § 322.4 (d).
§ 332.30 Except as otherwise required under other provisions of law and in accordance with the Federal Privacy Act of 1977 (12 U.S.C. 3401 et seq.), to undertake disclosure of personal information by the financial institution relating to the consumer's account, or to make other disclosures that would be lawful if not undertaken by the financial institution, the disclosures would be lawful if not undertaken by the financial institution, the consumer's account, or to make other disclosures that would be lawful if not undertaken by the financial institution, the Federal Reserve Board, or other appropriate methods, to enforce your rights or the rights of other parties, or to protect the confidentiality or security of your records or your account, service, product, or other financial institution, you may also, independently of the financial institution, file a complaint with the Federal Reserve Board, or other appropriate methods, to enforce your rights or the rights of other parties, or to protect the confidentiality or security of your records or your account, service, product, or other financial institution, you may also, independently of the financial institution, file a complaint with the Federal Reserve Board, or other appropriate methods, to enforce your rights or the rights of other parties, or to protect the confidentiality or security of your records or your account, service, product, or other financial institution.

Purpose of this provision

For purposes of this section, "disclosure" means any communication by a financial institution or any other person acting on the consumer's behalf to a nonaffiliated third party that is not otherwise protected by this section, and the disclosure does not apply when you provide nonpublic personal information to a nonaffiliated third party that is not otherwise protected by this section.

Amount of nonpublic personal information disclosed

You may disclose nonpublic personal information to a nonaffiliated third party only if you provide the consumer with the initial notice described in paragraph (c) of this section.

Example of an initial notice

You may provide the consumer with the initial notice by placing a written notice at or near the point of sale or delivery of the financial service or product, or by sending the notice to the consumer's last known address.

Additional information

You may provide the consumer with additional information about the nature and purpose of the disclosure, the type of information disclosed, and the identity of the recipient of the information.

Example of an additional notice

You may provide the consumer with an additional notice by sending the notice to the consumer's last known address.

§ 332.12 Limits on redisclosures and requests for information

(a) Limitation on redisclosures.

You may disclose nonpublic personal information to a nonaffiliated third party only if you provide the consumer with the initial notice described in paragraph (d) of this section.

(b) Requests for information.

You may disclose nonpublic personal information to a nonaffiliated third party only if you provide the consumer with the initial notice described in paragraph (d) of this section.

Example of a request for information

You may provide the consumer with a request for information by sending the notice to the consumer's last known address.

§ 332.14 Effective date and transition rule.

(c) Effective date.

This rule is effective on the [insert date].

(d) Notice requirement for consumers.

You may not disclose nonpublic personal information about a consumer to a nonaffiliated third party unless you provide the consumer with the initial notice described in paragraph (d) of this section.

Example of a notice requirement

You may provide the consumer with the notice requirement by sending the notice to the consumer's last known address.
Banks create business opportunities from consumer information databases. Advances in technology have made these information systems exhaustive and economical as they have never before. And bank customers benefit from this through new product and service offerings, faster service, and lower costs.

For example, financial institutions increasingly offer consumers a “one-stop” source for many different financial services and products. By allowing banks to share customer information with affiliates or third-party vendors, consumers can receive consolidated account statements of their financial activity, call a single customer service hotline to inquire about their mortgage, credit card, and investment accounts, and receive loan approvals in minutes rather than days. And, by allowing consumer information to be used for cross-marketing purposes, institutions offer consumers the benefit of customized products and services and access to discounts.

As for faster service, allowing institutions to utilize credit information already in the possession of an affiliate can streamline credit approvals, shortening the time that consumers may wait to receive funds.

And when it comes to cost, as different types of financial services firms merge to offer a wider range of financial products, the consolidation of redundant business units produces savings that will benefit both the consumers and the financial institutions.

There are other sides to this story, however. In one case an invitation sold millions of credit card numbers to a convicted felon who used the information to make more than $46 million in fraudulent charges.

And a poll last year indicates that almost nine out of ten Americans are concerned about threats to their privacy, and almost eight out of ten believe that they have lost all control of how companies use their personal information. Reflecting their constituent’s feelings, state legislators introduced more than 1,800 consumer privacy bills in 1998 alone.

The American public has said that privacy is among the things that matter to them most - we must listen. The tension between the consumer’s desire to keep personal information private and the desire of the financial industry to use the information in a variety of ways is at the center of an ongoing discussion on privacy - and it is the reason we are here today.

Many bankers understand that the new value of this information places greater pressure on them to keep the information secure and to use it properly. We know that some do not, and privacy practices, therefore, have not always kept pace with the new demands for this information.

This is one reason that Congress included provisions to clarify and strengthen privacy protections in the Gramm-Leach-Bliley Act. Allowing consumers to opt out of certain information sharing - as the new law mandates - brings market discipline into play. And it can be an important incentive for banks and other businesses to adopt good privacy practices, if consumers are aware of how their information is being handled.

To implement those provisions, FDIC and the other financial service regulators issued a proposed rule regarding information sharing with unaffiliated third parties. You will hear more specifics about this proposed rule later this morning - and anything that you say in response during that presentation will be part of the official record that we will take into account in developing the final regulation.

Although the new law specifies an opt-out privilege, some privacy advocates are making arguments that the law does not allow adequate protection for consumers. They would prefer that consumers must affirmatively grant permission - or opt-in - to any information sharing. Meanwhile, some industry groups have argued that adopting such an opt-in regime would be prohibitively expensive, would hinder efforts to provide consolidated financial services, and would cripple cross-marketing initiatives.

The banking regulators are also drafting a proposed Fair Credit Reporting Act regulation regarding certain information sharing with affiliates, which also would allow consumers to opt out of information sharing.

One of the other interesting issues I hope we will explore later today is how we may read the new law together with existing privacy protections, such as those in the FCRA. Also, to protect consumer privacy without strangling the information economy, we should discuss how to define "nonpublic personal information" and "publicly available information." And another question - one that is, in some ways, more ambiguous and that requires more judgment to manage - is how widely should private information be shared within a banking company? We need to think very hard about these and other important questions if we want to craft regulations that protect consumers, support the banking industry, and avoid future litigation.

In order to encourage public comment on the proposed interagency regulation, the FDIC has created an Electronic Public Comment Internet site accessible from the FDIC Home Page. This EPC site was developed to make it easier for consumers to tell us what they think. The comment period is open through March 31, 2000, and the FDIC Home Page is found at www.fdic.gov.

Today's meeting is another important opportunity for consumers, privacy advocates, and the financial services industry to help us do a better job.

Traditionally, bankers have sought to portray themselves, not just as business people, but as professionals. Like doctors and lawyers, bankers are privy to the intimate details of the lives of the people they provide services to - assets and income, debt and dependents, payments and trusts. From the inflow and outflow of this information through a financial institution, one can reconstruct another person’s life.

Many people open a passbook account in grade school. From that moment, the bank knows how much money you have. Later, the bank knows the size of your mortgage, and how promptly you pay your bills. Later, you may establish trusts for your children - and the bank will know which children you believe can manage their own money -- and which ones you don’t.

For consumers, the banking relationship is personal, and a banker might be chosen, in part, because he or she is trusted to maintain confidence - to protect the details of financial relationships and information. Successful bankers have done so. For years, we have asked the question: "Are banks special?" For many consumers, banks are special because of the trust they have in bankers. In our meeting today, perhaps we can explore ways to preserve this relationship in the new banking environment.

Today, we will hear a broad range of views about consumer privacy in the financial services industry - views from bankers and consumer advocates, regulators and other government officials, privacy experts and Congressional staff. Our distinguished guests will discuss their views in three panels.

Before the discussions begin, we will be treated to a thought-provoking presentation on the power of technology and how it is used in today’s marketplace. The presentation will underscore the urgency of developing appropriate safeguards that protect consumer privacy, yet allow consumers to enjoy the many benefits that result from faster, more efficient information sharing.
FDIC

Conferences & Events

Remarks of Ellen Seidman
Director, Office of Thrift Supervision
Moderator for the Future of Privacy Law Panel
March 23, 2000

Let me first thank Chairman Donna Tanoue and the FDIC for hosting this Interagency Public Forum on Consumer Information, Privacy, and the Financial Services Industry. I am pleased to participate.

The inspired title, "Is it Any of Your Business?" would not more perfectly focus us on the issue at hand and the context in which it arises. When we tell someone that something is none of their business, we are asserting our privacy. We are labeling particular information confidential and beyond the scope of the relationship we have with that person. Sometimes information about us is "nobody's business." But more often than not, personal information has gradations of privacy. We choose to share some information with select individuals, but not with others. We expect that when we share something in confidence that it is kept in confidence. For individuals privacy is about choices and expectations with respect to the use of information about ourselves.

"Is it any of your business?", we ask. "Business", as in the financial services business, is increasingly a matter of consumer information flows. The clearing process for personal checks. The settlement process for trading securities. The servicing of home mortgage payments and property tax escrows. The insurance claims process. All of these and more are the business of financial service enterprises that require the use of personal information. Customers expect banks to use consumer information to conduct their financial affairs-up to a point. Where that point is located is the pivot around which the debate on the privacy of consumer information revolves.

For businesses the information about a customer is valuable. It is an asset that is considered proprietary. Customer information affords advantages to those that have it, over those that do not. It is this incentive that reinforces the confidentiality under which most banks hold consumer information. There is a business interest in doing so.

There is also a business interest in "mining" the information obtained from customers. And lest we forget, there can be value to the consumer in terms of expanded choice enabled by such data mining. Information is very much the currency of modern business. Its liquidity is what drives so much of our consumer oriented society.

It all comes down to who will choose how to control the use of personal information.

In this technological world of accelerating information flows, the importance of controlling personal information affects all aspects of human commerce. The world has been digitally transformed and reassembled into a complex string of billions and billions of bits of personal information. Information is moving so fast that the future arrives not in terms of years, not even in the space between today and tomorrow, but in the ever shortening interval between tip and trade.

It is no wonder then, that in less time than it takes to finalize a government regulation and in the slightly more than four months since the passage of the Gramm-Leach-Bliley Act, I am moderating a panel on the Future of Privacy Law. We have not yet done with the current regulatory proposal and we are already looking to the future. Why?

Allow me to suggest three reasons why the privacy horizon is rushing towards us:

First, there is a feeling of unfinished business about the financial privacy debate. The GLBA was the opening rather than the endgame of financial privacy legislation. This was recognized at the time and has become more evident as the new session of Congress proceeds.

Second, there are new examples of technological intrusion, like the DoubleClick episode, that sound an alarm among many of the Information Age's most devoted disciples that the cherished anonymity of e-exchange will succumb to the burgeoning capacity of technology to track our every electronic footstep. Actions we wish to be "nobody's business" are becoming just another file in someone's database. Unless we act now, the argument goes, we will be too late to preserve our on-line privacy. The impetus of this concern has increasing relevance to the financial services industry as it expands its business presence in cyberspace.

Third, the consumer conscience has been raised. Always sensitive to the specter of Big Brother in the form of government oversight, people are increasingly appreciative of the loss of control over who intrudes on their private sphere. Not just in the virtual sense, but in the most traditional of personal spaces-one's home. The oft quoted privacy definition-the right to be left alone-has been battered. It is not a theoretical intrusion. It is not limited to the computer literate. It is the common experience of modern man. The dreaded phone call at dinner.

Each of these reasons contributes to the increasing pace at which the need to address the future of privacy presses.

Looking forward from here, there are three concrete areas that are likely to make up the immediate Future of Privacy Law as it pertains to the financial services industry:

• Tweaking GLBA.
  • Depending on the comments received about the proposed regulation there may be a few items that would benefit from statutory clarification.

• Grappling with State developments.
  • GLBA expressly allows the states to extend protections for consumer privacy beyond the boundary established in federal law.
  • Already state legislators are proposing a variety of additional privacy laws. How these proposals will fare and how they will impact the privacy rights landscape remain to be seen. However, there is no doubt that these proposals will contribute to the future of privacy law.

• Further federal protections.
  • The Administration and members of Congress are interested in building upon the foundation of GLBA.
  • Discussions range from restricting information sharing among corporate affiliates, to providing customer access and a right to have personal information corrected, and to prohibiting discrimination by financial firms on the basis of medical information obtained from an affiliate.

While these three areas describe the range of immediate future activity with respect to privacy and financial institutions, we should be mindful that this debate is occurring in a broader context of privacy that goes beyond the financial services, that even goes beyond commercial business, to reach virtually all of our dealings with our fellow citizens.

In fact, this is a debate with repercussions extending well beyond our shores. How we deal with personal information at home will have important consequences for how American companies do business abroad.

In 1933, George Bernard Shaw, an astute observer of social relationships, spoke to an audience in New York and remarked, "An American has no sense of privacy. He does not know what it means. There is no such thing in the country." Despite the intervening years, the European perspective on the American sense of privacy may be unchanged. But for me, there seems little doubt that going forward, Americans will at least search for the meaning of privacy.

I am honored to introduce my panel members who will help us divine the Future of Privacy Law:

[Names of panel members]
FDIC

Conferences & Events

KILLING THE GOLDEN GOOSE - How to Protect Consumer Privacy Without Strangling the Information Economy

Remarks by Jo Ann S. Barefoot
Managing Director, KPMG Consulting

To the FDIC Conference on Privacy Washington DC

March 23, 2000

Three weeks ago, my husband and I went to Alaska to photograph wolves. We flew far above the Arctic Circle in two small planes with two pilots. At night over drinks, the pilots regaled us with stories of the Alaska bush, including one about a friend who was a gold miner. This man worked his claim for twenty years, living in a cabin and searching for miles in every direction. Finding nothing, he eventually gave up and sold the land.

The new owner tore down the cabin, and there was the gold -- directly beneath it.

The financial services industry has realized that it sits atop a gold mine in the form of information about its customers. The information has always been there, but it has suddenly been "discovered" and made precious by new technology that enables companies to extract it, consolidate it, and put it to new uses.

By using that information well, smart businesses will increase their profits. But the very same innovations that raise those profits also will increase, profoundly, the benefits delivered to consumers.

The challenge facing both government and industry is to tap this rich vein of benefit, and at the same time, protect customer privacy.

It won't be possible. The issue is too complex, too fast-moving, and too volatile - both technologically and politically - to be fiscable by passing a law or two. And at bottom, the issue is intractable, because privacy-threatening innovation is entangled with consumer-benefiting innovation. They are, in fact, the very same thing. As a result, excessive privacy regulation could kill the golden goose of the Information Age marketplace.

Our public policy-making institutions, despite good intentions, will struggle to address these challenges at a snail's pace, while the marketplace moves ahead at cyber-speed. The result won't be pretty. Legislation, regulation, and litigation will proceed in bits and pieces, fits and starts, changing, conflicting, rife with unintended consequences.

The situation will be loaded with risk for businesses, problems for consumers, and daunting challenges for politicians and regulators.

I'm pleased to be here today at the FDIC's timely forum on these challenges. Other speakers will address the specifics of implementing the new Gramm-Leach-Bliley privacy law. I want to use my time to step back from those specifics and make five observations that seem to me to be the keys to getting the privacy issue right from a public policy standpoint. I'll also suggest four principles essential to shaping sound policy as we go forward.

Observation #1: This will be the most difficult consumer protection issue ever

I have worked with consumer issues in financial services for thirty years, in both the public and privacy sectors, and have never seen a challenge like this. It's unique, for three reasons.

First, there are no solutions that won't require massive tradeoffs in which consumers could lose more than they win.

Second, it's moving at light speed. Privacy was barely on the radar in the U.S. a year and a half ago when the European Union guidelines took effect. Today, one can't open a newspaper without finding a privacy story. While the issue involves off-line as well as on-line data, it's being driven into public consciousness by the rise of the Internet, at the same speed. Accordingly, both industry and government are being forced to take action on privacy, before having a chance to understand fully the implications of what they do.

Third, everyone cares about it. I recall watching a television crime drama some months ago with a cyberstalking plot. I thought to myself, in all my years working in consumer issues in banking, I've never seen a pop TV show about the Truth in Lending Act. Other consumer protection issues animate consumer activists or specific customer groups, but the average consumer doesn't care much unless he has a problem. Privacy is different. Everyone -- even bankers -- want a zone of protected privacy.

Observation #2: It's a mistake to "dumb down" privacy into a win/lose proposition - Consumers will win more than they lose

So far, privacy has been framed simplicistically as a business-versus-consumer contest, a win/lose scenario in which the business gains at the expense of the consumer whose information is exploited for the business' profit.

It is true that consumers will lose some privacy in the new economy. And it is true that businesses will profit from high-tech use of consumer data. But it is also true that consumers will benefit from the new data uses - probably more than industry does. We need public policy that respects the law of unintended consequences and allows for the very real risk that regulation undertaken with the good intent of protecting consumers, may end up harming them.

We have barely begun to perceive the consumer benefits of the new economy, but does anyone doubt they will eclipse any innovation in memory? Information Age consumers will get a vastly better deal than their industrial age predecessors. They will have infinitely more product choices and more information on which to base them. They will have convenience beyond their wildest dreams, in terms of time-savings, opportunities to pick and choose, the chance to customize what they want, the ability to switch from a bad provider to a new one - or even from a good one to a better one - with only negligible cost and effort. They will also benefit from massive cost efficiencies. These lost costs will be largely invisible and taken for granted, but will, especially when combined with the Internet's impulse toward pure-market competition, act to hold down and even lower prices.

In fact, the Information Age will produce a power shift in the relationship between business and customers, with leverage shifting to the consumer who will, to a degree never seen before, be empowered with information and freedom of choice.

Those benefits can be fully tapped only if the new economy can deliver services over the internet and can use the power of information to innovate in serving consumers. Privacy regulation that impedes those developments could delay, dilute, or block these consumer gains. In short, privacy regulation is not an unadulterated consumer benefit.

Every major new technology brings costs as well as benefits. The automobile has extracted a high cost in land use, pollution, and highway accidents. Few Americans, however, would give it up. Similarly, they will want to reap the benefits of Information Age services, at the cost of reasonable tradeoffs on their privacy.

Observation #3: The threat to privacy is real -- and scary

Having staked out my place on the free-market side of the debate, let me switch sides for a moment. The same uncertainties that make it impossible to foresee fully how the new economy will help the public, also make it impossible to foresee all the harm that could be done. We do, though, know that the harm could be substantial.

Some of that harm will come from companies selling data for profit. This is the main focus of both the new Gramm-Leach law and the litigation we have seen to date in financial services.

Some harm will arise from data security failures. As we noted earlier, customer data is newly-precious. It will be increasingly worthwhile for people to try to get it. And many companies are security sieve, highly vulnerable to having data improperly accessed and used or shared by hackers, thieves, business partners, and their own employees.

Beyond this, harm will occur over how businesses use their own customers' data, themselves. Interestingly, this is a realm barely touched by Gramm-Leach. But as businesses consolidate, analyze, and model customer data and use it to predict behavior and differentiate how customers are treated, controversy will erupt. Again, I believe that
customers will win more than they lose from this process, but still, some will lose. These practices will spark
concerns about fairness and discrimination, on top of concerns about loss of privacy.

Good companies will get into these problems. We have seen smart businesses, from Doubleclick to Amazon.com to
late, blindsided by privacy criticism for doing things that seemed uncontroversial to them. Beyond this, some bad
companies will do bad things, poisoning the environment for all.

Just last week, a colleague of mine attended a real estate conference where a speaker advised commercial landlords
to monitor, mine, and sell data from the email traffic of their business tenants. We’ve seen only the beginning edge of
the controversies to come.

Observation #4: Market forces will help (but not enough)

It’s conceivable that consumers will simply shrug off these risks. Just before the privacy firestorm erupted around
Doubleclick, its president compared today’s privacy issues to those when credit cards were new, and issuers
wondered if consumers would resist giving cards to, say, a waiter. If they did, it didn’t last. It’s possible that
Information Age consumers will ignore routine privacy disclosure statements, as they do many others, and just relax.

However, it’s much more likely that, as consumers start to understand the profoundly new ways in which their
information can be used, they will rebel. Again, this is an issue that can raise blood pressure in nearly everyone.
People feel shocked, frightened, violated, and even rearranged by the thought that personal, “private” information can be
viewed, used against them, or bought and sold for someone else’s gain.

And especially on the Internet. Recall the widely-circulated cartoon of a few years ago in which a dog sits in a chair
in front of a computer screen, talking to a little canine buddy. The character at the keyboard says, “You see, on the
Internet, no one knows you’re a dog.” Anonymity is a core attraction of the Net. People go on-line to do things, learn
things, say things, buy things, try things, meet people - anonymously. They do this thinking they are protected, with
only their buddy name known to others. They think they are safe and secure “in the privacy of their own homes.”

That perception collides with the reality of on-line data collection. Not only are one’s movements on the web not
anonymous and confidential. They are potentially scrutinized at every turn. The Internet, far from offering a veil of
confidentiality, is more like the Orwellian scenario in which every move is - or least could be - watched.

As consumers come to realize this, they will affirmatively choose options that give them privacy. They will shun
companies that become branded as privacy abusers. They will seek out and patronize companies that promise and
deliver privacy protection. Privacy will become a competitive differentiator, which will drive more companies to
offering more protection. The marketplace will self-regulate.

But only up to a point. Government will have to overlay the market with minimum rules to prevent abuse at the
margins and to let consumers put their trust in the infant e-commerce marketplace.

Observation #5: Privacy protection will be incredibly expensive and difficult to implement

Compliance with those government requirements (and even self-regulation) will cost a fortune. Beyond the
opportunity costs of lost innovation, industry will spend vast amounts on the basics of privacy protection. Those
basics, as reflected in Gramm-Leach, will be “notice and choice” - disclosing to customers how information may be
used, and offering choices about it.

In most large banks today, no one even knows what data is collected about customers, not to mention how all of it is
used. Few banks so far have fully linked their internal data bases well enough that they can easily attach an “opt out”
label to a customer’s file and have that flag follow the customer’s name throughout the organization. Creating this
capacity as a foothold process is a massive undertaking. So is the process of comprehensively notifying each
customer about data collection and use and choices. So is the upgrading of data security enough to assure full privacy
protection.

Privacy risks permeate every corner of every company. Closing them all down and keeping them closed, is likely to
be most expensive consumer protection undertaking in history.

What to do?
I would like to thank the Federal Deposit Insurance Corporation for inviting me to participate in this timely and important forum. The financial services industry, consumers and government are equal stakeholders in the uses of information and, as the financial services industry evolves in a post-Gramm Leach-Bliley world coincident with rapidly changing technology, it is crucial that we three stakeholders work in a spirit of partnership. This forum provides what I hope is the first of many such opportunities to explore one another's interests and concerns. The development of sound public policy must balance these interests. We commend Chairman Tenane for her leadership and contribution to the development of reasoned public policy.

I would like to state at the outset that the protection of customer financial information is the foundation upon which trust is built. The prudent use of information is likewise the foundation of superior customer service. Without trust and the ability to deliver the products customers want - when and where they want them - a financial services company cannot and will not survive.

We have experienced rapid consolidation in the banking industry over the past fourteen years. Yet consumers still enjoy an infinite variety of choice among providers. The Internet will expand the array of products and will, I believe, further the considerable democratization of credit in America. I don't think we truly appreciate in this country the status of the American consumer whose access to credit is equivalent to that enjoyed in other countries by only large businesses and sovereign governments.

Also important to remember is the portability of credit in America. The fact that an individual can be born and raised in one state, schooled in another, live and work in multiple places during the course of a career and have consistent and immediate access to credit should not be taken for granted.

The democratization of credit and the portability of credit are made possible by the collection and use of information. This system works because we all participate in it and it is reliable. It depends as much upon the free flow of public record information as it does the full and complete reporting of financial institutions to credit reporting services.

In addition to enhancing the availability of credit, information sharing has enabled the industry to develop very sophisticated neural networks to identify and stop fraud. Losses due to fraud have dramatically decreased over the past several years. At the same time, however, the incidence and fear of identity theft is on the rise. This is an area where we must focus more attention and work collaboratively to protect our customers and assist victims. The FDIC, Treasury, the Federal Trade Commission, Justice, consumers and the banking industry have committed to working together on the prevention and remediation of identity theft. During the coming months banks will be re-examining their own practices. We will be participating in renewed efforts to educate consumers and to raise public awareness to reduce the number of consumers who suffer as victims of identity theft. Obviously, consumer confidence is key to the growth of electronic commerce and we are pleased that the Internet community is actively participating in the dialogue to determine how we can balance the needs of consumers, commerce and law enforcement in this area.

Turning away from the emerging world for a moment, I would like to look back at how most large banking institutions have evolved. When interstate banking took effect around 1980, a gradual expansion took place. Mergers occurred in a patchwork fashion depending upon state reciprocity laws and takeovers were effected in communities where other banks had failed. The result today is a strong banking system with, as I stated earlier, an infinite variety of financial institutions. Part of that infinite variety is corporate structure. Many banks offer products and services through a diverse assortment of affiliates which exist for any number of reasons. To the customer, we are "the bank."

A Bank One or Wells Fargo customer, for example, with an account in Texas experiences virtually no interruption of service when visiting a branch in Arizona or Colorado. Yet, Texas, Arizona or Colorado branches are each a part of a separate affiliate. Likewise, in some institutions, mortgage lending may take place in one affiliate while home equity lending takes place in another. In other institutions, first and second mortgage lending take place in the same affiliate.

There has been a lot of heat and light generated around the issue of affiliate sharing. Perhaps more heat than light. This is an area where we need to proceed deliberately and, indeed, it will be a customer communication and customer service challenge for us to ensure our customers understand the particular benefits of information sharing at our individual institutions. The decision of the Congress to not legislate restrictions in this area does not constitute a loophole or a weakness in privacy protection. It reflects an understanding that banks are structured in many ways for myriad reasons. We work very hard to not let cumbersome corporate structures and legacy systems impair our ability to serve the customer in easy, safe and convenient ways.

Finally, I would like to emphasize that we view the privacy expectations of our customers as integral to customer service. We are committed to clear disclosures and to the exercise of informed choice. Our policies and practices must not only be understandable to consumers but to our employees as well. In a large and complex organization, this will be a challenge. It will require systems redesign, new business rules and extensive employee training. The time frame is very short and any mistakes will be costly. We hope consumers and the federal agencies will be pleased with our efforts will continue to work with us as trusted partners.
Why privacy, why now? There seem to be three factors. Consumers who are fed up with aggressive intrusions on their private lives. Institutions like those in Minnesota and New York, who were caught crossing the line. And members of Congress who are not only shining spotlight on privacy, but also working to ensure that consumers are told about how and why personal information is collected and used, provided access to that data, and given a choice in the matter.

There is some comfort in knowing that there is so much interest about protecting the privacy of American consumers. Whether that comfort is a warm blanket or wet blanket depends whether the Administration, Congress, regulators, and those in the states turn up the heat. It also depends on the willingness of industry to come in from the cold and adopt Fair Information Practices. Later today, the push for privacy continues at a Congressional Privacy Caucus briefing with the New York and Minnesota Attorneys General.

Do consumers care? You bet they do. According to a Forrester Research survey of online users, 67 percent said they were "extremely" or "very" concerned about releasing personal information over the Internet. It is estimated that those fears may have resulted in as much as $2.8 billion in lost sales for Internet retailers in 1999. The lack of privacy is costing business.

A new Business Week/Harris poll shows that 92% of Internet users are uncomfortable about Web sites sharing personal information. 57% favor the government passing laws on how personal information is collected and used. And many people are uncomfortable with the creation of profiles. 82% said they were not comfortable with linking their identity with personal information like income, credit data, and medical information.

The ability to collect, share and use data in all sorts of ways boggles the mind. Consumers, in many cases, aren't even aware that data is being collected, much less how profiles about them are created. The information collection overload is particularly troublesome when it becomes the basis for decisions made about an individual -- how much a product or service will cost.

What protections do consumers have today? Not much. The much ballyhooed privacy provision of the Gramm Leach Bliley Act does not protect consumers' privacy. And because the underlying bill is bad, the implementation of regulations provides little hope for consumers seeking to keep their personal information private. While states were given the ability to enact stronger protections, those efforts have met fierce resistance by the financial services industry.

We need stronger laws, like the one introduced by Senators Shelby and Bryan, and Congressmen Markay and Barton. That bill will put power and choice in the hands of consumers regarding the collection and use of their personal information.

Web-based businesses already seem to be willing to move beyond the privacy wasteland where GLB left consumers. There no longer appears to be a question, for some, of whether consumers should get notice, access, and control over their information. The challenge is how to effectively put these principles into practice.

What about privacy policies? Won't those do the trick? Privacy policies are not a substitute for privacy protections, especially when some companies don't even follow what is in their policies. Just because a company has a privacy policy does not mean that they follow Fair Information Practices. And consumers are skeptical about self-regulation. Only 15% of those surveyed in the Business Week poll supported letting groups develop voluntary privacy standards. Nor has industry shown the will power to adopt adequate self-regulatory programs.

Where is all this going? The marketplace is changing daily. The Wall Street Journal reports that Time Warner has the names, addresses and information on the reading and listening habits of 65 million households. USA Today says Time Warner has access to information about its 13 million cable subscribers and from its other businesses, like Time and People magazine. With so much information, how will the competitiveness of the marketplace be impacted by this merger? Will companies who seek to operate under a higher privacy standard be at a competitive disadvantage and unable to compete against a larger entity that is able to make unrestricted use of the personal information it obtains? Is this the future? Now imagine a Time Warner/AOL/Bank of X.

Today, business models are based on collecting and selling information. Financial institutions want to get into the business too. In a recent speech, Julie Williams, Counsel to the Comptroller of the Currency, said that consumers may become "more reliant on bank-maintained databases ... consumers may conclude that banks are a logical repository of all their information: financial and non-financial." At about the same time, the Financial Services Roundtable was asking the Federal Reserve for expanded powers to get into the data processing business.

Will consumers benefit from all this data sharing? Financial institutions promised that in exchange for a virtually unfettered ability to collect and share consumers' personal information, that consumers would get better quality products and services and lower prices. This is why, they claimed, consumers shouldn't have strong privacy protections like the ability to stop the sharing of their information among affiliates, or access to that information to make sure it's accurate. Final answer? Let's look at reality.

Bank fees for many consumers continue to rise. Information about financial health may actually be used to the consumer's detriment if it is perceived that the consumer will not be as profitable as other customers. Both Freddie Mac and Fannie Mae say between 30 and 50% of consumers who get subprime loans, actually qualify for more conventional products, despite all the information that is available to lenders today. Credit card issuers continue to issue credit cards to imposters, thus perpetuating identity theft, even when it seems like a simple verification of the victim's last known address should be a warning. Instead of offering affordable loans, banks are partnering with payday lenders. And when do some lenders choose not to share information? When sharing that information will benefit the consumer -- like good credit histories that would likely mean less costly loans.

Maybe the right approach is to let institutions that want a consumer's information to be put in a position to convince that consumer that some benefit will be derived from a willingness to give that information up to the institution. Such an approach may increase trust in financial institutions and let consumers have control and choice over their own personal information. The same technology that enables vast amounts of data to be collected can be used to let consumers access to that data. It is a simple thing to tell consumers what is collected and how it is used.

The comfort we seek may only be realized when basic Fair Information Practices are more fully embraced and when there is a realization that sound privacy principles are, in fact consistent, with sound business.
The Children's Online Privacy Protection Act becomes effective April 21, 2000. The regulations apply to the online collection of personal information from children under 13. They spell out what a Web site operator must include in a privacy policy, when and how to seek verifiable consent from a parent and what responsibilities an operator has to protect children's privacy and safety online.

The Federal Trade Commission staff prepared this guide to help you comply with the new requirements for protecting children's privacy online and understand the FTC's enforcement authority.

Who Must Comply

If you operate a commercial Web site or an online service directed to children under 13 that collects personal information from children or if you operate a general audience Web site and have actual knowledge that it collects personal information from children, you must comply with the Children's Online Privacy Protection Act.

• To determine whether a Web site is directed to children, the FTC will consider several factors, including the subject matter; visual or audio content; the age of models on the site; language; whether advertising on the Web site is directed to children; information regarding the age of the actual or intended audience; and whether a site uses animated characters or other child-oriented features.

• To determine whether an entity is an "operator" with respect to information collected at a site, the FTC will consider who owns and controls the information; who pays for the collection and maintenance of the information; what the pre-existing contractual relationships are in connection with the information; and what role the Web site plays in collecting or maintaining the information.

Personal Information

The Children's Online Privacy Protection Act and Rule apply to individually identifiable information about a child that is collected online, such as full name, home address, email address, telephone number or any other information that would allow someone to identify or contact the child. The Act and Rule also cover other types of information - for example, hobbies, interests and information collected through cookies or other types of tracking mechanisms - when they are tied to individually identifiable information.

Basic Provisions

Privacy Notice

Placement

An operator must post a link to a notice of its information practices on the home page of its Web site or online service and at each area where it collects personal information from children. An operator of a general audience site with a separate children's area must post a link to its notice on the home page of the children's area.

The link to the privacy notice must be clear and prominent. Operators may want to use a larger font size or a different color type on a contrasting background to make it so. A link in small print at the bottom of the page -- or a link that is indistinguishable from other links on your site -- is not considered clear and prominent.

Content

The notice must be clearly written and understandable; it should not include any unrelated or confusing materials. It must state the following information:

- The name and contact information (address, telephone number and email address) of all operators collecting or maintaining children's personal information through the Web site or online service. If more than one operator is collecting information at the site, the site may select and provide contact information for only one operator who will respond to all inquiries from parents about the site's privacy policies. Still, the names of all the operators must be listed in the notice.

- The kinds of personal information collected from children (for example, name, address, email address, hobbies, etc.) and how the information is collected - directly from the child or passively, say, through cookies.

- How the operator uses the personal information. For example, is it for marketing back to the child? Notifying contest winners? Allowing the child to make the information publicly available through a chat room?

- Whether the operator discloses information collected from children to third parties. If so, the operator also must disclose the kinds of businesses in which the third parties are engaged; the general purposes for which the information is used; whether the third parties have agreed to maintain the confidentiality and security of the information; and that the parent has the option to agree to the collection and use of the child's information without consenting to the disclosure of the information to third parties.

- That the operator may not require a child to disclose more information than is reasonably necessary to participate in an activity as a condition of participation.

- That the parent can review the child's personal information, ask to have it deleted and refuse to allow any further collection or use of the child's information. The notice also must state the procedures for the parent to follow.
Public Disclosures

Before collecting, using or disclosing personal information from a child, an operator must obtain verifiable parental consent from the child's parent. Until April 2002, the FTC will use a *sliding scale* approach to parental consent in which the required method of consent will vary based on how the operator uses the child's personal information. That is, if the operator uses the information for internal purposes, a less rigorous method of consent is required. If the operator discloses the information to others, the situation presents greater dangers to children, and a more reliable method of consent is required. The sliding scale approach will sunset in April 2002 subject to a Commission review planned for October 2001.

Internal Uses

Operators may use *email* to get parental consent for all internal uses of personal information, such as marketing back to a child based on his or her preferences or communicating promotional updates about site content, as long as they take additional steps to increase the likelihood that the parent has, in fact, provided the consent. For example, operators might seek confirmation from a parent in a follow-up email, or confirm the parent's consent by letter or phone call.

Public Disclosures

When operators want to disclose a child's personal information to third parties or make it publicly available (for example, through a chat room or message board), the *sliding scale* requires them to use a more reliable method of consent, including:

- getting a signed form from the parent via postal mail or facsimile;
- accepting and verifying a credit card number;
- taking calls from parents, through a toll-free telephone number staffed by trained personnel;
- *email* accompanied by a PIN or password obtained through one of the verification methods above.

But in the case of a monitored chat room, if all individually identifiable information is striped from postings before it is made public - and the information is deleted from the operator's records - an operator does not have to get prior parental consent.

Disclosures to Third Parties. An operator must give a parent the opportunity to agree to the collection and use of the child's personal information without agreeing to the disclosure of the information to third parties. That is, a parent can grant consent to allow his/her child to participate in activities on the site without consenting to the disclosure of the child's information to third parties.

Exceptions

The regulations include several exceptions that allow operators to collect a child's email address without getting the parent's consent in advance. These exceptions cover many popular online activities for kids, including *contests*, *online newsletters*, *homework help* and *electronic postcards*. Prior parental consent is not required when:

- an operator collects a child's or parent's email address to provide notice and seek consent;
- an operator collects an email address to respond to a *one-time* request from a child and then deletes it;
- an operator collects an email address to respond more than once to a specific request - say, for a subscription to a newsletter. In this case, the operator must notify the parent that it is communicating regularly with the child and give the parent the opportunity to stop the communication before sending or delivering a second communication to a child;
- an operator collects a child's name or online contact information to protect the safety of a child who is participating on the site. In this case, the operator must notify the parent and give him or her the opportunity to prevent further use of the information;
- an operator collects a child's name or online contact information to protect the security or liability of the site or to respond to law enforcement, if necessary, and does not use it for any other purpose.

October 2001/April 2002

Come October 2001, the Commission will seek comment from interested parties to determine whether technology has progressed as expected and whether secure electronic methods are widely available and affordable. Subject to the Commission's review, the sliding scale will expire in April 2002. Until then, operators are encouraged to use the more reliable methods of consent for all uses of children's personal information.

New Notice for Consent

An operator is required to send a *new notice* and request for consent to...
parents if there are material changes in the collection, use or disclosure practices to which the parent had previously agreed. Take the case of the operator who got parental consent for a child to participate in contests that require the child to submit limited personal information, but who now wants to offer the child chat rooms. Or, consider the case of the operator who wants to disclose the child's information to third parties who are in materially different lines of business from those covered by the original consent - for example, marketers of diet pills rather than marketers of stuffed animals. In these cases, the Rule requires new notice and consent.

Timing

The Rule covers all personal information collected after April 21, 2000, regardless of any prior relationship an operator has had with a child. For example, if an operator collects the name and email address of a child before April 21, 2000, but plans to seek information about the child's street address after that date, the later collection would trigger the Rule's requirements. In addition, come April 21, 2000, if an operator continues to offer activities that involve the ongoing collection of information from children - like a chat room - or begins to offer such activities for the first time, notice and consent are required for all participating children regardless of whether the children had already registered at the site.

Access Verification

At a parent's request, operators must disclose the general kinds of personal information they collect from children (for example, name, address, telephone number, email address, hobbies), as well as the specific information collected from children who visit their sites. Operators must ensure they are dealing with the child's parent before they provide access to the child's specific information. They can use a variety of methods to verify the parent's identity, including:

- obtaining a signed form from the parent via postal mail or facsimile,
- accepting and verifying a credit card number,
- taking calls from parents on a toll-free telephone number staffed by trained personnel,
- email accompanied by digital signature,
- email accompanied by a PIN or password obtained through one of the verification methods above.

Revoking & Deleting

At any time, a parent may revoke his/her consent, refuse to allow an operator to further use or collect their child's personal information and direct the operator to delete the information. In turn, the operator may terminate any service provided to the child, but only if the information at issue is reasonably necessary for the child's participation in that activity. For example, an operator may require children to provide their email addresses to participate in a chat room so the operator can contact a youngster if he is misbehaving in the chat room. If, after giving consent, a parent asks the operator to delete the child's information, the operator may refuse to allow the child to participate in the chat room in the future. If other activities on the Web site do not require the child's email address, the operator must allow the child access to those activities.

Safe Harbors

Industry groups or others can create self-regulatory programs to govern participants' compliance with the Children's Online Privacy Protection Rule. These guidelines must include independent monitoring and disciplinary procedures and must be submitted to the Commission for approval. The Commission will publish the guidelines and seek public comment in considering whether to approve the guidelines. An operator's compliance with Commission-approved self-regulatory guidelines will serve as a "safe harbor" in any enforcement action for violations of the Rule.

Enforcement

Once the Rule becomes effective (April 2000), the Commission may bring enforcement actions and impose civil penalties for violations in the same manner as for other Rules under the FTC Act. In the meantime, the Commission also retains authority under Section 5 of the FTC Act to examine information practices in use before the Rule's effective date for deception and unfairness. In interpreting Section 5 of the FTC Act, the Commission has determined that a representation, omission or practice is deceptive if it is likely to:

- mislead consumers; and
- affect consumers' behavior or decisions about the product or service.

Specifically, it is a deceptive practice under Section 5 to represent that a Web site is collecting personal identifying information from a child for one reason (say, to earn points to redeem a premium) when the information will be used for another reason that a parent would find material and when the Web site does not disclose the other reason clearly or prominently.

In addition, an act or practice is unfair if the injury it causes, or is likely to cause, is:

- substantial;
- not outweighed by other benefits; and
- not reasonably avoidable.

For example, it is likely to be an unfair practice in violation of Section 5 to collect personal identifying information from a child, such as email address, home address or phone number, and sell or otherwise disclose that information to a third party without giving parents adequate notice and a chance to control the collection and use of the information.
For More Information

If you have questions about complying with the Children's Online Privacy Protection Act, email kidsprivacy@ftc.gov. For more information about the FTC, visit www.ftc.gov.

Your Opportunity to Comment

The Small Business and Agriculture Regulatory Enforcement Ombudsman and 10 Regional Fairness Boards collect comments from small businesses about federal enforcement actions. Each year, the Ombudsman evaluates enforcement activities and rates each agency's responsiveness to small business. To comment on FTC actions, call 1-888-734-3247.
TO: Chief Executive Officers and Compliance Officers of All National Banks, Department and Division Heads, and All Examining Personnel

The Federal Trade Commission published a final rule to implement the Children's Online Privacy Protection Act of 1998 (COPPA) in the Federal Register on November 3, 1999. The COPPA, which is effective April 21, 2000, prohibits unfair or deceptive acts or practices in connection with the collection, use or disclosure of personal information from and about children on the Internet. The COPPA and the final rule apply to national banks. In addition, section 1306 of the COPPA gives the OCC enforcement responsibility. Examination procedures, currently being developed, will provide further guidance.

For more information, contact your supervisory office or the Community and Consumer Policy Department at (202) 874-4428.

Ralph E. Sharpe
Deputy Comptroller
Community and Consumer Policy

Attachment--64 FR 59888
OFFICE OF THE COMPTROLLER OF THE CURRENCY NEWS RELEASE
CONCERNING EFFECTIVE WEB PRIVACY PRACTICES
May 4, 1999

OFFICE OF THE COMPTROLLER OF THE CURRENCY NEWS RELEASE
CONCERNING EFFECTIVE WEB PRIVACY PRACTICES
May 4, 1999

NR 99-40
FOR IMMEDIATE RELEASE
Contact: Robert M. Garsson (202) 874-5770
May 4, 1999

OCC Guidance Describes Effective Web Privacy Practices
WASHINGTON -- The OCC today provided national banks with examples of effective practices for developing privacy policies and communicating them to customers who use their Internet sites.

"The Internet opens the door to new opportunities for financial institutions," said Comptroller of the Currency John D. Hawke, Jr. "However, to capitalize on those opportunities, banks must reassure consumers that the bank-customer relationship -- and the expectation of privacy that is an essential part of that relationship -- will be honored as much on the Internet as it is in the branch office."

The guidance issued today is intended to help banks develop and communicate privacy policies. It does not set new examination standards or impose new regulatory requirements on banks. While the guidance includes examples of practices that appear to work well, national banks are free to find other effective ways to devise and communicate privacy practices.

The most effective disclosures are clear, prominent and easy to understand. For example, some banks use "hypertext" links that automatically present disclosures to customers when different transaction options are selected. Other banks place links to privacy policies in the footer of each Web site page.

Effective policies and procedures often involve senior management knowledge or participation and, in a number of banks, the personnel responsible for developing privacy practices report directly to senior officials.

Various banks, particularly larger institutions, have formed privacy working groups with representatives from different departments in the bank, including legal, marketing, compliance, retail, systems, security and human resources.

Some smaller institutions have found that an interdisciplinary team approach was not needed. In those cases, senior management appointed a particular division or employee to develop policies and procedures.

Some institutions have initiated reviews of third party relationships to assess adherence with the bank's own privacy practices. Several banks that provide customer information to unaffiliated third parties for joint marketing purposes or operational support have required the third party to sign an agreement limiting the use of the information.

Banks with effective privacy practices have taken steps to ensure that their policies were understood by employees involved in the handling of confidential information. Policies have been communicated through employee handbooks, codes of ethics, internal newsletters and through mailings and internal Intranet postings, among other means.

In addition, a number of banks have established programs or procedures to enhance compliance with privacy policies. For example, some banks have determined the adequacy of compliance through internal audits, while others use periodic reviews rather than formal audits.

Many banks have established mechanisms for handling consumer privacy complaints and inquiries. One bank has appointed an Ombudsman to handle such complaints, while another catalogues complaints and routes them to different centralized locations for handling.

The OCC charters, regulates and examines approximately 2,600 national banks a 66 federal branches of foreign banks in the U.S., accounting for more than 58 percent of the nation's banking assets. Its mission is to ensure a safe and sound and competitive national banking system that supports the citizens, communities and economy of the United States.
BANKRUPTCY UPDATE

Bankruptcy Cases and Developments of Interest to Financial Institutions

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BANKRUPTCY UPDATE

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BANKRUPTCY UPDATE:
BANKRUPTCY CASES AND DEVELOPMENTS OF INTEREST
TO FINANCIAL INSTITUTIONS

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I. INTRODUCTION

This outline is intended to bring the reader up to date on selected developments in bankruptcy case law during approximately the last year. This material concentrates on developments of interest to lenders, and particularly Sixth Circuit and Kentucky decisions. Decisions of interest during the past year demonstrate continued development of the law on subjects such as dischargeability, plan confirmation, secured claims issues and other subjects which are of particular interest to financial institutions today.

Bankruptcy reform legislation has finally passed in both the House of Representatives and the Senate. The two versions passed are in conference and have many similar terms. However, it remains uncertain whether enactment of some reform will actually occur during this session of Congress.

II. NEW BANKRUPTCY CASES

A. Dischargeability and Discharge

The general discharge available to debtors, and the dischargeability of particular debts, continue to be active areas for litigation. There are several recent and interesting discharge cases.

The Bankruptcy Code provides for the discharge of debts under 11 U.S.C. §§ 727, 1141, 1228 and 1328. Particular debts may be excepted from discharge for reasons related to the nature of the debts themselves. These include, among other things, certain tax-related debts, debts for fraud or defalcation while acting in fiduciary capacity, debts for domestic obligations and debts arising from willful injuries.

There have been several recent decisions regarding nondischargeability of particular debts. In In re Sarff, 242 B.R. 620 (6th Cir. BAP 2000), the Sixth Circuit Bankruptcy Appellate Panel ("BAP") addressed nondischargeability under 11 U.S.C. §§ 523(a)(4) and (6). Section 523(a)(4) excepts from discharge debts which arise as a result of the debtor's "fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny." Section 523(a)(6) excepts from discharge debts arising from "willful and malicious injury by the debtor to another entity or to the

Many thanks to our associate Richard Warne for his very valuable research and drafting assistance.
property of another entity." Here, Mr. Sarff was an employee whose employment was terminated for aiding a competitor. The former employer subsequently filed suit against Mr. Sarff alleging breach of a non-competition agreement, breach of employment duties, misappropriation of trade secrets and intentional interference with business relations. Mr. Sarff subsequently consented to entry of an injunction prohibiting him from violating a non-competition agreement for two years and prohibiting disclosure of trade secrets. Approximately four months later, the former employer moved to hold Mr. Sarff in contempt for violating the injunction. The state court found that Mr. Sarff had violated the injunction, misappropriated trade secrets, interfered with his former employer's business relationships and breached his duty of loyalty. The findings were ultimately upheld by a state appellate court.

Mr. Sarff then filed a bankruptcy proceeding, and the former employer filed an adversary proceeding alleging that the debt to it was nondischargeable under § 523(a)(4) and (6). The court modified the automatic stay to permit the state court to determine damages, and it entered judgment in favor of the employer against Mr. Sarff on various claims in amounts totaling approximately $62,000. In the nondischargeability action, the bankruptcy court ultimately held that the award of compensatory damages for the breach of the duty of loyalty was dischargeable, but the balance of the judgment was nondischargeable under § 523(a)(6). Both parties appealed.

The BAP discussed the application of collateral estoppel principals where a state court judgment is alleged to be determinative of bankruptcy dischargeability. It cited the fact that the issues in the state court action were fully litigated with both parties present. It cited the U.S. Supreme decision of Kawaauhau v. Gieger, 523 U.S. 57 (1998), for the proposition that a debt is nondischargeable under § 523(a)(6) if it results from an act with "intent to cause injury." The court concluded that, if the state court found that Mr. Sarff intentionally injured his former employer, the bankruptcy court would be required, under the doctrine of collateral estoppel, to hold the debt nondischargeable. The BAP ultimately held that all of the debt was nondischargeable, including the portion of the judgment representing compensatory damages for breach of the duty of loyalty, because it was connected to Mr. Sarff's conduct and intention to cause his former employer injury.

In In re Meyers, 196 F.3d 622 (6th Cir. 1999), the Debtor's tax evasion debt was held to be nondischargeable. Mr. Meyers obtained a bankruptcy discharge in 1993. After that, the IRS attempted to collect back taxes for tax years 1980 through 1983, during which years Mr. Meyers had filed no returns at all. The IRS alleged that the tax debt was excepted from discharge pursuant to 11 U.S.C. § 523(a)(1)(c), which excepts tax debts "with respect to which the debtor made a fraudulent return or wilfully attempted in any manner to evade or defeat such tax." Mr. Meyers had claimed that, at that time, he "believed that only those individuals who volunteered to pay taxes had to file returns." He later changed his mind, reported the income and began making payment. However, he ultimately stopped making payments, and later sought bankruptcy relief. The Bankruptcy Court and BAP agreed that the tax liability was nondischargeable, noting that his subsequent "repentant conduct" did not vitiate the willfulness of his refusal. The Sixth Circuit affirmed. The Sixth Circuit held that it was unpersuaded that "the willfulness of his earlier
evasion of taxes was somehow nullified by later coming clean with the IRS.” Mr. Meyers also claimed that his failure to file tax returns was due to ignorance, rather than willful misconduct, because he honestly believed that only volunteers were required to file returns and pay taxes. The court disagreed.

In *The Andy Warhol Foundation for Visual Arts, Inc. v. Hayes*, 183 F.3d 162 (2nd Cir. 1999), the Second Circuit Court of Appeals addressed the nondischargeability of an attorney fee disgorgement obligation. There, Edward Hayes had acted as counsel to the Warhol estate. His negotiated fee agreement was amended several times but essentially provided that he was to receive approximately 2% of the gross estate, based upon New York state law concerning the payment of executors. There was no cap on the fee and the estate was ultimately much larger than expected. Pursuant to that agreement, Hayes received $4.85 million between 1987 and 1990. This was more than he initially expected to receive based upon initial evaluations of the estate, but less than his percentage interest based upon subsequent valuations of the estate. He petitioned the New York Surrogate Court for a determination regarding his fees and that court concluded that his services were worth $7.2 million. An appellate court then reduced that valuation to $3.5 million, based in part on its conclusion that the prior award would have given him an “exorbitant hourly rate.” As result, Hayes owed the Warhol estate $1.35 million.

Hayes subsequently filed for bankruptcy protection and The Andy Warhol Foundation (the assignee of the Warhol estate) sought to have the obligation declared nondischargeable under 11 U.S.C. § 523(a)(4), which excepts from discharge debts “for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” However, the bankruptcy court found that Mr. Hayes was not acting in a fiduciary capacity at the time he incurred the $1.35 million obligation to the Warhol estate and found no technical trust in his receipt of the funds representing his fee. The District Court affirmed.

The Second Circuit reversed, and found the debt to be nondischargeable. The court held that the defalcation exception is not limited to express trusts. The court held that the attorney-client relationship is one of the “highest fiduciary duties” and refused to distinguish between Hayes’s different roles (i.e., representing the estate as opposed to being a party to the fee dispute) with respect to whether defalcation occurred. The court relied on a 1937 decision by Judge Learned Hand that, while the word “defalcation” normally implies some “moral dereliction,” it may also include innocent defaults and can include all fiduciaries who are for any reason short in their accounts. Here, the Second Circuit held that Hayes had collected his money under a fee agreement which was invalid because it was not tied to actual services to the Warhol estate, but rather to a “rising art market” that had nothing to do with the services he was performing. The court then noted that Hayes chose not to limit his spending to a conservative estimate of what a court might eventually approve. The court concluded that this conduct was sufficiently at odds with Hayes’s fiduciary obligation as to constitute a defalcation under § 523(a)(4). The court noted that it did not reach the question of the dischargeability of debts incurred by attorneys “as a result of payments determined ex post by a court to be excessive where a good faith attempt was made to match fees and the value of services, or where no ready avenue to seek approval in advance
exists."

The cases discussed above address the nondischargeability of particular types of debts. Pursuant to 11 U.S.C. § 727, debtor also may be denied a discharge generally for various types of bankruptcy-related misconduct, such as transferring property, concealing or destroying records or making false representations in the bankruptcy case. There is a recent bankruptcy discussion of interest concerning a procedural issue related to the denial of a discharge generally for debtor misconduct.

In Bankruptcy Receivables Management v. de Armond, 240 B.R. 51 (Bankr. C.D. Cal. 1999), the court addressed the parties' ability to settle an action brought under both 11 U.S.C. §§ 523 and 727. Here, BRM alleged that the de Armonds purchased jewelry and gemstones from BRM’s assignor, which purchases were charged to an account for which there was a security agreement. BRM claimed that the debtors subsequently transferred the property without disclosing it in a later bankruptcy petition. BRM filed a complaint alleging that the individual debt was nondischargeable under 11 U.S.C. § 523(a)(6) because it constituted a conversion of assets, and BRM alleged that the debtors should be denied any discharge under § 727 because of their conduct. BRM and the debtors subsequently reached an agreement pursuant to which BRM would abandon the § 727 claim and would compromise the § 523 claim for approximately 50% of the original demand.

The court declined to approve the proposed compromise. The court held that the simultaneous settlement of a § 523 claim and dismissal of a § 727 claim was a “tainted compromise” prohibited by Bankruptcy Rule 7041. The court noted that, when the plaintiff filed a § 727 claim it “... became a fiduciary to the other creditors. ... The plaintiff may not now dismiss the § 727 claim in exchange for a settlement of the § 523 claim if the settlement will benefit solely the plaintiff.” The court concluded that these factors did not prohibit it from approving the settlement. However, the court held that the plaintiff’s fiduciary duties required it to turn the settlement proceeds over to the Chapter 7 Trustee for distribution among the creditors according to the priority established by 11 U.S.C. § 726. The court noted that a creditor who files a complaint for nondischargeability of a claim under § 523 “is free to settle the dispute with the debtor on any mutually agreeable terms, subject to court approval. In considering whether to approve such a settlement, the court usually gives no weight to the interest of other creditors.” The court noted where a party’s fiduciary duties are in conflict with the party’s own interests, “fiduciary duties trump personal interests.” The court also rejected the plaintiff’s claim that all of the settlement money was being allocated to the § 523 claim, and none was being allocated to the § 727 claim.

B. Plan Confirmation

Bankruptcy and appellate courts continue to interpret property valuation issues following the U.S. Supreme Court’s decision in Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct. 1879, 138 L. Ed.2d 148 (1997). The Rash decision addressed a conflict among the circuits
regarding the appropriate valuation of collateral for "cram down" purposes in a Chapter 13. In *Rash*, the debtor financed the purchase of a truck. He subsequently filed a Chapter 13. He sought to cram down a plan under which he would keep the truck and pay the lender a "repossession" or foreclosure value for the truck -- which was much less than what the debtor would have to pay to replace the truck. Pursuant to 11 U.S.C. § 506(a), a lender's claim is secured only to the extent of the value of the collateral. In order to have a plan confirmed in which the debtor retains a vehicle over the secured creditor’s objection, the debtor must invoke the cram down power and must pay to that creditor the present value of the allowed secured claim over the life of the plan. The court held that the proper measure of value is the replacement value, not foreclosure value. The court noted that replacement value is fair market value, not necessarily the cost of a new replacement item.

Among other issues, lower courts since *Rash* have been addressing how to determine "replacement value" in the context of a cramdown. In *In re Getz*, 242 B.R. 916 (6th Cir. BAP 2000), the Sixth Circuit BAP, in an Ohio case, held that it was not error for the bankruptcy court to start with the midpoint between retail and wholesale value to determine the value of a vehicle in a Chapter 13 cramdown. In *Getz*, the Debtors sought to value a vehicle at $7,500 for Chapter 13 cramdown purposes. The lienholder objected, alleging that the value was $8,825, which was the NADA retail value. The lender asserted that, under *Rash*, the value had to be NADA retail. Neither party submitted any evidence of value other than the NADA valuations. The bankruptcy court selected the midpoint between the NADA wholesale and retail values as "an appropriate starting point" for making an evidentiary determination of the value of the property, and thus the secured claim. The BAP noted that *Rash* held that replacement value was "the price a willing buyer in the debtor's trade, business or situation would pay a willing seller to obtain property of like age and condition." *Id.* at 919 (quoting *Rash* at 1884). The BAP then noted that *Rash* did not specify the method for determining replacement value. The court noted that numerous other lower courts, including some within the Sixth Circuit, had used the midpoint between wholesale and retail as the starting point, subject to adjustments based on evidence introduced by either party. The court held that, under these circumstances, the bankruptcy court’s selection of that midpoint would be upheld.

In *Gillman v. Continental Airlines*, 203 F.3d 203 (3rd Cir. 2000), the Third Circuit Court of Appeals reversed the confirmation of a Chapter 11 plan of reorganization which released and enjoined a variety of claims against non-debtor directors and officers. It reversed the confirmation on the ground that 11 U.S.C § 524(e) provides that the discharge of a debtor or debtor does not affect the liability of any other entity on the debt, and also rejected an attempt to accomplish the same through 11 U.S.C. § 105(a), which sets forth courts’ power to issue orders which are “necessary or appropriate” to carry out the provisions of the Code. The Third Circuit noted that § 105 does not “create substantive rights that would otherwise be unavailable under the Bankruptcy Code.” The court noted that some other courts have permitted non-debtor releases and injunctions but that the lower courts lacked sufficient evidentiary and legal basis to do that in this case. The court held that “the hallmarks of permissible non-consensual releases -- fairness, necessity to the reorganization, and specific factual findings to support these conclusions-- are all
C. Property of the Estate

In In re Fordu, 201 F.3d 693 (6th Cir. 1999), the Sixth Circuit held that the Debtor’s former wife’s lottery proceeds were marital property in which the Debtor had an interest at the time of an earlier dissolution of marriage. The Sixth Circuit also held that the dissolution decree was not entitled to a claim preclusive effect on the bankruptcy proceedings.

In 1986, Ms. Fordu won an Ohio lottery prize in the amount of approximately $388,000, payable in twenty annual installments of approximately $19,000. In 1991, Mr. and Mrs. Fordu divorced. They entered into an agreement, incorporated by a dissolution decree, which had provisions including that Mr. Fordu would not have to pay alimony, but would also relinquish his rights to the marital residence and any of Ms. Fordu’s future lottery payments. Two years later, Mr. Fordu filed a Chapter 7 bankruptcy proceeding. The Trustee brought an action against Ms. Fordu seeking to avoid and recover transfers she received pursuant to separation agreement. The Trustee’s complaint was deemed to be made under fraudulent conveyance provisions of Ohio law (the Trustee’s action would have been out of time under the one year fraudulent conveyance period set forth in 11 U.S.C. §§ 547 and 548). The bankruptcy court concluded that the lottery proceeds were Ms. Fordu’s separate property and that the dissolution decree’s language that the settlement was a just, fair and equitable division of the parties’ property collaterally estopped the Trustee from re-litigating the issue of whether the Debtor received reasonably equivalent value in exchange for the transfer of his interest in the lottery proceeds and the house.

The Sixth Circuit reversed. It held that the lottery proceeds were unquestionably marital property, notwithstanding lottery statutes which provide that only the individual who submits a winning ticket may receive payment of the prize. The court also held that the Trustee’s action was not subject to claim preclusion or issue preclusion because the issue of the fairness of the property division between the Debtor and his former wife was not actually litigated in the dissolution proceeding. Further, the court noted that the Debtor and Trustee were not in privity with each other, so as to bind the Trustee to the Debtor’s recitation that the property division was fair. This was based on a conclusion that the Trustee represents all creditors of the estate. The court held that “the standards for measuring the fairness of a property division in the domestic relations arena and reasonably equivalent value in a fraudulent transfer case are separate and distinct.” The court noted that the test used to determine whether a transfer is supported by reasonably equivalent value focuses on whether there is “reasonable equivalence between the value of what was surrendered and what was received in exchange.” The court noted that an Ohio domestic relations court is not constrained by that standard, but takes into account numerous equitable factors. As a result, the court concluded that a dissolution decree cannot be accorded claim preclusive effect. Further, the Court noted that, if the Ohio legislature had wanted to exempt court approved property divisions from challenge as constructive fraudulent transfers, it could have done so.
D. Secured Claims Issues and Preferences

*In re Holbrook* is a very recent decision in which the U.S. Bankruptcy Court for the Eastern District of Kentucky addressed a Trustee’s claim to avoid a lien under Kentucky’s preference statute (E.D.Ky., Case No. 99-10263). Transfers within the ninety days preceding a bankruptcy filing are considered to be preferential under 11 U.S.C. § 547 unless they meet a list of specific exceptions (i.e., “substantially contemporaneous” exchanges, exchanges for new value, etc.). However, Kentucky’s preference statute is considered to have a six month look back period and bankruptcy trustees can utilize it instead of the ninety day period under 11 U.S.C. § 547. However, under 11 U.S.C. § 547, the debtor is presumed to have been insolvent during the ninety day period preceding the bankruptcy. Under Kentucky’s preference statute, KRS § 378.060, the Trustee has the burden of demonstrating that insolvency. The creditor who received the allegedly preferential transfer may then rebut that evidence with proof that there was no intent to prefer.

The Holbrooks purchased a vehicle on October 24, 1998, financing the purchase through lender Household Automotive Finance Corporation (“Household”). Unfortunately, the automobile dealer did not record the title lien statement until November 25, 1998. The Holbrooks then filed their Chapter 7 bankruptcy proceeding on May 6, 1999. The bankruptcy filing was outside the ninety day period set forth in 11 U.S.C. § 547, but within six months of the recordation of the title lien statement. This Chapter 7 was otherwise a no asset case, but the Trustee brought an action pursuant to Kentucky’s preference statute, seeking to avoid Household’s lien. The case was tried before Judge William Howard, who found for Household, on February 23, 2000.

The court noted that the debtors did appear to be “balance sheet insolvent” as of the date they executed the note and the date of the perfection of the lien. However, the court noted that the insolvency contemplated by KRS § 378.060 is actual insolvency, and knowledge of the fact of that insolvency or contemplation of future insolvency is what is required under KRS § 378.060. The court held that the evidence established that this test was not met because the debtors were generally paying their debts on time at the time of the vehicle purchase. Thus, the court held that the Trustee did not meet her burden of proving insolvency. However, the court noted that, even if the Trustee had met that burden, there was also no evidence that the debtors had an actual intent to prefer Household over the other lenders.

In *In re Dorholt*, 237 B.R. 521 (8th Cir. BAP, 1999), the Eighth Circuit BAP addressed the late recordation of a lien in the context of the preference provisions of 11 U.S.C. § 547. Here, Marjorie Dorholt loaned Dorholt, Inc. slightly over $100,000, at which time the corporation signed and delivered to her a security agreement granting a security interest in inventory, accounts receivable, equipment and other collateral. However, Ms. Dorholt’s agent erred and recorded the lien sixteen days after the loan was made. The corporation filed its bankruptcy proceeding within ninety days of the recordation of the lien. The Trustee brought an action against Ms. Dorholt under 11 U.S.C. § 547(b) seeking to avoid the transfer of the security interest as a preference. Ms. Dorholt defended by asserting that the transfer was a contemporaneous exchange for new value.
under 11 U.S.C. § 547(c)(1). However, the bankruptcy court avoided the transfer, holding that she could not utilize the “contemporaneous exchange” defense because the lien had been filed outside the ten day requirement of 11 U.S.C. § 547(e)(2). The parties all agreed that the exchange had been intended to be contemporaneous. The issue on appeal was whether a lien recordation outside the ten day period can be a “contemporaneous exchange for new value.”

The Eighth Circuit BAP noted that there were two conflicting lines of authority. It noted Sixth Circuit authority, Ray v. Security Finance Corporation, 731 F.2d 358 (6th Cir. 1984), holding that such an exchange could not be substantially contemporaneous unless perfection occurred within the ten day grace period of § 547(e)(2). However, the Eighth Circuit BAP chose to rely on other authority, including a Seventh Circuit decision, holding that “substantially contemporaneous” is a flexible term and that a case-by-case analysis is required. The court reasoned that the Sixth Circuit’s construction nullified the use of the word “substantially” with respect to the contemporaneous nature of the transaction. It held that whether a transaction is “substantially contemporaneous is not determined solely by the ten day limitation, but also requires consideration of the intent of the parties and other surrounding circumstances, including the equities of the particular case.”

In Staiano v. Cain (In re Lan Associates XI LP), 192 F.3d 109 (3d Cir. 1999), the Third Circuit held that a trustee who sells property by credit bid cannot calculate his fee based on that bid. There, the principal asset of the debtor was office building property subject to a first mortgage in favor of First Fidelity Bank. First Fidelity offered to purchase the property through a credit bid at a liquidation price of approximately $7.7 million, pursuant to which it would also relinquish approximately $370,000 in cash collateral to cover administrative expenses and provide a distribution for unsecured creditors, and waive a deficiency claim. The Chapter 7 Trustee then moved the court for permission to sell the collateral based on that bid and for a commission for himself based upon the credit bid amount being part of the basis for calculating the commission. The court approved the sale based upon the notice and the sale took place. The Trustee subsequently filed an application for amounts including the commission. There was no objection to the fee application and no one raised the issue of whether the credit bid could be included in the base upon which the Trustee’s fee was calculated. The Court approved the application and the Trustee received an interim payment. There was another interim payment and the Trustee ultimately submitted a final report to Bankruptcy Court based upon the two prior payments.

One year later, the U.S. Trustee objected to the final report, arguing that the amount of the credit bid was improperly included in the base on which the Trustee’s compensation was calculated and that the Trustee had been overpaid by approximately $142,000. The U.S. Trustee requested disgorgement of the funds and for their disbursement to unsecured creditors. The Bankruptcy Court approved the final report, but required a small disgorgement because amounts disbursed to unsecured creditors had been lower than anticipated at that point, based upon a “reasonableness” analysis. The U.S. Trustee appealed and the district court reversed, holding that, under 11 U.S.C. § 326, the value of a credit bid is not money disbursed to the estate and
cannot be used to calculate the Trustee’s fee. The district court reversed and the Third Circuit affirmed the district court. The Third Circuit held that a credit bid amount could not be deemed to be part of the base on which the Trustee’s fee is calculated. The court remanded to the Bankruptcy Court for determination of the final Trustee compensation award, indicating that the bankruptcy court could not consider the potential hardship to the Trustee or the length of time between the Trustee’s report and the U.S. Trustee’s objections, noting that the bankruptcy court can only consider factors “somehow pertinent to assessing the Trustee’s services.”

In In re HenHouse Interstate, Inc., 177 F.3d 719 (8th Cir. 1999), the Eighth Circuit held that only the Trustee has standing to surcharge collateral under 11 U.S.C. § 506(c). Here, Magna Bank, N.A. made various loans to HenHouse Interstate, Inc., which owned and operated restaurants, service stations and other businesses. Magna took a security interest in essentially all of the debtor’s real and personal property. The debtor filed a Chapter 11 bankruptcy proceeding, owing Magna approximately $4.1 million. Immediately after the bankruptcy filing, Magna extended DIP financing in the amount of $300,000. The budget pursuant to which the DIP financing arrangement was ordered provided for workers’ compensation expenses in a certain amount. During the attempted reorganization, Hartford Underwriters Insurance Company provided workers’ compensation coverage to the debtor. The debtor made some premium payments but failed to pay full amount due and owed Hartford unpaid premiums in the amount of approximately $51,000 at the time the case was converted to a Chapter 7 liquidation proceeding. Hartford then brought an action seeking the allowance of its claim as an administrative expense and seeking to recover the unpaid premiums by surcharging Magna’s collateral under 11 U.S.C. § 506(c).

11 U.S.C. § 506(c) provides “the Trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.” The bankruptcy court held that non-trustees have standing under § 506(c) to surcharge a secured creditor’s collateral. Magna appealed to the district court, claiming that § 506(c) does not give Hartford standing to assert the claim. The district court affirmed and Magna appealed. A three judge panel of the Eighth Circuit Court of Appeals affirmed the district court.

On rehearing en banc, the Eighth Circuit reversed, holding that § 506(c) does not empower non-trustees to surcharge an allowed secured creditor’s collateral. The court noted that § 506(c) is the only provision of the Code that addresses this issue, or allows any party to recover from property securing the claim of an allowed secured creditor. The court looked at the plain language of § 506(c) and held that its function was to enforce it according to its terms. The court noted that a majority of circuits that have considered the issue have held that § 506(c) does grant standing to non-trustees to pursue surcharge claims. However, the court held that each court which had done so had circumvented the plain language of the statute. The court also held that allowing non-trustee surcharge claims would be incompatible with the fundamental equal distribution goals of the Code. Hartford also argued that the DIP financing order directed the debtor to pay the insurance expenses out of the cash collateral covered by Magna’s security
interest. However, Hartford only asserted its right to seek enforcement of that order later in the proceeding, stating only a § 506(c) surcharge claim in its complaint and throughout the earlier portions of the litigation. The former issue was simply never before the bankruptcy court and the court did not reach the issue of Hartford’s standing to enforce the order. The U.S. Supreme Court has granted a writ of certiorari in order to consider this question.

In *In re Shelton Harrison Chevrolet, Inc.*, 202 F.3d 834 (6th Cir. 2000), the Sixth Circuit addressed preference issues in the context of vehicle transfers. There, an automobile dealer contracted with Leisure Vans to purchase customized vans for resale to the public. During the summer of 1991, the dealer placed orders to purchase six vans from Leisure Vans and received delivery of these vans between August 22 and 24, 1991. Leisure Vans did not perfect a security interest in the vans. On delivery of the vans, the dealer tendered six checks to Leisure Vans in the total amount of approximately $36,000. All six checks bounced, but when they were presented again, they were finally honored on September 4, 1991. After the checks were honored, Leisure Vans delivered to the dealer a Manufacturer’s Statement of Origin (MSO) for each of the vehicles. The dealer filed a bankruptcy proceeding on November 26, 1991, less than ninety days after the checks cleared.

The Chapter 7 Trustee filed a complaint against Leisure Vans to recover the $36,000 as a preferential transfer, claiming that the delay between delivery of the vans and the payment of the checks made them a payment of an antecedent debt. The bankruptcy court found that the delivery of the MSOs in exchange for the honored checks was a contemporaneous exchange for new value and thus was not preferential under 11 U.S.C. § 547. It granted summary judgment in favor of Leisure Vans. The district court affirmed, holding that the bankruptcy court’s determination that the MSO’s had a value approximately equal to the vehicles is not clearly erroneous. The district court relied in part on a Tennessee statute which requires the purchaser of a new vehicle to submit an MSO in order to obtain a Certificate of Title, reasoning that this makes the MSO valuable. The Sixth Circuit reversed. It held that the dealer’s receipt of the MSOs did not constitute “new value” because the Dealer had the ability to sell and transfer legal title to the vans upon receipt of them and, thus, could realize the full value of the vehicles without the MSOs. The court noted that, under Tennessee law, legal title to the vans passed upon delivery. The court distinguished the legal title from the documentation of the title reflected by the Title Certificate. The court noted also that, once Leisure Vans had delivered the vans to the dealer, it could not legally withhold the MSOs if the dealer then resold the van in the ordinary course of business. On that basis, the court rejected Leisure Van’s argument that the vans were worthless without the MSOs. The court held that, to permit the MSO’s to constitute “new value” and thus an exception to the preference statute, “. . . would condone a creditor’s attempt to exert leverage over a troubled debtor by retaining a title-related document until a check clears.” Id. at 838.

E. Reaffirmation

In *In re Booth*, 242 B.R. 912 (6th Cir. BAP 2000), the Sixth Circuit upheld a bankruptcy
court's refusal to reopen a Chapter 7 proceeding to reinstate the automatic stay and permit the debtors to rescind a reaffirmation agreement. There, the Booths filed a Chapter 7 bankruptcy petition and subsequently signed a reaffirmation agreement with National City Bank to reaffirm a second mortgage on their home. The reaffirmation agreement provided that rescission had to be in writing. The Booths claimed that they later orally rescinded the reaffirmation agreement, but the lender subsequently filed that agreement with the court. The Booths received a copy of the filed document but took no action. The first mortgagee eventually obtained stay relief and foreclosed. The combination of the first mortgage foreclosure and the bankruptcy discharge would have left the Booths with no obligation to the second mortgagee except for the reaffirmation agreement. Approximately a year and a half after the filing of the reaffirmation agreement, the Booths moved the Court to reopen their case, reinstate the automatic stay and extend the time for them to rescind the reaffirmation agreement or to set the agreement aside. They claimed to have entered into the agreement under duress. The bankruptcy court declined to grant the relief. The Sixth Circuit BAP affirmed, noting that the reaffirmation agreement specifically required a written rescission and that the Code permits a creditor to negotiate for any legal terms in a reaffirmation agreement.

F. Set-Off/Automatic Stay

In Fleet Mortgage Group, Inc. v. Kaneb, 196 F.3d 265 (1st Cir. 1999), the First Circuit Court of Appeals upheld a $25,000 damage award to a debtor for his emotional distress and an $18,000 award of attorney fees as a result of an automatic stay violation. There, because of an apparent miscommunication between the lender and its counsel, the lender's counsel filed a residential mortgage foreclosure action against the debtor during the pendency of his bankruptcy proceeding. The lender dismissed the case six weeks after the debtor's counsel reminded the lender that the stay was in place. However, the debtor alleged that he had suffered significant anguish in the meantime.

A couple of recent decision address creditors' set-off and recoupment rights, in a bankruptcy context and otherwise. Set-off and recoupment are similar concepts, but the difference between them is significant in the bankruptcy court. Recoupment is the offset of claims between the same parties and involving the same transaction or occurrence. Set-off occurs between the same parties but does not necessarily involve the same transaction or occurrence. 11 U.S.C. § 553 governs a creditor's set-off rights in bankruptcy, and stay relief is required to effect a set-off. Conversely, recoupment is not addressed directly in the Code. It occurs somewhat more freely and stay relief may not be required. It is treated differently because it is more in the nature of a defense to a claim, than a separate claim itself. However, the determination of what is the same transaction or occurrence can be complex.

In In re Passafiume, 242 B.R. 630 (Bankr.W.D.Ky., 1999), the Court held that an agent cannot collect pre-petition advances or loans by withholding post-petition renewal commissions. Here, the debtor had worked as an insurance agent for a life insurance company. There were several written agreements among the insurer, its representative and Mr. Passafiume which permitted advances and loans to him. He sold policies on commission and was also entitled to
commissions when renewal premiums were paid. The agreements provided that loans made pursuant to them could be setoff, or paid through commissions earned. Mr. and Mrs. Passafiume filed for bankruptcy protection. The insurer representative did not file a proof of claim. The insurer representative began to withhold the debtor’s renewal commissions (relating to post-petition renewals of policies which the debtor sold pre-petition) without seeking stay relief. The debtors alleged that the withholding of the commissions constituted a violation of the automatic stay. The insurer representative alleged that he was entitled to withhold the commissions pursuant to the doctrines of setoff or recoupment.

The court found for the debtor. The court noted that, in order to offset a debt under 11 U.S.C. § 553, there must be mutuality—both the creditor’s claim against the debtor and the creditor’s debt to the debtor must have arisen pre-petition. The court found that mutuality lacking here. The court noted that, although the renewal commissions were the result of the debtor’s pre-petition effort, the terms of the agreement provided that those commissions were not payable until the premiums were paid. Accordingly, the insurer representative’s debt for that commission is post-petition debt. The court also rejected the insurer representative’s recoupment argument. The court noted other cases in which courts concluded that the use of commissions to recoup funds owed for loans or advances was permissible because both obligations arose from the same agreement. However, the court held that the debts owed by the debtor to the insurer representative here arose from several different contracts, the evidence about which was incomplete. The court cited other authority for the premise that the fact that the two obligations arise from a “similar subject matter” does not mean that the two obligations arise from the “same transaction.” The court commented that, while a creditor properly utilizing recoupment is not required to seek stay relief, a creditor who utilizes § 553 set-off is so required. The court found an automatic stay violation, but noted that no request for damages or sanctions had been made.

A recent decision of the Kentucky Supreme Court also affects bank set off rights in a non-bankruptcy context. In General Motors Acceptance Corporation v. Lincoln National Bank, Case No. 98-SC-0489-DG(Jan. 20, 2000), the court held that a bank cannot set off account funds to cover overdrafts if another lender has a security interest in those funds. There, the issue was “whether a Bank may apply the cash proceeds of collateral to overdrafts allowed a depositor, thereby defeating established priorities, on grounds of the “ordinary course of business” exception contained in official comment 2(c) to UCC § 9-306(2) (KRS 355.9-306(2)).” The Court concluded a bank may not do so.

Here, GMAC provided floor plan financing to an automobile dealer, which the dealer used to purchase vehicle inventory. The dealer granted GMAC a security interest in the vehicle inventory and proceeds. The security agreements and financing statements were executed by its president, who was also a long time officer and board member of Lincoln National Bank, where the dealer had an account. During September, October and November, 1991, the dealer’s account was frequently overdrawn and the bank honored numerous overdrafts, handling it through the bank officer who had the relationship with the dealer. The dealer ultimately defaulted on its obligation to GMAC, failing to pay GMAC for six vehicles in which GMAC had a security
interest. GMAC sued the bank for proceeds from the sale of those six vehicles, which proceeds the Bank had applied to the dealer’s overdrafts. The bank argued that it took the funds free of any security interest because those funds were used to cover the overdrafts in the ordinary course of the bank’s business with the dealer, and also argued that GMAC had acquiesced in the bank’s possession and use of the proceeds. The trial court granted the bank’s motion for summary judgment, concluding that, when the funds were deposited with other funds in the dealer account, they lost their “identifiable security cloak” because they were credited by the bank against the overdrafts in the ordinary course of the bank’s business with the dealer. The trial court also concluded that GMAC was aware of the Bank’s custom of covering the overdrafts and that, under GMAC’s agreement with the dealer, GMAC had access to the dealer’s bank records, which would have revealed the pattern of overdrafts. The trial court also noted that GMAC, despite knowledge of the dealer’s financial difficulties, did not request a segregation of the funds. The Court of Appeals affirmed, based upon the bank’s “ordinary course of business” argument.

The Kentucky Supreme Court reversed. It held:

Payment of an overdraft by a bank is of the nature of a loan to the account holder and is premised upon the condition of repayment [footnote omitted]. Thus, Lincoln National made loans to [the Dealer] in the amount of the overdrafts paid. Since the bank had no security interest for such loans, it was an unsecured creditor of [the Dealer].

The court rejected the lower courts’ conclusions that the ordinary treatment of overdrafts described operates as an exception to the secured lender’s rights, and followed a 1989 Iowa decision, concluding that the secured party’s right to proceeds of collateral deposited into the debtor’s bank account is superior to the bank’s right of setoff of the same proceeds:

Although the commentary provides an exception for proceeds from the debtor’s checking account and paid in the ordinary course of the operation of the debtor’s business, this exception does not apply when a bank seizes funds deposited in a customer’s account and applies such funds to payment of overdrafts or antecedent debts. Such an interpretation would eviscerate the security interest in proceeds of collateral contrary to KRS § 355.9-306(2) and permit a bank that had made an unsecured loan to leapfrog secured creditors.

G. Bad Faith Filing and Dismissal

In In re SGL Carbon Corp., 200 F.3d 154 (3rd Cir. 1999), the Third Circuit Court of Appeals held that good faith is a requirement for a Chapter 11 filing and that an otherwise financially healthy company facing significant civil liability had not filed its Chapter 11 proceeding in good faith. There, SGL Carbon was the subject of a federal price fixing
investigation and also was the defendant in various federal class action anti-trust lawsuits. The potential liability was estimated to be in excess of $200 million. SGL filed a Chapter 11 petition. It then issued a press release declaring itself to be “financially healthy” and stating that it had filed to protect itself against “excessive demands” made by the anti-trust plaintiffs. The company chairman called the Chapter 11 filing “fairly innovative” and “creative,” for the reason that the serious insolvency problems that normally prompt a Chapter 11 reorganization did not exist at that company. The debtor proposed a plan which provided for all creditors other than the anti-trust plaintiffs to receive payment in full. The U.S. Trustee appointed a nine member unsecured creditors’ committee, eight of which were anti-trust plaintiffs.

The committee moved to dismiss the filing for bad faith. The court concluded that a bad faith filing is “cause” for dismissal under 11 U.S.C. § 1112(b). The court further held that the evidence did not support the company’s claim that “distraction” as a result of the litigation was a serious threat. It held that “the mere possibility of a future need to file, without more, does not establish that a petition was filed in good faith.” The court acknowledged that the Code does not require evidence of insolvency in order to file Chapter 11, but that a potential debtor’s difficulty should be actual, rather than potential. The court did note that it was not holding that a company had to wait to file a Chapter 11 petition until after a large judgment had been entered against it.

In In re Gribbons, 242 B.R. 637 (Bankr. W.D.Ky. 1999), Judge Roberts dismissed a Chapter 12 proceeding for the Debtors’ failure to pay all disposable income and file monthly reports and financial statements.

In In re Makinen, 239 B.R. 532 (Bankr. Mn. 1999), the court held that, where a debtor could pay all of his debts from exempt life insurance proceeds, his Chapter 7 filing was a “substantial abuse” of the Bankruptcy Code under 11 U.S.C. § 707(b), permitting dismissal of the bankruptcy proceeding.

III. LEGISLATIVE DEVELOPMENTS

Both the House and Senate have passed their own versions of bankruptcy reform, with the two bills now in a joint House-Senate Conference Committee to resolve differences between them. However, the conference committee is faced with a significant procedural hurdle which could delay further progress. S. 625 includes business tax provisions added in a minimum wage bill. However, tax legislation must originate in the House. For political reasons in this election year, Senate leaders wish to retain the minimum wage provisions in the bankruptcy bill. It is unlikely the provisions will be dropped until the House passes its own increase in the minimum wage, thus taking the issue away from Democrats. Further, given recent findings that bankruptcy filings declined in 1999 and banks and credit card companies earned record profits last year, the political impetus for reform could wane, thus making room for some of the more controversial proposals to be dropped from an omnibus bill, with only milder reform being retained. The two bills contain provisions regarding a number of significant issues.
A. **Means Testing**

On the consumer side, H.R. 833 imposes a number of changes, including means testing. For example, amended § 707(b) would permit dismissal of Chapter 7 petition (or conversion to Chapter 13 if the debtor consents) upon a finding of abuse. Abuse is presumed if the debtor has more than $100 per month in income available to pay general unsecured debts, based on the Debtor’s income over the 180 days prior to the filing of the petition. Generally the trustee is required to bring the motion to dismiss, but creditors may have standing to do so if the debtor’s income exceeds a certain amount. S. 625 contains a comparable provision, but the presumption of abuse does not arise unless the debtor has more than $250 per month of available income.

Under the House bill, Chapter 7 and 13 cases are to be automatically dismissed by the court if the debtor fails to provide, within 45 days of the petition date, copies of federal income tax returns for the last three years and copies of salary or wage statements for the last two months. One 20-day extension is permitted.

B. **Lienstripping/Cramdown in Chapter 13**

S. 625 provides that no debtor may “cramdown” (reduce the amount owed on a secured party’s claim to the value of the collateral) on any debt created within 5 years prior to the petition date and which is secured by an automobile. For debts secured by other property, the period is six months prior to filing. This rule applies to both purchase-money and non-purchase money security interests.

H.R. 833 includes a similar provision, but amends § 506(a) to apply to any debt secured by personal property within five years before the petition date. However, the prohibition only applies to purchase money security interests. On the other hand, even where the prohibition does not apply, collateral must be valued at “the price a retail merchant would charge for property of that kind.” No such provision exists in S. 625. Further, H.R. 833 would amend § 348(f) to provide that when a debtor converts a Chapter 13 case to Chapter 7, the entire amount still owed to a secured creditor in the Chapter 13 case would be fully secured by the collateral in the Chapter 7 case. This effectively prevents a debtor from cramming down a claim by converting the case. Finally, H.R. 833 amends §1325 so that a lien on the debtor’s property is not released until the earlier of the debtor’s discharge or completed payment of both the secured and unsecured portions of the secured party’s claim.

C. **Chapter 13 Plans**

H.R. 833 also requires debtors to make, prior to confirmation, both proposed plan payments and adequate protection payments to lessors of personal property and secured parties. Payments would be made on a monthly basis, and in the amount set forth in the contract. In all Chapter 13 cases where the debtor’s income exceeds the national median income for a household of comparable size, H.R. 833 will require 60-month plans.
A court hearing is required to permit a debtor to reaffirm an unsecured debt, unless the debtor is represented by counsel and waives the hearing. The bill permits a Chapter 7 debtor to assume a pre-petition lease of personal property, and requires Chapter 13 debtors to provide proof of insurance of leased property and collateral within sixty days of the filing of the bankruptcy.

D. Dischargeability

S. 625 renders certain debts nondischargeable on account of fraud in defined circumstances. Fraud is presumed where a debtor incurs $250 or more of debt for luxury goods within the 90 days prior to the petition date, or $750 in cash advances within 70 days of the petition date. The same presumption of fraud applies to debts incurred to pay a nondischargeable debt within 70 days prior to the filing date.

Under H.R. 833, fraud is presumed where a debtor purchases more than $250 in luxury goods or borrows more than $250 on open credit from one creditor within 90 days prior to the petition date. The House bill also eliminates the “superdischarge” in Chapter 13 by rendering nondischargeable debts incurred by fraud, embezzlement, larceny, or willful or malicious injury.

H.R. 833 also prohibits a debtor from filing a “Chapter 20,” by filing a Chapter 13 case after the debtor has received a discharge in a Chapter 7. The bill provides that a discharge will not be granted in a Chapter 13 case if the debtor has previously received a bankruptcy discharge under any chapter filed within the last five years.

E. Exemptions

Current law permits the individual states to define the amount of homestead exemption that a debtor may claim in bankruptcy. S. 625 limits this power, creating a maximum homestead exemption of $100,000. H.R. 833 is much weaker, providing a $250,000 maximum, but permitting states to “opt-out” by subsequent state legislation. However, the debtor would have to reside in the state for 730 days before being entitled to claim that state’s exemptions. Further, if a debtor sells non-exempt property, and then puts the proceeds into an exempt residence within 730 days of the petition date, then those proceeds are not considered exempt property.

F. Consumer Credit Disclosure

S. 625 requires credit card lenders to disclose the impact of making only the minimum payment each month. In order to receive more specific information, a customer would be required to call a toll free number provided by the lender. Retail lenders regulated by the FTC would not have to provide the toll free number. The proposed rules would also require the prominent disclosure of introductory (or “teaser”) interest rates, and prohibit a lender from terminating a credit card account because the borrower did not carry a balance. In comparison, H.R. 833 requires a generic disclosure of the impact of paying only the monthly minimum on open credit accounts. The disclosure is only required when the account is first opened, and then annually.
G. Non-monetary Defaults

H.R. 833 provides that if a debtor fails to perform non-monetary obligations in a lease of personal property, assumption of the lease may be barred. For a lease of real estate, a trustee is not required to cure defaults that have become impossible to cure. There is no comparable provision in S. 625.

H. Chapter 12 (Farm Bankruptcies)

S. 625 permanently extends Chapter 12, doubles the maximum aggregate debt limit to $3 million, and eliminates the requirement that the farmers receive over 50% of their income from farming operations in the year before the petition date. H.R. 833 includes only a permanent extension of the chapter.

I. Venue

H.R. 833 establishes that the debtor's principal place of business constitutes the domicile and residence of a corporate debtor for purposes of venue for filing the petition. S. 625 contains no comparable provision.

J. Appeals

H.R. 833 provides that all appeals proceed directly from the bankruptcy court to the Circuit Court of Appeals (or the Bankruptcy Appellate Panel if one exists). No comparable provision exists in S. 625.
CHANGES UNDER
THE COMMUNITY REINVESTMENT ACT

Garry L. Throckmorton
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COMMMUNITY REINVESTMENT ACT
Gramm-Leach-Bliley Act Provisions

Introduction

The Gramm-Leach-Bliley Act contains three primary Community Reinvestment Act (CRA) provisions. First, a "Satisfactory" CRA rating is required in order for any "Financial Holding Company/Subsidiary" to engage in expanded powers. Second, a "sunshine" provision requires that CRA agreement between financial institutions and third parties must be disclosed. Finally, depending on the CRA rating, the exam cycle for banks and thrifts with $250 million and less in assets is extended to five years.

I. Expanded Powers

A. Financial Holding Companies/Subsidiaries

1. At Formation of a Company
   a) "Satisfactory" CRA rating required for any insured depository subsidiary

2. If CRA Rating Declines Below "Satisfactory"
   a) No further expansion of powers
      • By merger or acquisition with another company
   b) No rollback of existing powers

B. National Bank Subsidiaries

1. Same Rules Apply

II. Sunshine Rule

A. CRA Agreements

1. Payments to Community Organizations/Individuals

2. Disclosure Required
   a) By bank or bank affiliate
   b) By recipient community organization or person
      • Applies only to specific groups or persons involved in CRA discussions with bank

3. Recipient Disclosure
   a) Detailed accounting for use of funds

4. Annual Filing
Gramm-Leach-Bliley Act

a) Submitted to financial institution's regulator

b) Monetary thresholds
   - $10,000 (cash payments, grants or other considerations)
   - $50,000 (aggregate amount of principal for loans)
   - Sum of either category of agreement during 12-month period ($10,000/$50,000)

5. Non-Filing Penalty
   a) Recipient must return the money
   b) Ten-year ban from CRA agreements

III. Regulatory Relief

A. Extended CRA Exam Cycles
   1. Banks and Thrifts $250 Million and Less
      a) "Outstanding" Rating: 5-year Exam Cycle
      b) "Satisfactory" Rating: 4-year Exam Cycle
   2. Exceptions
      a) Merger or acquisition
      b) "Reasonable cause"

IV. Testing CRA Effectiveness

A. Federal Reserve Study
   1. CRA Loan Default and Delinquency Rates
   2. CRA Loan Profitability

B. Treasury Department Study
   1. Adequacy of Services to LMI Neighborhoods
   2. Adequacy of Services to Persons of "Modest Means"
SEC. 103. FINANCIAL ACTIVITIES.

(a) IN GENERAL- Section 4 of the Bank Holding Company Act of 1956 (12 U.S.C. 1843) is amended by adding at the end the following new subsections:

'(l) CONDITIONS FOR ENGAGING IN EXPANDED FINANCIAL ACTIVITIES-

'(1) IN GENERAL- Notwithstanding subsection (k), (n), or (o), a bank holding company may not engage in any activity, or directly or indirectly acquire or retain shares of any company engaged in any activity, under subsection (k), (n), or (o), other than activities permissible for any bank holding company under subsection (c)(8), unless-

'(A) all of the depository institution subsidiaries of the bank holding company are well capitalized;

'(B) all of the depository institution subsidiaries of the bank holding company are well managed; and

'(C) the bank holding company has filed with the Board--

'(i) a declaration that the company elects to be a financial holding company to engage in activities or acquire and retain shares of a company that were not permissible for a bank holding company to engage in or acquire before the enactment of the Gramm-Leach-Bliley Act; and

'(ii) a certification that the company meets the requirements of subparagraphs (A) and (B).

'(2) CRA REQUIREMENT- Notwithstanding subsection (k) or (n) of this section, section 5136A(a) of the Revised Statutes of the United States, or section 46(a) of the Federal Deposit Insurance Act, the appropriate Federal banking agency shall prohibit a financial holding company or any insured depository institution from--

'(A) commencing any new activity under subsection (k) or (n) of this section, section 5136A(a) of the Revised Statutes of the United States, or section 46(a) of the Federal Deposit Insurance Act; or

'(B) directly or indirectly acquiring control of a company engaged in any activity under subsection (k) or (n) of this section, section 5136A(a) of the Revised Statutes of the United States, or section 46(a) of the Federal Deposit Insurance Act (other than an investment made pursuant to subparagraph (H) or (I) of subsection (k)(4), or section 122 of the Gramm-Leach-Bliley Act, or under section 46(a) of the Federal Deposit Insurance Act by reason of such section 122, by an affiliate already engaged in activities under any such provision);

if any insured depository institution subsidiary of such financial holding company, or the insured depository institution or any of its insured depository institution affiliates, has received in its most recent examination under the Community Reinvestment Act of 1977, a rating of less than 'satisfactory record of meeting community credit needs'.

'(3) FOREIGN BANKS- For purposes of paragraph (l), the Board shall apply comparable capital and management standards to a foreign bank that operates a branch or agency or owns or controls a commercial lending company in the United States, giving due regard to the principle of national treatment and equality of competitive opportunity.
Subtitle B--Community Reinvestment

SEC. 711. CRA SUNSHINE REQUIREMENTS.

The Federal Deposit Insurance Act (12 U.S.C. 1811 et seq.) is amended by inserting after section 47, as added by section 305 of this Act, the following new section:

'SEC. 48. CRA SUNSHINE REQUIREMENTS.

'(a) PUBLIC DISCLOSURE OF AGREEMENTS- Any agreement (as defined in subsection (e)) entered into after the date of the enactment of the Gramm-Leach-Bliley Act by an insured depository institution or affiliate with a nongovernmental entity or person made pursuant to or in connection with the Community Reinvestment Act of 1977 involving funds or other resources of such insured depository institution or affiliate--

'(1) shall be in its entirety fully disclosed, and the full text thereof made available to the appropriate Federal banking agency with supervisory responsibility over the insured depository institution and to the public by each party to the agreement; and

'(2) shall obligate each party to comply with this section.

'(b) ANNUAL REPORT OF ACTIVITY BY INSURED DEPOSITORY INSTITUTION- Each insured depository institution or affiliate that is a party to an agreement described in subsection (a) shall report to the appropriate Federal banking agency with supervisory responsibility over the insured depository institution, not less frequently than once each year, such information as the Federal banking agency may by rule require relating to the following actions taken by the party pursuant to the agreement during the preceding 12-month period:

'(1) Payments, fees, or loans made to any party to the agreement or received from any party to the agreement and the terms and conditions of the same.

'(2) Aggregate data on loans, investments, and services provided by each party in its community or communities pursuant to the agreement.

'(3) Such other pertinent matters as determined by regulation by the appropriate Federal banking agency with supervisory responsibility over the insured depository institution.

'(c) ANNUAL REPORT OF ACTIVITY BY NONGOVERNMENTAL ENTITIES-

'(1) IN GENERAL- Each nongovernmental entity or person that is not an affiliate of an
insured depository institution and that is a party to an agreement described in subsection (a) shall report to the appropriate Federal banking agency with supervisory responsibility over the insured depository institution that is a party to such agreement, not less frequently than once each year, an accounting of the use of funds received pursuant to each such agreement during the preceding 12-month period.

'(2) SUBMISSION TO INSURED DEPOSITORY INSTITUTION- A nongovernmental entity or person referred to in paragraph (1) may comply with the reporting requirement in such paragraph by transmitting the report to the insured depository institution that is a party to the agreement, and such insured depository institution shall promptly transmit such report to the appropriate Federal banking agency with supervisory authority over the insured depository institution.

'(3) INFORMATION TO BE INCLUDED- The accounting referred to in paragraph (1) shall include a detailed, itemized list of the uses to which such funds have been made, including compensation, administrative expenses, travel, entertainment, consulting and professional fees paid, and such other categories, as determined by regulation by the appropriate Federal banking agency with supervisory responsibility over the insured depository institution.

'(d) APPLICABILITY- Subsections (b) and (c) shall not apply with respect to any agreement entered into before the end of the 6-month period beginning on the date of the enactment of the Gramm-Leach-Bliley Act.

'(e) DEFINITIONS-

'(1) AGREEMENT- For purposes of this section, the term 'agreement'--

'(A) means--

'(i) any written contract, written arrangement, or other written understanding that provides for cash payments, grants, or other consideration with a value in excess of $10,000, or for loans the aggregate amount of principal of which exceeds $50,000, annually (or the sum of all such agreements during a 12-month period with an aggregate value of cash payments, grants, or other consideration in excess of $10,000, or with an aggregate amount of loan principal in excess of $50,000); or

'(ii) a group of substantively related contracts with an aggregate value of cash payments, grants, or other consideration in excess of $10,000, or with an aggregate amount of loan principal in excess of $50,000, annually; made pursuant to, or in connection with, the fulfillment of the Community Reinvestment Act of 1977, at least 1 party to which is an insured depository institution or affiliate thereof, whether organized on a profit or not-for-profit basis; and

'(B) does not include--

'(i) any individual mortgage loan;

'(ii) any specific contract or commitment for a loan or extension of credit to individuals, businesses, farms, or other entities, if the funds are loaned at rates not substantially below market rates and if the purpose of the loan or extension of credit does not include any re-lending of the borrowed funds to other parties; or
(iii) any agreement entered into by an insured depository institution or affiliate with a nongovernmental entity or person who has not commented on, testified about, or discussed with the institution, or otherwise contacted the institution, concerning the Community Reinvestment Act of 1977.

(2) FULFILLMENT OF CRA- For purposes of subparagraph (A), the term 'fulfillment' means a list of factors that the appropriate Federal banking agency determines have a material impact on the agency's decision--

(A) to approve or disapprove an application for a deposit facility (as defined in section 803 of the Community Reinvestment Act of 1977); or

(B) to assign a rating to an insured depository institution under section 807 of the Community Reinvestment Act of 1977.

(f) VIOLATIONS-

(1) VIOLATIONS BY PERSONS OTHER THAN INSURED DEPOSITORY INSTITUTIONS OR THEIR AFFILIATES-

(A) MATERIAL FAILURE TO COMPLY- If the party to an agreement described in subsection (a) that is not an insured depository institution or affiliate willfully fails to comply with this section in a material way, as determined by the appropriate Federal banking agency, the agreement shall be unenforceable after the offending party has been given notice and a reasonable period of time to perform or comply.

(B) DIVERSION OF FUNDS OR RESOURCES- If funds or resources received under an agreement described in subsection (a) have been diverted contrary to the purposes of the agreement for personal financial gain, the appropriate Federal banking agency with supervisory responsibility over the insured depository institution may impose either or both of the following penalties:

(i) Disgorgement by the offending individual of funds received under the agreement.

(ii) Prohibition of the offending individual from being a party to any agreement described in subsection (a) for a period of not to exceed 10 years.

(2) DESIGNATION OF SUCCESSOR NONGOVERNMENTAL PARTY- If an agreement described in subsection (a) is found to be unenforceable under this subsection, the appropriate Federal banking agency may assist the insured depository institution in identifying a successor nongovernmental party to assume the responsibilities of the agreement.

(3) INADVERENT OR DE MINIMIS REPORTING ERRORS- An error in a report filed under subsection (c) that is inadvertent or de minimis shall not subject the filing party to any penalty.

(g) RULE OF CONSTRUCTION- No provision of this section shall be construed as authorizing any appropriate Federal banking agency to enforce the provisions of any agreement described in subsection (a).

(h) REGULATIONS-

(1) IN GENERAL- Each appropriate Federal banking agency shall prescribe regulations, in accordance with paragraph (4), requiring procedures reasonably designed to ensure and monitor compliance with the requirements of this section.
'(2) PROTECTION OF PARTIES- In carrying out paragraph (1), each appropriate Federal banking agency shall--

'(A) ensure that the regulations prescribed by the agency do not impose an undue burden on the parties and that proprietary and confidential information is protected; and

'(B) establish procedures to allow any nongovernmental entity or person who is a party to a large number of agreements described in subsection (a) to make a single or consolidated filing of a report under subsection (c) to an insured depository institution or an appropriate Federal banking agency.

'(3) PARTIES NOT SUBJECT TO REPORTING REQUIREMENTS- The Board of Governors of the Federal Reserve System may prescribe regulations--

'(A) to prevent evasions of subsection (e)(1)(B)(iii); and

'(B) to provide further exemptions under such subsection, consistent with the purposes of this section.

'(4) COORDINATION, CONSISTENCY, AND COMPARABILITY- In carrying out paragraph (1), each appropriate Federal banking agency shall consult and coordinate with the other such agencies for the purposes of assuring, to the extent possible, that the regulations prescribed by each such agency are consistent and comparable with the regulations prescribed by the other such agencies.'.

SEC. 712. SMALL BANK REGULATORY RELIEF.

The Community Reinvestment Act of 1977 (12 U.S.C. 2901 et seq.) is amended by adding at the end the following new section:

'SEC. 809. SMALL BANK REGULATORY RELIEF.

'(a) IN GENERAL- Except as provided in subsections (b) and (c), any regulated financial institution with aggregate assets of not more than $250,000,000 shall be subject to routine examination under this title--

'(1) not more than once every 60 months for an institution that has achieved a rating of 'outstanding record of meeting community credit needs' at its most recent examination under section 804;

'(2) not more than once every 48 months for an institution that has received a rating of 'satisfactory record of meeting community credit needs' at its most recent examination under section 804; and

'(3) as deemed necessary by the appropriate Federal financial supervisory agency, for an institution that has received a rating of less than 'satisfactory record of meeting community credit needs' at its most recent examination under section 804.

'(b) NO EXCEPTION FROM CRA EXAMINATIONS IN CONNECTION WITH APPLICATIONS FOR DEPOSIT FACILITIES- A regulated financial institution described in subsection (a) shall remain subject to examination under this title in connection with an application for a deposit facility.

'(c) DISCRETION- A regulated financial institution described in subsection (a) may be subject to
more frequent or less frequent examinations for reasonable cause under such circumstances as
may be determined by the appropriate Federal financial supervisory agency.'.

SEC. 713. FEDERAL RESERVE BOARD STUDY OF CRA LENDING.
The Board of Governors of the Federal Reserve System shall conduct a comprehensive study, in
consultation with the Chairman and Ranking Member of the Committee on Banking and Financial
Services of the House of Representatives and the Chairman and Ranking Member of the
Committee on Banking, Housing, and Urban Affairs of the Senate, of the Community
Reinvestment Act of 1977, which shall focus on--

(1) the default rates;
(2) the delinquency rates; and
(3) the profitability;

of loans made in conformity with such Act, and report on the study to such Committees not later
than March 15, 2000. Such report and supporting data shall also be made available by the Board
of Governors of the Federal Reserve System to the public.

Nothing in this Act shall be construed to repeal any provision of the Community Reinvestment

SEC. 715. RESPONSIVENESS TO COMMUNITY NEEDS FOR FINANCIAL SERVICES.
(a) STUDY- The Secretary of the Treasury, in consultation with the Federal banking agencies (as
defined in section 3(z) of the Federal Deposit Insurance Act), shall conduct a study of the extent to
which adequate services are being provided as intended by the Community Reinvestment Act of
1977, including services in low- and moderate-income neighborhoods and for persons of modest
means, as a result of the enactment of this Act.

(b) REPORTS-

(1) IN GENERAL- The Secretary of the Treasury shall--

(A) before March 15, 2000, submit a baseline report to the Congress on the study
conducted pursuant to subsection (a); and

(B) before the end of the 2-year period beginning on the date of the enactment of this
Act, in consultation with the Federal banking agencies, submit a final report to the
Congress on the study conducted pursuant to subsection (a).

(2) RECOMMENDATIONS- The final report submitted under paragraph (1)(B) shall
include such recommendations as the Secretary determines to be appropriate for
administrative and legislative action with respect to institutions covered under the
INTELLECTUAL PROPERTY CONCERNS FOR FINANCIAL INSTITUTIONS IN AN INTERNET MULTI-STATE ENVIRONMENT

Trademark Law: What’s In a Name?

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SECTION F
TRADEMARK LAW: WHAT'S IN A NAME?

By Jack A. Wheat†

In the United States, trademarks were originally protected by state law, first by common law, and now also by statute.

The Model State Trademark Act, a major portion of which has been enacted into law in Kentucky, KRS 365.560 et seq., in Section 1 defines a trademark as follows:

'Trademark' means any [1] word, name, symbol or device including, but not limited to, a distinctive package or container of any kind, or any combination of these [2] used by a person [3] to identify and distinguish the goods of that person, including a unique product, from those manufactured or sold by others, and to indicate the source of the goods, even if that source is unknown.

(Emphasis added.)

Federal trademark law is set forth in the Lanham Act, 15 USC 1051 et seq. Somewhat similar to the Model State Trademark Act, the Lanham Act defines a "trademark" as follows:

The term 'trademark' includes any word, name, symbol or device, or any combination thereof -

(1) used by a person, or
(2) which a person has a bonafide intention to use in commerce and applies to register on the principal register established by this Act,

to identify and distinguish his or her goods including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown.

15 USC 1127. (Emphasis added.)

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Whereas, trademarks are associated only with tangible "goods", marks utilized in association with "services" are protectible as "service marks". See KRS 365.563(2) and 15 U.S.C. 1127.

POLICY JUSTIFICATION FOR TRADEMARK PROTECTION

In Justice Stevens' concerning opinion in a fairly recent Supreme Court case, it was noted as follows:

'The purpose underlying any trademark statute is two-fold. One is to protect the public so that it may be confident that, in purchasing a product bearing a particular trade-mark which it favorably knows, it will get the product which it asks for and wants to get. Secondly, where the owner of a trade-mark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats. This is the well established rule of law protecting both the public and the trade-mark owner.' [Citation omitted.]

Two Pesos, Inc. v. Taco Cabana, Inc., ___ U.S. ___, 112 S.Ct. 2753, 120 L.Ed.2d 615, 23 USPQ2d 1081 (1992) (Stevens, J., concurring) at n. 15. A noted treatise on trademark law outlines this policy as follows:

A trademark functions and is accorded legal protection because it:
(a) designates the source of origin of a particular product or service, even though the source is to the consumer anonymous;
(b) denotes a particular standard of quality which is embodied in the product or service;
(c) identifies a product or service and distinguishes it from the products or services of others;
(d) symbolizes the good will of its owner and motivates consumers to purchase the trademarked product or service;
(e) represents a substantial advertising investment and is treated as a species of property; or
(f) protects the public from confusion and deception, insures that consumers are able to purchase the products and services they want, and enables the courts to fashion a standard of acceptable business conduct.

1 Gilson, Trademark, Protection and Practice, §1.03. See also 1 McCarthy on Trademarks and Unfair Competition, 3d Ed. §§ 2.10-2.14.
SIGNIFICANCE OF REGISTRATION

A trademark need not be registered to be protectible. More specifically, Section 43(a) of the Lanham Act, 15 USC 1125(a), as well as the common law protect unregistered marks. See for instance Covington Inn Corporation v. White Horse Tavern, Inc., 445 S.W.2d 135, 163 USPQ 438 (Ky., 1969).

However, the geographical scope of protection of an unregistered mark is limited to the geographical market in which the products are sold under the mark or are generally known, plus possibly the trademark owner's "natural zone of expansion". Also broader geographical protection for unregistered marks may also be available if the junior user's adoption of the same mark was in "bad faith". See for instance Hanover Star Milling Co. v. Metcalf, 240 U.S. 403, 36 S.Ct. 713 (1916); United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90, 39 S.Ct. 48, 63 L.Ed. 141 (1918); and 3 McCarthy on Trademarks and Unfair Competition, 3d Ed., §§ 26.01 et seq.

Regardless of limited geographical use, state registration of a mark should provide statewide protection and federal registration generally provides nationwide protection. See 15 USC 1057(c) and 15 USC 1072.

Also, a federal registration provides a presumption that the claimed matter does properly serve as a mark. 15 USC 1057(b) and 15 USC 1115(a).

Furthermore, once a federal registration has been in effect for five (5) years, the Registrant can obtain "incontestability" status which forecloses many of the grounds for claiming that the mark is not protectible. 15 USC 1065 and 15 USC 1115(b).

MARKS WHICH ARE NOT REGISTRABLE

Although registration is not necessarily required for a mark to be protectible, the United States Patent and Trademark Office and Secretaries of State maintain trademark registries.

However, certain marks are not registrable. More specifically, the Lanham Act and parallel provisions of the Model State Trademark Law provide that the following are not registrable:

1. IMMORAL OR SCANDALOUS MATTER

In denying registration for immoral or scandalous matter, 15 U.S.C. 1052(a) prohibits registration of matter which "would be offensive to public or individual sense or propriety or morality" or "lacking in taste, indelicate [or] morally crude". In re Rundsorff, 171 USPQ 443, 444 (TTAB 1971).

The focus of this guideline according to the predecessor of the Court of Appeals for the Federal Circuit is as follows:

Whether or not the mark, including innuendo, is scandalous is to be ascertained from the standpoint of not necessarily a majority, but a substantial composite of the general public.

In re McGinley, 660 F.2d 481, 211 USPQ 668, 673 (CCPA 1981).

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2 **See for instance KRS 365.575.
Moreover, what was considered scandalous as a trademark or service mark twenty, thirty or fifty years ago may no longer be considered so, given the changes in societal attitudes. Marks once thought to be scandalous may now be thought merely humorous (or even quaint. . . . The point to be made here is that, in deciding whether a mark is scandalous under Section 2(a) [15 USC 1052(a)], we must consider that mark in the context of contemporary attitudes. [Citations omitted.]

In re Old Glory Condom Corp., 26 USPQ2d 1216, 1219 (TTAB 1993). That is to say, the test is whether the mark is a "threat to present-day public morals or sense of propriety". In re Thomas Laboratories, Inc., 189 USPQ 50, 52 (TTAB 1975). See also In re David Media Group Ltd., 33 F.3d 1367, __, 31 USPQ2d 1923, 1926 (Fed.Cir. 1994). ("[W]e must be mindful of ever changing social attitudes and sensitivities. Today's scandal can be tomorrow's vogue." "Black Tail" held not to be immoral or scandalous.)

2. DECEPTIVE MATTER

15 USC 1052(a) also provides that "deceptive" matter is not registrable. For instance, the Supreme Court long ago held that one could not register a mark containing the word "patent" if the goods were not patented. Holzapfel's Compositions Co. v. Rahtjen's American Composition Co., 183 U.S. 1, 22 S.Ct. 6, 46 L.Ed. 49 (1901).

3. MATTER WHICH MAY DISPARAGE

For trademark registration purpose, "disparagement" is defined as follows:

Disparagement is essentially violation of one's right of privacy - the right to be 'let alone' from contempt and ridicule. . . . The two elements of such a claim are (1) that the communication reasonably would be understood as referring to the plaintiff; and (2) that the communication is disparaging, that is, would be considered offensive or objectionable by a reasonable person of ordinary sensibilities.


4. FALSE SUGGESTION OF ASSOCIATION

15 USC 1052(a) also specifies no mark is registrable which "falsely suggest a connection with persons, living or dead, institutions, beliefs, or national symbols. . . ." (Emphasis added.) The test of whether a mark "falsely" suggest a forbidden association is as follows:

First we must ask if the name . . . is unmistakably associated with the person or institution seeking relief. . . . next we must ask whether the opposer is connected with the goods sold by applicant under the mark. Then we must determine whether a connection with opposer would be presumed by purchasers of applicant's
goods when they see the mark used on the goods.


5. GOVERNMENT INSIGNIA

15 USC 1052(b) prohibits registration of the following:

[T]he flag or coat of arms or other insignia of the United States, or any state or municipality, or of any foreign nation, or any simulation thereof.

Giving a narrow interpretation of the qualifying language "any simulation thereof", the United States Patent and Trademark Office does allow registration of any "imagery" of a governmental flag holding as follows:

[W]hat Section 2(b) [15 USC 1052(b)] in fact prohibits is the registration of any flag design which deliberately imitates the flag of a particular country so closely that a viewer would not be likely to distinguish it from the actual flag.

In re Waltham Watch Company, 179 USPQ 59 (TTAB 1973). See also In re Old Glory Condom Corp., 26 USPQ 1216, 1220 (TTAB 1993) ("this Office [the PTO] has registered many trademarks and service marks that include imagery of the American flag." (Emphasis added.))

6. PERSONAL INDICIA

The Lanham Act also prohibits registration of any mark which -- comprises a name, portrait, or signature identifying a particular living individual except by his written consent, or the name, signature or portrait of a deceased President of the United States during the life of his widow, if any, except by the written consent of the widow.

15 USC 1052(c). (Emphasis added.)

7. CONFUSING SIMILARITY

Because marks need to be "distinctive" to be enforceable, a mark is not protectible if it is "likely to be confused" with a preexisting mark of another. More specifically, the Lanham Act provides that a mark is not registrable if it --

[c]onsists of or comprises a mark which so resembles a mark
registered in the Patent and Trademark Office, or a mark or trade name previously used in the United States by another and not abandoned, as to be likely, when used on or in connection with the goods of the applicant to cause confusion, or to cause mistake, or to deceive.

15 USC 1052(d).

In analyzing whether there is a "likelihood of confusion", the PTO scrutinizes the following factors:

In testing for likelihood of confusion under Sec. 2(d) . . . the following, when of record, must be considered:

1) the similarity or dissimilarity of the marks in their entireties as to appearance, sound, connotation and commercial impression.

2) the similarity or dissimilarity and nature of the goods or services as described in an application or registration or in connection with which a prior mark is in use.

3) the similarity or dissimilarity of established, likely-to-continue trade channels.

4) the conditions under which and buyers to whom sales are made, i.e. 'impulse' vs. careful, sophisticated purchasing.

5) the fame of the prior mark (sales, advertising, length of use).

6) the number and nature of similar marks in use on similar goods.

7) the nature and extent of any actual confusion.

8) the length of time during and conditions under which there has been concurrent use without evidence of actual confusion.

9) the variety of goods on which a mark is or is not used (house mark, "family" mark, product mark).

10) The market interface between applicant and the owner of a prior mark;

   a) a mere 'consent' to register or use.

   b) agreement provisions designed to preclude confusion, i.e. limitations on continued use of the marks by each party.

   c) assignment of mark, application, registration and good will of the related business.

   d) laches and estoppel attributable to owner of prior mark and indicative of lack of confusion.

11) the extent to which applicant has a right to exclude others from use of its mark on its goods.

12) the extent of potential confusion, i.e., whether de minimis or substantial.
(13) any other established fact probative of the effect of use.


8. DESCRIPTIVENESS

In a fairly recent case, Senior Judge Johnstone of the Western District of Kentucky noted as follows:

The primary principle of trademark law is to allow the use of marks to distinguish one source of goods or services from another. The use of terms for solely descriptive purposes runs contra to this ultimate goal and serves to make unavailable words useful in describing all such similar goods or services. [Court's emphasis.]


Consistent with the mainstream of trademark law, in an opinion written by the late Judge Meredith of the Western District of Kentucky sitting by designation, the Sixth Circuit explained "descriptiveness" as follows:

A mark is descriptive:

... if it describes: the intended purposes, function or use of the goods [or services]; the class of users of the goods [or services]; a desirable characteristic of the goods [or services]; or the end effect upon the user. [Citation omitted.] If the mark 'imparts information directly, it is descriptive'.... [Citation omitted.]

Burke-Parson-Bowlby v. Appalachian Log Homes, 871 F.2d 590, 594, 10 USPQ2d 1443, 1455 (6th Cir. 1989). See also Ashland Oil, Inc., supra.

Similarly, "geographically descriptive" marks are not registrable. 15 USC 1052(e). For instance, as noted by the Sixth Circuit,

Where it is determined that a mark as perceived by potential purchasers describes the geographic origin of the goods [or services] the mark is primarily geographically descriptive.[Citation omitted.] To further clarify whether the mark is primarily geographically descriptive it is valuable to examine the possibility that the geographic term is 'minor, obscure, remote or unconnected with the goods.' [Citations omitted, Court's emphasis.] Use of a geographic term such as DUTCH to describe paint, WORLD to describe carpets, EUROPEAN to describe health spas, TOURAINE to describe coffee and NANTUCKET to describe men's shirts is entirely arbitrary. The protected mark has no relationship to the source of the goods since none of the goods...
were manufactured in the geographic area described.

Burke-Parsons-Bowlby, supra at 10 USPQ2d, 1445.

Notwithstanding, a descriptive mark can become protectible if and when the mark attains "secondary meaning", infra.

9. DECEPTIVELY MISDESCRIPTIVE TERMS

Similarly, deceptively misdescriptive terms, as well as geographically deceptive misdescriptive terms are not protectible absent "secondary meaning". See for instance In re Budge Mfg. Co., 857 F.2d 773, 8 USPQ2d 1259 (Fed. Cir. 1988) (LOVEE LAMB for synthetic automobile seat covers); R. Neumann & Co. v. Bon-Ton Auto Upholstery, Inc., 326 F.2d 799, 140 USPQ 245 (CCPA 1964) (VYNAHYDE for vinyl furniture slipcovers); W.D. Byron & Sons, Inc. v. Stein Bros. Mfg. Co., 377 F.2d 1001, 153 USPQ 749 (CCPA 1967) (TUFIDE for briefcases made of PVC); T.M. Kildow Cigar Co. v. George B. Sprague Cigar Co., 35 App., DC 345 (1910) (HALF SPANISH for cigars which do not contain "half spanish" tobacco); and In re Richmond, 131 USPQ 441 (TTAB 1961) (MAID IN PARIS for perfumes.)

10. SURNAMES

Absent "secondary meaning", a mark which is "primarily merely a surname" is likewise unregistrable. 15 USC 1052(e)(3).

SECONDARY MEANING

As noted above, although descriptive marks, deceptively misdescriptive marks and marks which are primarily merely surnames lack the requisite distinctiveness to be protectible, it is recognized in trademark law that through substantially exclusive and extensive long term use and advertising, a mark can possibly acquire "distinctiveness". If so, the mark is then protectible and registrable.

In the granddaddy of all modern trademark cases, the "shredded wheat" case, Justice Brandeis set forth the guideline for determining whether a descriptive word has attained secondary meaning noting as follows:

But to establish a trade name in the term 'shredded wheat' the plaintiff must show more than a subordinate meaning which applies to it. It must show that the primary significance of the term in the minds of the consuming public is not the product but the producer.


Stated conversely, if the "primary" significance of a term to the consuming public is a description of the nature of the goods or services, rather than indication of a specific source for
the goods on services, secondary meaning does not exist. That is to say, the "paramount" commercial significance of a term is the key. For instance, as observed by the Seventh Circuit,

Descriptive terms . . . are ill-suited to serve as designations of origin, for such terms are naturally understood by the consuming public in their ordinary descriptive sense. In order to acquire the exclusive right to use such a term, the user must demonstrate, as a matter of empirical fact, that the paramount commercial significance of the term in the minds of the consuming public is not its ordinary descriptive import, but rather, a declaration that the item so labeled originates at a single, albeit perhaps anonymous source.

Walt-West Enterprises, Inc. v. Gannett Company, Inc., 695 F.2d 1050, 1057-1058, 217 USPQ2d 1206, 1214 (7th Cir. 1982). Furthermore, as noted by the Sixth Circuit,

Secondary meaning is proved when by a preponderance of the evidence it can be determined that the attitude of the consuming public toward the mark denotes 'a single thing coming from a single source. [Citations omitted.] Direct proof of secondary meaning is difficult to obtain. [Citation omitted.] Absent direct proof, the court must draw reasonable inferences from evidence of long term usage, from considerable effort and expenditure of money toward developing a reputation and good will for that trademark [Citation omitted.] Sales volume, though relevant, is not necessarily sufficient to indicate recognition of the mark by purchasers as an indication of the source. [Citations omitted.] Advertising expense also is relevant but will not standing alone, establish secondary meaning. [Citation omitted.] Where advertising expenditures are required to 'merely survive' in the competitive market, advertising expenditures cannot be used to prove secondary meaning [citation omitted.] However, extensive advertising which results in consumer association with a single source can establish secondary meaning.

Burke-Parson-Bowlby, supra at 10 USPQ2d 1447 (Emphasis added.) See also Ashland Oil, Inc., supra at 413; American Heritage Life Insurance Co. v. Heritage Life Ins. Co., 494 F.2d 3, 12, 182 USPQ 77, 83 (5th Cir. 1974) ("The test of secondary meaning is the effectiveness of the effort to create it") (Emphasis added); and Discount Muffler Shop v. Meineke Realty Corp., 535 F.Supp. 439, 447 (N.D. Ohio, 1982) ("Ultimately, however, 'the crucial issue is not the effort which was made to create it but the effectiveness of the effort'." (Emphasis added.))

"PREASSUMPTION" OF SECONDARY MEANING

The Lanham Act allows trademark examiners in the PTO to "assume" that a mark has acquired "secondary meaning" after a period of exclusive use of the mark by the Applicant. More specifically,
The Commissioner [of the PTO] may accept as prima facie evidence that the mark has become distinctive, as used on or in connection with the applicant's goods in commerce, proof of substantially exclusive and continuous use thereof as mark by the applicant in commerce for the five years before the date on which the claim of distinctiveness is made.

15 USC 1052(f).

**DURATION OF TRADEMARK**

Trademark protection continues *ad infinitum* so long as the owner continues to use the mark in relation to the same line of business.

However, a federal registration remains in effect for only ten years but is continually renewable in ten year increments if appropriate filings are made with the PTO. 15 USC 1059(a).

Similarly, a Kentucky state registration remains in effect for five years but is continually renewable in five year increments if appropriate filings are made with the Kentucky Secretary of State. KRS 365.581.

**INFRINGEMENT**

Violation of the exclusive rights of the owner of a mark constitutes "infringement" which is defined by the Lanham Act as follows:

Any person who shall, without the consent of the registrant --
(a) use in commerce any reproduction, counterfeit, copy or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive, or
(b) reproduce, counterfeit, copy, or colorably imitate a registered mark and apply such reproduction, counterfeit, copy, or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive,

shall be liable in a civil action by the registrant for the remedies hereinafter provided . . . .

15 USC 1114 (Emphasis added.) See also 15 USC 1125 (parallel claim available for
infringement of unregistered marks.) Similarly, as to infringement of state registered marks, see KRS 365.615.

"LIKELIHOOD OF CONFUSION"

The touchstone issue in any infringement case is to determine whether there is a "likelihood of confusion". That is to say, is there a likelihood that consumers would be confused into believing that the junior user's products are the products of the senior user of the mark or confused into believing that the junior user is otherwise affiliated with, sponsored or endorsed by the senior user.

The ultimate inquiry in most actions for false designation of origin, as with actions for trademark infringement, is whether there exist a likelihood that an appreciable number of ordinarily prudent purchasers [will] be misled, or indeed simply confused, as to the source of the goods in question.

Thompson Medical Company, Inc. v. Pfizer, 753 F.2d 208, 213, 225 USPQ2 124, 128 (2d Cir. 1985) (Emphasis added.)

In this circuit, factors to be considered to determine whether there exists an appreciable likelihood of confusion are as follows:

- Strength of plaintiff's mark;
- Relatedness of goods or services;
- Similarity of marks;
- Evidence of actual confusion;
- Marketing channels used;
- Likely degree of purchaser care;
- Defendant's intent in selecting the mark; and
- Likelihood of expansion of the product lines.

Frisch's Restaurant v. Elby's, 670 F.2d 642, 648 214 USPQ 15, 19-20 (6th Cir. 1982).

These factors are simply a guide to help determine whether confusion would be likely... they imply no mathematical precision, and a plaintiff need not show that all, or even most of the factors listed are present in any particular case to be successful.

Wynn Oil Co. v. Thomas, 839 F.2d 1183, 5 USPQ2d 1944, 1946 (6th Cir. 1988).

As to appellate review of a trial court's analysis and application of each of these factors, the Sixth Circuit has noted as follows:

A district court's finding regarding each factor are reviewed for clear error, but the further determination of likelihood of confusion based on those factors is a legal conclusion reviewed de novo.
1. STRENGTH OF MARK

Determination of the "strength" of a mark entails classification of the nature of the mark. More specifically, as fairly recently noted by the Supreme Court,

Marks are often classified in categories of generally increasing distinctiveness; following the classic formulation set out by Judge Friendly, they may be (1) generic; (2) descriptive; (3) suggestive; (4) arbitrary; or (5) fanciful. See Abercrombie & Fitch Co. v. Hunting World, Inc., 537 F.2d 4, 9 [189 USPQ 759] (CA 2 1976).

Two Pesos Inc. v. Taco Cabana Inc., U.S. , 112 S.Ct. 2753, 120 L.Ed.2d 615, 23 USPQ2d 1081, 1083 (1992). Similarly, as noted by Judge Johnstone of the Western District of Kentucky,

For purposes of legal recognition trademarks fall into four broad categories in ascending order of strength: (a) generic, (b) descriptive, (c) suggestive or (d) arbitrary or fanciful. [Citation omitted.] Generic marks refer to a class of goods or services without indicating a particular source or supply. For example, the terms 'fish', 'bread', 'drink', and 'oil change' are generic and receive no legal protection. Descriptive marks identify a characteristic or quality of a good or service and find protection under the Lanham Act if the mark distinctively identifies the registrant's goods or services or, in other words, has acquired secondary meaning. Examples of such descriptive terms include the adjectives 'speedy', 'friendly', 'green', or 'reliable.' Suggestive marks subtly connote something about a product or service which requires imagination and perception to reach a conclusion regarding the nature of the product or service. A common example of a suggestive mark is the word 'Penguin' as applied to refrigerators. Fanciful or arbitrary marks bear no relationship to the product or service and thus are inherently distinctive. Kodak and Xerox are examples of fanciful or arbitrary marks. [Court's emphasis; citation omitted.]


Accordingly, a product bearing the KODAK mark will very likely be recognized by the consuming public as a product specifically produced by the Kodak Company rather than a competitor. Consequently, such a mark is very strong and distinctive.

Conversely, a descriptive mark is very weak because it is more likely to be recognized by the consuming public as a description of a type of product from various merchants rather than a designation of a specific source of the product. More specifically, as noted by the Sixth Circuit,

A strong mark generally is considered suggestive or one so fanciful that it has come to symbolize the source of origin. [Citations omitted.] Alternatively, weak
marks include those which are generic or describe the usual and the not so fanciful qualities of the product. [Citations omitted.] Accordingly, the strong mark enjoys greater protection while the weak mark is afforded little support.


Similarly, the late Judge Allen of the Western District of Kentucky has noted as follows:

In an able opinion discussing trademark infringement, District Judge Thomas Lambros found in Jewel Companies, Inc. v. Westhall Company, 413 F.Supp. 994, 198 USPQ 432 (N.D.Ohio 1976) that the word 'jewel' is a common term which many firms have used because of its connotation of high quality or value, and that the defendant's registered trade name "Jewel Mart" was clearly an example of a descriptive use. The Court went on to hold that such a descriptive mark is what is known as a 'weak' mark, and that any confusion that might result by the use of the words 'Jewel Mart' by a company was a risk which the plaintiff took when it adopted 'Jewel' as its mark.


Scrutiny of the "strength" of a mark also requires analysis of the uniqueness of the mark. That is to say, "evidence of third party use of similar mark on similar goods is admissible and relevant to show that the mark is relatively weak and entitled to only a narrow scope of protection. 1 McCarthy on Trademarks and Unfair Competition (4th ed.) § 11:88. More specifically,

The purpose of a defendant introducing third party uses is to show that customers have become so conditioned by a plethora of such similar marks that customers 'have been educated to distinguish between different marks on the basis of minute distinctions.'

Id.

2. RELATEDNESS OF GOODS OR SERVICES

As noted by the Sixth Circuit,

Courts have recognized that there are basically three categories of cases: (1) direct competition of [goods or] services, in which case confusion is likely if the marks are sufficiently similar; (2) [goods or] services are somewhat related but not competitive, so that likelihood of confusion may or may not result depending on other factors; and (3) services are totally unrelated, in which case confusion is unlikely.

be confused with the world famous "Sweet Daddy" hamburger available at Genny's Diner.) Civil Action No. 92-0796-L(H), February 5, 1993 slip opinion at p. 3.

3. SIMILARITY OF MARKS

As noted by the Sixth Circuit,

A proper analysis of similarity includes examining the pronunciation, appearance, and verbal translation of conflicting marks.

Wynn Oil Co. v. Thomas, 839 F.2d 1183, 5 USPQ2d 1944, 1947 (6th Cir. 1988). Furthermore,

In evaluating similarity, ‘[i]t is axiomatic in trademark law that ‘side-by-side’ comparison is not the test. [Citation omitted.] Instead, a court must determine, in light of what occurs in the marketplace, whether the mark ‘will’ be confusing to the public when singly presented.’ [Citation omitted.]

Id.; see also Genny's Diner, supra at 747.

Furthermore, in analyzing similarity, marks are not to be dissected, because, "It is the overall impression of the mark, not an individual feature, that counts." Homeowners Group, supra at 18 USPQ 1594. See also Little Caesar, Inc. v. Pizza Caesar, Inc., 834 F.2d 568, 4 USPQ2d 1942, 1944 (6th Cir. 1987). As otherwise stated,

In determining the similarity of the marks, one must decide on the basis of ‘the total effect of the designation, rather than on a comparison of individual features.' WLWC Centers, 563 F.Supp at 725 . . . The overall impression of the mark is what matters.

Truckstops Corporation of America v. C-Poultry Company Limited, 596 F.Supp. 1094, 1099 (M.D.Tenn., 1983) Similarly, as noted by the Second Circuit,

First, even close similarity between two marks is not dispositive of the issue of likelihood of confusion. ‘Similarity in and of itself is not the acid test. Whether the similarity is likely to provoke confusion is the crucial question.’ . . . Second, in assessing the similarity of two marks, it is the effect upon prospective purchasers that is important.

. . . The fact that a trademark is always used in conjunction with a company name may be considered by the trial court as bearing on the likelihood of confusion.

McGregor-Doniger, Inc. v. Drizzle, Inc., 599 F.2d 1126, 1133, 202 USPQ 81, 89 (2d Cir. 1979). (Emphasis added.)

As did the Second Circuit in McGregor, supra, the other circuits, including the Sixth
Circuit note that such a prominent use by an alleged infringer of a distinct name lessens any likelihood of confusion.

It is well settled that under certain circumstances otherwise similar marks are not likely to be confused where used in conjunction with the clearly displayed name and/or logo of the manufacturer.


4. EVIDENCE OF ACTUAL CONFUSION

As noted by the Sixth Circuit,

Evidence of actual confusion is undoubtedly the best evidence of likelihood of confusion. Yet, it does not follow that lack of evidence of actual confusion should be a significant factor...

...as actual confusion is merely one factor to be considered... Further, because evidence of actual confusion is difficult to produce and frequently discounted as unclear or insubstantial, 'this factor is weighted heavily only when there is evidence of past confusion, or perhaps, when the particular circumstances indicate such evidence should have been available.'

Wynn Oil v. Thomas, 839 F.2d 1183, 5 USPQ2d 1944, 1948 (6th Cir. 1988). See also Wynn Oil Co. v. American Way Service Corp., 943 F.2d 595, 19 USPQ2d 1815, 1821 (6th Cir. 1991). More specifically, the absence of any appreciable actual confusion is significant only in the following type of situation;

[T]he existence of only a handful of instances of actual confusion after a significant time or a significant degree of concurrent sales under the respective marks may... lead to an inference that no likelihood of confusion exists.


5. MARKETING CHANNELS USED

The focus of this factor according to the Sixth Circuit is as follows:

This factor, also termed 'channels of trade' by some courts, consists of considerations of how and to whom the respective goods or services of the parties are sold...

Obviously, dissimilarities between the predominant
customers of a plaintiff's and defendant's goods or services lessens the possibility of confusion, mistake or deception. Likewise if the services of one party are sold through different marketing media in a different marketing context than those of another seller, the likelihood that either group of buyer's will be confused by similar service marks [or trademarks] is much lower than if both parties sell their services through the same channels of trade.

Homeowners Group, Inc., supra at 18 USPQ2d 1595.

6. LIKELY DEGREE OF PURCHASER CARE
This factor is well explained by the Sixth Circuit as follows:
Generally, in assessing the likelihood of confusion to the public, the standard used by the courts is the typical buyer exercising ordinary caution. However, when a buyer has expertise or is otherwise more sophisticated with respect to the purchase of the [goods or] services at issue, a higher standard is proper. Similarly, when [goods or] services are expensive or unusual, the buyer can be expected to exercise greater care in her purchases. When [goods or] services are sold to such buyers, other things being equal, there is less likelihood of confusion.

Homeowners Group, Inc., supra at 18 USPQ2d 1596. See also Wynn Oil Co. v. Thomas, supra at 5 USPQ2d 1948; Wynn Oil Co. v. American Way Service Corp., supra at 19 USPQ2d 1821; and Judge Simpson's decision in P.T.C. Brands, Inc. v. Conwood Co. L.P., 28 USPQ2d 1895, 1905 (W.D. Ky., 1993).
The rationale behind this factor is that a purchaser of an expensive item will, in theory, more closely scrutinize his purchase than the purchaser of a less expensive item. To use an example, the thinking is that a customer desiring to purchase a VOLVO automobile, an expensive item, will scrutinize his or her purchase and not mistakenly purchase a YUGO automobile. Conversely, a purchaser desiring to purchase TRIDENT chewing gum, an inexpensive item, may less casually scrutinize the purchase and buy DENSITY by mistake.

7. INTENT
The focus of this factor is to determine whether the junior user of a mark intentionally sought to create confusion in an effort to divert business from the senior user to the junior user. That is to say,

[I]f the mark was chosen with the intent of deriving benefit from the reputation of [the senior user], that fact alone 'may be sufficient to justify the inference that there is confusing similarity.' [Citation omitted.]

Wynn Oil Co. v. Thomas, 839 F.2d 1183, 5 USPQ2d 1944, 1948. But see Nalpac, Ltd. v.
Coming Glass Works, 784 F.2d 752, 228 USPQ 946, 948 (6th Cir. 1986). (Intentional adoption of mark of senior user "innocent" if adoption not with "intent to obtain a free ride on the reputation of" the Senior user.) Conversely, "good faith" intentions are virtually irrelevant. More specifically, as noted by the Sixth Circuit,

While in this circuit we do consider intention to be relevant when a plaintiff shows that a defendant knowingly copied the contested trademark, we agree completely with the Second Circuit that absent such a showing, intentions are irrelevant.

Id.; see also Genny's Diner, supra at 746, n.2.

8. LIKELIHOOD OF EXPANSION OF PRODUCT LINES

The focus of this factor is whether there appears to be any likelihood that either parties' "market will expand so as to increase the likelihood of confusion". Wynn Oil Co. v. Thomas, 839 F.2d 1183, 5 USPQ2d 1944, 1948 (6th Cir. 1988). Included in such an analysis is whether there appears to be any likelihood of expansion of either geographical markets or product mix which would lead to any overlap of the markets of the concurrent users of the mark. Homeowners Group, supra at 18 USPQ2d 1596. "[A] 'strong possibility' that either party may expand [its] business to compete with the other will weigh in favor of finding infringement." Wynn Oil Co. v. American Way Service Corp., 943 F.2d 595, 19 USPQ2d 1815, 1823 (6th Cir. 1991).

TRADE NAME DILUTION

It is well recognized that one may not use the name or distinctive marks of a competitor in situations that would cause a likelihood of confusion as to the source of a product. (e.g. trademark infringement).

Query: May an entity in a totally unrelated line of commerce appropriate a well known name of another company where there is no possibility that consumers will assume that the better known company is the source of the product marketed by the newer company?

In one of the earlier cases nationally on this point, Kentucky's highest Court addressed this issue. Churchill Downs Distillery Co. v. Churchill Downs, Inc., 262 Ky. 567, 90 S.W.2d 1041 (1936).

In Churchill Downs, supra, the Defendant incorporated a bourbon distilling business and appropriated the Churchill Downs name and the label used by the distillery on its bottles was easily recognizable as a depiction of the Churchill Downs grandstand. Apparently it was therein stipulated that the parties were

engaged in entirely different lines of business - they are not competing corporations - and there is no relation whatever in the products manufactured and sold by the former with the character of business conducted by the latter.

Id. at 90 S.W.2d 1042. Therefore, there was no possibility of "infringement" as that concept is
normally understood.

However, our Court recognized that "the tendency of the courts has been to widen the scope of protection in unfair competition, and to hold that it is not confined to actual market competition". Id. at 1043.

Therefore, noting at page 1043 that the distillery appropriated the name Churchill Downs "with the intent and purpose of ... deriving a profit in the sale of its products, from the reputation and renown of Churchill Downs, Inc.", the Court held as follows:

The right of Churchill Downs, Inc. to the exclusive use of the name 'Churchill Downs' is property in a qualified sense [Citation omitted] which equity by injunctive relief will protect from another's intentional use for the purpose of deriving a profit from its reputation. ...

Id. at 1044. See also KRS 365.110 which provides as follows:

No dealer or merchant shall make or apply to any parcel or package any kind or character of label bearing the brand or name of any manufacturer without the written authority of the manufacturer.

But see Kern's Kitchen, Inc. v. Bon Appetit, 669 F.Supp. 786, __, 3 USPQ2d 1382, 1286 (W.D. Ky., 1987) ("There is no basis for such an action [dilution] in the Lanham Act or the common law of Kentucky").

Now however, after many years and considerable debate, Congress has enacted a federal dilution act which, like the law of many states now recognizes a federal claim associated with the dilution of "famous" marks. See 15 USC 1125(c).
ELECTRONIC / INTERNET BANKING

Varying Viewpoints

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SECTION G
# ELECTRONIC / INTERNET BANKING — VARYING VIEWPOINTS —

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**SECTION G**
ELECTRONIC/INTERNET BANKING:
VARYING VIEWPOINTS

An Outline of the Presentation

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Topics:

Internet banking – what does it mean

> Marketing
> Interactive web sites

Getting into the Internet banking business

> Conducting Internet banking through a division of a "bricks and mortar" bank
> Organizing a new Internet bank
> The regulatory process

Conducting an Internet banking business

> Regulatory guidance on Internet banking – targeted exam procedures
> An illustration of how it works
> Accessing account information
> Engaging in banking transactions

Making the business fit within the banking laws

> What banking laws are applicable
> When is pen and paper required
> Legislative initiatives

Open Discussion
GETTING INTO THE INTERNET BANKING BUSINESS

I. Establishment of Internet Operation as a Department of an Existing Bank

A. Examples

1. WingspanBank.com, a division of First USA Bank, National Association
   http://www.wingspanbank.com

2. USAccess Bank, a division of The Central Bank USA, Inc.
   http://www.usaccessbank.com

B. Regulatory Requirements

1. No regulatory approval requirements if not using third party providers

2. A FDIC insured institution that uses a third party provider must file a Notification of Performance of Bank Services. Section 7 of the Bank Service Company Act (12 U.S.C. § 1867) ("BSCA") requires federally insured institutions to notify their appropriate federal bank regulatory agency in writing of contracts or relationships with third parties that provide BSCA-authorized services to the institution. The FDIC issued a Financial Institution Letter on June 3, 1999 (FIL-49-99) which reminded institutions of their reporting requirements for contracting with third parties to offer technology related services, including Internet banking services.

3. A savings associations must file a written notice with the Office of Thrift Supervision ("OTS") 30 days in advance of the establishment of a transactional web site and follow any procedures imposed in writing by the OTS in response to any supervisory or compliance concerns. See 12 C.F.R. § 555.310.

C. Advantages and Disadvantages

1. Advantages

   a. No regulatory requirements except for savings associations or FDIC insured institutions which use third party providers (see above)

   b. Quickest method for establishing Internet banking operation

   c. No requirement for additional capital
2. Disadvantages

a. Losses sustained from Internet operations could negatively impact bank earnings and capital because it is a department of the bank and not a separate corporate entity

b. May not provide the Internet operation with the flexibility and independence normally associated with a “stand alone” institution because it does not have its own management and board of directors

c. Could create customer confusion because the general public may believe its dealing with two banks rather than one

II. Use an Existing Commercial Bank Charter to Form an Internet Bank

A. Examples

1. Security First Network Bank
   http://www.sfnb.com

2. NetBank
   http://www.netbank.com

B. Regulatory Requirements

1. Transfer of traditional assets to another banking entity will require regulatory approval of the state department of financial institutions, OCC, FDIC, OTS or Federal Reserve or a combination of these agencies depending on the structure of the transaction.

2. Same requirement as above for FDIC insured institutions that use third party providers

C. Advantages and Disadvantages

1. Advantages

   a. More flexibility to conduct non traditional banking activities since it is a “stand alone” Internet bank with its own separate management

   b. Less customer confusion as to deposits

   c. As an independent bank, it has its own budget which makes it easier to track its profit/loss performance

   d. Potentially higher stock valuation because of Internet status
II. Chartering of De Novo Internet Bank

A. Examples

1. CompuBank (OCC)  
http://www.compubank.com

2. First Internet Bank of Indiana (State Charter)  
http://www.firstib.com

3. VirtualBank (OTS)  
http://www.virtualbank.com

B. Regulatory Requirements

1. Charter application with OCC, OTS or State Banking Authority

2. FDIC Insurance Application

3. Federal Reserve approval if formation of holding company or expansion of banking activities by existing bank holding company

C. Advantages and Disadvantages

1. Advantages

   a. More flexibility to conduct non traditional banking activities since it is a “stand alone” Internet bank with its own separate management

   b. Less customer confusion as to deposits.

   c. As an independent bank it has its own budget which makes it easier to track its profit/loss performance

   d. Potentially higher stock valuation because of Internet status

2. Disadvantages

   a. Longer time period to establish than other options because of extensive regulatory process
b. Higher start-up expenses than other options

IV. Web Sites of Interest

A. http://www.onlinebankingreport.com

B. http://www.ffhsj.com/21stbook/
Regulatory Guidance on Internet Banking

The Examination Process

Generally, there is no application or prior approval requirement under the Federal banking laws if a seasoned state or national bank wants to enter the Internet banking business. Unless the bank is

1. recently organized,
2. subject to special supervisory restrictions, or
3. entering into the business as a part of a business combination transaction,

the appropriate bank regulatory authority will not have the opportunity to review in advance the systems, procedures and vendor/service provider contracts that the bank will put in place for its Internet banking business.

To the extent the bank uses an Internet service provider in connection with its Internet banking services, notice of the arrangement may be required under the Bank Service Company Act (12 USC Section 1867(c)(2)). The FDIC construes the Bank Service Company Act as requiring notice by a bank that has services performed by a third party whenever the services are of the type authorized by the Act, such as data-processing services. Beyond that notice requirement, the first encounter with supervisory oversight may occur during a routine examination of the bank.

A federal savings bank will be required to provide advance regulatory notice before it can establish a "transactional web site" - i.e., an Internet site that enables users to conduct financial transactions such as accessing an account, obtaining an account balance, transferring funds, processing bill payments, opening an account, applying for or obtaining a loan, or purchasing other authorized products or services.

OTS Regulation Section 555.300 (adopting release can be found at http://www.ots.treas.gov/docs/73058.html). Thirty days' advance notice is required.

The federal banking regulators have prepared, and made available on their Internet web sites significant resource materials for bankers and their advisers providing guidance on Internet banking – including explanations about what Internet and electronic banking means, examination

---

1 The Notification of Performance of Bank Services form the FDIC has developed to facilitate compliance with this notice requirement can be found at 6 CCH Fed. Banking L. Rep. ¶ 62-251E. Based on the FDIC's accompanying Financial Institution Letter, dated June 3, 1999, notification is required even if the third party service provider is not a bank service company.
procedures and guidance to bankers and examiners, regulatory developments affecting the
conduct of business electronically, and warnings about pitfalls and problems.

**OCC materials concerning Internet banking**

- The OCC has developed an Internet banking web site on which it has collected
  links to OCC materials concerning Internet banking. Information that can be
  accessed from this site includes
  - press releases and speeches
  - regulatory guidance
  - opinions and letters on permissible electronic banking activities
  - information about establishing an Internet bank
  - research and analysis


- The Comptroller’s Handbook on Internet Banking, dated October 1999, is
  other things, it contains an introduction to Internet banking, a discussion of
  Internet banking risks, and examination procedures.

- The OCC site also provides a link to the Financial Institutions Examination
  Council’s Information Systems Handbook,

- On January 21, 2000, the OCC published an advance notice of proposed rule-
  making soliciting comments in connection with its review of regulations to
  facilitate the use of new technologies by national banks.

**FDIC guidance on Internet banking**

- The FDIC has a web site devoted to Information Systems and E-banking

- The FDIC’s Electronic Banking Safety and Soundness Examination Procedures
  can be accessed from this site. An on-line copy appears at

- The FDIC site also contains a link to the FFEIC Information Systems
  Examination Handbook and Financial Institution Letters addressing information
  systems and electronic banking.

Federal Reserve


- For an article about Internet banking from a community bank’s viewpoint, see "www.your-community-bank.com: Community Banks are Going Online" in the Federal Reserve Bank of Boston’s Fall 1999 Communities and Banking magazine, available at http://www.bos.frb.org/comaff/pdf/fall99.pdf

OTS electronic banking guidance

- The OTS electronic banking web site is located at http://www.ots.treas.gov/ebanking.html

- Information that can be accessed from this site includes the OTS Regulatory Bulletin updating the OTS examination guidelines for information technology http://www.ots.treas.gov/docs/74028.pdf

Uniform Rating System for Information Technology


- The "four critical components" of the Uniform Rating System for Information Technology are
  - Audit
  - Management
  - Development and Acquisition
  - Support and Delivery
INTERNET BANKING
AND ITS
RELATIONSHIP WITH TRADITIONAL BANKING PROCEDURES

I. Internet Methods of Traditional Banking Products.

A. Internet banking provides an additional delivery system for traditional bank products. Banking online to conduct financial transactions, such as accessing current account information, making account transfers and making bill payments, is performed by the customer over secure web sites protected by strong encryption technology and the use of a code or password.

Other banking services performed online will require some form of agreement between the customer and the bank to the terms and conditions governing the transaction, and documentation of that agreement is still customarily paper-based.

1. Opening a Deposit Account – Account Agreement and required disclosures must be acknowledged, customer’s signature must be on file.

2. Loans and Credit Cards – Application and loan documents must be signed and disclosures must be acknowledged.

The consummation of these online banking activities is governed by contract law, dealing with offer and acceptance and authentication thereof.

B. Several approaches to online banking are prevalent but paper documentation is frequently required.

1. Certain aspects of the delivery of the deposit or loan product can easily be accomplished online by use of interactive software. (application and KYC information, account agreement terms and conditions)

Methods for signifying agreement include a statement on the screen that submission of the application indicates agreement to be bound by the Account Agreement.

Is this binding? (See, e.g., ProCD, Inc. v. Zeidenberg, 867 F.3d 1447 (7th Cir. 1996); Hill v. Gateway 2000, 1057 F.3d 1147 (7th Cir. 1997)).

2. Paper-based – Some banks use a hybrid method, taking the application and providing certain information online, and ordering credit reports and other information germane to the credit decision...
II. Electronic or Digital Signature Legislation.

True online banking would permit the delivery of the bank product completely online. However, due to the uncertainty surrounding the legal enforceability of an electronic signature, electronic transactions in many cases still require a physical handwritten signature with paper documentation delivered by mail service to complete the transaction.

A. State Legislation.

All 50 states have enacted some form of e-sign legislation, but the state statutes vary considerably. Kentucky passed legislation in 1998 to authorize the use of and give validity to electronic records and electronic signatures in certain circumstances. K.R.S. sections 369.010-.030 allow the use of technology to generate, communicate, receive or store records, or to provide an electronic identifier for use by a person whose intention it is to use it as having the same force as a manual signature. The use of the statutory authorization is voluntary and must be agreed to by both parties. The statutes can be applied to both private sector transactions or in dealings with state or local governmental entities or agencies, if agreed to in advance. The statutes do not apply where the documents concern the conveyance of an interest in real property, negotiable instruments, instruments of title, or wills or trusts.

Some other examples of state laws:


2. Health care records only (Ohio Rev. Code Sec. 3701.75) -- Ohio H.B. 488 is pending, and would expand the e-sign law to be applicable to all communications, and would make fraudulent use of electronic signatures a crime)

3. Filing of tax returns only (Code of Alabama sec. 40-30-1 et. seq.)

4. Digital signatures and electronic notarizations recognized only, and applicable to the electronic filing of engineering related documents only (Fla. Stat. sec. 117.20)

5. Comprehensive electronic signature and records law (New York – State Technology Law, Chapter 57a of Consolidated Laws of New York, passed in September, 1999); excludes wills, trusts powers of attorney,
negotiable instruments, instruments of title, any document of conveyance under real estate law, or any other document excepted by the New York Electronic Facilitator by rule or regulation.

6. Illinois Electronic Commerce Security Act is considered a model for other states, according to Tom Smedinghoff, attorney at McBride, Baker & Coles and chair of the American Bar Association's e-commerce division.

B. Uniform Electronic Transactions Act (UETA).

The National Conference of Commissioners on Uniform State Laws ("NCCUSL") adopted the UETA in final form on July 29, 1999. The UETA is a uniform act that establishes recognition for both electronic records and electronic signatures. The uniform law was written in response to the exponential increase in commercial transactions occurring over the Internet.

Currently only three states have enacted the UETA: Pennsylvania, California and South Dakota. It has been introduced in the legislatures of twenty-one other states, and nine others are likely to begin deliberations sometime this year. The Kentucky legislature passed H.B. 571 which adopts the UETA, but which exempts certain consumer protection statutes from application of the Act. It has been delivered to the governor for signature.

C. Federal Legislation.

Two bills are currently pending in Congress: The Electronic Signatures in Global and National Commerce Act (H.B. 1714), sponsored by House Commerce Committee Chairman Thomas J. Bliley, Jr. (R-Va.); and The Millennium Digital Commerce Act (S.B. 761), sponsored by Senator Spencer Abraham (R-Mich.). Both bills were approved by their respective legislative body late last year and have been referred to a conference committee in order to reconcile the differences.

1. H.B. 1714.

This bill was originally meant to create a uniform federal law recognizing the validity of digital signatures. It would provide a national framework for the authentication of signatures and electronic documents of interstate commercial transactions. It looks at two key issues: authentication (assuring that the person you are dealing with is who he says he is) and legal effect (establishing that an electronic contract is legally binding). But the bill has received increasing criticism because it has been expanded in ways critics say would work against consumers.

At issue are thousands of state and local laws that require institutions such as banks and insurance companies to keep certain paper records and to notify customers by mail of certain situations (e.g., default on credit card debt or loans, changes in terms of deposit agreement or increases in monthly loan payments; foreclosure on home mortgage or cancellation of an insurance policy).
Under H.B. 1714, companies would be able to provide the notification electronically if the contract were made online instead of by paper. It would also relieve companies of some paper record-keeping rules. It would require electronic signatures on some documents, including the delivery electronically of disclosures required by consumer laws for mortgage loans and other loan transactions. It would preempt state laws that prohibit the use of electronic signatures.

The National Council of State Legislatures opposes this bill, arguing that it would force states to process electronic records from financial institutions and other businesses in any number of formats and technologies. They argue that they would be forced to spend their own funds to accommodate the records, amounting to an unfunded mandate. The NCSL asserts that this tramples on the states’ oversight authority, and that state regulators need and deserve the same flexibility as federal regulators. All federal agencies would be exempted from the provisions on the transmittal of electronic records.

2. S.B. 761.

This bill would give electronic contracts and documents the same standing as traditional paper transactions, and preempts only those state laws restricting or prohibiting the use of electronic signatures and records. It also provides the state the ability to reassert its authority by passing the UETA. In December, the National Council of State Legislatures unanimously endorsed S. 761. Previously, S.761 also addressed electronic delivery of records. However, that provision was eliminated after several senators, the White House and consumer advocates said e-delivery of records could be dangerous because customers might ignore or not be able to access the documents if they change their e-mail address or do not have computers.

Fairly substantial differences may make it difficult to reconcile the two bills. Critics of H.B. 1714 have voiced the following concerns:

Companies may still be open to legal challenge if they cannot prove that the signer knew what he was signing, that he is in fact signing a legal document, and cannot create an auditable trail of data for review by a court in case of a dispute.

There is no regulation of “certifying authorities”. Multiple certifying authorities means different levels of certainty of identity, adding to chances of confusion, both legal and practical.

The bills do not favor one technology yet there are a number of technologies competent for the market in online verification. Public Key Infrastructure (P.K.I.) is the simplest; it uses very large prime numbers and mathematical processes to identify a user. It can be easily shared and some analysts say it is not secure enough to prove persons are who they are. Security experts think the most likely technology to prevail is the biometric signature. It uses a person’s physical characteristics to verify identity, e.g., voice sample, fingerprint scan, or even a written signature (by attaching a tablet to a computer.
which can analyze the speed, pressure and shape of a person’s signature). These characteristics are then digitized, and attached electronically to the document being signed.

D. Federal Regulations and the Electronic Delivery of Disclosures.

1. Regulation E - Interim Rule

On March 25, 1998, the Federal Reserve Board published an interim rule amending Regulation E, which permits depository institutions to deliver by electronic communication disclosures required by the EFTA and Regulation E if the consumer agrees to such method of delivery. For purposes of Regulation E, an electronic communication is a message transmitted electronically that allows visual text to be displayed on equipment such as a modem-equipped computer. The reason for the interim rule was to allow financial institutions to begin delivering disclosures electronically while the Board considered similar proposals under other financial services and fair lending laws.

2. Proposed Rules - Regulations B (Equal Credit Opportunity), Regulation E (Electronic Fund Transfers), Regulation M (Consumer Leasing), Regulation Z (Truth in Lending) and Regulation DD (Truth in Savings).

At the same time as the Regulation E interim rule was published, the Federal Reserve Board proposed a rule for public comment which would amend the above mentioned consumer protection regulations to permit electronic delivery of disclosures. The deadline for public comment was extended several times, with revisions to the proposal being issued by the Board as well. The most recent deadline for comments was March 3, 2000. Although the Federal Reserve stated as late as February 29, 2000 that final action on the proposals is expected shortly after the expiration of the comment period, there is also speculation that the Board has tabled the proposals in anticipation of the passage of federal legislation.

3. Regulation DD.

Effective September 1, 1999, the Federal Reserve Board issued an interim rule amending Regulation DD, Truth in Savings (12 CFR 1230). The interim rule allows depository institutions to deliver Truth in Savings disclosures on periodic statements in electronic form if the consumer agrees to the electronic delivery. The rule did not specify any particular method for obtaining a consumer’s agreement, the validity of which would be determined by state law. The proposal discussed above would cover all Regulation DD disclosures.

III. Banks as Certification Authorities.

Banks have been asked to act as certification authorities (CA’s), which are the trusted third parties used to validate e-commerce transactions involving digital signatures. In doing so, banks face potential liability for conducting business-to-business transactions online because there is no uniform national digital signature
legislation in the United States. Because digital signature laws vary from state to state, parties involved in e-transactions are drafting contracts to determine liability. Many banks operating as CA's intend to assume most liability, but questions still remain about which party would be held liable for problems online because of the lack of a legal framework. Most particularly, liability issues can arise in case of identity theft and misrepresentation when transacting business online.

Existing state electronic signature laws would govern disputes arising out of a bank's activity as a CA. The pending federal legislation would not likely address liability issues, so that it is necessary to determine liability independently during the drafting stage of the contract. Meanwhile, liability issues are also addressed by the UETA.

The OCC recently issued guidance for banks acting as CA's that outlines various risks CA's need to address to issue digital certificates, such as ensuring security, verifying identities and disclosing information about basic service to customers.

The FDIC has expressed the desirability of a uniform standard for digital signatures and for guidance for financial institutions on liability issues, but believes the industry should be allowed to develop before the regulators issue rules. Issuing regulations prematurely could potentially limit banks, according to the FDIC, which favors determining liability contractually for now.

A uniform national standard and a uniform technology for digital signatures would provide parties with legal certainty for conducting e-transactions.

Additional information can be obtained on these and other technology law issues by accessing http://www.technologylawyer.com/legalinks.html
UNIFORM ELECTRONIC TRANSACTIONS ACT

PURPOSE:
The Uniform Electronic Transactions Act is designed to support the use of electronic commerce. The primary objective of this act is to establish the legal equivalence of electronic records and signatures with paper writings and manually-signed signatures, removing barriers to electronic commerce.

ORIGIN:
Completed by the Uniform Law Commissioners in 1999.

APPROVED BY:
American Bar Association

ENDORSED BY:
American Council of Life Insurance
Equipment Leasing Association of America

STATE ADOPTIONS:
California
Indiana
Kentucky
Nebraska
Pennsylvania
South Dakota
Utah

2000 INTRODUCTIONS:

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For any further information regarding the Uniform Electronic Transactions Act, please contact John McCabe or Katie Robinson at 312-915-0195.
INTRODUCTIONS & ADOPTIONS
Of Uniform Acts

UNIFORM ELECTRONIC TRANSACTIONS ACT

The Uniform Law Commissioners promulgated the Uniform Electronic Transactions Act (UETA) in 1999. It is the first comprehensive effort to prepare state law for the electronic commerce era. Many states have already adopted legislation pertaining to such matters as digital signatures, but UETA represents the first national effort at providing some uniform rules to govern transactions in electronic commerce that should serve in every state. Although related to the Uniform Commercial Code, the rules of UETA are primarily for “electronic records and electronic signatures relating to a transaction” that is not subject to any article of the Uniform Commercial Code, except for Articles 2 and 2A. A “transaction” means an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs. Much is excluded in this definition, including required notices, disclosures or communications by courts and governmental agencies.

UETA applies only to transactions in which each party has agreed by some means to conduct them by electronically. Agreement is essential. Nobody is forced to conduct to electronic transactions. Parties to electronic transactions come under UETA, but they may also opt out. They may vary, waive or disclaim most of the provisions of UETA by agreement, even if it is agreed that they will be transacted by electronic means. The rules in UETA are almost all default rules that apply only in the event the terms of an agreement do not govern.

Electronic commerce means, of course, persons doing business with other persons with computers and telephone or television cable lines. The Internet is the great marketplace for these kinds of transactions; a marketplace developing almost daily in 1999 (and presumably into the foreseeable future). The outlines and boundaries for this marketplace are still unknown and are not predictable. It is not possible to predict with any certainty how new law should develop to serve that marketplace or any other electronic marketplace that might develop in the future.

However, a few things are known about the existing electronic marketplace and there are some assumptions about the law that governs transactions within it that can be made with reasonable certainty in 1999, and that will continue to be reasonable certain into the future. Electronic transactions are conducted by communicating digitized information from one person to another. That digitized information can be communicated and stored without the use of paper, and the basic language of electronic transactions is fully and inherently paperless. In fact, relying on paper for the memorialization of transactions and upon manual signatures for verifying them are most likely to impede electronic transactions, adding to their costs. And there is no benefit to any party to an electronic transaction, with few very exceptions, in requiring that they be memorialized on paper with signatures that are manual. The need to expand requirements in the law for writings and manual signatures so that electronic records and electronic signatures will satisfy those requirements, is the one thing that is reasonably certain with respect to electronic transactions.

UETA does not attempt to create a whole new system of legal rules for the electronic marketplace. The objective of UETA is to make sure that transactions in the electronic marketplace are as enforceable as transactions memorialized on paper and with manual signatures, but without changing any of the substantive rules of law that apply. This is a very limited objective—that an electronic record of a transaction is the equivalent of a paper record, and that an electronic signature will be given the same legal effect, whatever that might be, as a manual signature. The basic rules in UETA serve this single purpose.

The basic rules are in Section 7 of UETA. The most fundamental rule in Section 7 provides that a “record or signature may not be denied legal effect or enforceability solely because it is in electronic form.” The second most fundamental rule says that “a contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.” The third most fundamental rule states that any law that requires a writing will be satisfied by an electronic record. And the fourth basic rule provides that any signature requirement in the law will be met if there is an electronic signature.

Almost all of the other rules in UETA serve the fundamental principles set out in Section 7, and tend to answer basic legal questions about the use of electronic records and signatures. Thus, Section 15 determines when information is legally sent or delivered in electronic form. It establishes when electronic delivery occurs—when an electronic record capable of retention by the recipient is legally sent and received. The traditional and statutory rules that govern mail delivery of the paper memorializing a transaction can’t be applied to electronic transactions. Electronic rules have to be devised, and UETA provides the rule.

Another rule that supports the general validity of electronic records and signatures in transactions is the rule on attribution in Section 9. Electronic transactions are mostly faceless transactions between strangers. UETA states that a signature is attributable to a person if it is an act of that person, and that act may be shown in any manner. If a security procedure is used, its efficacy in establishing the attribution may be shown. In the faceless environment of electronic transactions, the obvious difficulties of identification and attribution must be overcome. UETA, Section 9 gives guidance in that endeavor.

Much has been much written about digital signatures in electronic commerce. What is a digital signature? It is really a method of encryption that utilizes specific technology. In the faceless environment of the electronic marketplace and particularly the Internet, such technologies are highly useful.

It is not wholly certain what the legal impact of these technologies should be. For that reason UETA may not be characterized as a digital signature statute. It does facilitate the use of digital signatures and other security procedures in rules such as the one in Section 9 on attribution. Section 10 provides some rules on errors and changes in messages. It favors the party who conforms to the security procedure used in the specific transaction against the party who does not, in the event there is a dispute over the content of the message.

But nothing in UETA requires the use of a digital signature or any security procedure. It is technologically neutral. Persons can use the most up-to-date digital signature technology, or less sophisticated security procedures such as passwords or pin numbers. Whatever parties to transactions use for attribution
or assuring message integrity may be offered in evidence if there is a dispute.

UETA is procedural, not substantive. It does not require anybody to use electronic transactions or to rely upon electronic records and signatures. It does not prohibit paper records and manual signatures. Basic rules of law, like the general and statutory law of contracts, continue to apply as they have always applied.

There are three provisions in UETA that need special attention, and that are not directly in support of the basic rules in Section 7. First, UETA excludes transactions subject to the Uniform Commercial Code, except for those under Articles 2 and 2A, the Uniform Computer Information Transactions Act, laws governing estates and trusts, and any other specific laws that a state wants to exempt from the rules applied in UETA. Some writing and signature requirements in state law do not impact the enforceability of transactions, and have objectives that should not be affected by adoption of a statute like UETA. The limitation of UETA to agreed electronic transactions will eliminate any conflict with other writing requirements for the most part. However, there is some room for jurisdiction-specific tailoring of UETA permitted in each state, to assure no conflict. Exclusions should be carefully and conservatively selected. Most law relating to contracts and transactions between persons will serve the public better if electronic records and signatures are recognized.

Second, UETA provides for "transferable records" in Section 16. Notes under Article 3 and documents under Article 7 of the Uniform Commercial Code are "transferable records" when in electronic form. Notes and documents are negotiable instruments. The quality of negotiation relies upon the note or document as the single, unique token of the obligations and rights embodied in the note or document. Maintaining that quality as a unique token for electronic records is the subject of Section 16. A transferable record exists when there is a single authoritative copy of that record existing and unalterable in the "control" of a person. A person in "control" is a "holder" for the purposes of transferring or negotiating that record under the Uniform Commercial Code. Section 16 is essentially a supplement to the Uniform Commercial Code, until its relevant articles can be fully amended or revised to accommodate electronic instruments.

Third, UETA clearly validates contracts formed by electronic agents. Electronic agents are computer programs that are implemented by their principals to do business in electronic form. They operate automatically, without immediate human supervision, though they are certainly not autonomous agents. They are a kind of tool that parties use to communicate. Section 14 provides that a person may form a contract by using an electronic agent. That means that the principal, which is the person or entity which provides the program to do business, is bound by the contract that its agent makes.

When somebody buys something on the Internet, therefore, that person will be assured that the agreement is valid, even though the transaction is conducted automatically by a computer that solicits orders and payment information. Did anyone really think that every order on the Internet involves a direct communication with a human being?

Three sections of UETA deal with electronic records that state governmental agencies create and retain. Section 17 allows a state to designate one agency or officer as the authority on creation and retention of governmental records. Section 18 allows a state to designate which agency or officer regulates the communication of electronic records and use of electronic signatures between agencies and other persons. Section 19 allows a state to designate an agency or officer to set standards that promote consistency and interoperability between state agencies with respect to the use of electronic records and signatures. All three sections are optional sections, there for the state that needs them, but not mandatory for all states in order to implement uniformity. These are very important provisions, however, because they provide a state with some root law for organizing the electronic business of the state. They should be given very serious consideration in every state.

It is not possible to cover every aspect of UETA in a short summary. This summary highlights some important aspects. The adoption of these rules will be a boon to electronic commerce. They will not artificially skew any market or make any substantive law relating to contracts any different from that governing transactions memorialized on paper. Every state should adopt them as quickly as possible.
UNIFORM ELECTRONIC TRANSACTIONS ACT

Drafted by the

NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

and by it

APPROVED AND RECOMMENDED FOR ENACTMENT
IN ALL THE STATES

at its

ANNUAL CONFERENCE
MEETING IN ITS ONE-HUNDRED-AND-EIGHTH YEAR
IN DENVER, COLORADO
JULY 23 - 30, 1999

WITH DRAFT PREFATORY NOTE AND COMMENTS DATED 12-13-99

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By
NATIONAL CONFERENCE OF COMMISSIONERS
ON UNIFORM STATE LAWS

The ideas and conclusions set forth in the draft prefatory notes and comments have not been passed on by the National Conference of Commissioners on Uniform State Laws. They have been drafted by the Reporter and must be approved by the Chair of the Drafting Committee and the National Conference of Commissioners on Uniform State Laws.
UNIFORM ELECTRONIC TRANSACTIONS ACT

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DRAFT PREFATORY NOTES

With the advent of electronic means of communication and information transfer, business models and methods for doing business have evolved to take advantage of the speed, efficiencies, and cost benefits of electronic technologies. These developments have occurred in the face of existing legal barriers to the legal efficacy of records and documents which exist solely in electronic media.

Whether the legal requirement that information or an agreement or contract must be contained or set forth in a pen and paper writing derives from a statute of frauds affecting the enforceability of an agreement, or from a record retention statute that calls for keeping the paper record of a transaction, such legal requirements raise real barriers to the effective use of electronic media.

One striking example of electronic barriers involves so called check retention statutes in every state. A study conducted by the Federal Reserve Bank of Boston identified more than 2500 different state laws which require the retention of canceled checks by the issuers of those checks. These requirements not only impose burdens on the issuers, but also effectively restrain the ability of banks handling the checks to automate the process. Although check truncation is validated under the Uniform Commercial Code, if the bank's customer must store the canceled paper check, the bank will not be able to deal with the item through electronic transmission of the information. By establishing the equivalence of an electronic record of the information, the UETA removes these barriers without affecting the underlying legal rules and requirements.

A. Scope of the Act and Procedural Approach. The scope of this Act provides coverage which sets forth a clear framework for covered transactions, and also avoids unwarranted surprises for unsophisticated parties dealing in this relatively new media. The clarity and certainty of the scope of the Act have been obtained while still providing a solid legal framework that allows for the continued development of innovative technology to facilitate electronic transactions.

With regard to the general scope of the Act, the Act's coverage is inherently limited by the definition of "transaction." The Act does not apply to all writings and signatures, but only to electronic records
and signatures relating to a transaction, defined as those interactions between people relating to business, commercial and governmental affairs. In general, there are few writing or signature requirements imposed by law on many of the "standard" transactions that had been considered for exclusion. A good example relates to trusts, where the general rule on creation of a trust imposes no formal writing requirement. Further, the writing requirements in other contexts derived from governmental filing issues. For example, real estate transactions were considered potentially troublesome because of the need to file a deed or other instrument for protection against third parties. Since the efficacy of a real estate purchase contract, or even a deed, between the parties is not affected by any sort of filing, the question was raised why these transactions should not be validated by this Act if done via an electronic medium. No sound reason was found. Filing requirements fall particularly unwarranted in the event that a state chose to convert to an electronic recording system, as many have for Article 9 financing statement filings under the Uniform Commercial Code.

The exclusion of specific Articles of the Uniform Commercial Code reflects the recognition that, particularly in the case of Articles 5, 8 and revised Article 9, electronic transactions were addressed in the specific contexts of those revision processes. In the context of Articles 2 and 2A the UETA provides the vehicle for assuring that such transactions may be accomplished and effected via an electronic medium. At such time as Articles 2 and 2A are revised the extent of coverage in those Articles Acts may make application of this Act as a gap-filling law desirable. Similar considerations apply to the recently promulgated Uniform Computer Information Transactions Act ("UCITA").

The need for certainty as to the scope and applicability of this Act is critical, and makes any sort of a broad, general exception based on notions of inconsistency with existing writing and signature requirements unwise at best. The uncertainty inherent in leaving the applicability of the Act to judicial construction of this Act with other laws is unacceptable if electronic transactions are to be facilitated.

Finally, recognition that the paradigm for the Act involves two willing parties conducting a transaction electronically, makes it necessary to expressly provide that joint acquiescence or intent on the part of a person to conduct transactions electronically is necessary before the Act can be invoked. Accordingly, Section 5 specifically provides that the Act only applies between parties that have agreed to conduct transactions electronically. In this context, the construction of the term agreement must be broad in order to assure that the Act applies whenever the circumstances show the parties intention to transact electronically, regardless of whether the intent rises to the level of a formal agreement.

B. Procedural Approach. Another fundamental premise of the Act is that it be minimalist and procedural. The general efficacy of existing law, in an electronic context, so long as biases and barriers to the medium are removed, confirms this approach. The Act defers to existing substantive law. Specific areas of deference to other law in this Act include: 1) the meaning and effect of "sign" under existing law, 2) the method and manner of displaying, transmitting and formatting information in section 8, 3) rules of attribution in section 9, and 4) the law of mistake in section 10.

The Act's treatment of records and signatures demonstrates best the minimalist approach that has been adopted. Whether a record is attributed to a person is left to law outside this Act. Whether an electronic signature has any effect is left to the surrounding circumstances and other law. These provisions are salutary directives to assure that records and signatures will be treated in the same manner, under currently existing law, as written records and manual signatures.

The deference of the Act to other substantive law does not negate the necessity of setting forth rules and standards for using electronic media. The Act expressly validates electronic records, signatures and contracts. It provides for the use of electronic records and information for retention purposes, providing certainty in an area with great potential in cost savings and efficiency. The Act makes clear that the actions of machines ("electronic agents") programmed and used by people will bind the user of the machine, regardless of whether human review of a particular transaction has occurred. It specifies the standards for sending and receipt of electronic records, and it allows for innovation in financial services through the implementation of transferable records. In these ways the Act permits electronic transactions to be accomplished with certainty under existing substantive rules of law.

UNIFORM ELECTRONIC TRANSACTIONS ACT

SECTION 1. SHORT TITLE. This [Art] may be cited as the Uniform Electronic Transactions Act.

SECTION 2. DEFINITIONS. In this [Art]:

(1) "Agreement" means the bargain of the parties in fact, as found in their language or inferred from other circumstances and from rules, regulations, and procedures given the effect of agreements under laws otherwise applicable to a particular transaction.

(2) "Automated transaction" means a transaction conducted or performed, in whole or in part, by electronic means or electronic records, in which the acts or records of one or both parties are not reviewed by an individual in the ordinary course in forming a contract, performing under an existing contract, or fulfilling an obligation required by the transaction.

(3) "Computer program" means a set of statements or instructions to be used directly or indirectly in an information processing system in order to bring about a certain result.

(4) "Contract" means the total legal obligation resulting from the parties' agreement as affected by this [Art] and other applicable law.

(5) "Electronic" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities.

(6) "Electronic agent" means a computer program or an electronic or other automated means used independently to initiate an action or respond to electronic records or performances in whole or in part, without review or action by an individual.

(7) "Electronic record" means a record created, generated, sent, communicated, received, or stored by electronic means.

(8) "Electronic signature" means an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record.

(9) "Governmental agency" means an executive, legislative, or judicial agency, department, board, commission, authority, institution, or instrumentality of the federal government or of a State or of a county, municipality, or other political subdivision of a State.
(10) "Information" means data, text, images, sounds, codes, computer programs, software, databases, or the like.

(11) "Information processing system" means an electronic system for creating, generating, sending, receiving, storing, displaying, or processing information.

(12) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, governmental agency, public corporation, or any other legal or commercial entity.

(13) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form.

(14) "Security procedure" means a procedure employed for the purpose of verifying that an electronic signature, record, or performance is that of a specific person or for detecting changes or errors in the information in an electronic record. The term includes a procedure that requires the use of algorithms or other codes, identifying words or numbers, encryption, or callback or other acknowledgment procedures.

(15) "State" means a State of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States. The term includes an Indian tribe or band, or Alaskan native village, which is recognized by federal law or formally acknowledged by a State.

(16) "Transaction" means an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs.

Sources: UNICITRAL Model Law on Electronic Commerce; Uniform Commercial Code; Uniform Computer Information Transactions Act; Restatement 2d Contracts.

**DRAFT COMMENTS**

1. "Agreement"

Whether the parties have reached an agreement is determined by their express language and all surrounding circumstances. The Restatement of Contracts 2d §3 provides that, "An agreement is a manifestation of mutual assent on the part of two or more persons." See also Restatement of Contracts 2d, Section 2, Comment b. The Uniform Commercial Code specifically includes in the circumstances from which an agreement may be inferred "course of performance, course of dealing and usage of trade..." as defined in the UCC. Although the definition of agreement in this Act does not make specific reference to usage of trade and other party conduct, this definition is not intended to affect the construction of the parties' agreement under the substantive law applicable to a particular transaction. Where that law takes account of usage and conduct in informing the terms of the parties' agreement, the usage or conduct would be relevant as "other circumstances" included in the definition under this Act.

Where the law applicable to a given transaction provides that system rules and the like constitute part of the agreement of the parties, such rules will have the same effect in determining the parties agreement under this Act. For example, UCC Article 4 (Section 4-103(b)) provides that Federal Reserve regulations and operating circulars and clearinghouse rules have the effect of agreements. Such agreements by law properly would be included in the definition of agreement in this Act.

The parties' agreement is relevant in determining whether the provisions of this Act have been varied by agreement. In addition, the parties' agreement may establish the parameters of the parties' use of electronic records and signatures, security procedures and similar aspects of the transaction. See Model Trading Partner Agreement, 45 Business Lawyer Supp. Issue (June 1990). See Section 5(b) and comments thereto.

2. "Automated Transaction."

This definition addresses the use and effectiveness of machines beyond the issue of contract formation and deals with performances under a contract and other obligations accomplished by electronic means in a transaction. Such a broad application is necessary because of the diversity of transactions to which this Act may apply.

As with electronic agents, this definition addresses the circumstance where electronic records may result in action or performance by a party although no human review of the electronic records is anticipated. Section 14 provides specific rules to assure that where one or both parties do not review the electronic records, the resulting agreement will be effective.

The critical element in this definition is the lack of a human actor on one or both sides of a transaction. For example, if one orders books from Bookseller.com through Bookseller's website, the transaction would be an automated transaction because Bookseller took and confirmed the order via its machine. Similarly, if Automaker and supplier do business through Electronic Data Exchange, Automaker's computer, upon receiving information within certain pre-programmed parameters, will send an electronic order to supplier's computer. If Supplier's computer confirms the order and processes the shipment because the order falls within pre-programmed parameters in Supplier's computer, this would be a fully automated transaction. If, instead, the Supplier relies on a human employee to review, accept, and process the Buyer's order, then only the Automaker's side of the transaction would be automated. In either case, the entire transaction falls within this definition.

3. "Computer program." This definition refers to the functional and operating aspects of an electronic, digital system. It relates to operating instructions used in an electronic system such as an electronic agent. (See definition of "Electronic Agent").

4. "Electronic." The basic nature of most current technologies and the need for a recognized, single term warrants the use of "electronic" as the defined term. The definition is intended to assure that the
Act will be applied broadly as new technologies develop. The term must be construed broadly in light of developing technologies in order to fulfill the purpose of this Act to validate commercial transactions regardless of the medium used by the parties. Current legal requirements for "writings" can be satisfied by most any tangible media, whether paper, other fibers, or even stone. The purpose and applicability of this Act covers intangible media which are technologically capable of storing, transmitting and reproducing information in human perceivable form, but which lack the tangible aspect of paper, papyrus or stone.

The examples involving Bookseller.com and Automaker in the comment to the definition of Automated Transaction are equally applicable here. Bookseller acts through an electronic agent in processing an order for books. Automaker and the supplier each act through electronic agents in processing an order for books. Automaker acts through an electronic agent in facilitating and effectuating the just-in-time inventory process through EDI.

6. "Electronic record." An electronic record is a subset of the broader defined term "record." It is any record created, used or stored in a medium other than paper (see definition of electronic). The defined term is also used in this Act as a limiting definition in those provisions in which it is used.

Information processing systems, computer equipment and programs, electronic data interchange, electronic mail, voice mail, facsimile, telex, telecopying, scanning, and similar technologies all qualify as electronic under this act. Accordingly information stored on a computer hard drive or floppy disc, facsimiles, voice mail messages, messages on a telephone answering machine, audio and video tape recordings, among other records, all would be electronic records under this Act.

7. "Electronic signature." The idea of a signature is broad and not specifically defined. Whether any particular record is "signed" is a question of fact. Proof of that fact must be made under other applicable law. This act simply assumes that the signature may be accomplished through an electronic means. No specific technology need be used in order to create a valid signature. One's voice on an answering machine may suffice if the requisite intention is present. Similarly, including one's name as part of an electronic mail communication also may suffice, as may the firm name on a facsimile. It may be that circumstances may change the definition of electronic agent accordingly, in order to recognize such new capabilities.

The definition requires that the signer execute or adopt the sound, symbol or process with the intent to sign the record. The act of applying a sound, symbol or process to an electronic record could have differing meanings and effects. The consequence of the act and the effect of the act as a signature are determined under other applicable law. However, the essential attribute of a signature involves applying a sound, symbol or process with an intent to do a legally significant act. It is that intention that is understood in the law as a part of the word "sign", without the need for a definition.

This Act establishes, to the greatest extent possible, the equivalency of electronic signatures and manual signatures. The purpose is to overcome unwarranted biases against electronic methods of signing and authenticating records. Therefore the term "signature" has been used to connote and convey that equivalency. The term "authentication," used in other laws, often has a narrower meaning and purpose than an electronic signature as used in this Act. However, an authentication under any of those other laws constitutes an electronic signature under this Act.

The precise effect of an electronic signature will be determined based on the surrounding circumstances under section 9(b).

This definition includes as an electronic signature the standard webpage click through process. For example, when a person orders goods or services through a vendor's website, the person will be required to provide information as part of a process which will result in receipt of the goods or services. When the customer ultimately gets to the last step and clicks "I agree," the person has adopted the process and has done so with the intent to associate the person with the record of that process. The actual effect of the electronic signature will be determined from all the surrounding circumstances, however, the person adopted a process which the circumstances indicate she intended to have the effect of the goods/services and being bound to pay for them. The adoption of the process carried the intent to do a legally significant act, the hallmark of a signature.
Another important aspect of this definition lies in the necessity that the electronic signature be linked or logically associated with the record. In the paper world, it is assumed that the symbol adopted by a party is attached to or located somewhere in the same paper that is intended to be authenticated, e.g., an allonge firmly attached to a promissory note, or the classic signature at the end of a long contract. These tangible manifestations do not exist in the electronic environment, and accordingly, this definition expressly provides that the symbol must in some way be linked to, or connected with, the electronic record being signed. This linkage is consistent with the regulations promulgated by the Food and Drug Administration. 21 CFR Part 11 (March 20, 1997).

A digital signature using public key encryption technology would qualify as an electronic signature, as would the mere inclusion of one's name as a part of an e-mail message - so long as in each case the signer executed or adopted the symbol with the intent to sign.

8. "Governmental agency."

This definition is important in the context of optional Sections 17-19.

9. "Information processing system." This definition is consistent with the UNCITRAL Model Law on Electronic Commerce. The term includes computers and other information systems. It is principally used in Section 15 in connection with the sending and receiving of information. In that context, the key aspect is that the information enter a system from which a person can access it.

10. "Record." This is a standard definition designed to embrace all means of communicating or storing information except human memory. It includes any method for storing or communicating information, including "writings." A record need not be indestructible or permanent, but the term does not include oral or other communications which are not stored or preserved by some means. Information that has not been retained other than through human memory does not qualify as a record. As in the case of the terms "writing" or "written," the term "record" does not establish the purposes, permitted uses or legal effect which a record may have under any particular provision of substantive law. ABA Report on Use of the Term "Record," October 1, 1996.


A security procedure may be applied to verify an electronic signature, verify the identity of the sender, or assure the informational integrity of an electronic record. The definition does not identify any particular technology. This permits the use of procedures which the parties select or which are established by law. It permits the greatest flexibility among the parties and allows for future technological development.

The definition is this Act is broad and is used to illustrate one way of establishing attribution or content integrity of an electronic record or signature. The use of a security procedure is not accorded operative legal effect, through the use of presumptions or otherwise, by this Act. In this Act, the use of security procedures is simply one method for proving the source or content of an electronic record or signature.

A security procedure may be technologically very sophisticated, such as an asymmetric cryptographic system. At the other extreme the security procedure may be as simple as a telephone call to confirm the identity of the sender through another channel of communication. It may include the use of a mother's maiden name or a personal identification number (PIN). Each of these examples is a method for confirming the identity of a person or accuracy of a message.

12. "Transaction." The definition has been limited to actions between people taken in the context of business, commercial or governmental activities. The term includes all interactions between people for business, commercial, including specifically consumer, or governmental purposes. However, the term does not include unilateral or non-transactional actions. As such it provides a structural limitation on the Scope of the Act as stated in the next section.

It is essential that the term commerce and business be understood and construed broadly to include commercial and business transactions involving individuals who may qualify as "consumers" under other applicable law. If Alice and Bob agree to the sale of Alice's car to Bob for $2000 using an internet auction site, that transaction is fully covered by this Act. Even if Alice and Bob each qualify as typical "consumers," under other applicable law, their interaction was a transaction in commerce. Accordingly their actions would be related to commercial affairs, and fully qualify as a transaction governed by this Act.

Other transaction types may include:

1. A single purchase by an individual from a retail merchant, which may be accomplished by an order sent by facsimile from a printed catalog, or by exchange of electronic mail;

2. Recurring orders on a weekly or monthly basis between large companies which have entered into a master trading partner agreement to govern the methods and manner of their transaction parameters;

3. A purchase by an individual from an online Internet retail vendor. Such an arrangement may develop into an ongoing series of individual purchases, with security procedures and the like, as a part of doing ongoing business.

4. The closing of a business purchase transaction via facsimile transmission of documents or even electronic mail. In such a transaction, all parties may participate through electronic conferencing technologies. At the appointed time all electronic records are executed electronically and transmitted to the other party. In such a case, the electronic records and electronic signatures are validated under this Act, obviating the need for "in person" closings.

A transaction must include interaction between two or more persons. Accordingly, the execution of a will or trust, or the execution of a health care power of attorney or similar health care designation, for example, would not be covered by this Act because they are not a part of a transaction as defined in this Act.
SECTION 3. SCOPE.

(a) Except as otherwise provided in subsection (b), this Act applies to electronic records and electronic signatures relating to a transaction.

(b) This Act does not apply to a transaction to the extent it is governed by:

(1) a law governing the creation and execution of wills, codicils, or testamentary trusts;

(2) [The Uniform Commercial Code other than Sections 1-107 and 1-206, Article 2, and Article 2A];

(3) [the Uniform Computer Information Transactions Act]; and

(4) [other laws, if any, identified by State].

c) This Act applies to an electronic record or electronic signature otherwise excluded from the application of this Act under subsection (b) to the extent it is governed by a law other than those specified in subsection (b).

d) A transaction subject to this Act is also subject to other applicable substantive law.

SEE LEGISLATIVE NOTE BELOW - FOLLOWING DRAFT COMMENTS.

DRAFT COMMENTS

1. The Scope of this Act is inherently limited by the fact that it only applies to transactions related to business, commercial (including consumer) and governmental matters. Consequently, transactions with no relation to business, commercial or governmental transactions would not be subject to this Act. Unilaterally generated electronic records and signatures which are not part of a transaction also are not covered by this Act. See Section 2, Comment 12.

2. This Act affects the medium in which information, records and signatures may be presented and retained under current legal requirements. While this Act covers all electronic records and signatures which are used in a business, commercial (including consumer) or governmental transaction, the operative provisions of the Act relate to requirements for writings and signatures under other laws. Accordingly, the exclusions in subsection (b) focus on those legal rules imposing certain writing and signature requirements which will not be affected by this Act.

3. The exclusions listed in subsection (b) provide clarity and certainty regarding the laws which are and are not affected by this Act. This section provides that transactions subject to specific laws are unaffected by this Act and leaves the balance subject to this Act.

4. Paragraph (1) excludes wills, codicils and testamentary trusts. This exclusion is largely salutary given the unilateral context in which such records are generally created and the unlikely use of such records in a transaction as defined in this Act (i.e., actions taken by two or more persons in the context of business, commercial or governmental affairs). Paragraph (2) excludes all of the Uniform Commercial Code other than UCC Section 1-107 and 1-206, and Articles 2 and 2A. This Act does not apply to the excluded UCC articles, whether in "current" or "revised" form.

5. Articles 3, 4 and 4A of the UCC impact payment systems and have specifically been removed from the coverage of this Act. Moreover, the systems affected go well beyond the relationships between contracting parties and require broader attention to systemic effects. Articles 5, 8 and 9 have been excluded because the revision process relating to those Articles included significant consideration of electronic practices. Paragraph 4 provides for exclusion from this Act of UETA because the drafting process of that Act also included significant consideration of electronic contracting provisions.

6. The very limited application of this Act to Transferable Records in Section 16 does not affect payment systems, and the Section is designed to apply to a transaction through express agreement of the parties. The exclusion of Articles 3 and 4 will not affect the Act's coverage of Transferable Records. Section 16 is designed to allow for the development of systems which will provide "control" as defined in Section 16. Such control is necessary as a substitute for the idea of possession which undergirds negotiable instrument law. The technology has yet to be developed which will allow for the possession of a unique electronic token embodying the rights associated with a negotiable promissory note. Section 16's concept of control is intended as a substitute for possession.

The provisions in Section 16 operate as free standing rules, establishing the rights of parties using Transferable Records under this Act. The references in Section 16 to UCC Section 3-302, 7-501 and 9-308 (R9-330(d)) are designed to incorporate the substance of those provisions into this act for the limited purposes noted in section 16(c). Accordingly, an electronic record which is also a Transferable Record, would not be used for purposes of a transaction governed by Articles 3, 4, or 9, but would be an electronic record used for purposes of a transaction governed by Section 16. However, it is important to remember that those UCC Articles will still apply to the transferable record in their own right. Accordingly any other substantive requirements, e.g., method and manner of perfection under Article 9, must be complied with under those other laws. See Comments to Section 16.

7. This Act does apply, in toto, to transactions under unrevised Articles 2 and 2A. There is every reason to validate electronic contracting in these situations. Sales and leases do not implicate broad systems such as the case with payment systems. Further sales and leases generally do not have a far reaching effect on the rights of parties beyond the contracting parties, such as exists in the secured transactions system. Finally, it is in the area of sales, licenses and leases that electronic commerce is occurring to its greatest extent today. To exclude these transactions would largely gut the purpose of this Act.

In the event that Articles 2 and 2A are revised and adopted in the future, UETA will only apply to the extent provided in those Acts.

8. An electronic record/signature may be used for purposes of more than one legal requirement, or may be covered by more than one law. Consequently, it is important to make clear, despite any apparent redundancy, in subsection (c) that an electronic record used for purposes of a law which is not affected by this Act under subsection (b) may nonetheless be used and validated for purposes of other laws not excluded by subsection (b). For example, this Act does not apply to an electronic record of a check when used for purposes of a transaction governed by Article 4 of the Uniform Commercial Code other than UCC Section 1-107 and 1-206, and Articles 2 and 2A. This Act does not apply to the excluded UCC articles, whether in "current" or "revised" form.
Commercial Code, i.e., the Act does not validate so-called electronic checks. However, for purposes of check retention statutes, the same electronic record of the check is covered by this Act, so that retention of an electronic image/record of a check will satisfy such retention statutes, so long as the requirements of Section 12 are fulfilled.

In another context, subsection (c) would operate to allow this Act to apply to what would appear to be an excluded transaction under subsection (b). For example, Article 9 of the Uniform Commercial Code applies generally to any transaction that creates a security interest in personal property. However, Article 9 excludes landlord's liens. Accordingly, although this Act excludes from its application transactions subject to Article 9, this Act would apply to the creation of a landlord lien if the law otherwise applicable to landlord's liens did not provide otherwise, because the landlord's lien transaction is excluded from Article 9.

9. Additional exclusions under subparagraph (b)(4) should be limited to laws which govern electronic records and signatures which may be used in transactions as defined in Section 2(16). Records used unilaterally, or which do not relate to business, commercial (including consumer), or governmental affairs are not governed by this Act in any event, and exclusion of laws relating to such records may create unintended inferences about whether other records and signatures are covered by this Act.

It is also important that additional exclusions, if any, be included under subsection (b)(4) in order to assure that continued validation of such records under subsection (c) will occur.

LEGISLATIVE NOTE REGARDING POSSIBLE ADDITIONAL EXCLUSIONS UNDER SECTION 3(b)(4).

The following discussion is derived from the Report dated September 21, 1998 of The Task Force on State Law Exclusions (the "Task Force") presented to the Drafting Committee. After consideration of the Report, the Drafting Committee determined that exclusions other than those specified in the Act were not warranted. In addition, other inherent limitations on the applicability of the act (the definition of transaction, the requirement that the parties acquiesce in the use of an electronic format) also militate against additional exclusions. Nonetheless, the Drafting Committee recognized that some legislatures may wish to exclude additional transactions from the act, and determined that guidance in some major areas would be helpful to those legislatures considering additional areas for exclusion.

Because of the overwhelming number of references in state law to writings and signatures, the following list of possible transactions is not exhaustive. However, they do represent those areas most commonly raised during the course of the drafting process as areas that might be inappropriate for an electronic medium. It is important to keep in mind however, that the drafting committee determined that exclusion of these additional areas was not warranted.

1. Trusts (other than testamentary trusts). Trusts can be used for both business and personal purposes. By virtue of the definition of transaction, trusts used outside the area of business and commerce would not be governed by this Act. With respect to business or commercial trusts, the laws governing their formation contain few or no requirements for paper or signatures. Indeed, in most jurisdictions trusts of any kind may be created orally. Consequently, the drafting committee believed that the Act should apply to any transaction where the law leaves to the parties the decision of whether to use a writing. Thus, in the absence of legal requirements for writings, there is no sound reason to exclude laws governing trusts from the application of this Act.

2. Powers of Attorney. A power of attorney is simply a formalized type of agency agreement. In general, no formal requirements for paper or execution were found to be applicable to the validity of powers of attorney.

Special health powers of attorney have been established by statute in some states. These powers may have special requirements under state law regarding execution, acknowledgment and possibly notarization. In the normal case such powers will not arise in a transactional context and so would not be covered by this Act. However, even if such a record were to arise in a transactional context, this act operates simply to remove the barrier to the use of an electronic medium, and preserves other requirements of applicable substantive law, avoiding any necessity to exclude such laws from the operation of this Act. Especially in light of the provisions of Sections 8 and 11, the substantive requirements under such laws will be preserved and may be satisfied in an electronic format.

3. Real Estate Transactions. It is important to distinguish between the efficacy of paper documents involving real estate between the parties, as opposed to their effect on third parties. The latter consideration relates to the necessity of governmental filing. As between the parties, it is unnecessary to maintain existing barriers to electronic contracting. There are no unique characteristics to contracts relating to real property as opposed to other business and commercial (including consumer) contracts. Consequently, the decision whether to use an electronic medium for their agreements should be a matter for the parties to determine. In the event notarization and acknowledgment are required under other laws, Section 11 provides a means for such actions to be accomplished electronically.

With respect to the requirements of government filing, those are left to the individual states in the decision of whether to adopt and implement electronic filing systems. (See optional Section 17-19). However, government recording systems currently require paper deeds including notarized, manual signatures. Although California and Illinois are experimenting with electronic filing systems, until such systems become widespread, the parties likely will choose to use, at the least, a paper deed for filing purposes. Nothing in this Act precludes the parties from selecting the medium best suited to the needs of the particular transaction. Parties may wish to consummate the transaction using electronic media in order to avoid expensive travel. Yet the actual deed may be in paper form to assure compliance with existing recording systems and requirements. The critical point is that nothing in this Act prevents the parties from selecting paper or electronic media for all or part of their transaction.

4. Consumer Protection Statutes. Consumer protection provisions in state law often require that information be disclosed or provided to a consumer in writing. Because this act does apply to such transactions, the question of whether such laws should be specifically excluded was considered. Exclusion of consumer transactions would eliminate a huge group of commercial transactions which benefit consumers by enabling the efficiency of the electronic medium. Commerce over the internet is driven by consumer demands and concerns and must be included.

At the same time, it is important to recognize the protective effects of many consumer statutes. Consumer statutes often require that information be provided in writing, or may require that the consumer separately sign or initial a particular provision to evidence that the consumer's attention was brought to the provision. Subsection (1) requires electronic records to be retainable by a person whenever the law requires information to be delivered in writing. The section imposes a significant burden on the sender of information. The sender must be assured that the information system of the
recipient is compatible with, and capable of retaining the information sent by the sender's system. Furthermore, nothing in this Act permits the avoidance of legal requirements of separate signatures or initialing. The Act simply permits the signature or initialing to be done electronically.

Other consumer protection statutes require (expressly or implicitly) that certain information be presented in a certain manner or format. Laws requiring information to be presented in particular fonts, formats or in similar fashion, as well as laws requiring conspicuous displays of information are preserved. Section 8(b)(3) specifically preserves the applicability of such requirements in an electronic environment. In the case of conspicuous requirements, the determination of what is conspicuous will be left to other law. Section 8 was included to specifically preserve the protective functions of such disclosure statutes, while at the same time allowing the use of electronic media if the substantive requirements of the other laws could be satisfied in the electronic medium.

The requirement that both parties agree to conduct a transaction electronically also prevents the imposition of the electronic medium on unwilling parties See Section 5(b). In addition, where the law requires inclusion of specific terms or language, those requirements are preserved broadly by Section 5(e).

Requirements that information be sent to, or received by, someone have been preserved in Section 15. As in the paper world, obligations to send do not impose any duties on the sender to assure receipt, other than reasonable methods of dispatch. In those cases where receipt is required legally, Sections 5, 8 and 15 impose the burden on the sender to assure delivery to the recipient if satisfaction of the legal requirement is to be fulfilled.

Formatting and separate signing requirements serve a critical purpose in much consumer protection legislation, to assure that information is not slipped past the unsuspecting consumer. Not only does this Act not disturb those requirements, it preserves those requirements. In addition, other bodies of substantive law continue to operate to allow the courts to police any such bad conduct or overreaching, e.g., unconscionability, fraud, duress, mistake and the like. These bodies of law remain applicable regardless of the medium in which a record appears.

The preservation of existing safeguards, together with the ability to opt out of the electronic medium entirely, demonstrate the lack of any need generally to exclude consumer protection laws from the operation of this Act. Legislatures may wish to focus any review on those statutes which provide for post-contract formation and post-breach notices to be in paper. However, any such consideration must also balance the needed protections against the potential burdens which may be imposed.

The right granted by this subsection may not be waived by agreement.

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Consumers and others will not be well served by restrictions which preclude the employment of electronic technologies sought and desired by consumers.

SECTION 4. PROSPECTIVE APPLICATION. This [Act] applies to any electronic record or electronic signature created, generated, sent, communicated, received, or stored on or after the effective date of this [Act].

DRAFT COMMENT

This section makes clear that the Act only applies to validate electronic records and signatures which arise subsequent to the effective date of the act. Whether electronic records and electronic signatures arising before the effective date of this act are valid is left to other law.

SECTION 5. USE OF ELECTRONIC RECORDS AND ELECTRONIC SIGNATURES; VARIATION BY AGREEMENT.

(a) This [Act] does not require a record or signature to be created, generated, sent, communicated, received, stored, or otherwise processed or used by electronic means or in electronic form.

(b) This [Act] applies only to transactions between parties each of which has agreed to conduct transactions by electronic means. Whether the parties agree to conduct a transaction by electronic means is determined from the context and surrounding circumstances, including the parties' conduct.

(c) A party that agrees to conduct a transaction by electronic means may refuse to conduct other transactions by electronic means. The right granted by this subsection may not be waived by agreement.

(d) Except as otherwise provided in this [Act], the effect of any of its provisions may be varied by agreement. The presence in certain provisions of this [Act] of the words "unless otherwise agreed", or words of similar import, does not imply that the effect of other provisions may not be varied by agreement.

(e) Whether an electronic record or electronic signature has legal consequences is determined by this [Act] and other applicable law.

DRAFT COMMENTS

This Section limits the applicability of this Act to transactions which parties have agreed to conduct electronically. Accordingly, a broad interpretation of the term agreement is necessary to assure that this Act has the widest possible application consistent with its purpose of removing barriers to electronic commerce.

1. This section makes clear that this Act is intended to facilitate the use of electronic means, but does not require the use of electronic records and signatures. This fundamental principle is set forth in subsection (a) and elaborated by subsections (b) and (c), which require an intention to conduct transactions electronically and preserve the right of a party to refuse to use electronics in any subsequent transaction.

2. The paradigm of this Act is two willing parties doing transactions electronically. It is therefore appropriate that the Act is voluntary and preserves the greatest possible party autonomy to refuse electronic transactions. The requirement that party agreement be found from all the surrounding circumstances is a limitation on the scope of this Act.

3. If this Act is to serve to facilitate electronic transactions, it must be applicable under circumstances not rising to a full fledged contract to use electronics. While absolute certainty can be accomplished by obtaining an explicit contract before relying on electronic transactions, such an explicit contract should not be necessary before one may feel safe in conducting transactions electronically. Indeed,
such a requirement would itself be an unreasonable barrier to electronic commerce, at odds with the fundamental purpose of this Act. Accordingly, the requisite agreement, express or implied, must be determined from all available circumstances and evidence.

4. Subsection (b) provides that the Act applies to transactions in which the parties have agreed to conduct the transaction electronically. In this context it is essential that the parties' actions and words be broadly construed in determining whether the requisite agreement exists. Accordingly, the Act expressly provides that the party's agreement is to be found from all circumstances, including the parties' conduct. The critical element is the intent of a party to conduct a transaction electronically. Once that intent is established, this Act applies. See Restatement of Contracts 2d, Sections 2, 3 and 19.

Examples of circumstances from which it may be found that parties have reached an agreement to conduct transactions electronically include the following:

EXAMPLES:

A. Automaker and supplier enter into a Trading Partner Agreement setting forth the terms, conditions and methods for the conduct of business between them electronically.

B. Joe gives out his business card with his business e-mail address. It may be reasonable, under the circumstances, for a recipient of the card to infer that Joe has agreed to communicate electronically for business purposes. However, in the absence of additional facts, it would not necessarily be reasonable to infer Joe's agreement to communicate electronically for purposes outside the scope of the business indicated by use of the business card.

C. Sally may have several e-mail addresses - home, main office, office of a non-profit organization on whose board Sally sits. In each case, it may be reasonable to infer that Sally is willing to communicate electronically with respect to business related to the business/purpose associated with the respective e-mail addresses. However, depending on the circumstances, it may not be reasonable to communicate with Sally for purposes other than those related to the purpose for which she maintained a particular e-mail account.

D. Among the circumstances to be considered in finding an agreement would be the time when the assent occurred relative to the timing of the use of electronic communications. If I order books from an on-line vendor, such as Bookseller.com my intention to conduct that transaction and to receive any correspondence related to the transaction, electronically can be inferred from my conduct. Accordingly, as to information related to that transaction it is reasonable for Bookseller to deal with me electronically.

The examples noted above are intended to focus the inquiry on the party's agreement to conduct a transaction electronically. Similarly, if two people are at a meeting and one tells the other to send an e-mail to confirm a transaction - the requisite agreement under subsection (b) would exist. In each case, the use of a business card, statement at a meeting, or other evidence of willingness to conduct a transaction electronically must be viewed in light of all the surrounding circumstances with a view toward broad validation of electronic transactions.

4. Just as circumstances may indicate the existence of agreement, express or implied from surrounding circumstances, circumstances may also demonstrate the absence of true agreement. For example:

A. If Automaker, Inc. were to issue a recall of automobiles via its Internet website, it would not be able to rely on this Act to validate that notice in the case of a person who never logged on to the website. Or, indeed, had no ability to do so, notwithstanding a clause in a paper purchase contract by which the buyer agreed to receive such notices in such a manner.

B. Buyer executes a standard form contract in which an agreement to receive all notices electronically in set forth on page 3 in the midst of other fine print. Buyer has never communicated with Seller electronically, and has not provided any other information in the contract to suggest a willingness to deal electronically. Not only is it unlikely that any but the most formalistic of agreements may be found, but nothing in this Act prevents courts from policing such form contracts under common law doctrines relating to contract formation, unconscionability and the like.

5. Subsection (c) has been added to make clear the ability of a party to refuse to conduct a transaction electronically, even if the person has conducted transactions electronically in the past. The effectiveness of a party's refusal to conduct a transaction electronically will be determined under other applicable law in light of all surrounding circumstances.

6. Subsection (e) is an essential provision in the overall scheme of this Act. While this Act validates and effectuates electronic records and electronic signatures, the legal effect of such records and signatures is left to existing substantive law outside this Act except in very narrow circumstances.

For example, beyond validation of records, signatures and contracts based on the medium used, Sections 7 (a) and (b) should not be interpreted as establishing the legal effectiveness of any given record, signature or contract. Where a rule of law requires that the record contain minimum substantive content, the legal effect of such a record will depend on whether the record meets the substantive requirements of other applicable law.

Section 8 expressly preserves a number of legal requirements in currently existing law relating to the presentation of information in writing. Although this Act now would allow such information to be presented in an electronic record, Section 8 provides that the other substantive requirements of law must be satisfied in the electronic medium as well.

SECTION 6. CONSTRUCTION AND APPLICATION. This [Act] must be construed and applied:

(1) to facilitate electronic transactions consistent with other applicable law;

(2) to be consistent with reasonable practices concerning electronic transactions and with the continued expansion of those practices; and

(3) to effectuate its general purpose to make uniform the law with respect to the subject of this [Act]
I. The purposes and policies of this Act are

a) to facilitate and promote commerce and governmental transactions by validating and authorizing the use of electronic records and electronic signatures;

b) to eliminate barriers to electronic commerce and governmental transactions resulting from uncertainties relating to writing and signature requirements;

c) to simplify, clarify and modernize the law governing commerce and governmental transactions through the use of electronic means;

d) to permit the continued expansion of commercial and governmental electronic practices through custom, usage and agreement of the parties;

e) to promote uniformity of the law among the states (and worldwide) relating to the use of electronic and similar technological means of effecting and performing commercial and governmental transactions;

f) to promote public confidence in the validity, integrity and reliability of electronic commerce and governmental transactions; and

g) to promote the development of the legal and business infrastructure necessary to implement electronic commerce and governmental transactions.

2. This Act has been drafted to permit flexible application consistent with its purpose to validate electronic transactions. The provisions of this Act validating and effectuating the employ of electronic media allow the courts to apply them to new and unforeseen technologies and practices. As time progresses, it is anticipated that what is new and unforeseen today will be commonplace tomorrow. Accordingly, this legislation is intended to set a framework for the validation of media which may be developed in the future and which demonstrate the same qualities as the electronic media contemplated and validated under this Act.

III. SIGNATURES AND ELECTRONIC CONTRACTS.

(a) A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.

(b) A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.

(c) If a law requires a record to be in writing, an electronic record satisfies the law.

(d) If a law requires a signature, an electronic signature satisfies the law.

Source: UNCITRAL Model Law on Electronic Commerce, Articles 5, 6, and 7.

DRAFT COMMENTS

1. This section sets forth the fundamental premise of this Act: namely, that the medium in which a record, signature, or contract is created, presented or retained does not affect its legal significance. Subsections (a) and (b) are designed to eliminate the single element of medium as a reason to deny effect or enforceability to a record, signature, or contract. The fact that the information is set forth in an electronic, as opposed to paper, record is irrelevant.

2. Under Restatement 2d Contracts Section 8, a contract may have legal effect and yet be unenforceable. Indeed, one circumstance where a record or contract may have effect but be unenforceable is in the context of the Statute of Frauds. Though a contract may be unenforceable, the records may have collateral effects, as in the case of a buyer that insures goods purchased under a contract unenforceable under the Statute of Frauds. The insurance company may not deny a claim on the ground that the buyer is not the owner, though the buyer may have no direct remedy against seller for failure to deliver. See Restatement 2d Contracts, Section 8, Illustration 4.

While this section would validate an electronic record for purposes of a statute of frauds, if an agreement to conduct the transaction electronically cannot reasonably be found (See Section 5(b)) then a necessary predicate to the applicability of this Act would be absent and this Act would not validate the electronic record. Whether the electronic record might be valid under other law is not addressed by this Act.

3. Subsections (c) and (d) provide the positive assertion that electronic records and signatures satisfy legal requirements for writings and signatures. The provisions are limited to requirements in laws that address requirements for writings and signatures See, e.g., Section 8.

Subsections (c and d) are particularized applications of subsection (a). The purpose is to validate and effectuate electronic records and signatures as the equivalent of writings, subject to all of the rules applicable to the efficacy of a writing, except as such other rules are modified by the more specific provisions of this Act.

Illustration 1: A sends the following e-mail to B: "I hereby offer to buy widgets from you, delivery next Tuesday. /s/ A." B responds with the following e-mail: "I accept your offer to buy widgets for delivery next Tuesday. /s/ B." The e-mails may not be denied effect solely because they are electronic. In addition, the e-mails do qualify as records under the Statute of Frauds. However, because there is no quantity stated in either record, the parties' agreement would be unenforceable under existing UCC Section 2-201(1).

Illustration 2: A sends the following e-mail to B: "I hereby offer to buy 100 widgets for $1000, delivery next Tuesday. /s/ A." B responds with the following e-mail: "I accept your offer to purchase 100 widgets for $1000, delivery next Tuesday. /s/ B." In this case the analysis is the same as in
Illustration 1 except that here the records otherwise satisfy the requirements of UCC Section 2-201 (1). The transaction may not be denied legal effect solely because there is not a pen and ink “writing” or “signature”.

4. Section 8 addresses additional requirements imposed by other law which may affect the legal effect or enforceability of an electronic record in a particular case. For example, in section 8(a) the legal requirement addressed is the provision of information in writing. The section then sets forth the standards to be applied in determining whether the provision of information by an electronic record is the equivalent of the provision of information in writing. The requirements in section 8 are in addition to the bare validation that occurs under this section.

5. Under the substantive law applicable to a particular transaction within this Act, the legal effect of an electronic record may be separate from the issue of whether the record contains a signature. For example, where notice must be given as part of a contractual obligation, the effectiveness of the notice will turn on whether the party provided the notice regardless of whether the notice was signed (See Section 15). An electronic record attributed to a party under Section 9 and complying with the requirements of Section 15, would suffice in that case, notwithstanding that it may not contain an electronic signature.

SECTION 8. PROVISION OF INFORMATION IN WRITING; PRESENTATION OF RECORDS.

(a) If parties have agreed to conduct a transaction by electronic means and a law requires a person to provide, send, or deliver information in writing to another person, the requirement is satisfied if the information is provided, sent, or delivered, as the case may be, in an electronic record capable of retention by the recipient at the time of receipt. An electronic record is not capable of retention by the recipient if the sender or its information processing system inhibits the ability of the recipient to print or store the electronic record.

(b) If a law other than this [Act] requires a record (i) to be posted or displayed in a certain manner, (ii) to be sent, communicated, or transmitted by a specified method, or (iii) to contain information that is formatted in a certain manner, the following rules apply:

(1) The record must be posted or displayed in the manner specified in the other law.

(2) Except as otherwise provided in subsection (d)(2), the record must be sent, communicated, or transmitted by the method specified in the other law.

(3) The record must contain the information formatted in the manner specified in the other law.

(c) If a sender inhibits the ability of a recipient to store or print an electronic record, the electronic record is not enforceable against the recipient.

(d) The requirements of this section may not be varied by agreement, but:

(1) to the extent a law other than this [Act] requires information to be provided, sent, or delivered in writing but permits that requirement to be varied by agreement, the requirement under subsection (a)

that the information be in the form of an electronic record capable of retention may also be varied by agreement; and

(2) a requirement under a law other than this [Act] to send, communicate, or transmit a record by [first-class mail, postage prepaid] [regular United States mail], may be varied by agreement to the extent permitted by the other law.

Source: Canadian - Uniform Electronic Commerce Act

DRAFT COMMENTS

1. This section is a savings provision, designed to assure, consistent with the fundamental purpose of this act, that otherwise applicable substantive law will not be overridden by this Act. The section makes clear that while the pen and ink provisions of such other law may be satisfied electronically, nothing in this Act vitiates the other requirements of such laws. The section addresses a number of issues related to disclosures and notice provisions in other laws.

2. This section is independent of the prior section. Section 7 refers to legal requirements for a writing. This section refers to legal requirements for the provision of information in writing or relating to the method or manner of presentation or delivery of information. The section addresses more specific legal requirements of other laws, provides standards for satisfying the more particular legal requirements, and defers to other law for satisfaction of requirements under those laws.

3. Under subsection (a), to meet a requirement of other law that information be provided in writing, the recipient of an electronic record of the information must be able to get to the electronic record and read it, and must have the ability to get back to the information in some way at a later date. Accordingly, the section requires that the electronic record be capable of retention for later review.

The section specifically provides that any inhibition on retention imposed by the sender or the sender's system will preclude satisfaction of this section because electronic information may be given to a person in a manner which prevents the person from retaining a copy of the information. The policies underlying laws requiring the provision of information in writing warrant the imposition of an additional burden on the sender to make the information available in a manner which will permit subsequent reference. A difficulty does exist for senders of information because of the disparate systems of their recipients and the capabilities of those systems. Certainly where the sender or sender's system imposes an inhibition on retention by the recipient, this section has not been satisfied. It is left for the courts to determine whether the sender has complied with this section if evidence demonstrates that it is the recipient's system which precludes subsequent reference to the information.

4. Subsection (b) is a savings provision for laws which provide for the means of delivering or displaying information and which are not affected by the Act. For example, if a law requires delivery of notice by first class US mail, that means of delivery would not be affected by this Act. The information to be delivered may be provided on a disc, i.e., in electronic form, but the particular means of delivery must still be via the US postal service. Display, delivery and formatting requirements will continue to be applicable to electronic records and signatures. If those legal requirements can be satisfied in an electronic medium, e.g., the information can be presented in 20 point bold type as required by other law, this Act will validate the use of the medium, leaving to the other applicable law the question of whether the particular electronic record meets the other legal requirements. If a law requires that particular records be delivered together, or attached to other
records, this Act does not preclude the delivery of the records together in an electronic communication, so long as the records are connected or associated with each other in a way determined to satisfy the other law.

5. Subsection (c) provides incentives for senders of information to use systems which will not inhibit the other party from retaining the information. However, there are circumstances where a party providing certain information may wish to inhibit retention in order to protect intellectual property rights or prevent the other party from retaining confidential information about the sender. In such cases inhibition is understandable, but if the sender wishes to enforce the record in which the information is contained, the sender may not inhibit its retention by the recipient. Unlike subsection (a), subsection (c) applies in all transactions and simply provides for unenforceability against the recipient. Subsection (a) applies only where another law imposes the writing requirement, and subsection (a) imposes a broader responsibility on the sender to assure retention capability by the recipient.

6. The protective purposes of this section justify the non-waivability provided by Subsection (d). However, since the requirements for sending and formatting and the like are imposed by other law, to the extent other law permits waiver of such protections, there is no justification for imposing a more severe burden in an electronic environment.

SECTION 9. ATTRIBUTION AND EFFECT OF ELECTRONIC RECORD AND ELECTRONIC SIGNATURE.

(a) An electronic record or electronic signature is attributable to a person if it was the act of the person. The act of the person may be shown in any manner, including a showing of the efficacy of any security procedure applied to determine the person to which the electronic record or electronic signature was attributable.

(b) The effect of an electronic record or electronic signature attributed to a person under subsection (a) is determined from the context and surrounding circumstances at the time of its creation, execution, or adoption, including the parties' agreement, if any, and otherwise as provided by law.

DRAFT COMMENTS

1. Under subsection (a), so long as the electronic record or electronic signature resulted from a person's action it will be attributed to that person - the legal effect of that attribution is addressed in subsection (b). This section does not alter existing rules of law regarding attribution. The section assures that such rules will be applied in the electronic environment. A person's actions include actions taken by human agents of the person, as well as actions taken by an electronic agent, i.e., the tool, of the person. Although the rule may appear to state the obvious, it assures that the record or signature is not ascribed to a machine, as opposed to the person operating or programming the machine.

In each of the following cases, both the electronic record and electronic signature would be attributable to a person under subsection (a):

A. The person types his/her name as part of an e-mail purchase order;

B. The person's employee, pursuant to authority, types the person's name as part of an e-mail purchase order;

C. The person's computer, programmed to order goods upon receipt of inventory information within particular parameters, issues a purchase order which includes the person's name, or other identifying information, as part of the order.

In each of the above cases, law other than this Act would ascribe both the signature and the action to the person if done in a paper medium. Subsection (a) expressly provides that the same result will occur when an electronic medium is used.

2. Nothing in this section affects the use of a signature as a device for attributing a record to a person. Indeed, a signature is often the primary method for attributing a record to a person. In the foregoing examples, once the electronic signature is attributed to the person, the electronic record would also be attributed to the person, unless the person established fraud, forgery, or other invalidating cause. However, a signature is not the only method for attribution.

3. In the context of attribution of records, normally the content of the record will provide the necessary information for a finding of attribution. It is also possible that an established course of dealing between parties may result in a finding of attribution. Just as with a paper record, evidence of forgery or counterfeiting may be introduced to rebut the evidence of attribution.

The use of facsimile transmissions provides a number of examples of attribution using information other than a signature. A facsimile may be attributed to a person because of the information printed across the top of the page that indicates the machine from which it was sent. Similarly, the transmission may contain a letterhead which identifies the sender. Some cases have held that the letterhead actually constituted a signature because it was a symbol adopted by the sender with intent to authenticate the facsimile. However, the signature determination resulted from the necessary finding of intention in that case. Other cases have found facsimile letterheads NOT to be signatures because the requisite intention was not present. The critical point is that with or without a signature, information within the electronic record may well suffice to provide the facts resulting in attribution of an electronic record to a particular party.

4. Certain information may be present in an electronic environment that does not appear to attribute but which clearly links a person to a particular record. Numerical codes, personal identification numbers, public and private key combinations, all serve to establish the party to whom an electronic record should be attributed. Of course security procedures will be another piece of evidence available to establish attribution.

The inclusion of a specific reference to security procedures as a means of proving attribution is salutary because of the unique importance of security procedures in the electronic environment. In certain circumstances, a technical and technological security procedure may be the best way to convince a trier of fact that a particular electronic record or signature was that of a particular person. In certain circumstances, the use of a security procedure to establish that the record, and related signature came from the person's business might be necessary to overcome a claim that a hacker intervened. The reference to security procedures is not intended to suggest that other forms of proof of attribution should be accorded less persuasive effect. It is also important to recall that the particular strength of a given procedure does not affect the procedure's status as a security procedure, but only affects the...
weight to be accorded the evidence of the security procedure as tending to establish attribution.

5. This section does apply in determining the effect of a "click-through" transaction. A "click-through" transaction involves a process which, if executed with an intent to "sign," will be an electronic signature directly covered. See definition of Electronic Signature. In the context of an anonymous "click-through" issues of proof will be paramount. This section will be relevant to establish that the resulting electronic record is attributable to a particular person upon the requisite proof, including security procedures which may track the source of the click-through.

6. Once it is established that a record or signature is attributable to a particular party, the effect of a record or signature must be determined in light of the context and surrounding circumstances, including the parties' agreement, if any. Also informing the effect of any attribution will be other legal requirements considered in light of the context. Subsection (b) addresses the effect of the record or signature once attributed to a person.

SECTION 10. EFFECT OF CHANGE OR ERROR. If a change or error in an electronic record occurs in a transmission between parties to a transaction, the following rules apply:

1. If the parties have agreed to use a security procedure to detect changes or errors and one party has conformed to the procedure, but the other party has not, and the nonconforming party would have detected the change or error had that party also conformed, the conforming party may avoid the effect of the changed or erroneous electronic record.

2. In an automated transaction involving an individual, the individual may avoid the effect of an electronic record that resulted from an error made by the individual in dealing with the electronic agent of another person if the electronic agent did not provide an opportunity for the prevention or correction of the error and, at the time the individual learns of the error, the individual:
   (A) promptly notifies the other person of the error and that the individual did not intend to be bound by the electronic record received by the other person;
   (B) takes reasonable steps, including steps that conform to the other person's reasonable instructions, to return to the other person or, if instructed by the other person, to destroy the consideration received, if any, as a result of the erroneous electronic record; and (C) has not used or received any benefit or value from the consideration, if any, received from the other person.

3. Paragraph (1) or paragraph (2) applies, the change or error has the effect provided by other law, including the law of mistake, and the parties' contract, if any.

4. Paragraphs (2) and (3) may not be varied by agreement.

5. Paragraph (2) applies only to errors made by individuals. If the error results from the electronic agent it would constitute a system error. In such a case, consistent with the law of mistake generally, the record is made avoidable at the instance of the party who took all available steps to avoid the mistake. See Restatement 2d Contracts Section 152-154.

Making the erroneous record avoidable by the conforming party is consistent with Sections 153 and 154 of the Restatement 2d Contracts because the non-conforming party was in the best position to avoid the problem, and would bear the risk of mistake. Such a case would constitute mistake by one party. The mistaken party (the conforming party) would be entitled to avoid any resulting contract under Section 153 because s/he does not have the risk of mistake and the non-conforming party had reason to know of the mistake.

6. As with paragraph (1), paragraph (2), when applicable, allows the mistaken party to avoid the effect of the erroneous electronic record. However, the subsection is limited to human error on the part of an individual when dealing with the electronic agent of the other party. In a transaction between individuals there is a greater ability to correct the error before parties have acted on it.

Parahgraph (2) applies only to errors made by individuals. If the error results from the electronic agent it would constitute a system error. In such a case the effect of that error would be resolved under paragraph (1) if applicable, otherwise under paragraph (3) and the general law of mistake.

5. The party acting through the electronic agent/machine is given incentives by this section to build in safeguards which enable the individual to prevent the sending of an erroneous record, or correct the error once sent. For example, the electronic agent may be programmed to provide a "confirmation screen" to the individual setting forth all the information the individual initially approved. This would provide the individual with the ability to prevent the erroneous record from ever being sent. Similarly, the electronic agent might receive the record sent by the individual and then send back a confirmation (paragraphs 1 and 2). The section focuses on the effect of changes and errors occurring when records are exchanged between parties. In cases where changes and errors occur in contexts other than transmission, the law of mistake is expressly made applicable to resolve the conflict.

The section covers both changes and errors. For example, if Buyer sends a message to Seller ordering 100 widgets, but Buyer's information processing system changes the order to 1000 widgets, a "change" has occurred between what Buyer transmitted and what Seller received. If on the other hand, Buyer typed in 1000 intending to order only 100, but sent the message before noting the mistake, an error would have occurred which would also be covered by this section.

2. Paragraph (1) deals with any transmission where the parties have agreed to use a security procedure to detect changes and errors. It operates against the non-conforming party, i.e., the party in the best position to have avoided the change or error, regardless of whether that person is the sender or recipient. The source of the error/change is not indicated, and so both human and machine errors/changes would be covered. With respect to errors or changes that would not be detected by the security procedure even if applied, the parties are left to the general law of mistake to resolve the dispute.

3. Paragraph (1) applies only in the situation where a security procedure would detect the error/change but one party fails to use the procedure and does not detect the error/change. In such a case, consistent with the law of mistake generally, the record is made avoidable at the instance of the party who took all available steps to avoid the mistake. See Restatement 2d Contracts Section 152-154.

Making the erroneous record avoidable by the conforming party is consistent with Sections 153 and 154 of the Restatement 2d Contracts because the non-conforming party was in the best position to avoid the problem, and would bear the risk of mistake. Such a case would constitute mistake by one party. The mistaken party (the conforming party) would be entitled to avoid any resulting contract under Section 153 because s/he does not have the risk of mistake and the non-conforming party had reason to know of the mistake.
which the individual must again accept before the transaction is completed. This would allow for correction of an erroneous record. In either case, the electronic agent would "provide an opportunity for prevention or correction of the error," and the subsection would not apply.

6. Paragraph (2) also places additional requirements on the mistaken individual before the paragraph may be invoked to avoid an erroneous electronic record. The individual must take prompt action to advise the other party of the error and the fact that the individual did not intend the electronic record. Whether the action is prompt must be determined from all the circumstances including the individual's ability to contact the other party. The individual should advise the other party both of the error and of the lack of intention to be bound (i.e., avoidance) by the electronic record received. Since this provision allows avoidance by the mistaken party, that party should also be required to expressly note that it is seeking to avoid the electronic record, i.e., lacked the intention to be bound.

Second, restitution is normally required in order to undo a mistaken transaction. Accordingly, the individual must also return or destroy any consideration received, adhering to instructions from the other party in any case. This is to assure that the other party retains control over the consideration sent in error.

Finally, and most importantly in regard to transactions involving intermediaries which may be harmed because transactions cannot be unwound, the individual cannot have received any benefit from the transaction. This section prevents a party from unwinding a transaction after the delivery of value and consideration which cannot be returned or destroyed. For example, if the consideration received is information, it may not be possible to avoid the benefit conferred. While the information itself could be returned, mere access to the information, or the ability to redistribute the information would constitute a benefit precluding the mistaken party from unwinding the transaction. It may also occur that the mistaken party receives consideration which changes in value between the time of receipt and the first opportunity to return. In such a case restitution cannot be made adequately, and the transaction would not be avoidable. In each of the foregoing cases, under subparagraph (2)(c), the individual would have received the benefit of the consideration and would NOT be able to avoid the erroneous electronic record.

7. In all cases not covered by paragraphs (1) or (2), where error or change to a record occur, the parties contract, or other law, specifically including the law of mistake, applies to resolve any dispute. If the error occurs in the context of record retention, Section 12 will apply. In that case the standard is one of accuracy and retrievability of the information.

8. Paragraph (4) makes the error correction provision in paragraph (2) and the application of the law of mistake in paragraph (3) non-variable. Paragraph (2) provides incentives for parties using electronic agents to establish safeguards for individuals dealing with them. It also avoids unjustified windfalls to the individual by erecting stringent requirements before the individual may exercise the right of avoidance under the paragraph. Therefore, there is no reason to permit parties to avoid the paragraph by agreement. Rather, parties should satisfy the paragraph's requirements.

SECTION 11. NOTARIZATION AND ACKNOWLEDGMENT. If a law requires a signature or record to be notarized, acknowledged, verified, or made under oath, the requirement is satisfied if the electronic signature of the person authorized to perform those acts, together with all other information required to be included by other applicable law, is attached to or logically associated with the signature or record.

DRAFT COMMENTS
This Section permits a notary public and other authorized officers to act electronically, effectively removing the stamp/seal requirements. However, the section does not eliminate any of the requirements of notarial laws, and consistent with the entire thrust of this Act, simply allows the signing and information to be accomplished in an electronic medium.

For example, Buyer wishes to send a notarized Real Estate Purchase Agreement to Seller via e-mail. The notary must appear in the room with the Buyer, satisfy him/herself as to the identity of the Buyer, and swear to that identification. All that activity must be reflected as part of the electronic Purchase Agreement and the notary's electronic signature must appear as a part of the electronic real estate purchase contract.

As another example, Buyer seeks to send Seller an affidavit averring defects in the products received. A court clerk, authorized under state law to administer oaths, is present with Buyer in a room. The Clerk administers the oath and includes the statement of the oath, together with any other requisite information, in the electronic record to be sent to the Seller. Upon administering the oath and witnessing the application of Buyer's electronic signature to the electronic record, the Clerk also applies his electronic signature to the electronic record. So long as all substantive requirements of other applicable law have been fulfilled and are reflected in the electronic record, the sworn electronic record of Buyer is as effective as if it had been transcribed on paper.

SECTION 12. RETENTION OF ELECTRONIC RECORDS; ORIGINALS.
(a) If a law requires that a record be retained, the requirement is satisfied by retaining an electronic record of the information in the record which:

(1) accurately reflects the information set forth in the record after it was first generated in its final form as an electronic record or otherwise; and

(2) remains accessible for later reference.

(b) A requirement to retain a record in accordance with subsection (a) does not apply to any information the sole purpose of which is to enable the record to be sent, communicated, or received.

(c) A person may satisfy subsection (a) by using the services of another person if the requirements of that subsection are satisfied.

(d) If a law requires a record to be presented or retained in its original form, or provides consequences if the record is not presented or retained in its original form, that law is satisfied by an electronic record retained in accordance with subsection (a).

(e) If a law requires retention of a check, that requirement is satisfied by retention of an electronic record of the information on the front and back of the check in accordance with subsection (a).
(f) A record retained as an electronic record in accordance with subsection (a) satisfies a law requiring a person to retain a record for evidentiary, audit, or like purposes, unless a law enacted after the effective date of this Act specifically prohibits the use of an electronic record for the specified purpose.

(g) This section does not preclude a governmental agency of this State from specifying additional requirements for the retention of a record subject to the agency’s jurisdiction.

Source: UNCITRAL Model Law on Electronic Commerce Articles 8 and 10.

DRAFT COMMENTS

1. This section deals with the serviceability of electronic records as retained records and originals. So long as there exists reliable assurance that the electronic record accurately reproduces the information, this section continues the theme of establishing the functional equivalence of electronic and paper-based records. This is consistent with Fed.R.Evid. 1001(3) and Unif.R.Evid. 1001(3) (1974). This section assures that information stored electronically will remain effective for all audit, evidentiary, archival and similar purposes.

2. In an electronic medium, the concept of an original document is problematic. For example, as one drafts a document on a computer the “original” is either on a disc or the hard drive to which the document has been initially saved. If one periodically saves the draft, the fact is that at times a document may be first saved to disc then to hard drive, and at others vice versa. In such a case the “original” may change from the information on the disc to the information on the hard drive. Indeed, it may be argued that the “original” exists solely in RAM and, in a sense, the original is destroyed when a “copy” is saved to a disc or to the hard drive. In any event, in the context of record retention, the concern focuses on the integrity of the information, and not with its “originality.”

3. Subsection (a) requires accuracy and the ability to access at a later time. The requirement of accuracy is derived from the Uniform and Federal Rules of Evidence. The requirement of continuing accessibility addresses the issue of technology obsolescence and the need to update and migrate information to developing systems. It is not unlikely that within the span of 5-10 years (a period during which retention of much information is required) a corporation may evolve through one or more generations of technology. More to the point, this technology may be incompatible with each other necessitating the reconversion of information from one system to the other.

For example, certain operating systems from the early 1980’s, e.g., memory typewriters, became obsolete with the development of personal computers. The information originally stored on the memory typewriter would need to be converted to the personal computer system in a way meeting the standards for accuracy contemplated by this section. It is also possible that the medium on which the information is stored is less stable. For example, information stored on floppy discs is generally less stable, and subject to a greater threat of disintegration, that information stored on a computer hard drive. In either case, the continuing accessibility issue must be satisfied to validate information stored by electronic means under this section.

This section permits parties to convert original written records to electronic records for retention so long as the requirements of subsection (a) are satisfied. Accordingly, in the absence of specific requirements to retain written records, written records may be destroyed once saved as electronic records satisfying the requirements of this section.

The subsection refers to the information contained in an electronic record, rather than relying on the term electronic record, as a matter of clarity that the critical aspect in retention is the information itself. What information must be retained is determined by the purpose for which the information is needed. If the addressing and pathway information regarding an e-mail is relevant, then that information should also be retained. However if it is the substance of the e-mail that is relevant, only that information need be retained. Of course, wise record retention would include all such information since what information will be relevant at a later time will not be known.

4. Subsections (b) and (c) simply make clear that certain ancillary information or the use of third parties, does not affect the serviceability of records and information retained electronically. Again, the relevance of particular information will not be known until that information is required at a subsequent time.

5. Subsection (d) continues the theme of the Act as validating electronic records as originals where the law requires retention of an original. The validation of electronic records and electronic information as originals is consistent with the Uniform Rules of Evidence. See Uniform Rules of Evidence 1001(3), 1002, 1003 and 1004.

6. Subsection (e) specifically addresses particular concerns regarding check retention statutes in many jurisdictions. A Report compiled by the Federal Reserve Bank of Boston identifies hundreds of state laws which require the retention or production of original canceled checks. Such requirements preclude banks and their customers from realizing the benefits and efficiencies related to truncation processes otherwise validated under current law. The benefits to banks and their customers from electronic check retention are effectuated by this provision.

7. Subsections (f) and (g) generally address other record retention statutes. As with check retention, all businesses and individuals may realize significant savings from electronic record retention. So long as the standards in Section 12 are satisfied, this section permits all parties to obtain those benefits. As always the government may require records in any medium, however, these subsections require a governmental agency to specifically identify the types of records and requirements that will be imposed.

SECTION 13. ADMISSIBILITY IN EVIDENCE. In a proceeding, evidence of a record or signature may not be excluded solely because it is in electronic form.

Source: UNCITRAL Model Law on Electronic Commerce Article 9.

DRAFT COMMENT

Like section 7, this Section prevents the nonrecognition of electronic records and signatures solely on the ground of the media in which information is presented.

Nothing in this section relieves a party from establishing the necessary foundation for the admission

SECTION 14. AUTOMATED TRANSACTION. In an automated transaction, the following rules apply:

(1) A contract may be formed by the interaction of electronic agents of the parties, even if no individual was aware of or reviewed the electronic agents' actions or the resulting terms and agreements.

(2) A contract may be formed by the interaction of an electronic agent and an individual, acting on the individual's own behalf or for another person, including by an interaction in which the individual performs actions that the individual is free to refuse to perform and which the individual knows or has reason to know will cause the electronic agent to complete the transaction or performance.

(3) The terms of the contract are determined by the substantive law applicable to it.

Source: UNICTRAL Model Law on Electronic Commerce Article 11.

DRAFT COMMENTS

1. This section confirms that contracts can be formed by machines functioning as electronic agents for parties to a transaction. It negates any claim that lack of human intent, at the time of contract formation, prevents contract formation. When machines are involved, the requisite intention flows from the programming and use of the machine. As in other cases, these are salutary provisions consistent with the fundamental purpose of the Act to remove barriers to electronic transactions while leaving the substantive law, e.g., law of mistake, law of contract formation, unaffected to the greatest extent possible.

2. The process in paragraph (2) validates an anonymous click-through transaction. It is possible that an anonymous click-through process may simply result in no recognizable legal relationship, e.g., A goes to a person's website and acquires access without in any way identifying herself, or otherwise indicating agreement or assent to any limitation or obligation, and the owner's site grants A access. In such a case no legal relationship has been created.

On the other hand it may be possible that A's actions indicate agreement to a particular term. For example, A goes to a website and is confronted by an initial screen which advises her that the information at this site is proprietary, that A may use the information for her own personal purposes, but that, by clicking below, A agrees that any other use without the site owner's permission is prohibited. If A clicks "agree" and downloads the information and then uses the information for other prohibited purposes, should not A be bound by the click? It seems the answer properly should be, and would be, yes.

If the owner can show that the only way A could have obtained the information was from his website, and that the process to access the subject information required that A must have clicked the "I agree" button after having the ability to see the conditions on use, A has performed actions which A was free to refuse, which A knew would cause the site to grant her access, i.e., "complete the transaction." The terms of the resulting contract will be determined under general contract principles, but will include the limitation on A's use of the information, as a condition precedent to granting her access to the information.

3. In the transaction set forth in Comment 2, the record of the transaction also will include an electronic signature. By clicking "I agree" A adopted a process with the intent to "sign," i.e., bind herself to a legal obligation, the resulting record of the transaction. If a "signed writing" were required under otherwise applicable law, this transaction would be enforceable. If a "signed writing" were not required, it may be sufficient to establish that the electronic record is attributable to A under section 9. Attribution may be shown in any manner reasonable including showing that, of necessity, A could only have gotten the information through the process at the website.

SECTION 15. TIME AND PLACE OF SENDING AND RECEIPT.

(a) Unless otherwise agreed between the sender and the recipient, an electronic record is sent when it:

(1) is addressed properly or otherwise directed properly to an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent and from which the recipient is able to retrieve the electronic record;

(2) is in a form capable of being processed by that system; and

(3) enters an information processing system outside the control of the sender or of a person that sent the electronic record on behalf of the sender or enters a region of the information processing system designated or used by the recipient which is under the control of the recipient.

(b) Unless otherwise agreed between a sender and the recipient, an electronic record is received when:

(1) it enters an information processing system that the recipient has designated or uses for the purpose of receiving electronic records or information of the type sent and from which the recipient is able to retrieve the electronic record; and

(2) it is in a form capable of being processed by that system.

(c) Subsection (b) applies even if the place the information processing system is located is different from the place the electronic record is deemed to be received under subsection (d).

(d) Unless otherwise expressly provided in the electronic record or agreed between the sender and the recipient, an electronic record is deemed to be sent from the sender's place of business and to be received at the recipient's place of business. For purposes of this subsection, the following rules apply:

(1) If the sender or recipient has more than one place of business, the place of business of that person is the place having the closest relationship to the underlying transaction.
(2) If the sender or the recipient does not have a place of business, the place of business is the sender's or recipient's residence, as the case may be.

(e) An electronic record is received under subsection (b) even if no individual is aware of its receipt.

(f) Receipt of an electronic acknowledgment from an information processing system described in subsection (b) establishes that a record was received but, by itself, does not establish that the content sent corresponds to the content received.

(g) If a person is aware that an electronic record purportedly sent under subsection (a), or purportedly received under subsection (b), was not actually sent or received, the legal effect of the sending or receipt is determined by other applicable law. Except to the extent permitted by the other law, the requirements of this subsection may not be varied by agreement.

Source: UNCITRAL Model Law on Electronic Commerce Article 15.

DRAFT COMMENTS

1. This section provides default rules regarding when and from where an electronic record is sent and when and where an electronic record is received. This section does not address the efficacy of the record that is sent or received. That is, whether a record is unintelligible or unusable by a recipient is a separate issue from whether that record was sent or received. The effectiveness of an illegible record, whether it binds any party, are questions left to other law.

2. Subsection (a) furnishes rules for determining when an electronic record is sent. The effect of the sending and its import are determined by other law once it is determined that a sending has occurred.

In order to have a proper sending, the subsection requires that information be properly addressed or otherwise directed to the recipient. In order to send within the meaning of this section, there must be specific information which will direct the record to the intended recipient. Although mass electronic sending is not precluded, a general broadcast message, sent to systems rather than individuals, would not suffice as a sending.

The record will be considered sent once it leaves the control of the sender, or comes under the control of the recipient. Records sent through e-mail or the internet will pass through many different server systems. Accordingly, the critical element when more than one system is involved is the loss of control by the sender.

However, the structure of many message delivery systems is such that electronic records may actually never leave the control of the sender. For example, within a university or corporate setting, e-mail sent within the system to another faculty member is technically not out of the sender's control since it never leaves the organization's server. Accordingly, to qualify as a sending, the e-mail must arrive at a point where the recipient has control. The effect of an electronic record that is thereafter "pulled back," e.g., removed from a mailbox, is not addressed by this section. The analog in the paper world would be removing a letter from a person's mailbox. As in the case of providing information electronically under Section 8, the recipient's ability to receive a message should be judged from the perspective of whether the sender has done any action which would preclude retrieval. This is especially the case in regard to sending, since the sender must direct the record to a system designated or used by the recipient.

3. Subsection (b) provides simply that when a record enters the system which the recipient has designated or uses and to which it has access, in a form capable of being processed by that system, it is received. By keying receipt to a system which is accessible by the recipient, the issue of a recipient leaving messages with a server or other service to avoid receipt, is removed. However, the issue of how the sender proves the time of receipt is not resolved by this section.

To assure that the recipient retains control of the place of receipt, subsection (b) requires that the system be specified or used by the recipient, and that the system be used or designated for the type of record being sent. Many people have multiple e-mails for different purposes, and the purpose is to assure that recipients can designate the e-mail address or system to be used in a particular transaction. For example, the recipient retains the ability to designate a home e-mail for personal matters, work e-mail for official business, or a separate organizational e-mail solely for the business purposes of that organization. If A sends B a notice at his home which relates to business, it may not be deemed received if B designated his business address as the sole address for business purposes. Actual knowledge upon seeing it at home would qualify as receipt under the otherwise applicable substantive law.

4. Subsections (c) and (d) provide default rules for determining where a record will be considered to have been sent or received. The focus is on the place of business of the recipient and not the physical location of the information processing system, which may bear absolutely no relation to the transaction between the parties. It is not uncommon for users of electronic commerce to communicate from one State to another without knowing the location of information systems through which communication is operated. In addition, the location of certain communication systems may change without either of the parties being aware of the change. Accordingly, where the place of sending or receipt is an issue under other applicable law, e.g., conflict of laws issues, tax issues, the relevant location should be the location of the sender or recipient and not the location of the information processing system.

Subsection (d) assures individual flexibility in designating the place from which a record will be considered sent or at which a record will be considered received. Under subsection (d) a person may designate the place of sending or receipt unilaterally in an electronic record. This ability, as with the ability to designate by agreement, may be limited by otherwise applicable law to places having a reasonable relationship to the transaction.

5. Subsection (e) makes clear that receipt is not dependent on a person having notice that the record is in the person's system. Receipt occurs when the record reaches the designated system whether or not the recipient ever retrieves the record. The paper analog is the recipient who never reads a mail notice.

6. Subsection (f) provides legal certainty regarding the effect of an electronic acknowledgment. It only addresses the fact of receipt, not the quality of the content, nor whether the electronic record was read or "opened."

7. Subsection (g) limits the parties' ability to vary the method for sending and receipt provided in subsections (a) and (b), when there is a legal requirement for the sending or receipt. As in other
circumstances where legal requirements derive from other substantive law, to the extent that the other law permits variation by agreement, this Act does not impose any additional requirements, and provisions of this Act may be varied to the extent provided in the other law.

SECTION 16. TRANSFERABLE RECORDS.

(a) In this section, "transferable record" means an electronic record that:

(1) would be a note under [Article 3 of the Uniform Commercial Code] or a document under [Article 7 of the Uniform Commercial Code] if the electronic record were in writing; and

(2) the issuer of the electronic record expressly has agreed is a transferable record.

(b) A person has control of a transferable record if a system employed for evidencing the transfer of interests in the transferable record reliably establishes that person as the person to which the transferable record was issued or transferred.

(c) A system satisfies subsection (b), and a person is deemed to have control of a transferable record, if the transferable record is created, stored, and assigned in such a manner that:

(1) a single authoritative copy of the transferable record exists which is unique, identifiable, and, except as otherwise provided in paragraphs (4), (5), and (6), unalterable;

(2) the authoritative copy identifies the person asserting control as:

(A) the person to which the transferable record was issued; or

(B) if the authoritative copy indicates that the transferable record has been transferred, the person to which the transferable record was most recently transferred;

(3) the authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

(4) copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the consent of the person asserting control;

(5) each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) any revision of the authoritative copy is readily identifiable as authorized or unauthorized.

(d) Except as otherwise agreed, a person having control of a transferable record is the holder, as defined in [Section 1-201(20) of the Uniform Commercial Code], of the transferable record and has the same rights and defenses as a holder of an equivalent record or writing under [the Uniform Commercial Code], including, if the applicable statutory requirements under [Section 3-302(a), 7-501, or 9-308 of the Uniform Commercial Code] are satisfied, the rights and defenses of a holder in due course, a holder to which a negotiable document of title has been duly negotiated, or a purchaser, respectively. Delivery, possession, and indorsement are not required to obtain or exercise any of the rights under this subsection.

(e) Except as otherwise agreed, an obligor under a transferable record has the same rights and defenses as an equivalent obligor under equivalent records or writings under [the Uniform Commercial Code].

(f) If requested by a person against which enforcement is sought, the person seeking to enforce the transferable record shall provide reasonable proof that the person is in control of the transferable record. Proof may include access to the authoritative copy of the transferable record and related business records sufficient to review the terms of the transferable record and to establish the identity of the person having control of the transferable record.

Source: Revised Article 9, Section 9-105.

DRAFT COMMENTS

1. Paper negotiable instruments and documents are unique in the fact that a tangible token - a piece of paper - actually embodies intangible rights and obligations. The extreme difficulty of creating a unique electronic token which embodies the singular attributes of a paper negotiable document or instrument, dictates that the rules relating to negotiable documents and instruments not be simply amended to allow the use of an electronic record for the requisite paper writing. However, the desirability of establishing rules by which business parties might be able to acquire some of the benefits of negotiability in an electronic environment is recognized by the inclusion of this Section on Transferable Records.

This section provides legal support for the creation, transferability and enforceability of electronic note and document equivalents, as against the issuer/obligor. The certainty created by the section provides the requisite incentive for industry to develop the systems and processes, which involve significant expenditures of time and resources, to enable the use of such electronic documents.

The importance of facilitating the development of systems which will permit electronic equivalents is a function of cost, efficiency and safety for the records. The storage cost and space needed for the billions of paper notes and documents is phenomenal. Further, natural disasters can wreak havoc on the ability to meet legal requirements for retaining, retrieving and delivering paper instruments. The development of electronic systems meeting the rigorous standards of this Section will permit retention of copies which reflect the same integrity as the original. As a result storage, transmission and other costs will be reduced, while security and the ability to satisfy legal requirements governing such paper records will be enhanced.

Section 16 provides for the creation of an electronic record which may be controlled by the holder who in turn may obtain the benefits of holder in due course and good faith purchaser status. If the benefits and efficiencies of electronic media are to be realized in this industry it is essential to establish a means by which transactions involving paper promissory notes may be accomplished completely electronically. Particularly as other aspects of such transactions are accomplished electronically, the drag on the transaction of requiring a paper note becomes evident. In addition to alleviating the logistical problems of generating and storing and retrieving such paper notes, the
mailing and transmission costs associated with such transactions will also be reduced.

2. The definition of transferable record is limited in two significant ways. First, only the equivalent of paper promissory notes and paper documents of title can be created as transferable records. Notes and Documents of Title do not impact the broad systems that relate to the broader payments mechanisms related, for example, to checks. Impacting the check collection system by allowing for "electronic checks" has ramifications well beyond the ability of this Act. Accordingly, this Act excludes from its scope, transactions governed by UCC Articles 3 and 4. The limitation to promissory note equivalents in Section 16 is quite important in that regard because of the ability to deal with many enforcement issues by contract without affecting such systemic concerns.

Second, not only is Section 16 limited to electronic records which would qualify as negotiable promissory notes or documents if they were in writing, but the issuer of the electronic record must expressly agree that the electronic record is to be considered a transferable record. The definition of transferable record as "an electronic record that...the issuer of the electronic record expressly has agreed is a transferable record" indicates that the electronic record itself will likely set forth the issuer's agreement, though it may be argued that a contemporaneous electronic or written record might set forth the issuer's agreement. However, conversion of a paper note issued as such would not be possible because the issuer would not be the issuer, in such a case, of an electronic record. The purpose of such a restriction is to assure that transferable records can only be created at the time of issuance by the obligor. The possibility that a paper note might be electrified and then intentionally destroyed was not intended to be covered by Section 16.

The requirement that the obligor expressly agree in the electronic record to its treatment as a transferable record does not otherwise affect the characterization of a transferable record (i.e., does not affect what would be a paper note) because it is a statutory condition. Further, it does not obligate the issuer to undertake to do any other act than the payment of the obligation evidenced by the transferable record. Therefore, it does not make the transferable record "conditional" within the meaning of Section 104(a)(3).

3. Under Section 16 acquisition of "control" over an electronic record serves as a substitute for "possession" in the paper analog. More precisely, "control" under Section 16 serves as the substitute for delivery, indorsement and possession of a negotiable promissory note or negotiable document of title. Section 16(b) allows control to be found so long as "a system employed for evidencing the transfer interests in the transferable record reliably establishes [the person claiming control] as the person to which the transferable record was issued or transferred." The key point is that a system, whether involving third party registry or technological safeguards, must be shown to reliably establish the identity of the person entitled to payment. Section 16(c) then sets forth a safe harbor list of very strict requirements for such a system. The specific provisions listed in Section 16(c) are derived from Section 105 of Revised Article 9. Generally, the transferable record must be unique, identifiable, and except as specifically permitted, unalterable. That "authoritative copy" must (i) identify the person claiming control as the person to whom the record was issued or most recently transferred, (ii) be maintained by the person claiming control or its designee, and (iii) be unalterable except with the permission of the person claiming control. In addition any copy of the authoritative copy must be readily identifiable as a copy and all revisions must be readily identifiable as authorized or unauthorized.

The control requirements may be satisfied through the use of a trusted third party registry system. Such systems are currently in place with regard to the transfer of securities entitlements under Article 8 of the UCC, and in the transfer of cotton warehouse receipts under the program sponsored by the United States Department of Agriculture. This Act would recognize the use of such a system so long as the standards of subsection (c) were satisfied. In addition, a technological system which met such exacting standards would also be permitted under Section 16.

For example, a borrower signs an electronic record which would be a promissory note or document if it were paper. The borrower specifically agrees in the electronic record that it will qualify as a transferable record under this section. The lender implements a newly developed technological system which dates, encrypts, and stores all the electronic information in the transferable record in a manner which lender can demonstrate reliably establishes lender as the person to which the transferable record was issued. In the alternative, the lender may contract with a third party to act as a registry for all such transferable records, retaining records establishing the party to whom the record was issued and all subsequent transfers of the record. An example of this latter method for assuring control is the system established for the issuance and transfer of electronic cotton warehouse receipts under 7 C.F.R. section 735 et seq.

Of greatest importance in the system used is the ability to securely and demonstrably be able to transfer the record to others in a manner which assures that only one "holder" exists. The need for such certainty and security resulted in the very stringent standards for a system outlined in subsection (c). A system relying on a third party registry is likely the most effective way to satisfy the requirements of subsection (c) that the transferable record remain unique, identifiable and unalterable, while also providing the means to assure that the transferee is clearly noted and identified.

It must be remembered that Section 16 was drafted in order to provide sufficient legal certainty regarding the rights of those in control of such electronic records, that legal incentives would exist to warrant the development of systems which would establish legal control. During the drafting of Section 16, representatives from the Federal Reserve carefully scrutinized the impact of any electronicization of any aspect of the national payment system. Section 16 represents a compromise position which, as noted, serves as a bridge pending more detailed study and consideration of what legal changes, if any, are necessary or appropriate in the context of the payment systems impacted. Accordingly, Section 16 provides limited scope for the attainment of important rights derived from the concept of negotiability, in order to permit the development of systems which will satisfy its strict requirements for control.

4. It is important to note what the Section does not provide. Issues related to enforceability against intermediate transferees and transferees (i.e., indorser liability under a paper note), warranty liability that would attach in a paper note, and issues of the effect of taking a transferable record on the underlying obligation, are NOT addressed by this section. Such matters must be addressed, if at all, by contract between and among the parties in the chain of transmission and transfer of the transferable record. In the event that such matters are not addressed by the contract, the issues would need to be resolved under otherwise applicable law. Other law may include general contract principles of assignment and assumption, or may include rules from Article 3 applied by analogy.

For example, Issuer agrees to pay a debt by means of a transferable record issued to A. Unless there is agreement between issuer and A that the transferable record "suspends" the underlying obligation (see UCC Section 3-310), A would not be prevented from enforcing the underlying obligation without the transferable record. Similarly, if A transfers the transferable record to B by means granting B control, B may obtain holder in due course rights against the obligor/issuer, but B's recourse against A would not be clear unless A specifically agreed to remain liable under the transferable record. Although the
rules of Article 3 may be applied by analogy in an appropriate context, in the absence of agreement in the transferable record, the liability of the transferor would not be clear.

5. Current business models exist which rely for their efficacy on the benefits of negotiability. A principal example, and one which informed much of the development of Section 16, involves the mortgage backed securities industry. Aggregators of commercial paper acquire mortgage secured promissory notes followed a chain of transfers beginning with the origination of the mortgage loan by a mortgage broker. In the course of the transfers of this paper, buyers of the notes and lenders/secured parties for these buyers will intervene. For the ultimate purchaser, the ability to rely on holder in due course and a good faith purchaser status creates the legal security necessary to issue its own investment securities which are backed by the obligations evidenced by the notes purchased. Only through their HIDC status can these purchasers be assured that third party claims will be barred. Only through their HIDC status can the end purchaser avoid the incredible burden of requiring and assuring that each person in the chain of transfer has waived any and all defenses to performance which may be created during the chain of transfer.

6. This Section is a stand-alone provision. Although references are made to specific provisions in Article 3, Article 7, and Article 9 of the Uniform Commercial Code, these provisions are incorporated into this Act and made the applicable rules for purposes of this Act. The rights of parties to transferable records are established under subsections (d) and (e). Subsection (d) provides rules for determining the rights of a party in control of a transferable record. The subsection makes clear that the rights are determined under this section, and not under other law, by incorporating the rules on the manner of acquisition into this statute. The last sentence of subsection (d) is intended to assure that requirements related to notions of possession, which are inherently inconsistent with the idea of an electronic record, are not incorporated into this statute.

If a person establishes control, Section 16(d) provides that person is the "holder" of the transferable record which is equivalent to a holder of an analogous paper negotiable instrument. More importantly, if the person acquired control in a manner which would make it a holder in due course of an equivalent paper record, the person acquires the rights of a HIDC. The person in control would therefore be able to enforce the transferable record against the obligor regardless of intervening claims and defenses. However, by pulling these rights into Section 16, this Act does NOT validate the wholesale electrification of promissory notes under Article 3.

Further, it is important to understand that a transferable record under Section 16, while having no counterpart under Article 3, would likely be an "account" under Article 9. Accordingly, two separate bodies of law would apply to that asset of the obligee. A taker of the transferable record under Section 16 may acquire purchaser rights under Article 9, however, those rights may be defeated by a trustee in bankruptcy of a prior person in control unless perfection under Article 9 by filing is achieved. If the person in control also takes control in a manner granting it holder in due course status, of course that person would take free of any claim by a bankruptcy trustee or lien creditor.

7. Subsection (e) accords to the obligor of the transferable record rights equal to those of an obligor under an equivalent paper record. Accordingly, unless a waiver of defense clause is obtained in the electronic record, or the transferee obtains HIDC rights under subsection (d), the obligor has all the rights and defenses available to it under a contract assignment. Additionally, the obligor has the right to have the electronic record altered or "noted" to indicate payment.

8. Subsection (f) grants the obligor the right to have the transferable record and other information made available for purposes of assuring the correct person to pay. This will allow the obligor to protect its interest and obtain the defense of discharge by payment or performance. This is particularly important because a person receiving subsequent control under the appropriate circumstances may well qualify as a holder in course who can again enforce payment of the transferable record.

9. Section 16 is a singular exception to the thrust of this Act to simply validate electronic media used in commercial transactions. Section 16 actually provides a means for expanding electronic commerce. It provides certainty to lenders and investors regarding the enforceability of a new class of financial services. It is hoped that the legal protections afforded by Section 16 will engender the development of technological and business models which will permit realization of the significant cost savings and efficiencies available through electronic transacting in the financial services industry. Although only a bridge to more detailed consideration of the broad issues related to negotiability in an electronic context, Section 16 provides the impetus for that broader consideration while allowing continuation of developing technological and business models.

[SECTION 17. CREATION AND RETENTION OF ELECTRONIC RECORDS AND CONVERSION OF WRITTEN RECORDS BY GOVERNMENTAL AGENCIES. (Each governmental agency) [(The designated state officer)] of this State shall determine whether, and the extent to which, [(it)] [a governmental agency] will create and retain electronic records and convert written records to electronic records.]

DRAFT COMMENT: See Draft Comments following Section 19.

[SECTION 18. ACCEPTANCE AND DISTRIBUTION OF ELECTRONIC RECORDS BY GOVERNMENTAL AGENCIES.

(a) Except as otherwise provided in Section 12(f), [(each governmental agency) [the designated state officer]] of this State shall determine whether, and the extent to which, [(it)] [a governmental agency] will send and accept electronic records and electronic signatures to and from other persons and otherwise create, generate, communicate, store, process, use, and rely upon electronic records and electronic signatures.

(b) To the extent that a governmental agency uses electronic records and electronic signatures under subsection (a), the [governmental agency] [designated state officer], giving due consideration to security, may specify:

(1) the manner and format in which the electronic records must be created, generated, sent, communicated, received, and stored and the systems established for those purposes;

(2) if electronic records must be signed by electronic means, the type of electronic signature required, the manner and format in which the electronic signature must be affixed to the electronic record, and the identity of, or criteria that must be met by, any third party used by a person filing a document to facilitate the process;

(3) control processes and procedures as appropriate to ensure adequate preservation, disposition, integrity, security, confidentiality, and auditability of electronic records; and]
(4) any other required attributes for electronic records which are specified for corresponding non-electronic records or reasonably necessary under the circumstances.

(c) Except as otherwise provided in Section 12(f), this [Act] does not require a governmental agency of this State to use or permit the use of electronic records or electronic signatures.

Source: Illinois Act Section 25-101; Florida Electronic Signature Act, Chapter 96-324, Section 7 (1996).

DRAFT COMMENT: See Draft Comments following Section 19.

[SECTION 19. INTEROPERABILITY. The [governmental agency] [designated officer] of this State which adopts standards pursuant to Section 18 may encourage and promote consistency and interoperability with similar requirements adopted by other governmental agencies of this and other States and the federal government and nongovernmental persons interacting with governmental agencies of this State. If appropriate, those standards may specify differing levels of standards from which governmental agencies of this State may choose in implementing the most appropriate standard for a particular application.]


DRAFT COMMENTS

1. Section 17-19 have been bracketed as optional provisions to be considered for adoption by each State. Among the barriers to electronic commerce are barriers which exist in the use of electronic media by State governmental agencies - whether among themselves or in external dealing with the private sector. In those circumstances where the government acts as a commercial party, e.g., in areas of procurement, the general validation provisions of the Act will apply. That is to say, the government must agree to conduct transactions electronically with vendors and customers of governmental services.

However, there are other circumstances when government ought to establish the ability to proceed in transactions electronically. Whether in regard to records and communications within and between governmental agencies, or with respect to information and filings which must be made with governmental agencies, these sections allow a state to establish the ground work for such electronicization.

2. The provisions in Sections 17-19 are broad and very general. In many states they will be unnecessary because those states have already enacted legislation designed to facilitate governmental use of electronic records and communications. However, in many states broad validating rules are needed and desired. Accordingly, this Act provides these Sections as a baseline.

Of paramount importance in all states however, is the need for states to assure that whatever systems and rules are adopted, the systems established are compatible with the systems of other governmental agencies and with common systems in the private sector. A very real risk exists that implementation of systems by myriad governmental agencies and offices may create barriers because of a failure to consider compatibility, than would be the case otherwise.

3. The provisions in Section 17-19 are broad and general to provide the greatest flexibility and adaptation to the specific needs of the individual states. The differences and variations in the organization and structure of governmental agencies mandates this approach. However, it is imperative that each state always keep in mind the need to prevent the erection of barriers through appropriate coordination of systems and rules within the parameters set by the State.

4. Section 17 authorizes state agencies to use electronic records and electronic signatures generally for intra-governmental purposes, and to convert written records and manual signatures to electronic records and electronic signatures. By its terms the section gives enacting legislatures the option to leave the decision to use electronic records or convert written records and signatures to the governmental agency or assign that duty to a designated state officer. It also authorizes the destruction of written records after conversion to electronic form.

5. Section 18 broadly authorizes state agencies to send and receive electronic records and signatures in dealing with non-governmental persons. Again, the provision is permissive and not obligatory (see subsection (c)). However, it does provide specifically that with respect to electronic records used for evidentiary purposes, Section 12 will apply unless a particular agency expressly opts out.

6. Section 19 is the most important section of the three. It requires governmental agencies or state officers to take account of consistency in applications and interoperability to the extent practicable when promulgating standards. This section is critical in addressing the concern that inconsistent applications may promote barriers greater than currently exist. Without such direction the myriad systems that could develop independently would be new barriers to electronic commerce, not a removal of barriers. The key to interoperability is flexibility and adaptability. The requirement of a single system may be as big a barrier as the proliferation of many disparate systems.

SECTION 20. SEVERABILITY CLAUSE. If any provision of this [Act] or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of this [Act] which can be given effect without the invalid provision or application, and to this end the provisions of this [Act] are severable.

SECTION 21. EFFECTIVE DATE. This [Act] takes effect .................
HB571
WWW Version

HB 571/EN (BR 841) - C. Geveden, J. Richards, S. Riggs

AN ACT adopting the Uniform Electronic Transactions Act, and making changes incidental thereto.

Create new sections of KRS Chapter 369 to adopt the Uniform Electronic Transactions Act (UETA) drafted by the National Conference of Commissioners on Uniform State Laws to provide uniform rules to govern transactions in electronic commerce in every state; define "electronic signature" as an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record; define "transaction" as an action or set of actions occurring between two or more persons relating to the conduct of business, commercial, or governmental affairs; define various additional terms; direct that UETA apply to electronic records and electronic signatures relating to a transaction; provide exemptions; provide that UETA apply to electronic records or electronic signatures created, generated, sent, communicated, received, or stored on or after the effective date of this Act, direct that UETA does not require the creation or use of an electronic record or electronic signature; direct that UETA apply only to transactions in which each party has agreed by some means to conduct them electronically; allow a party who agrees to conduct a transaction by electronic means to refuse to conduct other transactions electronically; permit the use of UETA to be varied by agreement; describe how UETA is to be construed and applied; provide that a record or signature may not be denied legal effect or enforceability solely because it is in electronic form, provide that a contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation; direct that any law that requires a record to be in writing will be satisfied by an electronic record; direct that any signature requirement in the law will be satisfied by an electronic signature; describe the relationship between UETA and other law; prescribe attribution and effect of an electronic record or electronic signature; establish rules regarding errors and changes in messages; provide for record retention subject to the agency's jurisdiction; prohibit, in a proceeding, exclusion of evidence regarding consumer contracts entered into for personal, family, or household reasons, establish the use of electronic records or electronic signatures; direct that UETA apply to contracts created or renegotiated on and after the effective date of this Act; provide that contracts based on the repealed KRS 369.010 to 369.030 shall continue under their terms until those contracts expire or are renegotiated and direct that the application of the repealed electronic signature statutes to those contracts shall continue as if the specified statutes had not been repealed; make technical amendment; repeal KRS 369.010 (Legislative intent of KRS 369.010 to 369.030), 369.020 (Definitions for KRS 369.010 to 369.030), and 369.030 (Use of electronic record or electronic signature—Construction and scope of); establish August 1, 2003, as the effective date of this Act.

SFA (1. W. Blevins) - Exempt certain consumer protection statutes from application of the Act regarding consumer contracts entered for personal, family, or household reasons; establish circumstances by which an electronic agent provides an opportunity for the prevention or correction of an error; establish rules that apply to a transaction entered into by an individual for personal, family, or household purposes.

Feb 3-introduced in House
Feb 4-to State Government (H)
Feb 8-posted in committee
Feb 22-reported favorably, 1st reading, to Calendar
Feb 23-2nd reading, to Rules
Feb 26-recommitted to Appropriations and Revenue (H)
Mar 1-posted in committee
Mar 6-reported favorably, to Rules
Mar 13-3rd reading, passed 95-0
Mar 14-received in Senate
Mar 16-to Economic Development, Tourism & Labor (S)
Mar 20-reported favorably, 1st reading, to Calendar
Mar 21-2nd reading, to Rules, floor amendment (1) filed
Mar 24-3rd reading, floor amendment (1) withdrawn; passed 34-0
Mar 27-received in House, enrolled, signed by each presiding officer, delivered to Governor
Apr 3-signed by Governor (Acts ch. 301)
KENTUCKY ADOPTION OF THE UNIFORM ELECTRONIC TRANSACTIONS ACT
- Full Text -

UNOFFICIAL COPY AS OF: 04/10/2006
REG. SESS. 00 KS HB 571/GA

AN ACT adopting the Uniform Electronic Transactions Act, and making changes incidental thereto:

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Sections 1 to 20 of this Act may be cited as the Uniform Electronic Transactions Act.

SECTION 2. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

As used in Sections 1 to 20 of this Act, unless the context requires otherwise:

(1) "Agreement" means the bargain of the parties in fact, as found in their language or inferred from other circumstances and from rules, regulations, and procedures given the effect of agreements under laws otherwise applicable to a particular transaction;

(2) "Automated transaction" means a transaction conducted or performed, in whole or in part, by electronic means or electronic records, in which the acts of records of one or both parties are not reviewed by an individual in the ordinary course in forming a contract, performing under an existing contract, or fulfilling an obligation required by the transaction;

(3) "Computer program" means a set of statements or instructions to be used directly or indirectly in an information processing system in order to bring about a certain result;

(4) "Contract" means the total legal obligation resulting from the parties' agreement as affected by Sections 1 to 20 of this Act and other applicable law;

(5) "Electronic means" means relating to technology having electrical, digital, magnetic, wireless, optical, electromagnetic, or similar capabilities;

(6) "Electronic agent" means a computer program or an electronic or automated means used independently to initiate an action or respond to electronic records or performances in whole or in part, without review or action by an individual;

(7) "Electronic record" means a record created, generated, sent, communicated, received, or stored by electronic means;

(8) "Electronic signature" means an electronic sound, symbol, or process attached to or logically associated with a record and executed or adopted by a person with the intent to sign the record;

(9) "Governmental agency" means an executive, legislative, or judicial agency, department, board, commission, authority, institution, or instrumentality of the federal government or of a state or of a political subdivision of a state;

(10) "Information" means data, text, images, sounds, codes, computer programs, software, databases, or the like;

(11) "Information processing system" means an electronic system for creating, generating, sending, receiving, storing, displaying, or processing information;

(12) "Person" means an individual, corporation, business trust, estate, trust, partnership, limited liability company, association, joint venture, governmental agency, public corporation, or any other legal or commercial entity;

(13) "Record" means information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form;

(14) "Signature" means a procedure employed for the purpose of verifying that an electronic signature, record, or performance is that of a specific person or for detecting changes or errors in the information in an electronic record. The term includes a procedure that requires the use of algorithms or numbers or other acknowledgment procedures; and

(15) "State" means a state of the United States, the District of Columbia, Porto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States. The term includes an Indian tribe or band, or Alaskan native village, which is recognized by federal law or otherwise acknowledged by a state; and

(16) "Transaction" means an action or set of actions occurring between two (2) or more persons relating to the conduct of business, commercial, or governmental affairs.

SECTION 3. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Except as otherwise provided in subsection (2) of this section, Sections 1 to 20 of this Act applies to electronic records and electronic signatures relating to a transaction.

Sections 1 to 20 of this Act does not apply to a transaction in the extent it is governed by:

(a) A law governing the creation and execution of wills, codicils, or testamentary trusts;

(b) KRS Chapter 355 other than KRS 355.1-107 and 355.1-206, and Articles 2 and 2A of KRS Chapter 355;

(c) A law governing the conveyance of any interest in real property; and

(d) A law governing the creation or transfer of any negotiable instrument or any instrument establishing title or an interest in title.

SECTION 4. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Sections 1 to 20 of this Act applies only to transactions between parties each of which has agreed to conduct transactions by electronic means. Whether the parties agree to conduct a transaction by electronic means is determined from the context and surrounding circumstances, including the parties' conduct.

A party that agrees to conduct a transaction by electronic means may refuse to conduct other transactions by electronic means. The right granted by this subsection may not be waived by agreement.

Except as otherwise provided in Sections 1 to 20 of this Act, the effect of any of its provisions may be varied by agreement. The presence in certain provisions of Sections 1 to 20 of this Act of the words "unless otherwise agreed," or words of similar import, does not imply that the effect of other provisions may not be varied by agreement.

Whether an electronic record, electronic signature or electronic record has legal consequences is determined by Sections 1 to 20 of this Act and other applicable law.

SECTION 5. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Sections 1 to 20 of this Act and all sections of KRS relating to electronic transactions, including any other existing sections of KRS relating to electronic transactions, are made uniform with the respect to the subject of Sections 1 to 20 of this Act among states enacting it.

SECTION 6. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) A record or signature may not be denied legal effect or enforceability solely because it is in electronic form.

(2) A contract may not be denied legal effect or enforceability solely because an electronic record was used in its formation.

(3) If a law requires a record to be in writing, an electronic record satisfies the law.

(4) If a law requires a signature, an electronic signature satisfies the law.

SECTION 7. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) If a party to a transaction by electronic means and a law requires a person to send, or deliver information in writing to another person, the requirement is satisfied if the information is provided, sent, or delivered, as the case may be, in an electronic record capable of retention by the recipient at the time of receipt. An electronic record is not capable of retention by the recipient if the sender or its information processing system inhibits the ability of the recipient to print or store the electronic record.

(2) If a law other than Sections 1 to 20 of this Act requires a record to be posted or displayed in a certain manner, but, or transmitted by a specified method, or to contain information that is formatted in a certain manner, the following rules apply:

(a) The record must be posted or displayed in the manner specified in the other law.

(b) Except as otherwise provided in subsection (4)(b) of this section, the record must be sent, communicated, or transmitted by the method specified in the other law.

(c) The record must contain the information formatted in the manner specified in the other law.

(d) If a sender inhibits the ability of a recipient to store or print an electronic record, the electronic record is not enforceable.

(3) The requirements of this section may not be varied by agreement, but:

(a) To the extent a law other than Sections 1 to 20 of this Act requires information to be provided, sent, or delivered in writing but permits that requirements to be varied by agreement, the requirement under subsection (1) of this section that the information be in the form of an electronic record capable of retention may also be varied by agreement; and
A requirement under a law other than Sections 1 to 20 of this Act to send, communicate, or transmit a record by United States mail may be varied by agreement to the extent permitted by the other law.

SECTION 5. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) An electronic record or electronic signature is attributable to a person if it was the act of the person. The act of the person may be shown in any manner, including a showing of the efficacy of any security procedure applied to determine the person to which the electronic record or electronic signature was directed. An act specifically attributable to a person includes, but is not limited to, the following:

(a) It triggers a security procedure intended by that person to detect changes or errors in an electronic record.

(b) It authorizes a person to make a change or error in an electronic record. This affirmative act must be in writing or another form that is not open to public inspection unless a person has notice of or reason to believe that the record is publicly accessible. An act specifically attributable to a person includes, but is not limited to, an act that:

(i) Is based on a consent of the sender of a person under subsection (1) of this section.

(ii) Is made by the sender or another person, including the parties' agreement, if any, otherwise directed to the person.

(c) It directs a person to perform any act required by an agreement, including the parties' contract, if any, otherwise directed to the person.

A requirement under a law other than Sections 1 to 20 of this Act to send, communicate, or transmit a record by United States mail may be varied by agreement to the extent permitted by the other law.

SECTION 6. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) An electronic record or electronic signature is attributable to a person if it was the act of the person. The act of the person may be shown in any manner, including a showing of the efficacy of any security procedure applied to determine the person to which the electronic record or electronic signature was directed. An act specifically attributable to a person includes, but is not limited to, the following:

(a) It triggers a security procedure intended by that person to detect changes or errors in an electronic record.

(b) It authorizes a person to make a change or error in an electronic record. This affirmative act must be in writing or another form that is not open to public inspection unless a person has notice of or reason to believe that the record is publicly accessible. An act specifically attributable to a person includes, but is not limited to, an act that:

(i) Is based on a consent of the sender of a person under subsection (1) of this section.

(ii) Is made by the sender or another person, including the parties' agreement, if any, otherwise directed to the person.

(c) It directs a person to perform any act required by an agreement, including the parties' contract, if any, otherwise directed to the person.

A requirement under a law other than Sections 1 to 20 of this Act to send, communicate, or transmit a record by United States mail may be varied by agreement to the extent permitted by the other law.
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00 REG. SESS. 00 RS HB 571/GA

2. If the authoritative copy indicates that the transferrable record has been transferred, the person to which the transferrable record was most recently transferred;

(c) The authoritative copy is communicated to and maintained by the person asserting control or its designated custodian;

(d) Copies of revisions that add or change an identified assigment of the authoritative copy can be made only with the consent of the person asserting control;

(e) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(f) Any revision of the authoritative copy is readily identifiable as authorized or unauthorized.

(4) Except as otherwise agreed, a person having control of a transferrable record is the holder, as defined in KRS 355.1-201(20), of the transferrable record and has the same rights and defenses as a holder of an equivalent record or writing under KRS Chapter 355. Including, if the applicable statutory requirements under KRS 355.3-302(1), 355.7-501, or 355.9-308 are satisfied, the rights and defenses of a holder in due course, a holder to which a negotiable title has been duly negotiated, or a purchaser, respectively. Delivery, possession, and indorsement are not required to obtain or exercise any of the rights under this subsection.

(5) Except as otherwise agreed, an obligor under a transferrable record has the same rights and defenses as an equivalent obligor under equivalent records or writing under KRS Chapter 355.

(6) If requested by a person against which enforcement is sought, the person seeking to enforce the transferrable record shall provide reasonable proof that the person is in control of the transferrable record. Proof may include access to the authoritative copy of the transferrable record and related business records sufficient to review the terms of the transferrable record and to establish the identity of the person having control of the transferrable record.

SECTION 17. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

Each governmental agency of this Commonwealth shall determine whether, and to the extent to which, it will create electronic records. The Kentucky Department of Libraries and Archives shall determine whether, and to the extent to which, the Commonwealth will retain electronic records and convert written records to electronic records.

SECTION 18. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (5) of Section 12 of this Act, each governmental agency of this state, in compliance with standards established by the Governor's Office for Technology, shall determine whether, and to the extent to which, it will send and accept electronic records and electronic signatures to and from other persons and otherwise create, generate, communicate, store, process, use, and rely upon electronic records and electronic signatures.

(2) To the extent that a governmental agency uses electronic records and electronic signatures under subsection (1) of this section:

(a) The Governor's Office for Technology, giving due consideration to security, may specify the manner and format in which the electronic records must be created, generated, sent, communicated, received, and stored and the systems established for those purposes;

(b) If electronic records must be signed by electronic means, each governmental agency, giving due consideration to security, may specify the type of electronic signature required, the manner and format in which the electronic signature must be affixed to the electronic record, and the identity of, or criteria that must be met by, any third party used by a person filing a document to facilitate the process;

(c) The Governor's Office for Technology and the Department for Libraries and Archives, giving due consideration to security, may specify control processes and procedures as appropriate to ensure adequate preservation, disposition, integrity, privacy, confidentiality, and auditability of electronic records; and

(d) Each governmental agency, giving due consideration to security, may specify any other required attributes for electronic records which are specified for corresponding non-electronic records or reasonably necessary under the circumstances.

(3) Except as otherwise provided in subsection (5) of Section 12 of this Act, Sections 1 to 20 of this Act does not require a governmental agency of this state to use or permit the use of electronic records or electronic signatures.

SECTION 19. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

The Governor's Office for Technology which adopts standards pursuant to subsection (2)(a) of Section 18 of this Act may encourage and promote consistency and interoperability with similar requirements adopted by other governmental agencies of this and other states and the federal government and nongovernmental persons interacting with governmental agencies of this state. If appropriate, those standards may specify differing levels of standards from which governmental agencies of this state may choose in implementing the most appropriate standard for a particular application.

SECTION 20. A NEW SECTION OF KRS CHAPTER 369 IS CREATED TO READ AS FOLLOWS:

If any provision of Sections 1 to 20 of this Act or its application to any person or circumstance is held invalid, the invalidity does not affect other provisions or applications of Sections 1 to 20 of this Act which can be given effect without the invalid provision or application, and to this extent the provisions of Sections 1 to 20 of this Act are severable.

SECTION 21. The following KRS sections are repealed:

369.010 Legislative intent of KRS 369.010 to 369.030.

369.020 Definitions for KRS 369.010 to 369.030.

369.030 Use of electronic record or electronic signature -- Construction and scope of KRS 369.010 to 369.030.

SECTION 22. Sections 1 to 20 of this Act applies to contracts created or renegotiated on and after the effective date of this Act. To the extent that Sections 1 to 20 of this Act may be inconsistent, and notwithstanding the repeal of KRS 369.010 to 369.030 contained in Section 21 of this Act, contracts based on those statutes shall continue in force under their terms until they expire or are renegotiated, and the application of those statutes to such contracts shall continue as if the specified statutes had not been repealed.

SECTION 23. If the General Assembly enacts the revised version of Article 9 of the Uniform Commercial Code during this 2000 Regular Session and that legislation becomes law, the reference to KRS 355.9-328 in subsection (4) of Section 16 of this Act shall be changed to 355.9-330, as of the effective date of revised Article 9, to reflect the location of the relevant text in the revised Article 9.

SECTION 24. In the event that the Governor's Executive Order 99-1359, dated October 6, 1999, creating the Governor's Office for Technology, is not confirmed by the 2000 General Assembly, references in Sections 18 and 19 of this Act to the Governor's Office for Technology shall be deleted, and in codification the Chief Information Officer shall be inserted in lieu thereof.

Section 25. This Act shall take effect August 1, 2000.
LITIGATION ISSUES FOR FINANCIAL INSTITUTIONS

Fraudulent Instruments, Fraud Schemes, and Bank Scams

R. Gregg Hovious
Tachau Maddox Hovious & Dickens PLC
Louisville, Kentucky

SECTION H
Fraud in today’s market

Fraud is global and dynamic. New fraud patterns emerge rapidly and can quickly change and migrate. No sooner do businesses have security measures in place to prevent one type of fraud, than fraud artists have moved on to a less risky approach. No sooner is a fraud ring shut down in one city, perhaps just in one zip code area, than another is driving up dollar losses in a different geographic locale.

Fraud artists can be found anywhere. They’re on-line, on the telephone, in consumers’ mailboxes, at retailers’ stores. Their intent is to perpetrate a scam, and with that in mind, they’re constantly searching for new markets, new regions and new ways of doing business.

Fraud artists are also technologically sophisticated, making it even harder to track and catch them. In fact, they invest dollars more often in technological advancements than does law enforcement, which is charged with apprehending them, and the credit industry, which attempts to thwart fraud. On average, fraud artists turn over their systems, hardware and software every six hours. Comparably, law enforcement invests in crime-fighting technology upgrades every 48 months; the credit industry every 18 months, says the National Fraud Center, a fraud prevention and interdiction company in Horsham, Pa.

Yet, U.S. businesses lost $800 billion to fraud in 1996—and that’s a conservative estimate. The loss could be as high as $1.4 trillion when economic crimes such as money laundering (a $750 billion business) are factored into the mix. The credit card industry alone lost $3 billion to fraud—$894 million of which belonged to Visa and MasterCard, the only card payment systems that release fraud statistics.

With such losses, businesses is forced to pick up the slack. They do, spending an estimated $100 billion annually on private security in manpower and technology to fight fraud. However, fraud losses increase at a rate of over 20 percent annually, reports the Fraud Assessment & Impact Study. Based on current fraud ratios, cumulative credit card losses between 1997 and the Year 2000 would exceed $14 billion—almost three times the accumulated loss of the past seven years, reports the National Fraud Center.

Tackling—let alone eliminating—fraud is difficult, if not impossible. That’s because fraud is multi-faceted. There are multitudes of scams, involving a multitude of types of fraud—many of which cross over into different industries. Fraud is no longer limited to just floating bad paper (such as counterfeit money or forged checks) or plastic (such as stolen credit cards). Now, a fraud artist can take over someone’s identity, opening a credit card account in that consumer’s name, getting a duplicate driver’s license, filing fraudulent insurance claims and much more.

What can you do to stop fraud?

Americans have gotten used to credit approval in minutes. Consumers like quick loans, which allow them to grab surprise bargains or finance an emergency. We are an "instant credit" society. This often allows credit issuers to capitalize on unexpected purchases or offer "special promotions" to attract customers, it also allows fraud artists to capitalize on the anonymity and limited attention to detail given to "instant" credit applications.

The credit approval process often amounts to matching two pieces of information on the application—name and Social Security number—with the same information on a credit report. As long as those pieces of information match and the credit report indicates a good risk score, credit is granted. The review and decision time on applications can be done in 1 to 3 minutes, especially if automated scoring systems are used.

Credit issuers are sometimes satisfied when only five of the nine Social Security number digits match. Issuers often don’t look at the payment history and they often don’t even get to the bottom of the report where they may find dozens of inquiries that are indicative of identity theft.

In addition, credit approval is totally anonymous. Today’s credit application processes afford thieves the opportunity to commit criminal acts. Easy credit amounts to easy crime.

How can fraud be reduced? More time spent reviewing applications and verifying information can help to identify fraudulent applications. In addition, analyzing an application for obvious inconsistencies can aid in fraud detection.
Spotting a fraudulent credit application

Today's electronic age makes it more and more difficult to spot fraudulent information on credit applications. Consumers are moving away from the traditional process in which an application is filled out by hand and mailed to a credit issuer or returned to the store in person.

Instead, they're taking advantage of technology fets such as automated loan machines (ALMS) in which a consumer talks to a credit manager via a video monitor hook-up. In this instance, the credit manager jogs down the consumer's personal history, without requiring so much as a signature from the would-be borrower.

Or, consumers apply for "instant credit" via the telephone. They simply call a credit issuer, which has a computerized voice mail system for credit applications. Following prompts from the system, a consumer punches in required personal data, such as name and Social Security number, using the telephone keypad.

These innovations make it harder to detect application fraud—especially since there is usually no application file in the consumer's handwriting. Fortunately, handwriting analysis isn't the only tool credit issuers use in screening credit applications for fraud.

Issuers look for inconsistencies in data supplied by the consumer—whether that information was collected via a telephone keypad, an ALM or the old-fashioned way of a handwritten application. These inconsistencies may be found during manual processing (or spot checking batches) of applications by credit managers. Or, automated systems may score application information against "characteristics" compiled by databases of fraud patterns.

Whether credit applications are processed manually or by automated systems, these "characteristics" need to be reviewed carefully—application information verified—when inconsistencies pop up. That's because these inconsistencies give credit managers reason to be suspicious about an application. These "characteristics" do not, however, mean that the application is fraudulent.

For instance, a customer might inadvertently transpose a digit on a Social Security number, which is an error but not an attempt to defraud a credit issuer.

With that word of caution, here are the red flag indicators to look for in reviewing credit applications:

Name and signature
- Improper professional title
- Double meaning or unusual combinations of names, such as George L. John or Robert T. George
- Name and signature match
- Signature written over

Address
- Residence or non-residence
- Multiple use of same address on

application
- Previous address is verifying as current with directory assistance or database
- Zip code matches the address
- PO box listing for a home or business address could be an indication of a mail drop

Telephone numbers
- Same number used for different purposes
- Does not belong to applicant
- Phone numbers and area codes do not match the address
- Prefixes do not match address areas

Credit report review
- Multiple inquiries within last 30 to 60 days
- Numerous recent addresses within past year
- Recent credit history - shallow accounts
- Security alert or consumer statement
- Social Security number not issued per national repository
- Social Security number reported deceased per national repository
- Social Security number on file doesn't match the Social Security number on the application
- Variations in identification
- Account near or over limit in short period of time
- Accounts on application not on report
- No credit history
- Credit references in same sequence as on credit report
- All closed accounts
- All unknown companies
- Balance has "paid in full"

Bank accounts
- Account numbers omitted
- Not verified by bank
Recently opened
New savings account and loan with same institution

Credit references
- Section left blank
- Account numbers omitted
- Account number not properly formatted
- Account numbers truncated
- Real accounts or "no records"

Nearest relative: cousin, doctor, friend

Employment
- Any portion left blank
- Position is not logical with age
- Salary not reasonable
- Length of time on job is unusual

Occupations
- Job title is misspelled, such as "seargeon," "physican," "engineer"
- Job title is unusual or is an unreasonable match for the type of employment
- Salary appears incorrect or is an unreasonable match for the type of employment, such as a daycare worker earning $3,000 per month
- Title does not match the age or income of the applicant
- High-level professional titles or specialized management positions are listed, such as lawyer, physician, vice president, president

Places of employment
- Hospitals
- Construction companies
- Computer companies
- Universities
- "Fortune 500" or similar large companies

Income levels
- Generally use high income, will often use cents
- Lists other income from parents
- Stock and investment income (often unusually high-dollar amount)
- Discrepancies between position and income

Handwriting fraud indicators
(again handwriting analysis is only possible when the application was completed by the applicant)
- Floating periods
- Sky high T's (a T that is high and crossed at the top, not in the middle of the letter)
- Pregnant D's (a fat loop at the bottom of the D)
- Unusual punctuation or misspelling of common words
- Run-on or stick lettering
- Name reversal or single name signature
- Unfamiliarity with structure on name and titles
- Listing occupation as retired, but the handwriting appears to be that of a younger person
- Tracing or scratchy appearance
- Disconnected letters
- Foreign characteristics or spellings (i.e., "tissue" instead of "tissue")
- Spacing
- False starts
- Pen lifts
- Ink blots
- Length
- Criminal tremor

Verification Process:
A thorough application review includes a verification process. Here are a few items to verify, which can be done using a fraud detect database.
- Verify residence phone number through database or personal contact
- Verify business phone number through database or personal contact
- Verify current address through database
- Verify previous address through database
- Verify employment using number obtained from database; hire date, position, salary, who you spoke with and their position
- Verify driver's license number format
- Visit residence or business address personally (costly)
- Applicant is reading application information during telephone verification
- Same person answers phone and verifies employment
- Business phone is answered with last 4 digits of number or "hello"
- Phone disconnected with no referral number

Aside from these "characteristics," another sign of fraud is filling out an application too carefully. Legitimate customers tend to put as little information down as possible. They do so because they don't understand the information contained on a credit application, and how this information is point scored. Or, they do so because they are in a hurry. For example, they are rushing to complete a credit application in the store so they can qualify for a discount offer or promotion.

Fraud artists on the other hand take extraordinary care in completing credit applications. They ensure that any "characteristics" that may be point-scored are answered and that any information that may be used to verify the application will lead a credit issuer to them. If the employer is likely to be called for job and income verification, a telephone number and address of a "boiler room" will be used to ensure that the application is successfully verified.

The above information was taken from the Resource Guide to Credit manual, 5th edition.
To obtain more information or to order the complete manual, contact the C1 staff at 612.928.3000, ext 143.
Vast online credit card theft revealed
Hacker hid data on 485,000 cards on U.S. agency’s Web site

By Mike Brunker
© MSNBC

March 17 — In the largest known case of cybertheft, a computer intruder stole information on more than 485,000 credit cards from an e-commerce site and then secretly stored the massive database on a U.S. government agency’s Web site, MSNBC.com has learned. Credit card companies notified financial institutions, but many of the compromised accounts remain open to this day because the banks neither closed them nor notified customers of the theft.
THE HEIST occurred in January 1999, but only a few details have previously been made public.

The scope of the crime emerged in a letter dated Dec. 27 from Visa USA to member financial institutions. Jim Macken, a Secret Service spokesman, confirmed that the incident had occurred and added some details in an interview on Thursday.

The Visa letter, a copy of which was provided to MSNBC by a source in the banking industry, quotes federal authorities as saying that the credit card information — including expiration dates and cardholder names and addresses — was stolen from an Internet retail site by a hacker.

It said the store of data on Visa, MasterCard, American Express and Discover cards was discovered on an unspecified government computer system during an audit. The letter did not say when the stolen data was found, but Macken said it was discovered before March 1999 on the Web site of a U.S. government agency, which he declined to identify.

"This government Web administrator noticed that a lot of the memory was chewed up for no reason, so he checked and found the file (containing the stolen data)," he said.

NO EVIDENCE OF FRAUDULENT USE

There was no evidence that any of the cards were used to commit fraud and some of the accounts were not active, Macken added.

The letter said that authorities had not identified the thief, but Macken said investigators have since traced the criminal to Eastern Europe. The investigation is ongoing and involves diplomatic contacts with the country in question, he said.

The Internet retail site from which the data was stolen has also since been identified, but Macken declined to name it.

It was unclear why the thief hacked the government Web site and stored the data there, Macken said, though he allowed that the act might have been the online equivalent of thumbing one's nose at U.S. authorities.

As MSNBC reported last week, U.S. authorities have so far been stymied in their attempts to prosecute credit card thieves and fraud rings based in the former Soviet bloc nations and Asia.

Secret Service officials testified about some details of the case before Congress early last year to demonstrate the peril that computer hackers pose to online commerce, Macken said. Their comments generated little coverage, however, and the scope of the case is only now becoming clear.

EFFORT TO HIGHLIGHT INACTION

The copy of the letter from Visa was obtained by MSNBC from an employee at the Navy Federal Credit Union, in Merrifield, Va., the world's largest credit union with 19 million members. The letter was provided, the source said, to highlight the fact that some financial institutions are failing to act to protect consumers when there is evidence that their credit card information has been stolen.

Officials at the credit union took no action to warn customers whose account numbers were among those stolen by the hacker, said the source, who spoke on condition of anonymity. Instead, they ordered a "spot check" of 50 to 100 accounts and then decided that no further action was necessary, the source said.

The source said the same procedure was followed two weeks later, when Visa alerted the institution of the theft of data on 300,000 credit cards from the CD Universe Web site — the biggest theft of credit card data over the Internet that previously had been made public.

"It was decided that ... it would be too much of an inconvenience and too costly to shut down the accounts and issue new numbers," said the source. "It was deemed not the credit union's responsibility."

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Several financial institutions ordered the wholesale closure and replacement of cards that were compromised in the CD Universe case, which also remains under investigation. Such across-the-board replacement programs were well publicized in an effort to assure online consumers.

Banks and credit card companies often point out that consumers are responsible only for the first $50 of fraudulent online purchases — and that is nearly always waived.

But stolen credit card information can be used to commit fraud against unsuspecting Internet merchants, who in most cases bear the cost of the crime, or for identity theft — a practice in which criminals use personal data to obtain new credit, borrow money or make big-ticket purchases.

The Treasury Department on Wednesday held a two-day national summit on identity theft to focus attention on what Treasury Secretary Lawrence Summers described as "a growing and major criminal threat."

At the session, victims said that while they did not ultimately have to pay for the losses run up in their names, identity theft is by no means a victimless crime.

"It has been sheer hell, and I do mean hell," said Darlene Zele, a Rhode Island hospital worker who one of the victims who testified about years of struggling to repair the havoc wrought on their credit records. "At this point, after five years, it's still not over."

The credit union source said that fraudulent charges have subsequently appeared on some of the accounts that were compromised, though it is impossible to definitively link the fraud to the theft.

CREDIT UNION RESPONDS

In a statement issued Friday in response to MSNBC.com's story, Navy Federal Credit Union officials did not challenge the assertion that they did not warn customers of the theft. But they denied that cost or inconvenience were factors in the decision.

"When we received notification of this problem from VISA USA, we reviewed our systems and were confident that all appropriate controls were in place to protect our members' financial welfare," said Tom Steele, a credit union vice president in charge of the credit card division. "Additional checks of the 1,500 Navy Federal credit card accounts identified by VISA USA confirmed that the steps we had taken safeguarded every cardholder — we have also not seen any increase in fraud losses."

The statement also indicated that no Navy Federal cardholders have been victims of identity theft as a result of the heist.

Calls to American Express and a half dozen major banks seeking information on their response when notified of the theft were not returned.

Scott Lynch, a spokesman for Visa USA, said he could not comment on the case. Nor would he explain why Visa didn't notify its members of the theft until December.

Alicia Zatkowski, a spokeswoman for Discover Financial Services, said the firm's fraud investigators were not aware of such a case.

Vincent DeLuca, vice president of fraud control at MasterCard International, said, "We are aware of some cases but we're not at liberty to talk about any ongoing investigations."
TIPS FOR ON-LINE SHOPPERS TO PROTECT AGAINST CREDIT CARD FRAUD

Tip 1
- Use only one credit card online to make it easier to identify fraudulent charges.

Tip 2
- Use only a credit or charge card — never a bank debit card — for online purchases. Under the Fair Credit Billing Act, consumers are liable for a maximum of $50 if a credit card is used fraudulently and have the right to dispute charges under certain circumstances and temporarily withhold payment while the creditor is investigating them. Debit cards don't offer such protection — using one online puts your entire checking or savings account at risk.

Tip 3
- Unless your debit card offers purchase protection, use only a credit or charge card for online purchases. Under the Fair Credit Billing Act, consumers are liable for a maximum of $50 if a credit card is used fraudulently and have the right to dispute charges under certain circumstances and temporarily withhold payment while the creditor is investigating them. Debit cards don't have such a blanket rule. Using one online can put your entire checking or savings account at risk. However, several issuers have begun offering the protection for debit cards, so check with your issuer.
Every construction project has its perils. The fact that the collateral is usually the project itself involves some risk taking. Hopefully for the sake of all involved, the project is built to adequate specifications, without significant design flaws, and is economically viable.

When approaching a construction loan, the lender should walk softly to avoid the pitfalls and the liabilities of the following "seven deadly sins."

I. **THOU SHALL NOT EXERCISE TOO MUCH CONTROL.**

A bank, which claimed expertise in disbursing construction funds and required exclusive control of such loans funds, as well as the borrower's separate construction funds, was held liable when 90% of the construction funds were expended on 40% of the construction job.

*Melamed v. Lake County National Bank, 727 F.2d 1399, 1401, 1404 (6th Cir. 1984).*

II. **THOU SHALL NOT EXERCISE TOO LITTLE CONTROL...**

A lender may incur additional duties if it strays too far from traditional lending activities. A bank was viewed as an active participant in a home construction enterprise, and was found liable to the ultimate home buyer for not exercising control over the developer to avoid negligent construction of the foundation of the homes.

*Conner v. Great Western Savings and Loan, 69 Cal.2d 871.*
III. **THOU SHALL STAY WITHIN THE BASICS.**

A $135 million judgment against a bank for refusing to close a construction loan for a Penthouse Hotel on the Atlantic City Boardwalk was reversed in a "back to basics" opinion that concluded that the loan commitment had expired by its terms without breach by the bank.


IV. **THOU SHALL BEWARE OF ACTING AS A CREDIT REFERENCE.**

A bank has been held liable to a third party for negligently representing that its construction customer was not in financial jeopardy. The court noted that the moral of the story is that "a bank incurs no liability to anyone when it declines to act as a credit reference."

*Brayton Chem., Inc. v. First Farmers State Bank*, 671 F.2nd 1047, 1050 (7th Cir. 1982).

V. **THOU SHALL AVOID EQUITABLE SUBORDINATION.**

Where a construction contractor experienced financial difficulty and the surety made advances to assist the contractor on the project, the court equitably subrogated the claims of the construction lender to those of the surety.


VI. **THOU SHALL ALWAYS DEAL IN GOOD FAITH.**

A lender foreclosed on a construction project. The debtor countersued for tortious breach of implied covenant of good faith and fair dealing as was awarded $3 million in compensatory damages and $28 million in punitive damages, that was reduced to $15 million. *Jacques v. F & B*, 515 A.2d 756 (Md. 1996). It is important to note that courts historically have singled out lenders over businesses in applying the general contractual duty of good faith. Traditionally, banks and their officers have been held to a high degree of integrity and responsive in view of their public calling. Courts historically have found that there is a public interest in honest banking and they have held bankers to good faith standard which is viewed as "honesty in fact."
VII. **THOU SHALL SPEAK CAREFULLY.**

A bank has been held liable for "misrepresenting" that the customer should be able to "do alright" with the project. The court held that bankers must exercise care in making affirmative misrepresentations of fact because bankers are viewed as having expertise in their lending areas.

A TWENTY YEAR PERSPECTIVE
ON
BANKING LAW IN KENTUCKY AND THE NATION

M. Brooks Senn
Kentucky Bankers Association
Louisville, Kentucky

and

M. Thurman Senn
Morgan & Pottinger, P.S.C.
Louisville, Kentucky

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SECTION J
"Those who cannot remember the past are condemned to repeat it."
--George Santayana

"There are three kinds of lies: lies, damned lies, and statistics."
- Mark Twain

**Some Interesting Statistics**

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<td></td>
<td></td>
</tr>
<tr>
<td>Federal Gov't Debt</td>
<td>$961 billion</td>
<td>$5.75 trillion</td>
</tr>
<tr>
<td>State Budget [General Fund]</td>
<td>$2.0 billion [FY80-81]</td>
<td>$5.7 billion [FY1997-98]</td>
</tr>
<tr>
<td>United States Population</td>
<td>226 million</td>
<td>274 million [4/14/00]</td>
</tr>
<tr>
<td>Kentucky Banks/Branches</td>
<td>343 banks</td>
<td>261 banks [12/31/98]</td>
</tr>
<tr>
<td></td>
<td>794 branches</td>
<td>1,186 branches</td>
</tr>
<tr>
<td>United States Banks/Branches</td>
<td>14,401 banks</td>
<td>8,756 [12/31/98]</td>
</tr>
<tr>
<td></td>
<td>40,500 branches</td>
<td>61,394 branches</td>
</tr>
<tr>
<td></td>
<td>1981</td>
<td>2000</td>
</tr>
<tr>
<td>------------------------------</td>
<td>-----------------</td>
<td>-----------------</td>
</tr>
<tr>
<td><strong>Number of Bank Employees</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kentucky</td>
<td>19,283</td>
<td>16,520 [12/31/98]</td>
</tr>
<tr>
<td>United States</td>
<td>1,480,923</td>
<td>1,609,469</td>
</tr>
<tr>
<td><strong>Commercial Bank Deposits</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Kentucky</td>
<td>$17.8 billion</td>
<td>$39.9 billion</td>
</tr>
<tr>
<td>United States</td>
<td>$1.6 trillion</td>
<td>$3.6 trillion</td>
</tr>
<tr>
<td><strong>Prime Rate:</strong></td>
<td>17.5%</td>
<td>9.00%</td>
</tr>
<tr>
<td><strong>FRB Discount Rate:</strong></td>
<td>13.0%</td>
<td>5.50%</td>
</tr>
<tr>
<td><strong>Consumer Price Index</strong></td>
<td>$1.00</td>
<td>$1.83</td>
</tr>
<tr>
<td>(All Urban Consumers; 1981 = $1.00)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>S&amp;P 500</strong></td>
<td>256.09 [4/4/88]</td>
<td>1,504.46 [4/10/00]</td>
</tr>
<tr>
<td><strong>DJIA</strong></td>
<td>1,511.70 [12/11/85]</td>
<td>11,186.56</td>
</tr>
<tr>
<td><strong>NASDAQ</strong></td>
<td>210.18 [3/31/81]</td>
<td>4,188.20</td>
</tr>
<tr>
<td><strong>Proportion of consumer mortgages that are securitized</strong></td>
<td>8% [1971]</td>
<td>50% [1991]</td>
</tr>
<tr>
<td><strong>Personal saving as a percentage of disposable income</strong></td>
<td>10.7%</td>
<td>2.4% [1999]</td>
</tr>
<tr>
<td><strong>FDIC Coverage Amount</strong></td>
<td>$40,000 [1979]</td>
<td>$100,000 [changed 1980]</td>
</tr>
<tr>
<td><strong>United States Bank Failures</strong></td>
<td>40</td>
<td>3 [1998]</td>
</tr>
</tbody>
</table>

Banking’s Share of the Financial Services Market:
1975: 36% of typical household’s financial assets were held by banks
1998: 17%

Percentage of American Households That Own Mutual Funds:
1992: 24%
1998: 37.4%

Household Debt Service As A Percentage Of Disposable Personal Income:
1982: 14.2%
1992: 16.6%
Internet Usage:
1981: Did not exist for the general public.
1999: 115 million people in United States estimated to have Internet access.

Amount Banking Industry Spent On Technology:
1982: $5.1 billion
1996: $19.1 billion

Credit Card Offers Mailed:
1992: 850 million
1995: 2.6 billion

Non-Interest Income As A Percentage of Bank Earnings:
1984: 24.7%
1998: 39.7%

Per Capita Personal Income (1992 constant dollars)
1990: Kentucky $15,085 (rank 43) U.S.: $19,156 Conn. (1st): $23,453

J-3
**Timeline**

1977  
Fair Debt Collection Practices Act enacted.

1977  
Community Reinvestment Act enacted.

1978  
Electronic Funds Transfer Act enacted.

1980  
Hong Kong Shanghai Bank acquires Marine Midland Bank.

1980  
Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") enacted.

3/31/80  
Depository Institutions Deregulation and Monetary Control Act of 1980 ("DIDMCA") enacted.

3/31/80  
Truth In Lending Simplification And Reform Act enacted as Title VI of DIDMCA.

8/12/81  
IBM introduces IBM PC personal computer. Specifications: 4.77 MHz Intel 8088 microprocessor with 16k memory, one or two 160k floppy disk drives, an optional color monitor, and a price tag starting at $1,565. Operating system was Microsoft’s MS-DOS Version 1.0 which had been developed from an earlier system Microsoft purchased for $50,000.

8/81  
--Provides powerful tax incentives for real-estate investment by individuals.  
This legislation helps create a "boom" in real estate and contributes to overbuilding in real estate markets exacerbating the S&L crisis.

1982  
Wave of bank failures begins. From 1982 through 1991, more than 1,400 FDIC-Insured banks fail.

12/82  

2/11/83  
Mack & Ruby Duff file class action lawsuit against Bank of Louisville alleging that KRS 287.215 is sole authority under which banks may make installment loans repayable in the period between 5 years and 32 days and not exceeding 10 years and 32 days.

1983  
Supreme Court in American Bank & Trust Co. v. Dallas County invalidates Texas’ bank share tax because it indirectly taxed United States obligations thereby raising questions about Kentucky’s bank share tax. Numerous Kentucky banks file refund requests.

1984  
Kentucky’s bank share tax amended in response to Dallas County decision.
using the "taxable fair cash value" concept.

1984  Continental Illinois National Bank ($45 billion assets) fails.


1984  Domain Name System created for Internet.

7/13/84  Kentucky one-bank holding company legislation takes effect.

3/85  Anticipated failure of Home State Savings Bank of Cincinnati, Ohio and possible depletion of Ohio state deposit insurance fund cause Governor Celeste to close Ohio S&L's.

1985  K.M.C. v. Irving Trust Co., 757 F.2d 752 (6th Cir. 1985) (bank held liable for $7.5 million value of failed business which jury found failed because bank did not act in good faith in terminating line of credit to wholesale grocery business).

1985  U.S. v. Mirabile, 19 Envir. Law Rpt. ¶20992 (E.D. Pa. 1985). EPA sues bank lenders claiming they are liable for the borrower's contaminated real property. Mellon Bank's defense was preliminarily rejected because its loan officers had served on an advisory board which supervised various company activities, including the manner in which it dealt with hazardous materials.


11/25/85  Microsoft releases Windows 1.0 graphic user interface.

6/30/86  PNC Financial Corp executes agreement to acquire Citizens Fidelity Corporation.

2/27/86  Supreme Court affirms dismissal of Duff lawsuit and holds that banks may elect between KRS 287.215 and KRS 360.010 in structuring loan and interest rate terms.  Duff v. Bank of Louisville & Trust Co., Ky., 705 S.W.2d 920 (1986).

7/15/86  KRS 371.065 takes effect and imposes new requirements for a valid and enforceable guaranty of indebtedness.

10/27/86  President Reagan signs the Family Farmer Reorganization Act of 1986 which creates a special Chapter 12 of the Bankruptcy Code for "family farmers."
-bank regulatory agencies directed to prescribe regulations to require institutions maintain procedures designed to assure and monitor compliance with Bank Secrecy Act

Exemption in the Fair Debt Collection Practices Act for lawyers eliminated.

Second Circuit rules that an ATM owned by a supermarket and leased to a bank on a non-exclusive basis was not a "branch" of the bank because it was not "established" by the bank. Independent Bankers Association of New York State, Inc. v. Marine Midland Bank, N.A., 757 F.2d 453 (2nd Cir. 1986).

First meeting of the Kentucky EFT Task Force held to address possible legislation regulating the permissible locations of "electronic terminals."

Edwin Gray, chairman of Federal Home Loan Bank Board, is summoned to the office of Sen. Dennis DeConcini. DeConcini, with four other Senators (John McCain, Alan Cranston, John Glenn, and Donald Riegle) question Gray about the appropriateness of Bank Board investigations into Charles Keating’s Lincoln Savings and Loan. All five senators, who have received campaign contributions from Keating, would become known as the "Keating Five". The subsequent Lincoln failure is estimated to have cost taxpayers over $2 billion.

Kentucky begins system of perfecting liens on motor vehicles by notation on the title certificate.

-Nonbank bank loophole closed.
-Moratorium imposed on certain securities, insurance and real estate activities.
-Authorized $10.8 billion recapitalization of FSLIC.
-Expeditied Funds Availability Act was Title VII of Act.
-Required adjustable rate residential mortgages to have a rate ceiling.

Record number of FDIC insured institutions fail - 280. Insured losses, net of recoveries, are a record $6.9 billion.

National City Bank acquires First National Bank of Louisville.


Second Circuit decides in Independent Insurance Agents of America, Inc. v. Board of Governors, 890 F.2d 1275 (2nd Cir. 1989) ("Merchants II"), that Bank Holding Company act does not give Federal Reserve Board authority to regulate bank subsidiaries of a holding company.
8/89 Financial Institutions Reform, Recovery and Enforcement Act "FIRREA") enacted.
--abolishes the Federal Home Loan Bank Board and FSLIC, switches S&L regulation to newly created Office of Thrift Supervision.
--The Resolution Trust Corporation is created to resolve the insolvent S&Ls.

1990 "The World" comes on-line becoming the first commercial provider of Internet dial-up access.

4/24/90 National Bank and Trust Company of Paris, Kentucky files application to relocate its main office from Paris, Bourbon County to Lexington, Fayette County pursuant to 12 U.S.C. §30(b) while retaining a branch in Paris, Kentucky.

7/13/90 Home office branching protection eliminated in Kentucky.

7/26/90 Americans With Disabilities Act signed into law, impacting hiring decisions and the design of branches and ATMs.

8/2/90 Iraq invades Kuwait. Bankers begin dusting off old copies of the Soldiers’ and Sailors’ Civil Relief Act of 1940.

11/90 Treasury Regulations take effect prohibiting financial institutions from issuing or selling cashier’s checks, traveler’s checks, money orders and bank checks in amounts of $3,000 or more unless financial institution verifies and records the identity of the purchaser.

1991 FDIC Insurance Fund annual disbursements on account of bank failures peaks at $21.4 billion dollars. 127 banks fail. Balance of FDIC insurance fund, excluding loss reserves, was negative $7 billion.

1991 Second Circuit extends reasoning of Merchants II by holding the Federal Reserve Board does not have authority to regulate subsidiaries of a bank even if bank is part of a holding company. Citicorp v. Board of Governors, 936 F.2d 66 (2nd Cir. 1991)

3/91 Soldiers’ and Sailors’ Civil Relief Act Amendments of 1991 enacted.

12/19/91 Federal Deposit Insurance Corporation Improvement Act of 1991 enacted.
--Risk-based FDIC premium system
--Prompt corrective action.
--Recapitalization of BIF
--Truth In Savings Act.

Kentucky Supreme Court stresses rigorous standard for granting summary judgment and holds that in certain cases a fiduciary relationship may exist between a bank and its customer in transactions other than traditional trust contexts.

8/4/92 Federal District Court holds that federal "small town" bank insurance statute preempts Kentucky anti-bank agent statute and directs Department of Insurance to issues licenses to qualifying national banks.

8/25/92 Kentucky DFI issues first parity letter (92-1) authorizing state banks to calculate lending limits as if it were a national bank.

12/17/92 Kentucky Supreme Court affirms $1.065 million compensatory and $5.775 million jury verdict against American National Bank in Hanson case.

8/24/93 Department of Financial Institutions issues Parity Letter 92-3 authorizing state banks to relocate main offices across county lines while simultaneously retaining branches in the county of the main office prior to relocation.

9/22/93 Kentucky Bankers Association files suit in Franklin Circuit Court challenging Parity Letter 92-3.


7/15/94 Limited liability companies are permissible under Kentucky law.

7/15/94 Kentucky health insurance laws are substantially "reformed" at the urging of Governor Brereton Jones beginning of process of uncertainty in the health insurance market that still continues.

1994 8.4 billion ATM transactions in United States.


8/16/94 America On Line reaches 1,000,000 subscribers.

9/23/94 President Clinton signs Reigle Community Development and Regulatory Improvement Act of 1994 enacted in response to banking industry's "Cut The Red Tape" campaign.

5/18/95 Truth In Lending Class Action Relief Act of 1995 enacted in response to Eleventh Circuit’s ruling in *Rodash v. AIB Mortgage Co.*, that failure to include a $22 federal express delivery charge and a state intangible tax in the finance charge constituted a TILA violation.

5/95 BIF reaches full capitalization of 1.25% of insured deposits eleven years ahead of the deadline established in FDICIA.

7/13/95 Kentucky Bankers Association dismisses its lawsuit challenging the DFI’s main office relocation parity letter effectively opening Kentucky to cross-county branching via main office relocations.

8/24/95 Microsoft releases Windows 95.

9/13/95 Truth In Lending Act Amendments of 1995 enacted in further response to *Rodash* decision.

10/95 First Security Network Bank opens internet banking site.

3/25/96 Kentucky bank share tax replaced with bank franchise tax in light of valuation disputes with Kentucky Revenue Cabinet and implications of interstate branching.

1996 Deposit Insurance Funds Act of 1996
   -Special SAIF assessment of $4.5 billion
   -BIF members subject to FICO assessment to repay S&L costs.

1996 1990 revisions to Articles 3 and 4 and 1994 revision to Article 8 of the Uniform Commercial Code adopted in Kentucky.

10/1/86 National Flood Insurance Reform Act of 1994 requires the escrowing of flood insurance premiums beginning on this date.

1997 BIF assessments total $25 million compared to $5.6 billion in 1994.

9/23/97 Kentucky Bankers Association and two banks sue the Kentucky State Treasurer challenging examination and audit procedures being used to enforce Kentucky’s escheat laws. *Kentucky Bankers Association v. John Kennedy Hamilton*.

2/25/98 Supreme Court rules in favor of banking industry’s challenge to liberal interpretation by NCUA of credit union "common bond" requirement. *National Credit Union Administration v. First National Bank*.

3/5/98 Kentucky State Treasurer begins airing radio advertisements challenging bank efforts in the 1998 General Assembly to amend Kentucky’s escheat laws. Lawsuit challenging the advertisements filed the next day in Franklin Circuit
Court. Ultimately, the banking industry successfully obtains revisions to escheat laws, and the advertisements are declared illegal.

4/7/98 Citicorp and Travellers announce $82 billion merger.

8/7/98 Credit Union Members Access Act enacted to overrule Supreme Court’s decision six month’s earlier restricting credit union membership.

2/99 USAaccess, an internet bank headquartered in Louisville, Kentucky, opens for business. AOL and First USA (credit cards) announce joint marketing effort reportedly valued at up to $500 million.

11/12/99 Gramm-Leach-Bliley Act signed by President Clinton.

1/1/00 Y2K arrives without serious disruption.
REGULATORY CONCERNS WITH LENDING TO DIRECTORS, EXECUTIVE OFFICERS, PRINCIPAL SHAREHOLDERS AND AFFILIATES

David L. Kinsella
Frost & Jacobs, LLP
Lexington, Kentucky
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I. INTRODUCTION

It is no surprise to anyone that banks and savings and loans have been among the most highly regulated institutions in the United States for a very long time. In fact, even for most people involved in the industry, the various regulatory lines of authority are often confused.

One of the particular concerns of many of the regulatory agencies that have exerted authority over banks and savings and loans has been the making of extensions of credit to insiders (i.e., directors, executive officers and principle shareholders), to any related interest of an insider, and affiliates. Certainly, some of the concerns of these regulatory agencies have been based on real problems regarding insider and affiliate transactions at such institutions. A General Accounting Office study found that insider problems have been "prevalent at failed banks," particularly smaller institutions with assets of less than $100 million. The most common violations were insider loans that exceeded lending limits and where on "preferential terms not available to the general public."

Disregarding regulatory concerns, officers and directors who engage in insider transactions may be subject to a number of laws that have the potential for liability. General principles of law prohibiting fraudulent conduct and defining fiduciary responsibilities of officers may apply if the transaction involves conflicts of interest, appropriation of an asset or benefit that belongs to the institution, misrepresentation, etc.

The topics discussed herein relate to the specific statutes and regulations in the federal banking laws that regulate a bank's ability to extend credit to bank insiders and affiliates.

II. EXTENSIONS OF CREDIT TO DIRECTORS, EXECUTIVE OFFICERS AND PRINCIPAL SHAREHOLDERS

The Federal Reserve Act restricts banks that are members of the Federal Reserve System from extending credit to designated insiders, such as directors, officers, and principal shareholders. Section 22(g) of the Federal Reserve Act limits the amounts and types of credit
that a member bank may extend to its executive officers. Section 22(h) of the Federal Reserve Act imposes limitations on the extension of credit to a broader group of insiders: executive officers, principal shareholders, and directors of banks and political or campaign committees. As indicated in the Introduction, Sections 22(g) and 22(h) of the Federal Reserve Act have been extended to non-member insured banks and savings associations.

The Federal Reserve Board is specifically given authority to implement the provisions of Sections 22(g) and 22(h) of the Federal Reserve Act relating to member banks. In two situations, narrow areas of authority had been delegated from the Federal Reserve Board to specific federal banking agencies. Specifically, the threshold amount that determines when it is necessary to have the advance approval of the member banks’ board of directors for loans to insiders and the general limitations on loans to an executive officer are set by the appropriate federal banking agency.

A. Definition of Extension of Credit

The insider transaction restrictions in Sections 22(g) and 22(h) of the Federal Reserve Act apply to extensions of credit to the covered insiders. The Federal Reserve Board’s Regulation O defines what constitutes an extension of credit for the purpose of these limitations as “a making or renewal of any loan, a granting of a line of credit, or an extension of credit in savings associations, respectively. 12 U.S.C. § 1828 (j)(1)-(2) (Federal Deposit Insurance Act); 12 U.S.C. § 1468 (a)-(b) (Home Owners’ Loan Act).


Quick reference guides to each of Regulation O, 12 C.F.R. § Part 215 (issued by the Fed) and 12 C.F.R. Part 31 (where the OCC adopts by reference the Fed’s Regulation O) are attached hereto as Exhibit 5 and 6, respectively.

any manner whatsoever." An extension of credit specifically includes repurchase transactions, advances through an overdraft or cash item, issuance of a standby letter of credit, certain increases in existing indebtedness, and acquiring a debt instrument (note, draft, bill of exchange, etc.) for which an insider is liable by purchase, discount, or otherwise. There are, however, certain exceptions; for example, checks being collected in the "usual course of business," collateral acquired through foreclosure, nonrecourse discounts of promissory notes or similar paper, qualifying credit card arrangements up to $15,000.00, and advances against "accrued compensation" are not treated as an extension of credit.

B. Definition of Insider

Extensions of credit by a member bank to executive officers, directors, principal shareholders, and any related interest of such a person of: (i) a member bank; (ii) a bank holding company of which the member bank is a subsidiary, and (iii) any other subsidiary of such a bank holding company. The definition of a "related interest of a person" covers any company controlled by the person, as well as any political or campaign committee controlled by the person or the funds or services of which will benefit the person. An individual may be subject to the restrictions as director although the individual does not receive compensation.

1. Executive Officer

An executive officer is a person who "participates or has authority to participate (other than as a director) in major policy making functions of the company or bank." It is not necessary the "executive officer" have a title or receive compensation, and it does not matter that the person’s title designates the position as an assistant. Under the Federal Reserve Board’s regulations, each of the following are considered executive officers unless a resolution of the board of directors or the bylaws of the bank or company exclude the person from participation in major policy making and the person in fact does not participate in major policy making: (i) chairman of the board; (ii) president; (iii) vice-president; (iv) cashier; (v) secretary; and (vi) treasurer.

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15 Id.
16 12 C.F.R. § 215.3(b) (1999).
2. **Principal Shareholder**

A principal shareholder is someone who "directly or indirectly, or acting through or in concert with one or more persons," owns, controls or has power over more than 10% of any class of voting securities of the bank or company. Shares held by the members of an individual’s immediate family are attributed to the individual.

3. **Parent Bank Holding Companies and Affiliated Companies**

Executive officers, directors and principal shareholders of parent companies to member banks and "affiliate companies" to member banks are deemed to be executive officers, directors and principal shareholders (as applicable) of the member bank for purposes of application of the insider restrictions. Consequently, officers of bank holding companies or of any affiliate of the parent bank holding company are subject to the limitations on credit to insiders. However, the Federal Reserve Board can make exceptions for an executive officer or director of an affiliate company of a member bank when two conditions exist: “(i) the executive officer or director does not have authority to participate, and does not participate, in major policy making functions of the member bank; and (ii) the assets of such subsidiary do not exceed 10% of the consolidated assets of [the parent bank holding company].” In addition to affecting parent holding companies and affiliated companies, the restrictions on extending credit to insiders apply to any of the member bank’s own subsidiaries.

C. **General Credit Restrictions to Insiders**

1. **General Restrictions**

The general prohibition on a member bank’s extension of credit to a bank insider is obviated if: (i) the credit is made on “substantially the same terms” (including interest rates and collateral requirements), as those prevailing at the time for comparable transactions by the bank with persons who are not insiders; (ii) the credit does not involve “more than the normal risk of repayment or present other unfavorable features”; and (iii) the bank follows credit underwriting procedures no less stringent than those applicable to comparable transactions by the bank with non-insiders. These requirements effectively prohibit a bank from lending on preferential

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28 12 U.S.C. § 375b(2)(A) (1999). However, there is no prohibition against an extension of credit made pursuant to a benefit or compensation program: “(i) that is widely available to employees of the member bank; and (ii) that does not give preference to any officer, director, or principal shareholder of the member bank, or to any related interest of such person, over employees of the member bank.” 12 U.S.C. § 275b(2)(B) (1999).
terms to an insider. Even when the terms of a credit satisfy these conditions, there are additional restrictions on the amounts and types of credit a bank may provide.

There are restrictions that limit the amount of credit a bank may give any single insider, and there are limitations on the total amount of credit that a bank may extend to all of its insiders and their related interests. Specifically, there are both bank board of director prior approval requirements and a maximum amount of total credit that the bank can give to: (i) any single insider and (ii) all insiders in total. The prior approval conditions apply when the loan exceeds a threshold amount set by the relevant federal banking agency.29

2. Rules for Extending Credit to Individual Insiders

a. Prior Approval Requirements

The Federal Reserve Board established a bank board of directors prior approval threshold requirement of $25,000 or 5 percent of the member bank’s unimpaired capital and surplus, whichever is greater. When the total credit extended to the insider or the related interests of that person exceeds the threshold, the prior approval of the bank’s board of directors is necessary. However, prior approval must be obtained in any event whenever the aggregate amount of credit extended to the particular insider and that person’s related interests exceeds $500,000.30

b. Maximum Amount of Total Credit to an Individual Insider

In addition to the prior approval requirements, there is a cap on the maximum amount of total credit that the bank can give to any insider. The limit is an amount that “when aggregated with the amount of all outstanding extensions of the credit by the bank to that person and that person’s related interest” would not exceed the limits on loans to a single borrower established by the banking laws.31


31 12 U.S.C. § 275b(4) (1999). For these purposes, the single borrower lending limits apply to a state-chartered member bank as if it were a national bank. Id.
3. Total Amount of Credit to All Insiders Collectively

Finally, there is an overall limit on the amount of credit a bank may extend to all of its insiders and their related interests combined. The total amount of credit extended by the bank to all insiders can not exceed the bank’s “unimpaired capital surplus”.32 The Federal Reserve Board is authorized by statute to describe a more stringent limit by regulation.33 However, the Federal Reserve Board may make exceptions for member banks with less than $100 million in deposits if it determines that the exceptions are important to avoid constricting the availability of credit in small communities or to attract directors to such banks.34

Certain banks may raise their aggregate lending limit to two times their unimpaired capital and surplus by annually adopting a resolution specifying the higher limit.35 To qualify for such an allowance, the bank’s board of directors must determine that the higher limit is prudent “in the light of the bank’s experience” with insider loans, the purposes for increasing the limit are present, and the “facts and reasoning” on which the finding is based are explicitly set forth.36 Additionally, the bank must have met its applicable capital requirements and have received a satisfactory composite rating in its most recent report of examination.37 The aggregate limit on insider credit does not apply in the case of credit that is fully secured by United States government securities or certain specific types of security that are highly liquid and safe.38 There is also an exception to the aggregate limit for the discounts of installment consumer paper from an insider where the bank certificates in writing that it is primarily relying upon the maker of the obligation for repayment, not the insider.39

4. Overdraft Protection for Insiders

As a general rule, a member bank is not permitted to allow overdrafts in deposit accounts of its directors and executive officers.40 There are two exceptions to this prohibition, specifically: (i) the bank may allow overdraft protection in the form of a written pre-authorized

34 12 U.S.C. § 275b(5)(C) (1999). The aggregate amount of all outstanding extensions of credit to a bank’s insiders and related interests can not exceed an amount equal to 200% of the bank’s unimpaired capital and unimpaired surplus. Id.; see also 12 C.F.R. § 215.4(d)(2)(i)-(ii) (allowing exceptions for member banks with deposits of less than $100 million).
36 Id.
37 Id.
interest bearing extension of credit specifying a method of repayment and (ii) the bank may allow sweep arrangements, in the form of a written pre-authorized transfer of funds to another account of the director or executive officer at the bank. 41

D. The Tangible Economic Benefit Rule

The Federal Reserve Board has adopted a rule that attributes a loan to the person who receives the tangible economic benefit of the loan or credit, although the loan was ostensibly made to another. Under this rule, the extension of credit will be “considered made to an insider to the extent that the proceeds are transferred to the insider or are used for the tangible economic benefit of the insider.” 42 However, the Federal Reserve Board has an exception to the tangible economic benefit rule for extensions of credit where the proceeds are used in a “bona fide transaction to acquire property, goods, or services” from an insider, provided the terms of the credit are non-preferential and the credit does not involve more than the normal risk of repayment. 43

E. Special Rules for Loans to Executive Officers

Under Section 22(g) of the Federal Reserve Act, there are additional limitations on the circumstances under which a bank may make loans or otherwise extend credit to its “executive officers.” 44 These restrictions only apply to credit extensions to executive officers of the bank and do not apply to officers of affiliate companies. 45

Such extensions of credit to executive officers can only be made if they meet the following requirements:

1. The loan must be one that the bank would be authorized to make to borrowers other than its officers; 46

2. The credit must be on terms no more favorable than those afforded other borrowers 47 and it must “not involve more than the normal risk of repayment or present other unfavorable features”; 48

3. The officer must supply in advance a “detailed current financial statement”;49 and

4. The loan must be due and payable on demand if the officer becomes indebted to other banks in excess of the limits permitted for loans to the officer.50

There is also a limit on the total amount of loans that may be made to an executive officer. The allowed amount varies depending on the purpose of the loan. Certain specific types of loans are specifically allowed by statute or regulation:

1. Loans “[t]o finance or refinance the purchase, construction, maintenance, or improvement” of the officer’s personal residence secured by a first mortgage lien;51

2. Loans in any amount to finance the education of the officer’s children;52 and

3. Other allowed loans as prescribed in regulations issued by the appropriate federal banking regulator.53

In addition to the specifically approved types of loans enumerated immediately above, the Federal Reserve Board permits a bank to make a loan to an executive officer for other purposes, subject to a ceiling computed on the basis of the bank’s capital and surplus.54

The statute specifically prohibits a bank from extending credit to a partnership in which one or more of the bank’s executive officers individually or together have a majority interest, 12 U.S.C. § 375a(1)(C) (1999); 12 C.F.R. § 215.5(d)(3) (1999).


12 C.F.R. § 215.5(c)(2) (1999); See also 12 U.S.C. § 375a(2) (1999). While such home loans do not require the approval of the bank’s board of directors, such loans remain subject to the individual and aggregate lending limits for loans to executive officers. See H.R. Rep. No. 652, 103d Cong., 2d Sess. 180 (1994).


12 C.F.R. § 215.5(c)(4) (1999). The aggregate amount of credit extended can not exceed at any one time the higher of: (i) 2.5 percent of the bank’s capital and unimpaired surplus or (ii) $25,000 — but in no event more than $100,000.
except to the extent that the credit may be justified under the general limitation authorized by regulation. 54

F. Recordkeeping and Reporting Requirements

1. Recordkeeping

The Federal Reserve Board regulations require member banks to maintain records needed to comply with insider credit rules. The banks must maintain records of credit extended to insiders of member banks and insiders of affiliates. 55 In addition, the recordkeeping requirements necessitate an annual survey by the bank to determine who are insiders of the bank. 56 As to the insiders of the bank’s affiliates, the bank may choose either the annual survey approach, a borrower inquiry method at the time the person obtains an extension of credit, or any other acceptable method as determined by the applicable federal banking agency. 57

2. Reporting

Executive officers have a duty to report when their indebtedness to other banks exceeds the amounts that are permissible under the categories for educational, residential mortgage, and general loans for an executive officer. 58 Every member bank must include in its report of condition information on the extensions of credit made to its executive officers. 59

For institutions whose shares are not publicly traded, there is a requirement that executive officers and directors report annually to the institution’s board of directors or holding company the outstanding amount of any credit extended to the officer or director that is secured by the shares of the institution or holding company. 60

54 12 U.S.C. § 375a(5) (1994); 12 C.F.R. § 215.5(b) (1999). In these cases, “the full amount of any credit so extended [to the partnership] shall be considered to be extended to each officer of the bank who is a member of the partnership.” 12 U.S.C. § 375a(5) (1999).


57 12 C.F.R. § 215.8(c) (1999).


3. Disclosure to Public

On request, a member bank must make available to the public the names of the executive officers and principal shareholders to whom it extended credit (including related interests) that equaled or exceeded 5% of the member bank’s capital and unimpaired surplus or $500,000, whichever is less. Notwithstanding this requirement of disclosure, the public is not entitled to anything more than the names of these individuals. No disclosure is required in any manner if the total amount outstanding for the particular executive officer or principal shareholder and their related interests does not exceed $25,000.

G. Personal Liability for Violation of Insider Rules

Officers and directors of member banks have personal liability for knowingly violating or permitting an agent or officer of a member bank to violate the insider credit rules in Sections 22(g) and 22(h) of the Federal Reserve Act. Additionally, officers and directors of the member bank who participate in or assent to such violations are liable in their personal and individual capacities to the bank, its shareholders, and to other persons for all damages sustained because of the violations.

In addition to liability for damages, there are also civil penalties. The maximum penalty that may be assessed varies in amount according to a system of penalty tiers that is based on the seriousness of the violation. The first tier authorizes a penalty of as much $5,000 per day, while the highest tier authorizes a penalty of up to $1 million per day.

Civil penalties may also be assessed against any member bank or “institution-affiliated” person for violation of any of the previously stated provisions. Similar civil penalties may be imposed on any non-member insured bank or savings association, or institution-affiliated person, for violation of the insider credit limitations as a result of the extension of the insider rules to such depository institutions. Institution-affiliated persons remain liable for six (6) years from

their date of termination, resignation, or other “separation” from the institution. (including separation by closing of the institution).⁶⁹

H. Other Special Rules

Federal law directs member banks not to engage in preferential transactions involving the purchase of securities or other property from their directors, and similar limitations apply when a member bank sells securities or other property to one of its directors or to an entity in which a director is a member.⁷⁰

Federal law also limits the ability of a bank to make loans to executive officers of banks with whom the bank has a correspondent relationship.⁷¹ These restrictions apply to all banks and savings and loan associations. If a bank holds a correspondent account of another bank, neither bank may loan funds or extend credit to executive officers, directors, or other persons with a control interest in their correspondent bank, except as specifically permitted by statute.⁷²

III. TRANSACTIONS WITH AFFILIATES

As with transactions between member banks and insiders, federal banking law extensively regulates transactions between a member bank, its subsidiaries and affiliates.⁷³

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⁷² Id.
⁷³ 12 U.S.C. § 371c (1999). The definition of affiliate in Section 23A of the Federal Reserve Act includes the following companies of a member bank: (i) a company that controls a member bank; (ii) a company that is controlled by a company that controls the member bank; (iii) a bank subsidiary of the member bank; (iv) any company this is controlled “directly or indirectly by a trust or otherwise, by or for the benefit of shareholders who beneficially or otherwise control” the member bank or company that controls the member bank; (v) any company in which a majority of its directors constitute a majority of the persons who are directors of the member bank or a company that controls the member bank; (vi) a company, including a real estate investment trust, “that is sponsored and advised on a contractual basis” by the member bank or a subsidiary or affiliate of the member bank; (vii) a company for which the member bank or an affiliate is an investment advisor; and (viii) any company that the Federal Reserve Board determines “to have a relationship with the member bank or any subsidiary or affiliate of the member bank such that covered transactions by the member bank or its subsidiary with that company may be affected by the relationship to the detriment of the member bank or its subsidiary.” 12 U.S.C. § 371c(b)(1)(A)-(E) (1999).

Certain types of companies are excluded from the definition of affiliate for purposes of Section 23A of the Federal Reserve Act: (i) a subsidiary of a member bank that is itself not a bank (subject to the authority of the Federal Reserve Board to make a determination that the particular relationship should be regulated as an affiliate relationship); (ii) a company engaged solely in holding the bank’s premises; (iii) a company engaged solely in the safe deposit business; (iv) a company engaged solely in holding specified types of United States government and agency securities; and (v) a company that was acquired by the bank as a result of an exercise of contract rights under a debt (but this exclusion only lasts for a limited time). 12 U.S.C. § 371c(b)(2)(A)-(E) (1999).
Sections 23A\textsuperscript{74} and 23B\textsuperscript{75} of the Federal Reserve Act establishes these restrictions and applies them to member banks. These prohibitions are also applied to nonmember insured banks and savings associations.\textsuperscript{76}

A. Transactions Regulated by Section 23A of the Federal Reserve Act

Section 23A of the Federal Reserve Act reflects two basic concerns: (i) that the bank might be used to extend credit improvidently to an affiliate or purchase poor quality assets of an affiliate and (ii) that the bank might become overly dependent upon or tied to the financial fate of its sister companies.

Section 23A addresses these concerns in several ways:

1. A member bank and its subsidiaries may not have "covered transactions" with any one affiliate that exceed 10 percent of the capital stock and surplus of the member bank;\textsuperscript{77}

2. The total amount of covered transactions that a member bank, in combination with all of its subsidiaries, may have with all of its affiliates can not exceed 20 percent of the capital stock and surplus of the member bank;\textsuperscript{78}

3. Unless special conditions are met, a member bank and its subsidiaries may not purchase "low-quality" assets from an affiliate;\textsuperscript{79}

4. Extensions of credit by a member bank or its subsidiary to an affiliate and guarantees or letters of credit issued on behalf of an affiliate by a member bank or its subsidiaries, must be secured by collateral having a market value of at least 100 percent of the amount of the credit, depending on the nature of the collateral;\textsuperscript{80} and

\textsuperscript{74} 12 U.S.C. § 371c (1999) (regulates "covered transactions" between a member bank and its subsidiaries and an affiliate and also regulates transactions involving assets that are defined as "low-quality assets").

\textsuperscript{75} 12 U.S.C. § 371c-1 (1999) (regulates transactions that a member bank and its subsidiaries have with non-bank affiliates).

\textsuperscript{76} 12 U.S.C. §§ 1467a(d), 1468(a)(1) (1999).


\textsuperscript{80} 12 U.S.C. § 371c(c)(1) (1999). United States government or agency securities, obligations fully guaranteed by the United States, commercial paper eligible for rediscount by a federal reserve bank and segregated deposit accounts at the member bank are types of collateral that can be used to satisfy the 100 percent collateral
5. If the member bank engages in a covered transaction with an affiliate, the transaction must be on "terms and conditions that are consistent with safe and sound banking practices".  

1. Types of Covered Transactions

There are five types of "covered transactions": (i) loans or extensions of credit to the affiliate; (ii) purchases or investments in securities issued by the affiliate; (iii) purchases of assets from the affiliate (except certain property exempted by the Federal Reserve Board); (iv) acceptance, as collateral for a loan from any person, of securities issued by an affiliate; and (v) issuance of guarantees, acceptances or letters of credit "including an endorsement or standby letter of credit," on behalf of an affiliate.  

2. Transactions Exempt From Coverage Under Section 23A

Certain types of transactions are specifically exempted from coverage under Section 23A – the majority of which are exempted so as to not restrict transactions between banks that are part of the same holding company system. Specific exemptions include:

1. Transactions between a member bank and another bank where there is a control relationship involving at least 80 percent of the voting shares;
2. Deposits in an affiliated bank in the "ordinary course" of business in a correspondent relationship;
3. Credit given for "uncollected items received in the ordinary course of business";
4. A loan or extension of credit that is fully secured by United States government securities or by a separate "earmarked deposit account" at the member bank;
5. Purchase of stock in companies engaged in certain kinds of operational activities for the bank;
6. Purchase of assets with a "readily identifiable and publicly available market quotation" at the public price;
7. Purchase of loans on a non-recourse basis from an affiliate bank, subject to the prohibition against the purchase of a low-quality asset; and

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8. A repurchase from an affiliate of a loan that the member bank sold to the affiliate subject to a repurchase agreement or without recourse.\textsuperscript{83}

3. Prohibitions on Purchases of Low-Quality Assets

To avoid the purchase of poor quality assets of an affiliate, Section 23A prohibits such acquisitions by a member bank or its subsidiaries where such asset falls into any of the following categories: (i) an asset which is substandard, doubtful, or loss or treated as other loans mentioned in the latest federal or state report of examination; (ii) an asset in a “non-accrual status”; (iii) an asset for which principal or interest payments are “more than thirty days past due”; or (iv) an asset for which the terms have been negotiated or compromised because of the “deteriorating financial condition of the obligor.”\textsuperscript{84}

B. Restrictions on Transactions With an Affiliate Under Section 23B of the Federal Reserve Act

As previously stated, the restrictions on transactions with affiliates in Section 23B deals with transactions between a member bank and its subsidiaries and its non-bank affiliates (as opposed to Section 23A, which deals with “affiliates” as defined in footnote 73, supra). The definition of an “affiliate” for the purposes of Section 23B is narrower than as applied for the purposes of Section 23A. Specifically, a bank is not an affiliate for purposes of Section 23B.\textsuperscript{85}

Under Section 23B of the Federal Reserve Act, there is a general requirement that transactions between a member bank and its subsidiaries and their affiliates not be on preferential terms. Specifically, transactions must be: (i) on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to such bank or its subsidiary, as those prevailing at the time for comparable transactions with or involving other non-affiliated companies or (ii) in the absence of comparable transactions, on terms and under circumstances, including credit standards that in good faith would be offered to, or would apply to, non-affiliated companies.\textsuperscript{86}

In contrast to Section 23A of the Federal Reserve Act, Section 23B applies to a broader range of transactions, specifically:

1. Any covered transaction with an affiliate;

2. The sale of “securities or other assets to an affiliate,” including sales subject to repurchase agreements;


3. The payment of money or the furnishing of services to an affiliate under a contract or otherwise;

4. A transaction in which the affiliate is "an agent or broker" or receives a fee for services to the bank or another person; and

5. Transactions with third persons in which the affiliate has an "financial interest in the third party" or participates in the transaction. 87

Section 23B prohibits member banks and their subsidiaries from purchasing any security from an affiliate in two specific circumstances: (i) a bank or its subsidiary acting as a trustee or other fiduciary can not purchase an affiliate’s security unless the purchase is permitted under the “instrument creating the fiduciary relationship”, by a court order, or by the law of the jurisdiction that controls the fiduciary relationship and (ii) member banks and their subsidiaries can not knowingly purchase any security “during the existence of any underwriting or selling syndicate. . if a principal underwriter of that security is an affiliate of such bank.” 88

IV. CONCLUSION

The Federal Reserve Act’s provisions prohibiting and regulating certain transactions with insiders and affiliates, including provisions concerning extensions of credit to executive officers, directors, and principal shareholders and affiliates (and the various regulations issued pursuant to such statutes), are of primary importance. Entities and individuals involved with banks and other lending institutions bound by and regulated by such statutes and regulations must pay close and stringent attention to these provisions to avoid stepping into the regulatory quagmire.

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# Regulatory Lines of Authority

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OCC – Office of the Comptroller of the Currency  
Fed – Federal Reserve Board  
FDIC – Federal Deposit Insurance Corporation  
NCUA – National Credit Union Association  
OTS – Office of Thrift Supervision  
State Regulator – Various state agencies

a. As to transactions by the institution involving investment securities. 12 U.S.C. §§ 24 (Seventh), 378.
b. As to deposit reserves only. 12 U.S.C. § 461(b)(1)(A).
c. As to activities of national bank subsidiaries. See American Ins. Ass'n v. Clarke, 865 F.2d 278 (D.C. Cir. 1988) (discussing role of OCC).

Chart adapted from Michael P. Malloy, Bank Regulation, § 1.9 (1999).
Part 31—Extensions of Credit to Insiders and Transactions with Affiliates

Part 31 of Title 12, Code of Federal Regulations, was revised November 20, 1996 in 61 Federal Register 54533. See § 90-414.

Authority: 12 U.S.C. 93a, 375a(4), 375b(3), 1817(k), and 1972(2)(G), as amended.

§ 11-601

§ 31.1 Authority.

This part is issued by the Comptroller of the Currency pursuant to 12 U.S.C. 93a, 375a(4), 375b(3), 1817(k), and 1972(2)(G), as amended.

§ 11-602

§ 31.2 Insider lending restrictions and reporting requirements.

(a) General rule. A national bank and its insiders shall comply with the provisions contained in 12 CFR part 215.

(b) Enforcement. The Comptroller of the Currency administers and enforces insider lending standards and reporting requirements as they apply to national banks and their insiders.

§ 11-619

APPENDIX A TO PART 31—INTERPRETATIONS

Section 1. Loans Secured by Stock or Obligations of an Affiliate

A bank that makes a loan to an unaffiliated third party may take a security interest in securities of an affiliate as collateral for the loan without the loan being deemed a "covered transaction" under section 23A of the Federal Reserve Act (12 U.S.C. 317(c)).

The borrower provides additional collateral that, taken alone, meets or exceeds the collateral requirements specified in section 23A(c) (12 U.S.C. 317(c)); and

1. Are not used to purchase the bank affiliate's securities that serve as collateral; and

2. Are not otherwise used for the benefit of, or transferred to, any affiliate.

Section 2. Deposits Between Affiliated Banks

a. General rule. The OCC considers a deposit made by a bank in an affiliated bank to be a loan or an extension of credit to the affiliate under 12 U.S.C. 371c. These deposits must be secured in accordance with 12 U.S.C. 371c(c).

b. Exceptions. The restrictions of 12 U.S.C. 371c (other than 12 U.S.C. 371c(a)(4), which requires affiliate transactions to be consistent with safe and sound banking practices) do not apply to deposits:

1. Made in the ordinary course of correspondent business;

2. Made in an affiliate that qualifies as a “saver bank” under 12 U.S.C. 371c(6).}

APPENDIX B TO PART 31—COMPARISON OF STANDARDS OF PART 31 AND PART 32 (AS OF OCTOBER 1, 1996)

Note: Even though part 31 now simply requires that national banks comply with the insider lending provisions contained in Regulation O (Reg. O) (12 CFR part 215), the chart in this appendix refers to part 31 because Reg. O is a Federal Reserve Board regulation and part 31 is the means by which several provisions of Reg. O are made applicable to national banks and their insiders.

§ 11-620

APPENDIX B

Funds advanced for taxes, etc., necessary to close an indebtedness or that are incidental to indebtedness.

Loan participations.

Exclusions to Definition

Both rules exclude funds advanced for items such as taxes, insurance, or other expenses related to existing indebtedness. However, Part 32 includes these advances for the purpose of determining whether subsequent loans meet the lending limit, whereas Part 31 excludes these advances for all purposes. In addition, Part 32 requires that the funds, which are advanced "for the benefit of" a borrower, be advanced by the bank directly to the third party to whom the borrower is indebted. Part 31 contains no such requirement.

Both rules exclude loan participations if the participation is without recourse. However, Part 32 elaborates on this exclusion by requiring that the participation result in a pro rata sharing of credit risk proportionate to the respective interests of the originating and participating lenders. Part 32 also requires the originating bank, if funding the entire loan, to receive funding from the participants before the close of the next business day. Otherwise, the portion funded will be treated as a loan by the originating bank to the underlying borrower, and may be treated as a "nonconforming" loan rather than a violation if (i) the originating bank had an agreement with the participating bank that reduced the loan to an amount within the originating bank’s lending limit, (ii) the participating bank refinanced its participation and the originating bank had no knowledge of information that would permit the participating bank to withdraw its participation, and (iii) the participation was to be funded by close of business of the originating bank’s next business day.
Acquisition of debt through merger or foreclosure. Under Part 31, a note or other evidence of indebtedness acquired through a merger is excluded from the definition of "extension of credit." Under Part 32, the indebtedness is deemed to be a loan or extension of credit. However, if a loan that conformed with Part 32 when originally made exceeds the lending limits following a merger after the loan is aggregated with other extensions of credit to the same borrower, the loan will not be deemed to be a lending limits violation. Rather, the loan will be treated as "nonconforming," and the bank will have to exercise reasonable efforts to bring the loan into compliance unless to do so would be inconsistent with safe and sound banking practices.

Credit card indebtedness. An insider may incur up to $15,000 in debt on a credit card or similar open-ended credit plan offered by the insider's bank without the debt counting as an extension of credit under Part 31. The terms of the credit card or other credit plan must be no more favorable than those offered by the bank to the general public. Part 32 does not exclude credit card debt from the lending limits.

Combination/Attribution Rules

General rule. Under Part 31, a loan will be attributable to an insider if the loan proceeds are "transferred to," or used for the "tangible economic benefit of," the insider or if the loan is made to a "related interest" of the insider. Under Part 32, a loan will be attributable to another person when either (i) the proceeds of the loan are to be used for the direct benefit of the other person or (ii) a common enterprise exists between the borrower and the other person. The "transfer" test and "tangible economic benefit" test of Part 31 are substantially the same as the "direct benefit" test of Part 32. Under each of these tests, a loan will be attributable to another person where the proceeds are transferred to the other person, unless the proceeds are used in a bona fide arm's-length transaction to acquire property, goods, or services. However, the "related interest" test of Part 31 and the "common enterprise" test under Part 32 will lead to different results in many instances. Under Part 31, a "related interest" is a company or a political or campaign committee that is "controlled" by an insider. Part 31 defines "control" as meaning, generally speaking, that someone owns or controls at least 25 percent of a class of voting securities of a company, controls the election of a majority of the company's directors, or can "exercise a controlling influence" over the company. Part 32 uses the same definition of "control" in the "common enterprise" test, but a more "finding of control" is not, by itself, a sufficient basis to find that a common enterprise exists. Part 32 will attribute a loan under the "common enterprise" test if the borrowers are under common control (including where one of the persons in question controls the other) and there is a "substantial financial interdependence" between the borrowers (i.e., where at least 30 percent of the gross receipts or expenditures of one borrower comes from transactions with the other). If there is not both common control and substantial financial interdependence, the OCC will not attribute a loan under the "common enterprise" test unless (i) the expected source of repayment for a loan is the same for each borrower and neither borrower has another source of income from which the loan may be repaid, (ii) two people borrow to acquire a business of which they will own a majority of the voting securities, or (iii) OCC determines that a common enterprise exists based on facts and circumstances of a particular transaction.

Loans to corporate groups. Both Parts 31 and 32 will consider a loan that was made to a corporation to have been made to a third person if the tests identified in the previous discussion of the "General Rule" are satisfied. If these tests are not met, Parts 31 and 32 will still may require attribution, but the circumstances when this will occur and the consequences of attribution under these circumstances differ under the two rules. Under Part 31, a loan to a corporation will be deemed to have been made to an insider if the corporation is a "related interest" of the insider (i.e., the insider owns at least 25 percent of a class of voting shares of the company, controls the election of a majority of the company's directors, or has the power to exercise a controlling influence over the company). Under Part 32, a loan to an individual or company will not be considered to have been made to a corporate group unless a "person" (which includes individuals and companies) owns more than 50% of the voting shares of a company. If a loan is found to have been made to a related interest of an insider under Part 31, the loan must comply with all of the insider lending restrictions of Part 31. If a loan is found to have been made to a corporate group under Part 32, the loan, when aggregated with all other loans to that corporate group, generally may not exceed 50% of the bank's capital and surplus.

Part 31 applies different rules to implement different restrictions applicable to partnerships. For purposes of the limits on loans to executive officers, a loan made to a partnership in which an executive officer of the lending bank holds a majority interest is deemed to have been made to the executive officer. For all other purposes under Part 31, a loan to a partnership will be attributed to an executive officer or other insider only if the partnership is a "related interest" of the insider or if the loan is transferred to, or used for the tangible economic benefit of, the insider. Part 32 does not make any similar distinction based on the restriction in question. Under Part 32, a loan made to a partnership, joint venture, or association will be attributed to all members of such an entity—regardless of the percentage of ownership—unless a person's liability is limited by a valid agreement. Conversely, loans to members of a partnership, joint venture, or association will not be attributed to the entity under Part 32 unless either the "common enterprise" or "direct benefit" test is met.
Part 215—Loans to Executive Officers, Directors, and Principal Shareholders of Member Banks (Regulation Q)

§ 215.1 Authority, purpose, and scope.

(a) Authority. This subpart is issued pursuant to sections 110, 22(g) and 22(h) of the Federal Reserve Act (12 U.S.C. 246(c), 375a, 375g, 12 U.S.C. 1817(k)(3), and section 306 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (Pub. L. No. 102-242, 105 Stat. 2236 (1991)).

(b) Purpose and scope. This subpart governs any extension of credit by a member bank to an executive officer, director, or principal shareholder of (1) the member bank; (2) a bank holding company of which the member bank is a subsidiary; and (3) any other subsidiary of that bank holding company. It also applies to any extension of credit by a member bank to (1) a company controlled directly or indirectly, or acting through or in concert with one or more persons: (i) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of the company or bank; or (ii) Controls in any manner the election of a majority of the directors of the company or bank; or (iii) Has the power to exercise a controlling influence over the management or policies of a company or bank.

(2) A person is presumed to have control, including the power to exercise a controlling influence over the management or policies, of a company or bank if:

(i) The person is:

(A) An executive officer or director of the company or bank; or

(B) Directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the company or bank; or

(ii) The person directly or indirectly owns, controls, or has the power to vote more than 10 percent of any class of voting securities of the company or bank; and

(iii) No other person owns, controls, or has the power to vote a greater percentage of that class of voting securities.

(3) An individual is not considered to have control, including the power to exercise a controlling influence over the management or policies, of a company or bank solely by virtue of the individual's position as an officer or director of the company or bank.

(4) A person may rebut a presumption established by paragraph (c)(2) of this section by submitting to the appropriate Federal banking agency (as defined in 12 U.S.C. 1813(a)) written materials that, in the agency's judgment, demonstrate an absence of control.

§ 215.2 Definitions.

For the purposes of this subpart A, the following definitions apply unless otherwise specified:

(A) Affiliate means any company of which a member bank is a subsidiary or any other subsidiary of that company.

(B) Company means any corporation, partnership, trust (business or otherwise), association, joint venture, pool, syndicate, sole proprietorship, unincorporated organization, or any other form of business entity not specifically listed herein. However, the term does not include:

(1) An insured depository institution (as defined in 12 U.S.C. 1813); or

(2) A corporation the majority of the shares of which are owned by the United States or by any State.

(C) Control of a company or bank means:

(1) A majority of the board of directors of the company or bank;

(2) The director of the company or bank is considered a director if the advisory director:

(i) Is not elected by the shareholders of the company or bank; and

(ii) Is not authorized to vote on matters before the board of directors; and

(iii) Provides solely general policy advice to the board or directors.

(D) Extension of credit to a director of an affiliate of a bank means:

(1) Director of a company or bank means any director of the company or bank, whether or not receiving compensation. An advisory director is not considered a director if the advisory director:

(i) Is not elected by the shareholders of the company or bank; or

(ii) Is not authorized to vote on matters before the board of directors; and

(iii) Provides solely general policy advice to the board or directors.

(2) Extensions of credit to a director of an affiliate of a bank are not subject to §§ 215.4, 215.6, and 215.8 if:

(i) The director of the affiliate is excluded, by resolution of the board of directors or by the bylaws of the bank, from participation in major policymaking functions of the bank and the director does not actually participate in such functions;

(ii) The affiliate does not control the bank; and

(iii) As determined annually, the assets of the affiliate do not constitute more than 10 percent of the consolidated assets of the company that—

(A) Controls the bank; and

(B) Is not controlled by any other company; and

(iv) The executive officer of the affiliate is not otherwise subject to §§ 215.4, 215.6, and 215.8.

(3) For purposes of paragraphs (c)(1) and (c)(2) of this section, a resolution of the board of directors or a corporate bylaw may—

(A) Include the executive officer (by name or by title) in a list of persons excluded from participation in such functions; or

(B) Not include the executive officer in a list of persons authorized (by name or by title) to participate in such functions.

(4) Foreign bank has the meaning given in 12 U.S.C. 310(t).

(g) Immediate family means the spouse of an individual, the individual's minor children, and any of the individual's children (including adults) residing in the individual's home.

(h) Insider means an executive officer, director, or principal shareholder, and includes any related interest of such a person.

(1) Lending limit for a member bank is the amount equal to the limit of loans to a single borrower established by the senior management of the bank or company. For example, the term does not include a manager or assistant manager of a branch of a bank unless that individual participates, or has the power to participate, in major policymaking functions of the bank or company.
section 5200 of the Revised Statutes,1 12
U.S.C. 84. This amount is 15 per cent of the bank's unimbayed capital and unimbayed surplus in the case of loans that are not fully secured by readily marketable collateral having an aggregate market value one and one-half times the amount of the loan, as determined by reliable and continuously available price quotations, at least equal to the amount of the loan. The lending limit also includes any higher amounts that are permitted by section 5200 of the Revised Statutes for the types of obligations listed in (1) and (2) that do not fall within the limit. A member bank's unimbayed capital and unimbayed surplus equals:

(1) The bank's Tier 1 and Tier 2 capital included in the bank's risk-based capital under the capital guidelines of the appropriate Federal banking agency, based on the bank's most recent consolidated report of condition filed under 12 USC 1817(k)(3); and

(2) The balance of the bank's allowance for loan and lease losses not included in the bank's tiers of capital for purposes of the calculation of risk-based capital by the appropriate Federal banking agency, based on the bank's most recent consolidated report of condition filed under 12 USC 1817(k)(3).

(1) Member bank means any banking institution that is a member of the Federal Reserve System, including any subsidiary of a member bank. The term does not include any foreign bank that maintains a branch in the United States, or the branch is insured (within the meaning of 12 U.S.C. 1813(h) and 12 U.S.C. 1828(b)(3)(B)).

(2) Overdraft on an account means to pay an amount upon the order of an account holder in excess of funds on deposit in the account.

(3) Person means an individual or a company.

(a) Principal shareholder means a person (other than an insured bank) that directly or indirectly exercised control over an insured bank in concert with one or more persons, owns, controls, or has the power to vote more than 10 percent of any class of voting securities of a member bank or company. Shares owned or controlled by a member of an individual's immediate family are considered to be held by the individual.

(b) A principal shareholder of a member bank does not include a company of which a member bank is a subsidiary.

(c) Related interest of a person means:

(1) A company that is controlled by that person;

(2) A political or campaign committee that is controlled by that person or the funds or services of which are controlled by that person;

(3) A subsidiary that has the meaning given in 12 U.S.C. 1841(d), but does not include a subsidiary of a member bank.

(d) Subsidiary has the meaning given in 12 U.S.C. 1841(d), but does not include a subsidiary of a member bank.


§ 13-303 215.3 Extension of credit.

(a) An extension of credit is making or renewal of any loan, a granting of a line of credit, or an extending of credit in any manner whatsoever, and includes:

(1) A purchase or repurchase agreement of securities, other assets, or obligations;

(2) An advance by means of an overdraft, petty cash item, or otherwise;

(3) Issuance of a bearer or order letter of credit (or other similar arrangement regardless of name or description) or an eligible acceptance, as those terms are defined in § 208.24 of this chapter;

(4) An acquisition by discount, purchase, sale, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which an insider may be liable as maker, drawer, endorser, guarantor, or surety;

(5) An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for:

(I) Accrued interest;

(ii) Taxes, insurance, or other expenses incidental to the existing indebtedness;

(iii) An advance of expenses, salary, or other unearned compensation for a period in excess of 30 days; and

(iv) Any other similar transaction as a result of which a person becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or

(b) An extension of credit does not include:

(1) An advance against accrued salary or other accrued compensation, or an advance for the services of an indemnity agent, travel or other expenses incurred or to be incurred on behalf of the bank;

(2) A receipt by a bank of a check deposited in or delivered to it in the ordinary course of business unless it results in the carrying of a cash item or for the granting of an overdraft (other than an inadvertent overdraft in a limited amount that is promptly repaid, as described in § 215.4(e) of this part);

(3) An acquisition of a note, draft, bill of exchange, or other evidence of indebtedness through:

(i) A merger or consolidation of banks or a similar transaction by which a bank acquires assets and assumes liabilities of another bank or similar organization;

(ii) Foreclosure on collateral or similar proceeding for the protection of the bank, provided that such indebtedness is not held for a period of more than three years from the date of such protection, subject to extension by the appropriate Federal banking agency for good cause;

(iii) An endorsement or guarantee for the protection of a bank of any loan or other asset previously acquired by the bank in good faith; or

(iv) Any indebtedness to a bank for the purpose of protecting the bank against loss or of giving financial assistance to it;

(v) Indebtedness of $15,000 or less arising by reason of a non-interest-bearing overdraft credit plan of the type specified in § 215.4(e) of this part;

(vi) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, without recourse.

(c) Non-interest-bearing deposits to the credit of the bank are not considered loans, advances, or extensions of credit to the bank of its member; nor is the giving of immediate credit to a bank upon uncollected items received in the ordinary course of business considered to be a loan, advance, or extension of credit to the depositing bank.

(d) For purposes of § 215.4 of this part, an extension of credit by a member bank is considered to have been made when the bank enters into a binding commitment to make the extension of credit.

(e) A credit extension without recourse is considered to be an extension of credit by the participating bank, not by the originating bank.

(f) Tangible economic benefit rule—(1) In general. An extension of credit is considered made to an insider to the extent that the proceeds are transferred to the insider or are used for the tangible economic benefit of the insider.

(2) Exception. An extension of credit is not considered made to an insider under paragraph (f)(1) of this section if:

(I) The credit is extended on terms that would satisfy the standard set forth in § 215.4(e) of this part for extensions of credit to insiders;

(3) The proceeds of the extension of credit are used in a bona fide transaction to acquire property, goods, or services from the insider;

(4) Any indebtedness to a bank for the purpose of protecting the bank against loss or of giving financial assistance to it;

(5) Indebtedness of $15,000 or less arising by reason of a non-interest-bearing overdraft credit plan of the type specified in § 215.4(e) of this part;

(6) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, without recourse.

§ 13-304 215.4 General prohibitions.

(a) Terms and creditworthiness—(1) In general. No member bank may extend credit to any insider of the bank or insider of its affiliates unless the extension of credit:

(i) Is made on substantially the same terms (including interest rates and collateral) as, and following credit underwriting procedures that are not less stringent than, those prevailing at the time for comparable transactions by the bank with other persons.
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(iii) The board of directors

on an extension of credit.

(c) Individual lending limit.—No member

bank may extend credit to any insider of the bank or

in an amount that, when aggregated with the amount of all

other extensions of credit to that person and to all related

interests of that person, exceeds the lending limit of the

member bank specified in § 215.2(d) of this

This prohibition does not apply to an

extension of credit by a member bank to a

company of which the member bank is a sub-

sidary or to any other subsidiary of that company.

d) Aggre­gate lending limit.—(1) General

limit. A member bank may not extend credit to

any insider of the bank or insider of its

affiliates unless the extension of credit is in an

amount that, when aggregated with the amount of all outstanding

extensions of credit to that bank and to all

related interests of that person, exceeds the

higher of $25,000 or 5 percent of the member

bank's unimpaired capital and unimpaired surplus

unless:

(i) The extension of credit has been

approved in advance by a majority of the

entire board of directors of that bank and

(ii) The interested party has abstained

from participating directly or indirectly in

the voting.

(2) In no event may a member bank extend

credit to any insider of the bank or insider of

its affiliates in an amount that, when aggregated

with all other extensions of credit to that

person, and all related interests of that person,

exceeds $500,000, except by complying with the

requirements of this paragraph (b).

(3) Approval by the board of directors under

paragraphs (b)(1) and (b)(2) of this section is not

required for an extension of credit that

is made pursuant to a line of credit that was

approved under paragraph (b)(1) of this

section within twelve months of the date of

extension of credit. The extension of credit must

also be in compliance with the requirements of

§ 215.4(a) of this part.

(4) Participation in the discussion, or any

attempt to influence the voting, by the board

of directors in extending an extension of credit

constitutes indirect participation in the voting

section, the member bank shall not extend

any additional credit (including a renewal of any

existing extension of credit) to any in­
sider or its affiliates unless such

extension or renewal is consistent with the

general limit in paragraph (d)(1) of this

section.

(3) Exceptions. (i) The general limit specified

in paragraph (d)(1) of this section does not

apply to the following:

(A) Extensions of credit secured by a per­

fect security interest in bonds, notes, cer­

tificates of indebtedness, or Treasury bills

of the United States or in other such obliga­

tions fully guaranteed as to principal and

interest by the United States;

(B) Extensions of credit to or secured by

unconditional takeout commitments or

guarantees of any department, agency, bu­

reau, board, commission or establish­

ment of the United States or any corporation

wholly owned directly or indirectly by the

United States;

(C) Extensions of credit secured by a per­

fected security interest in a segregated
deposit account in the lending bank;

or

(D) Extensions of credit arising from the

disclosure of false or nonnegotiable in­

stallment consumer paper that is acquired

from an insider and carries a full or partial

recorded security interest or guarantee by

the insider, provided that:

(i) The financial condition of each maker

of such consumer paper is reasonably docu­

mented in the bank's files or known to its

officers.

(ii) An officer of the bank designated for

that purpose by the board of directors of

the bank certifies in writing that the bank

is relying primarily upon the responsibility

of each maker for payment of the obligation

and not upon any endorsement or guaran­

tee by the insider; and

(iii) The maker of the instrument is not

an insider.

(ii) The exceptions in paragraphs (d)(3)(A) through (d)(3)(C) of this

section apply only to the amounts of such ex­

tension or renewal that are secured in the

manner described therein.

(c) Overdrafts. (1) No member bank may

pay an overdraft of an executive

officer or director of the bank or executive officer or

director of its affiliates3 on an account at the

bank, unless the payment of funds is made in accordance

with:

(i) A written, preauthorized, interest­

bearing extension of credit that specifies

a method of repayment; or

(ii) A written, preauthorized transfer of

funds from another account of the account

holder at the bank.

(2) The prohibition in paragraph (e)(1) of this

section does not apply to payment of inad­

vertent overdrafts on an account in an aggre­

gate amount of $1,000 or less.

(i) The account is not overdrawn for more

than 5 business days; and

(ii) The member bank charges the execu­
tive officer or director the same fee charged

any other consumer of the bank in similar

circumstances.

History: Sec. 215.4 as amended October 20, 1983, 48 FR 42804 (§97,725); May 18, 1992, 57 FR 21199 (§86.915); effective date revised May 28, 1992, 57 FR 22247; March 3, 1993, 58 FR 26507 (§89,423); May 18, 1993 (comment

deadline); July 15, 1993, 58 FR 28492 (§89,435); November 18, 1993, 58 FR 61603 (§89,592); February 18, 1994, 59 FR 8831 (§89,305); final corrections adopted July 19, 1994, 59 FR 37930 (§190,133); amended November 4, 1996, 61 FR 57769 (§90-432); effective date corrected to September 1, 1996, 61 FR 58782 (§90-442); amended April 1, 1997, 62 FR 13294 (§90-386).

§ 215.5 Additional restrictions on loans to executive officers of member banks.

The following restrictions on extensions of credit by a member bank to any of its executive officers and directors are in addition to any restrictions on extensions of credit by a member bank to its insiders and is necessary to attract or maintain consumer confidence in the banking system.

(a) No member bank may extend credit to any of its executive officers and directors (including former executive officers and directors) of a member bank or an affiliate of a member bank or spouse or parent, step-parent, child, step-child, grandchild or grandparent of any such executive officer or director (or any corporation wholly owned by such officer or director) unless:

(i) The extension of credit is on terms and conditions established by the Federal reserve banks or discount houses or any other Federal lending agency and is necessary to attract or maintain consumer confidence in the banking system; or

(ii) The extension of credit is for the purpose of purchasing or carrying a margin security in respect of a loan or extension of credit by another bank or banks to an executive officer or director (or any corporation wholly owned by such officer or director) of a member bank or an affiliate of a member bank or spouse or parent, step-parent, child, step-child, grandchild or grandparent of any such executive officer or director (or any corporation wholly owned by such officer or director).

(b) No member bank may extend credit in an aggregate amount greater than the amount

This prohibition does not apply to the payment by a member bank of an overdraft of a related interest of an executive officer, director, or principal shareholder of the member bank, unless the principal shareholder is also an executive officer or director. This prohibition also does not apply to the payment by a member bank of an overdraft of a related interest of an executive officer, director, or principal shareholder of the member bank or executive officers, directors or principal shareholders of its affiliates.
permitted in paragraph (c)(4) of this section to a partnership in which one or more of the bank's executive officers are partners and, either individually or together, hold a majority interest. For the purposes of paragraph (c)(4) of this section, the total amount of credit extended by a member bank to such partnership is considered to be extended to each executive officer of the member bank who is a member of that partnership.

(c) A member bank is authorized to extend credit to any executive officer of the bank:

(1) In any amount to finance the education of the executive officer's children;

(2) In any amount to finance or refinance the purchase, construction, maintenance, or improvement of a residence of the executive officer, provided:

(i) The extension of credit is secured by a first lien on the residence and the residence is owned (or expected to be owned after the extension of credit) by the executive officer; and

(ii) In the case of a refinancing, that the amount thereof used to repay the original extension of credit, together with the closing costs of the refinancing, and any additional amount thereof used for any of the purposes enumerated in paragraphs (c)(2) and (c)(3) of this section, is included with category of credit;

(3) In any amount, if the extension of credit is secured in a manner described in §215.4(d)(3)(i)(A) through (d)(3)(i)(C) of this part; and

(4) For any other purpose not specified in paragraphs (c)(1) through (c)(3) of this section, if the aggregate amount of extensions of credit to that executive officer under this paragraph does not exceed at any one time the higher of 2.5 per cent of the bank's unimpaired capital and unimpaired surplus or $25,000, but in no event more than $100,000.

(d) Any extension of credit by a member bank to any of its executive officers shall be:

(1) Promptly reported to the member bank's board of directors;

(2) In compliance with the requirements of §215.4(a) of this part;

(3) Preceded by the submission of a detailed current financial statement of the executive officer; and

(4) Made subject to the condition in writing that the extension of credit will, at the option of the member bank, become due and payable at any time that the officer is indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit.

§ 215.6 Prohibition on knowingly receiving unregistered extension of credit.

No executive officer, director, or principal shareholder of a member bank or any of its affiliates shall knowingly receive (or knowingly permit any of that person's related interests to receive) from a member bank, directly or indirectly, any extension of credit not authorized under this part.

History: Sec. 215.6 as added May 18, 1992, 57 FR 21199 ($88,915); effective date revised May 28, 1992, 57 FR 22417; February 18, 1994, 59 FR 8831 ($89,671).

§ 215.7 Extensions of credit outstanding on March 10, 1979.

(a) Any extension of credit that was outstanding on March 10, 1979, and that, if made on or after March 10, 1979, violates §215.4(c) of this part, shall be reduced in amount by March 10, 1980, to be in compliance with the lending limit in §215.4(c) of this part.

(b) A member bank is unable to bring all extensions of credit outstanding on March 10, 1979, into compliance as required by paragraph (a) of this section, the member bank shall promptly report that fact to the Comptroller of the Currency, in the case of a national bank, or to the appropriate Federal Reserve Bank, in the case of a State member bank, and explain the reasons why all the extensions of credit cannot be brought into compliance. The Comptroller of the Reserve Bank, as the case may be, is authorized, on the basis of the prohibition of §215.4(c) of this part, a specific maturity date of March 10, 1980, and, if made on or after March 10, 1979, that bears a specific maturity date of March 10, 1980, or later, shall be repaid in accordance with its repayment schedule in existence on or before March 10, 1979.

(c) A member bank is unable to bring all extensions of credit outstanding on March 10, 1979, into compliance as required by paragraph (a) of this section, the member bank shall promptly report that fact to the Comptroller of the Currency, in the case of a national bank, or to the appropriate Federal Reserve Bank, in the case of a State member bank, and explain the reasons why all the extensions of credit cannot be brought into compliance. The Comptroller of the Reserve Bank, as the case may be, is authorized, on the basis of the prohibition of §215.4(c) of this part, a specific maturity date of March 10, 1980, and, if made on or after March 10, 1979, that bears a specific maturity date of March 10, 1980, or later, shall be repaid in accordance with its repayment schedule in existence on or before March 10, 1979.

(d) If a member bank is unable to bring all extensions of credit outstanding on March 10, 1979, into compliance as required by paragraph (a) of this section, the member bank shall promptly report that fact to the Comptroller of the Currency, in the case of a national bank, or to the appropriate Federal Reserve Bank, in the case of a State member bank, and explain the reasons why all the extensions of credit cannot be brought into compliance. The Comptroller of the Reserve Bank, as the case may be, is authorized, on the basis of the prohibition of §215.4(c) of this part, a specific maturity date of March 10, 1980, and, if made on or after March 10, 1979, that bears a specific maturity date of March 10, 1980, or later, shall be repaid in accordance with its repayment schedule in existence on or before March 10, 1979.

§ 215.8 Records of member banks.

(a) In general. Each member bank shall maintain records necessary for compliance with the requirements of this part.

(b) Recordkeeping for insiders of the member bank. Any recordkeeping method adopted by a member bank shall:

(1) Identify, through an annual survey, all insiders of the bank itself, and

(2) Maintain records of all extensions of credit to insiders of the bank itself, including the amount and terms of each such extension of credit.

§ 215.9 Reports by executive officers.

Each executive officer of a member bank who becomes indebted to any other bank or banks in an aggregate amount greater than the amount specified for a category of credit in §215.7 of this part, shall, within 10 days of the date the indebtedness reaches such a level, make a written report to the board of directors of the officer's bank. The report shall state the lender's name, the date and amount of each extension of credit, any security for it, and the purposes for which the proceeds have been or are to be used.

History: Sec. 215.9 as amended October 20, 1983, 48 FR 42804 ($99,725); as redesignated from Sec. 215.8, May 18, 1992, 57 FR 21199 ($88,915); effective date revised May 28, 1992, 57 FR 22417; February 18, 1994, 59 FR 8831 ($89,671).
§ 215.10 Report on credit to executive officers.

Each member bank shall include with (but not as part of) each report of condition (and certified copy thereof) filed pursuant to 12 U.S.C. 3101(7) a report of all extensions of credit made by the member bank to its executive officers and each director for the period of the bank's previous report of condition.

History: Sec. 215.10 as amended October 23, 1973, 48 FR 42304 (§ 99,725); as redesignated from Sec. 215.9, May 18, 1992, 57 FR 21199 (§ 88,915); effective date revised May 28, 1992, 57 FR 22417; February 18, 1994, 59 FR 8831 (§ 89,671).

§ 215.11 Disclosure of credit from member banks to executive officers and principal shareholders.

(a) Definitions: For the purposes of this section, the following definitions apply:

(1) Principal shareholder of a member bank means any person other than an insured bank or a foreign bank as defined in 12 U.S.C. 3101(7); that, directly or indirectly, owns, controls, or has power to vote more than 10 percent of any class of voting securities of the member bank. The term includes a person that controls a principal shareholder (e.g., a person that controls a bank holding company). Shares of a bank (including a foreign bank), bank holding company, or other company owned or controlled by a member of an individual's immediate family are presumed to be owned or controlled by the individual for the purposes of determining principal shareholder status.

(2) Related interest means:

(i) Any company controlled by a person; or

(ii) Any political or campaign committee the funds or services of which will benefit a person or that is controlled by a person. For the purpose of this section and subpart B, a related interest does not include a bank or a foreign bank (as defined in 12 U.S.C. 3101(7)).

(b) Public disclosure. (1) Upon receipt of a written request from the public, a member bank shall make available the names of each of its executive officers and each of its principal shareholders to whom, or to whose related interests, the member bank had outstanding as of the end of the latest previous quarter of the year, an extension of credit that, when aggregated with all other outstanding extensions of credit at such time from the member bank to such executive officer or principal shareholder of such person, equaled or exceeded 5 percent of the member bank's capital and unimpaired surplus.

(2) A member bank is not required to disclose the specific amounts of individual extensions of credit.

(c) Maintaining records. Each member bank shall maintain records of all requests for the information described in paragraph (b) of this section and the disposition of such requests. These records may be disposed of after two years from the date of the request.

History: Sec. 215.11 as amended December 31, 1983, 48 FR 30543 (§ 89,810); corrected January 24, 1984, 49 FR 2902; as redesignated from Sec. 215.10, May 18, 1992, 57 FR 21199 (§ 88,915); effective date revised May 28, 1992, 57 FR 22417; February 18, 1994, 59 FR 8831 (§ 89,671).

§ 215.12 Reporting requirement for credit secured by certain bank stock.

Each executive officer or director of a member bank the shares of which are not publicly traded shall report annually to the board of directors of the member bank the outstanding amount of any credit that was extended to the executive officer or director and that is secured by shares of the member bank.

History: Sec. 215.12 as added May 18, 1992, 57 FR 21199 (§ 88,915); effective date revised May 28, 1992, 57 FR 22417.

§ 215.13 Civil penalties.

Any member bank, or any officer, director, employee, agent, or other person participating in the conduct of the affairs of the bank, that violates any part of this section (other than § 215.11 of this part) is subject to civil penalties as specified in section 5 of the Federal Reserve Act (12 U.S.C. 554).

§ 215.10

Fed. Reg. 13-310

APPENDIX

APPENDIX—SECTION 5200 OF THE REVISED STATUTES TOTAL LOANS AND EXTENSIONS OF CREDIT

(1) The total loans and extensions of credit by a national banking association to a person outstanding at one time and not fully secured, as determined in a manner consistent with paragraph (2) of this subsection, by collateral having a market value at least equal to the amount of the loan or extension of credit shall not exceed 15 percent of the unimpaired capital and unimpaired surplus of the association.

(2) The total loans and extensions of credit by a national banking association to a person outstanding at one time and fully secured by readily marketable collateral having a market value, as determined in a manner consistent with paragraph (3) of this subsection, of the end or the latest previous quarter of the year, an extension or credit that, when aggregated with all other outstanding extensions of credit at such time from the member bank to such person, equaled or exceeded 5 percent of the member bank's capital and unimpaired surplus.

(3) A member bank is not required to disclose the specific amounts of individual extensions of credit.

(4) A member bank shall make available the names of each of its officers and of its executive officers and each of its principal shareholders to whom, or to whose related interests, the member bank had outstanding as of the end of the latest previous quarter of the year, a loan or extension of credit that, when aggregated with all other outstanding extensions of credit at such time from the member bank to such person, equaled or exceeded 5 percent of the member bank's capital and unimpaired surplus.

(5) A member bank is not required to disclose the specific amounts of individual extensions of credit.

(6) A member bank shall make available the names of each of its executive officers and each of its principal shareholders to whom, or to whose related interests, the member bank had outstanding as of the end of the latest previous quarter of the year, an extension of credit that, when aggregated with all other outstanding extensions of credit at such time from the member bank to such person, equaled or exceeded 5 percent of the member bank's capital and unimpaired surplus.
Note: The text is too voluminous to be displayed in its entirety. It pertains to financial regulations, specifically focusing on rules and definitions related to the lending practices of banks, indebtedness reporting, and related executive officer disclosures. The text includes detailed sections on the calculation and reporting of indebtedness, the definitions of various financial terms, and the requirements for disclosing such information to the Comptroller of the Currency. The regulations aim to provide a clear framework for banks to follow in reporting their financial obligations and activities to the regulatory body.
banks of the member bank to the executive officer or principal shareholder of the member bank and to all related interests of such a person does not exceed $25,000 at any time during the previous calendar year.

(2) A member bank is not required to disclose the specific amounts of individual extensions of credit.

(b) Maintaining records. Each member bank shall maintain records of all requests for the information described in paragraph (a) of this section and the disposition of such requests. These records may be disposed of after two years from the date of the request.

(a) **Restriction.** A standby letter of credit issued by an insured state nonmember bank shall be combined with all other standby letters of credit and all loans for purposes of applying any legal limitation on loans of the bank (including limitations on loans to any one borrower, on loans to affiliates of the bank, or on aggregate loans). Provided, however, that if such standby letter of credit is subject to separate limitation under applicable state or federal law, then the separate limitation shall apply in lieu of the loan limitation.\(^{(10)}\)

(\(^{(2)}\)Where the standby letter of credit is subject to a non-recourse participation agreement with another bank or other banks, this section shall apply to the issuer and each participant in the same manner as in the case of a participated loan.)

(c) **Exceptions.** All standby letters of credit shall be subject to the provisions of paragraph (b) of this section except where:

(1) Prior to or at the time of issuance, the issuing bank has set aside sufficient funds in a segregated deposit account, clearly earmarked for that purpose, to cover the bank's maximum liability under the standby letter of credit.

(2) Prior to or at the time of issuance, the issuing bank has set aside sufficient funds in a segregated deposit account, clearly earmarked for that purpose, to cover the bank's maximum liability under the standby letter of credit.

(d) **Disclosure.** Each insured state nonmember bank must maintain adequate control and subsidiary records of its standby letters of credit comparable to the records maintained in connection with the bank's direct loans so that at all times the bank's potential liability thereunder and the bank's compliance with this section 337.2 may be readily determined. In addition, all such standby letters of credit must be adequately reflected on the bank's published financial statements.

[Codified to 12 C.F.R. § 337.2]

§ 337.3 Limits on extensions of credit to executive officers, directors, and principal shareholders of insured nonmember banks.

(a) With the exception of 12 CFR 215.5(b), 215.5(c)(3), 215.5(c)(4), and 215.11, insured nonmember banks are subject to the restrictions contained in subpart A of Federal Reserve Board Regulation O (12 CFR Part 215, subpart A) to the same extent and to the same manner as though they were member banks.

(b) For the purposes of compliance with § 215.4(b) of Federal Reserve Board Regulation O, no insured nonmember bank may extend credit or grant a line of credit to any of its executive officers, directors, or principal shareholders or to any related interest of any such person in an amount that, when aggregated with the amount of all other extensions of credit and lines of credit by the bank to that person and to all related interests of that person, exceeds the greater of $25,000 or five percent of the bank's capital and unimpaired surplus.

For the purposes of § 337.3, an insured nonmember bank's capital and unimpaired surplus shall have the same meaning as found in § 215.2(f) of Federal Reserve Board Regulation O (12 CFR 215.2(f)).

or $500,000 unless (1) the extension of credit or line of credit has been approved in advance by a majority of the entire board of directors of that bank and (2) the interested party has abstained from participating directly or indirectly in the voting.

(c)(1) No insured nonmember bank may extend credit in an aggregate amount greater than the amount permitted in paragraph (c)(2) of this section to a partnership in which one or more of the bank's executive officers are partners and, either individually or together, hold a majority interest. For the purposes of paragraph (c)(2) of this section, the total amount of credit extended by an insured nonmember bank to such partnership is considered to be extended to each executive officer of the insured nonmember bank who is a member of the partnership.

(2) An insured nonmember bank is authorized to extend credit to any executive officer of the bank for any purpose not specified in § 215.5(c)(1) and (2) of Federal Reserve Board Regulation O (12 CFR 215.5(c)(1) and (2)) if the aggregate amount of such other extensions of credit does not exceed at any one time the higher of 2.5 percent of the bank's capital and unimpaired surplus or $25,000 but in no event more than $100,000, provided, however, that no such extension of credit shall be subject to...
§ 337.3. Definitions: for the purposes of this section, (12-31-87 p.2639)\{12-30-94 p.2638.01\}

(1) "Affiliate" shall mean any company that directly or indirectly, through one or more intermediaries, controls or is under common control with an insured nonmember bank.

(2) "Banc fee subsidiary" means a subsidiary of an insured nonmember bank that at a minimum: (i) is adequately capitalized; (ii) is physically separate and distinct in its operations from the operation of the bank;\(^\text{[4]}\)

\(^{[4]}\) If the subsidiary conducts business in the same location in which the bank conducts business, the subsidiary must utilize physically separate offices or office space from that used by the bank. Such offices or office space must be clearly and prominently identified so as to distinguish the subsidiary from the bank. The physically separate office or office space requirement only applies in areas to which the public has access.\(^{[5]}\)

(3) maintains separate accounting and other corporate records; (iv) observes separate formalities such as separate board of directors' meetings; (v) maintains separate employees who are compensated by the subsidiary.\(^{[5]}\)

\(^{[5]}\) This requirement shall not be construed to prohibit the use by the subsidiary of bank employees to perform functions which do not directly involve customer contact such as accounting, data processing and recordkeeping, so long as the bank and the subsidiary conduct for such services on terms and conditions comparable to those agreed to by independent entities.)

(2) "Control" shall mean the power to directly or indirectly vote 25 percent or more of the voting stock of a bank or company, or the ability to control in any manner the election of a majority of a bank's or company's directors or trustees, or the ability to exercise a controlling influence over the management and policies of a bank or company.

(3) "Extension of credit" shall mean the making or renewal of any loan, a draw upon a line of credit, or an extension of credit in any manner whatsoever and includes, but is not limited to:

(i) A purchase, whether or not under repurchase agreement, of securities, other assets, or obligations;

(ii) An advance by means of an overdraft, cash item, or otherwise;

(iii) Issuance of a standby letter of credit (or other similar arrangement regardless of name or description);

(iv) An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which a natural person or company may be liable as maker, drawer, endorser, guarantor, or surety;

(v) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse;

(vi) An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for (A) accrued interest or (B) taxes, insurance, or other expenses incidental to the existing indebtedness; or

(vii) Any other transaction as a result of which a natural person or company becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of the extension of credit in any manner whatsovever and includes, but is not limited to:

(i) A purchase, whether or not under repurchase agreement, of securities, other assets, or obligations;

(ii) An advance by means of an overdraft, cash item, or otherwise;

(iii) Issuance of a standby letter of credit (or other similar arrangement regardless of name or description);

(iv) An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which a natural person or company may be liable as maker, drawer, endorser, guarantor, or surety;

(v) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse;

(vi) An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for (A) accrued interest or (B) taxes, insurance, or other expenses incidental to the existing indebtedness; or

(vii) Any other transaction as a result of which a natural person or company becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of the extension of credit in any manner whatsoever and includes, but is not limited to:

(i) A purchase, whether or not under repurchase agreement, of securities, other assets, or obligations;

(ii) An advance by means of an overdraft, cash item, or otherwise;

(iii) Issuance of a standby letter of credit (or other similar arrangement regardless of name or description);

(iv) An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which a natural person or company may be liable as maker, drawer, endorser, guarantor, or surety;

(v) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse;

(vi) An increase of an existing indebtedness, but not if the additional funds are advanced by the bank for its own protection for (A) accrued interest or (B) taxes, insurance, or other expenses incidental to the existing indebtedness; or

(vii) Any other transaction as a result of which a natural person or company becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of the extension of credit in any manner whatsoever and includes, but is not limited to:

(i) A purchase, whether or not under repurchase agreement, of securities, other assets, or obligations;

(ii) An advance by means of an overdraft, cash item, or otherwise;

(iii) Issuance of a standby letter of credit (or other similar arrangement regardless of name or description);

(iv) An acquisition by discount, purchase, exchange, or otherwise of any note, draft, bill of exchange, or other evidence of indebtedness upon which a natural person or company may be liable as maker, drawer, endorser, guarantor, or surety;

(v) A discount of promissory notes, bills of exchange, conditional sales contracts, or similar paper, whether with or without recourse;
investments other than obligations of the United States or United States Government agencies, repurchase agreements involving such obligations, bank certificates of deposit, banker’s acceptances and other bank money instruments, short-term corporate debt instruments, and other similar investments normally associated with a money market fund; and
(6) The subsidiary, or thereunder to be, a bona fide subsidiary if that subsidiary conducts securities activities not authorized to the bank under section 16 of the Glass-Steagall Act as made applicable to insured nonmember banks by section 21 of the Glass-Steagall Act.
(7) The subsidiary is composed of persons who are neither directors nor officers of the bank, and (8) neither the subsidiary nor any of its directors, officers, general partners, employees, or 10 percent shareholders of any class of voting securities of the subsidiary is subject to any state or federal administrative order or court order, judgment, or decree entered within five years of the notice required by this part temporarily or preliminarily enjoining or restraining such person or the subsidiary from engaging in, or continuing, any conduct or practice in connection with the purchase or sale of any security involving the making of a false filing with the Securities and Exchange Commission or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, or investment adviser;
(vi) Neither the subsidiary nor any of its directors, officers, general partners, employees, or 10 percent shareholders of any class of voting securities of the subsidiary is subject to any order entered within five years of the notice required by this part of the Securities and Exchange Commission entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o, 78o-4) or section 15(f) of the Investment Advisors Act of 1940 (15 U.S.C. 80b-3(c)); (f); and
(vii) All officers of the subsidiary who have supervisory responsibility for underwriting activities have at least five years experience in similar activities at NASD member securities firms.
(3) An insured nonmember bank’s direct investment in a securities subsidiary described in paragraphs (b)(1) or (b)(2) of this section will not be counted toward the bank’s capital. (212-31-87 2641)Conduct of the business of an underwriter, broker, dealer, municipal securities dealer, or investment adviser;
(a) Not later than five years of the notice required by this part of the Securities and Exchange Commission entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o, 78o-4) or section 15(f) of the Investment Advisors Act of 1940 (15 U.S.C. 80b-3(c)); (f); and
(b) No affiliate who has supervisory responsibility for underwriting activities have at least five years experience in similar activities at NASD member securities firms.
(c) If the affiliate conducts business in the same location in which the bank conducts business, the affiliate must utilize physically separate offices or office space from that used by the bank. Such offices or office space must be clearly and prominently identified so as to distinguish the affiliate from the bank. The physically separate office or office space requirement only applies in areas to which the public has access.]
(2) The bank and affiliate share no common officers; (3) a majority of the board of directors of the bank is composed of persons who are neither directors nor officers of the affiliate; (4) any employee of the affiliate who is also an employee of the bank does not conduct any securities activities on behalf of the affiliate on the premises of the bank that involve customer contact; and (5) the affiliate conducts business pursuant to independent policies and procedures designed to inform customers and prospective customers of the affiliate that the affiliate is a separate organization from the bank and that investments recommended, offered or sold by the affiliate are not bank deposits, are not insured by the FDIC, and are not guaranteed by the bank nor are otherwise obligations of the bank. (This requirement shall not be construed to prohibit the affiliate from brokering deposits to the extent and in the manner as otherwise permitted by statute and regulation.)
(4) Neither the subsidiary nor any of its directors, officers, general partners, employees, or 10 percent shareholders of any class of voting securities of the subsidiary is subject to any state or federal administrative order or court order, judgment, or decree entered within five years of the notice required by this part temporarily or preliminarily enjoining or restraining such person or the subsidiary from engaging in, or continuing, any conduct or practice in connection with the purchase or sale of any security involving the making of a false filing with the Securities and Exchange Commission or arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, or investment adviser; (v) Neither the subsidiary nor any of its directors, officers, general partners, employees, or 10 percent shareholders of any class of voting securities of the subsidiary is subject to an order entered within five years of the notice required by this part of the Securities and Exchange Commission entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o, 78o-4) or section 15(f) of the Investment Advisors Act of 1940 (15 U.S.C. 80b-3(c)); (f); and
(6) All officers of the subsidiary who have supervisory responsibility for underwriting activities have at least five years experience in similar activities at NASD member securities firms.

Restrictions.
(a) An insured nonmember bank which has a subsidiary or affiliate that engages in the sale, distribution, or underwriting of stocks, bonds, debentures, notes, or other securities, or as an investment adviser to any investment company shall not:
(1) Purchase in its discretion as fiduciary, co-fiduciary, or managing agent any security currently issued by an investment company advised by such subsidiary or affiliate, unless (i) the purchase is expressly authorized by the trust instrument, court order, or local law, or specific authority for the purchase is obtained from all interested parties after full disclosure of the nature of the transaction and of the relationship of the bank to the investment company; (ii) the purchase is permissible under applicable federal and/or state statute or regulation; (2) Engage in any other securities activity, if the 60-day advance notice and 10-day follow-up notice pertain to the establishment or acquisition of a subsidiary that engages in underwriting activities as limited by § 337.4(b)(3) of this part.
(b) In complying with § 331.4(e)(5) of this part, the banks shall be entitled to rely in good faith on
(c) An insured nonmember bank which has a subsidiary or affiliate that engages in the sale, distribution, or underwriting of stocks, bonds, debentures, notes, or other securities, or as an investment adviser to any investment company shall not:
(1) Purchase in its discretion as fiduciary, co-fiduciary, or managing agent any security currently issued by an investment company advised by such subsidiary or affiliate, unless (i) the purchase is expressly authorized by the trust instrument, court order, or local law, or specific authority for the purchase is obtained from all interested parties after full disclosure of the nature of the transaction and of the relationship of the bank to the investment company; (ii) the purchase is permissible under applicable federal and/or state statute or regulation; (2) Engage in any other securities activity, if the 60-day advance notice and 10-day follow-up notice pertain to the establishment or acquisition of a subsidiary that engages in underwriting activities as limited by § 337.4(b)(3) of this part.
(b) In complying with § 331.4(e)(5) of this part, the banks shall be entitled to rely in good faith on
(d) Filing of notice: Every insured nonmember bank that intends to acquire or establish a subsidiary that (1) engages in the sale, distribution, or underwriting of stocks, bonds, debentures, notes, or other securities, (2) acts as an investment adviser to any investment company; (3) conducts any activity for which the subsidiary is required to register with the Securities and Exchange Commission as a broker/dealer; or (4) engages in any other securities activity, shall notify the regional director of the FDIC region in which the bank is located of such intent. Notice shall be in writing and must be received in the regional office at least 60 days prior to consummation of the acquisition or commencement of the operation of the subsidiary, whichever is earlier. The bank shall also notify the regional office in writing within 10 days of consummation of the acquisition or commencement of the operation of the subsidiary, whichever is earlier. The 60-day notice requirement may be waived in FDIC’s discretion where such notice is impracticable such as in the case of a purchase and assumption transaction or an emergency merger. Where the above notices pertain solely to the transfer of securities activities previously performed by the bank to the subsidiary, an additional written notice must be filed with the regional office if the subsidiary commences any securities activity covered by § 337.4(b)(1) or (b)(2) of this part. This notice must be received in the regional office within thirty days after the subsidiary commences any securities activity. If the 60-day advance notice and 10-day follow-up notice pertain to the establishment or acquisition of a subsidiary that engages in underwriting activities as limited by § 337.4(b)(3) of this part, an additional written notice must be filed with the regional office if the subsidiary commences underwriting activities as permitted by
(e) Restrictions. An insured nonmember bank which has a subsidiary or affiliate that engages in the sale, distribution, or underwriting of stocks, bonds, debentures, notes, or other securities, or as an investment adviser to any investment company shall not:
(1) Purchase in its discretion as fiduciary, co-fiduciary, or managing agent any security currently issued by an investment company advised by such subsidiary or affiliate, unless (i) the purchase is expressly authorized by the trust instrument, court order, or local law, or specific authority for the purchase is obtained from all interested parties after full disclosure of the nature of the transaction and of the relationship of the bank to the investment company; (ii) the purchase is permissible under applicable federal and/or state statute or regulation; (2) Engage in any other securities activity, if the 60-day advance notice and 10-day follow-up notice pertain to the establishment or acquisition of a subsidiary that engages in underwriting activities as limited by § 337.4(b)(3) of this part.
(f) In complying with § 331.4(e)(5) of this part, the banks shall be entitled to rely in good faith on
customer's statement as to the purpose of the extension of credit or loan.)

(6) Make any loan or extension of credit to a subsidiary or affiliate of the bank that (i) distributes or underwrites stocks, bonds, debentures, notes, or other securities, or (ii) advises any investment company, if such loans or extensions of credit would be in excess of the limit as to amount, and not in accordance with the restrictions imposed on "covered transactions" by section 23A of the Federal Reserve Act (12 U.S.C. 371c) and that are not within any exemptions established thereby; and

(7) Make any loan or extension of credit to any investment company for which the bank's subsidiary or affiliate acts as an investment adviser if the loan or extension of credit would be in excess of the limit as to amount, and not in accordance with the restrictions imposed on "covered transactions" by section 23A of the Federal Reserve Act and that are not within any exemptions established thereby; and

(8) Directly or indirectly condition any loan or extension of credit to any person on the requirement that that person purchase any security currently underwritten or distributed by the bank's subsidiary or affiliate.

An insured nonmember bank in complying with the requirements of §§337.4(a)(1), (a)(3), and (e) of this part concerning "current" underwritings and distributions may rely upon the affiliate's or subsidiary's statement that the underwriting or distribution of any particular security has terminated.

(f) Nothing in this section prohibits an insured nonmember bank from establishing or acquiring a subsidiary that sells, distributes, or underwrites stocks, bonds, debentures, notes, or other securities or engages in other securities activities if the activities are performed by an insured nonmember bank by sections 16 and 21 of the Glass-Steagall Act (12 U.S.C. 24 (Seventh) and 378).

(g) Nothing in this section authorizes an insured nonmember bank to directly engage in any securities activity not authorized to it under sections 18 and 21 of the Glass-Steagall Act (12 U.S.C. 24 (Seventh) and 378).

(h) Disclosure—(1) Applicability. Any subsidiary of an insured nonmember bank required by §337.4(b)(1)(i) to be a bona fide subsidiary, and any affiliate of an insured nonmember bank whose affiliation with such a bank is governed by §337.4(c), which: (i) shares the same name or logo with the insured nonmember bank, (ii) conducts business in the same location in which the insured nonmember bank conducts business, (iii) advertises or promotes particular securities or solicits purchasers for particular securities in advertisements, promotions, solicitations or other similar communications in which the insured nonmember bank also advertises or promotes its services, or (iv) places or causes to be placed in communications from the insured nonmember bank to the bank's customers advertisements, promotions or solicitations concerning particular securities, must comply with the disclosure requirements of paragraphs (h)(2) and (h)(3) of this section in order for the subsidiary to meet the definition of a bona fide subsidiary and in order for the affiliation to be permissible. Any insured nonmember bank that established or acquired a securities subsidiary or became affiliated with a securities company prior to December 28, 1984 and which as of December 14, 1987, conducted business in the same location as its securities subsidiary or affiliate or shared the same or a similar name or logo with its securities subsidiary or affiliate has until not later than January 1, 1988 to comply with paragraphs (h)(2) and (h)(3) of this section.

(2) Content of Disclosure. Sections 337.4(a)(2)(i) and 337.4(c)(5) notwithstanding, any subsidiary and/or affiliate of an insured nonmember bank described in paragraph (h)(1) of this section must disclose to its customers and prospective customers that its securities recommended, offered or sold by or through the subsidiary and/or affiliate are not FDIC insured deposits (unless otherwise indicated), that such securities are not guaranteed by, nor are they obligations of, the bank, and that the subsidiary and/or affiliate and the bank are separate organizations. The following or a similar statement will satisfy the disclosure requirement:"[name of affiliate/subsidiary] is not a bank and securities offered by it are not backed or guaranteed by any bank nor are they insured by the FDIC.”

(3) Timing and Placement of Disclosure. In order for any subsidiary or affiliate of an insured nonmember bank described in paragraph (h)(1) to comply with paragraph (h)(2) the subsidiary/affiliate must make disclosure to its customers prominently, in writing, in opening account documents and periodically, at least semiannually in customer communications in lieu of customer statements. In the case of joint advertisements, promotions, or solicitations and advertisements, promotions, or solicitations placed in bank communications, the advertisement, promotion, or solicitation must carry the requisite disclosure. Disclosure may be in a form and manner consistent with the advertising or other media utilized. Television or radio advertisements which do not exceed 30 seconds in length need not contain disclosure. Disclosure in television advertisements may either be spoken or displayed. All disclosures must be prominent and clearly legible. Disclosure in opening account documents and periodic statements.

(12-31-98 p.2644)Disclosures in customer statements or confirmations is only required for one year after the opening and the subsidiary/affiliate cease to jointly advertise, promote or solicit and for one year after advertisements, promotions, or solicitations are placed in bank communications with bank customers provided, however, that at least two semiannual disclosures must have been made during that one year period.

(4) It is considered an unsafe and unsound banking practice for an insured nonmember bank to: (i) share the same or a similar name or logo with a securities subsidiary that is required to be a bona fide subsidiary and is subject to the provisions contained in §337.4; (ii) conduct business in the same location as any such subsidiary or affiliate; (iii) jointly advertise or promote its services in an advertisement, promotion, or solicitation concerning particular securities made by such a subsidiary or affiliate; or (iv) permit such a subsidiary or affiliate to place advertisements, promotions, or solicitations concerning particular securities in communications sent by the bank to the bank's customers, unless the disclosure requirements of paragraph (h)(2) and (h)(3) are met. Failure to comply with paragraphs (h)(2) and (h)(3) will subject the insured nonmember bank to appropriate administrative action including, but not necessarily limited to, an order to cease and desist use of the same or a similar name or logo as the subsidiary/affiliate, the conduct of business in the same location as the subsidiary/affiliate, the making of joint advertisements, or the placement of the subsidiary's/affiliate's promotions, advertisements, or solicitations in the bank's communications with its customers.

(i) Coordination with part 362 of this chapter—(1) New subsidiary or affiliate relationships. Beginning January 1, 1999, every insured state nonmember bank that establishes a new subsidiary relationship subject to the provisions of §362.4(b)(4) or §362.4(b)(5)(ii) of this chapter or a new affiliate relationship that is subject to §362.4(b) of this chapter shall comply with §362.4(b)(4), §362.4(b)(5)(ii) or §362.8(b) of this chapter, respectively, or to the extent the insured state nonmember bank's planned subsidiary or affiliate will not comply with all requirements thereunder, submit an application to the FDIC under §362.2 of this chapter.

(2) Existing insured state nonmember bank subsidiaries subject to §362.4. Applicable transition rules for insured state nonmember bank subsidiaries engaged, before January 1, 1999, in securities activities pursuant to this section and also subject to §362.4 of this chapter are set out in §362.5 of this chapter.

(3) Continued effectiveness of this section. Insured state nonmember banks establishing or holding subsidiaries subject to this section, but not covered by paragraph (d) of this section, remain subject to the requirements of this section, except that to the extent such subsidiaries or affiliates engage only in activities permissible for a national bank directly, including such permissible activities that may require the subsidiary or affiliate to register as a securities broker, no notice under paragraph (d) of this section is required.

(2) Coordination with part 12 of this chapter—(1) New subsidiary or affiliate relationships. Beginning January 1, 1999, every insured state nonmember bank that establishes a new subsidiary relationship subject to the provisions of §362.4(b)(4) or §362.4(b)(5)(ii) of this chapter or a new affiliate relationship that is subject to §362.4(b) of this chapter shall comply with §362.4(b)(4), §362.4(b)(5)(ii) or §362.8(b) of this chapter, respectively, or to the extent the insured state nonmember bank's planned subsidiary or affiliate will not comply with all requirements thereunder, submit an application to the FDIC under §362.2 of this chapter.

(2) Existing insured state nonmember bank subsidiaries subject to §362.4. Applicable transition rules for insured state nonmember bank subsidiaries engaged, before January 1, 1999, in securities activities pursuant to this section and also subject to §362.4 of this chapter are set out in §362.5 of this chapter.

(3) Continued effectiveness of this section. Insured state nonmember banks establishing or holding subsidiaries subject to this section, but not covered by paragraph (d) of this section, remain subject to the requirements of this section, except that to the extent such subsidiaries or affiliates engage only in activities permissible for a national bank directly, including such permissible activities that may require the subsidiary or affiliate to register as a securities broker, no notice under paragraph (d) of this section is required.

[12-31-98 p.2644]Disclosures in customer statements or confirmations is only required for one year after the opening and the subsidiary/affiliate cease to jointly advertise, promote or solicit and for one year after advertisements, promotions, or solicitations are placed in bank communications with bank customers provided, however, that at least two semiannual disclosures must have been made during that one year period.

§337.5 Exemption.

Check guaranty card programs, customer-sponsored credit card programs, and similar arrangements in which a bank undertakes to guarantee the obligations of individuals who are its retail banking deposit customers are exempted from §337.2: Provided, however, that the bank establishes the creditworthiness of the individual before undertaking to guarantee his/her obligations and that any such arrangement is not subject to any bank's principal shareholders. 

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§ 337.6 Brokers deposits.

(a) Definitions. For the purposes of this § 337.6, the following definitions apply:

(1) Appropriate federal banking agency has the same meaning as provided under section 3(g) of the Federal Deposit Insurance Act (12 U.S.C. 1813(g)).

(2) Brokered deposit means any deposit that is obtained, directly or indirectly, from or through the mediation or assistance of a deposit broker.

(3) Capital categories. (i) For purposes of section 29 of the Federal Deposit Insurance Act and this § 337.6, the terms well capitalized, adequately capitalized, and undercapitalized include any institution that is significantly undercapitalized or critically undercapitalized under regulations implementing section 38 of the Federal Deposit Insurance Act and issued by the appropriate federal banking agency for that institution.

shall have the same meaning as to each insured depository institution as

The page following this is 2645.

(b) Solicitation and acceptance of brokered deposits by insured depository institutions.

(ii) An adequately capitalized insured depository institution may not accept, renew or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC in accordance with the provisions of this section.

(iii) Any adequately capitalized insured depository institution that has been granted a waiver to accept, renew or roll over any brokered deposit may not pay an effective yield on any such deposit which, at the time that such deposit is accepted, renewed or rolled over, exceeds by more than 75 basis points:

(A) The effective yield paid on deposits of comparable size and maturity in such institution's normal market area for deposits accepted from within its normal market area; or

(B) The national rate paid on deposits of comparable size and maturity for deposits accepted outside the institution's normal market area. For purposes of this paragraph (b)(ii)(B), the national rate shall be:

(1) 120 percent of the current yield on similar maturity U.S. Treasury obligations; or

(2) In the case of any deposit at least half of which is uninsured, 130 percent of such applicable yield.

(iii) An undercapitalized insured depository institution may not accept, renew or roll over any brokered deposit.
(4) An undercapitalized insured depository institution may not solicit deposits by offering an effective yield that exceeds by more than 75 basis points the prevailing effective yields on insured deposits of comparable maturity in such institution’s normal market area or in the market area in which such deposits are being solicited.

(5) For purposes of the restriction contained in paragraphs (b)(2)(ii)(A) and (b)(3)(ii) of this section, the effective yields in the relevant markets are the average of effective yields offered by other insured depository institutions in the market area in which deposits are being solicited. An effective yield on a deposit with an odd maturity violates paragraphs (b)(2)(ii)(A) and (b)(3)(ii) of this section if it is more than 75 basis points higher than the yield calculated by interpolating between the yields offered by other insured depository institutions on deposits of the next longer and shorter maturities offered in the market. A market area is any readily defined geographical area in which the rates offered by any one insured depository institution soliciting deposits in that area may affect the rates offered by other insured depository institutions operating in the same area.

(c) Waiver. The FDIC may, on a case-by-case basis and upon application by an adequately capitalized insured depository institution, waive the prohibition on the acceptance, renewal or rollover of brokered deposits upon a finding that such acceptance, renewal or rollover does not constitute an unsafe or unsound practice with respect to such institution. The FDIC may conclude that it is not unsafe or unsound and may grant a waiver when the acceptance, renewal or rollover of brokered deposits is determined to pose no undue risk to the institution. Any waiver granted may be revoked at any time by written notice to the institution. For filing requirements, consult 12 CFR 303.243.

(d) Exclusion for institutions in FDIC conservatorship. No insured depository institution for which the FDIC has been appointed conservator shall be subject to the prohibition on the acceptance, renewal or rollover of brokered deposits contained in the section 337.6 or section 29 of the Federal Deposit Insurance Act for 90 days after the date on which the institution was placed in conservatorship. During this 90-day period, the institution shall, nevertheless, be subject to the restriction on the payment of interest contained in paragraph (b)(2)(ii) of the section. After such 90-day period, the institution may not accept, renew or rollover any brokered deposit.

(3) The Director of the Division of Supervision, or designee may request, from time to time, quarterly written reports from any deposit broker regarding the volume of brokered deposits placed with a specified insured depository institution and the maturities, rates and costs associated with such deposits.

(4) When a deposit broker ceases to act as such, it shall notify the FDIC in writing at the address indicated in paragraph (h)(1) of this section that it is no longer acting as a deposit broker.

§ 337.10 Waiver.

An insured state nonmember bank has the right to petition the Board of Directors of the Corporation for a waiver of this part or any subpart thereof with respect to any particular transaction or series of similar transactions. A waiver may be granted at the discretion of the Board upon a showing of good cause. All such petitions should be filed with the Office of the Executive Secretary, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.
REFERENCE GUIDE TO REGULATION O
12 C.F.R. Part 215

REGULATION O
12 C.F.R. PART 215
LOANS TO EXECUTIVE OFFICERS, DIRECTORS, AND PRINCIPAL SHAREHOLDERS OF MEMBER BANKS
(Regulation of the Federal Reserve Board)

What is Regulation O?
Regulation O governs extensions of credit to certain categories of borrowers called “insiders.”

Who are “insiders” subject to Regulation O?
Insiders (also called “Regulation O borrowers”) include:
- Directors and Executive Officers of the member bank of the Federal Reserve System
- Directors and Executive Officers of a bank holding company of which a member bank is a subsidiary
- Directors and Executive Officers of any other subsidiary of that bank holding company
- Principal shareholders who own, control or have the power to vote 10% or more of any class of the bank or company’s voting stock (shares held by members of an individual’s immediate family are attributed to the individual)
- “related interests” of the above, including business entities, partnerships, charitable organizations, trusts, or political or campaign committees which a person benefits from or controls

Who are executive officers?
An institution’s executive officers are officers who participate in major policy-making transactions. Executive Officer status is conferred by inclusion of that officer in a resolution adopted by the institution’s Board of Directors – not simply an officer’s title. Having a Senior Vice President title, for example, does not necessarily make one a Regulation O executive officer.

No preferential terms
The bank may not extend credit on preferential terms to any Regulation O borrowers or to any Regulation O borrowers of any of its correspondent banks. It is important to remember that Regulation O does not prohibit lending to insiders. Rather, it places various reporting, pre-approval, amount and term requirements and limits on such lending.

Eligibility for widely-available employee benefit programs
Regulation O insiders employed by the bank are eligible to participate in reduced rate loans or similar credit-related programs which are widely available to employees.

Board approval requirement
Aggregate extensions of credit to each Regulation O insider and his or her related interests may not exceed $500,000 without prior approval of the bank’s board.

Limit on loans to executive officers
Credits to bank’s Executive Officers may not exceed $100,000 except to finance their children’s education or to finance or refinance the purchase, construction, maintenance or improvement of the Executive Officer’s residence on a first lien basis.

Coverage of overdrafts is restricted
Overdrafts of Regulation O insiders may not be paid except in accordance with a written pre-authorized credit plan or under a written agreement to transfer funds from one account to another to cover the overdraft.

How do I ensure that the loan does not involve preferential terms?
The loan must be made on substantially the same terms (including interest rate and collateral) and follow credit underwriting procedures that are no less stringent than those prevailing at the time for comparable transactions with other customers, and the loan may not involve more than the normal risk of repayment or present other unfavorable features.

Lending limit
The aggregate principal amount of loans and extensions of credit to a Regulation O borrower and his or her “related interests” may not exceed the bank’s legal lending limit.

Recordation and Reporting
Regulation O contains various recordation and reporting requirements on insiders and extensions of credit to insiders; particular attention should be paid to Sections 215.8 - 215.12 and 215.22.
REFERENCE GUIDE TO OCC REGULATION
12 C.F.R. Part 31

12 C.F.R. PART 31
EXTENSIONS OF CREDIT TO NATIONAL BANK INSIDERS
(Regulation of the Office of the Comptroller of the Currency)

- Permits bank to extend credit to executive officer (other than under 12 USC 375a) up to higher of $25,000 or 2.5% capital/surplus, but not above $100,000
- Requires majority of disinterested directors to approve credit extensions to any executive officer/director/principal shareholder aggregating above higher of $25,000 or 5% capital/surplus
- Requires majority of disinterested directors to approve credit extensions to any executive officer/director/principal shareholder/related interests above $500,000
- Requires bank to disclose, in response to written request, name of each executive officer/principal shareholder having credit extensions aggregating lesser of 5% capital/surplus or $500,000 from bank during calendar/surplus or $500,000 from bank during calendar quarter/from correspondent banks during calendar year
- No aggregation of bank credit with correspondent bank credit
- Exempts from disclosure if credit extensions not in excess of $25,000
- No requirement to disclose additional information
- Permits disclosure to be based on call report data
- Requires recordkeeping of disclosure requests for 2 years
- Applies FRB Regulation O (12 CFR Part 215) definitions
- Cites annual reports of insider indebtedness under 12 USC 1972(2)

INTERPRETATIONS

31.100
Loans secured by stock or obligations of an affiliate:
- Permits bank to take security interest in affiliate securities as collateral for loan to nonaffiliate without regard to 12 USC 371c restrictions if borrower gives additional collateral and loan not used to purchase affiliate securities

31.101
Federal funds transactions between affiliates:
- Asserts applicability of 12 USC 371c limitations

31.102
Deposits between affiliates banks:
- Recognizes as loans to affiliates subject to 12 USC 371c
- Prohibits bank from pledging assets to secure private deposits unless federal law allows
- Prohibits bank from making deposit in affiliate national bank
- Prohibits bank from making deposit in affiliate state bank unless state law allows state bank to offer collateral satisfactory under 12 USC 371c
UNIFORM COMMERCIAL CODE UPDATE

REVISED ARTICLE 9 - SECURED TRANSACTIONS

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Louisville, Kentucky

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SECTION I
REVISED ARTICLE 9 – SECURED TRANSACTIONS

OVERVIEW

The model revision to Article 9, recommended to the states by the American Law Institute and the National Conference of Commissioners on Uniform State Laws, is the most substantial revision of Article 9 since Kentucky adopted the Uniform Commercial Code in 1958. The 1972 revision, adopted in Kentucky in 1986, was more of a fine tuning of the original article. Introduced and adopted by the 2000 Kentucky General Assembly as Senate Bill 11, Revised Article 9 makes wholesale changes to the law of secured transactions.

Ten states have adopted Revised Article 9 and it is before the Legislature of 26 states. A nationwide effort is underway to have the Revised Article adopted in all 50 states prior to the model effective date of July 1, 2001. The failure of any state to adopt the revisions will create serious conflict of law issues.

Revised Article 9 takes into account advances in technology, particularly the trend toward paperless transactions, and new forms of collateral such as healthcare receivables. The new version resolves the uncertainty of the 1972 version on where to file to perfect security interests. More importantly, Senate Bill 11 Kentucky, adopts central filing in the office of the Secretary of State. Prior to the adoption of Senate Bill 11, Kentucky was the only remaining state with a purely local filing system. Twelve states have some form of dual filing which is expected to disappear as our sister states adopt Revised Article 9.

The scope of Article 9, or the kinds of property in which a security interest can be taken, is larger. More forms of transactions, including the sale of payment intangibles and promissory notes, healthcare receivables, commercial tort claims, and security interests created by certain governmental debtors, will be included under the rules of Article 9.

The primary form of perfection of a security interest will continue to be the filing of a financing statement. However, perfection through control, previously recognized for investment property, is now expanded to letter of credit rights and deposit accounts. Under current Article 9, the location of collateral determines what state's law applies to the perfection of a security interest in collateral. In contract, to simplify various conflicts of law issues, Revised Article 9 will use the law of the state where the debtor resides. Any debtor that is created by a state registration (corporation, LLC, etc.) will be deemed to reside in the state where its charter is filed or it is registered. There will be no more conflicts over the location of the chief executive office, principal place of business, or registered agent.

All states will move to central filing. The goal is for filing systems to be searchable on the Internet. Fixtures are the only form of collateral that will require local filing. The fee schedule in most states, including Kentucky, anticipates and encourages electronic filing without the debtor's signature.

A new part of Article 9, Part 4, deals with the rights of third parties in secured transactions. In many instances, as a matter of law, Part 4 voids anti-assignability provisions. However, there are many specific exceptions, such as one included in Kentucky's bill to preserve the rights of the beneficiaries of structured settlements and supplemental needs trusts.
The former Part 4 on filing becomes Part 5 and the former Part 5 on enforcement rights becomes Part 6. The new part on enforcement rights makes a clear distinction between consumer and commercial transactions and recognizes the rights of "secondary obligors" such as guarantors.

Amendments to other statutes establish a sunset on title liens and remove problems related to the assignment of security interest in motor vehicles.

PART 1. Definitions and Scope.

Deposit accounts, except in consumer transactions, are now included as collateral. A new type of collateral, "payment intangibles," is established (general intangibles under which an account debtor's principal obligation is monetary). Prior Article 9's exclusion of interests in insurance policies is narrowed, and "healthcare insurance receivables" are specifically included within the definition of "account." Pure consignments, previously treated in Article 2, are moved to Article 9. Current Article 9 generally excludes tort claims; however, Revised Article 9 picks up "commercial tort" claims. Tort claims for bodily injury and nonbusiness tort claims of a natural person remain excluded. Transfers of interest by states and their governmental units, now subject to a general exclusion, will be included under Article 9 unless exclusion is specifically mandated by another statute to the extent that it governs the creation, perfection, priority, or enforcement of security interest.

Subject to the provisions of Part 4, Article 9 now enables a security interest to attach to nonassignable general intangibles such as letter of credit rights, promissory notes, permits, licenses, etc.

A nonstandard definition, carried over from former 355.9-109(3), relates to equine interests and defines them as farm products: "Equine interests, including, but not limited to, interests in horses, mares, yearlings, foals, weanlings, stallions, syndicated stallions, and stallion shares (including seasons and other rights in connection therewith), whether or not the debtor has engaged in farming operations and without regard to the use thereof."

PART 2. Creation and Attachment of Security Interest.

As under former 9, attachment continues to require a security agreement, value, and that the debtor have rights in the collateral. Recognizing electronic transactions, the security agreement may be "authenticated." The revision emphasizes that a description may be by type. However, as opposed to a description for financing statements, the description must be sufficient to describe the property and may not be a super generic description.

New duties of the secured party relate to release of collateral over which the secured party exercises control when there is no secured obligation and no commitment to give value. Secured parties have expanded duties to provide a debtor with information concerning collateral and the obligations for which the collateral serves as security.

PART 3. Perfection and Priority.

Part 3 sets the choice of law rules governing perfection and priority in 9-301 through 9-307. Perfection is always at the location of the debtor. 9-307 provides that a "registered organization" is
located in the state under whose law the debtor is organized. Individuals are located at their principal
residence. There are special rules to determine the location for organizations registered under the law of
the United States. Non-US debtors located in a jurisdiction that does not require public notice as a
condition of perfection are deemed to be located in the District of Columbia.

Priority rights in tangible collateral will continue to be determined by the law of the state in
which the collateral is located but for intangible collateral the law will be the jurisdiction of the debtor’s
location.

Special rules are set for the priority of security interests in deposit accounts. 9-327 makes the
priority rules applicable to deposit accounts. The new rules clarify the area where there has been
confusing case law between the rights of secured parties to proceeds of collateral vis-a-vis the rights of a
depository bank to setoff. 9-340 generally makes a bank’s right of setoff prior to a security interest held
by another secured party. Inventory and account lenders will be required to protect their interest in
deposited proceeds through control agreements and lock box accounts.

The priority rules for investment property move from Part 1 to Part 3 and are similar to those
added with the 1994 revisions to Article 8.

Purchase money security interests remain much the same, with the automatic perfection
expanded to 20 days. Kentucky did not adopt Appendix 2 to the model revisions concerning production
money security interests.


This is a new part of Article 9 and contains sections relating to the rights of third parties in
secured transactions. Specific provisions include sections on alienability of debtors’ rights, that a
secured party is not obligated on its debtor’s contracts, the agreement of third parties not to assert
defenses against an assignee, and matters relating to the assignment of accounts. Although Part 4
expands the types of property that can serve as collateral, it also protects the rights of a nondebtor party.
Anti-assignability provisions are limited under 9-407, 408, and 409. To the extent that the anti-
assignability provisions interfere with a debtor’s ability to grant a security interest, Part 4 renders those
provisions unenforceable.

A specific nonuniform section was added to Kentucky’s enactment that prevents the restrictions
on assignability from affecting structured settlements and special needs trusts. This matter has been
brought to the attention of the ABA’s Enactment Committee and may be addressed in a similar manner
on a national scale.

PART 5. Filing—CENTRAL FILING!

Formerly Part 4, the section on filing has been substantially rewritten. It is media neutral and
encourages filing.

A national form of financing statement is offered (9-521). It must provide the name of the
debtor, the secured party, and an indication of the collateral it covers. As opposed to security
agreements, the description for filing purposes may be "super generic" such as "all assets" or "all personal property."

To facilitate electronic filing, Revised 9 does not require a debtor's signature or other form of authorization on a financing statement. As a matter of law, Revised 9 prohibits the filing of an unauthorized financing statement and imposes liability on violators.

Most importantly, for Kentucky's secured parties, it brings our state into the world of central filing. Twelve states retained a form of dual filing, however, Kentucky was the lone state with no central file. Beginning July 1, 2001, the office of the Secretary of State is designated as the proper place to file financing statements in Kentucky.

The Article anticipates most file searches will be accomplished by computer, and tries to address the problem of the adequacy of a debtor's name as it appears on a financing statement. Under revised 9-506, a financing statement is effective if a computer search under the debtor's name reveals the financing statement, even though the name is incorrect on the financing statement itself. Thus, the existing Code's the concept of "seriously misleading" is translated to "whether the computer is fooled."


Secured parties maintain their right to self-help repossession. The concept of "commercial reasonableness" is also carried over into the new Part 6. Revised 9 addresses several issues that have come up in regard to commercially reasonable sales. The Article specifies that a low price will not make a foreclosure sale unreasonable but suggests that a "court should scrutinize carefully all aspects of the disposition."

The rights of third parties, such as guarantors, are specifically recognized. A guarantor, as a matter of statutory law, is entitled to the same notices of sale and protections as the debtor, and cannot waive those rights prior to default.

Revised Article 9 picks up the rule from the original version, changed in 1972, that a secured party must give a notice of sale to all other secured parties.

The rebuttable presumption rule on sale, adopted in Kentucky for all matters other than a failure to give notice, is adopted as a matter of law. Under the rebuttable presumption rule, the secured party's deficiency is diminished to the extent that its failure to comply with the law affected the sale price. The absolute bar rule, existing in some states and in Kentucky for a failure of notice, is statutorily stricken.

An aspect of Revised Article 9 sure to cut down on unnecessary litigation is the safe harbor notice of sale. Specific notices are provided for both commercial and consumer transactions. This concept is borrowed from the federal regulation of consumer credit.

The remedy of strict foreclosure is revitalized. Revised Article 9 will allow a secured party to retain collateral in satisfaction of a debt even if the secured party is not in possession of the collateral or if the collateral is an intangible. Strict foreclosure by default, due to lengthy possession of collateral, is rejected. Strict foreclosure is also made available to a secured party that proposes only partial satisfaction of a debt.
Special consumer rights under Part 6 include: exemption from the 10-day safe harbor notice of disposition, special requirements for the contest of a notice of disposition including a "plain English" form of notice, notification of how a deficiency is calculated prior to collection, exemption from partial strict foreclosure on consumer goods unless waived by the debtor, and, except as allowable by state courts, exemption from the rebuttable presumption rule.

A nonuniform addition to Part 6 will clear an issue relating to repossession titles in Kentucky. Secured parties frequently take a repossession title to collateral prior to sale in order to maximize the value at sale because of a readily available title transfer. Some debtors argue that the taking of a repossession title constitutes a disposition that requires notice of sale. A nonuniform addition to Part 6 in the Kentucky enactment specifies that a secured party’s taking a repossession title is not a disposition for the purposes of Part 6.

PART 7. Transition Rules.

The Article takes effect on July 1, 2001. However, existing KRS 355.9-401A, passed in 1998, and requiring a form of dual filing with the Secretary of State, is repealed effective 90 days following the end of this legislative session. This will give the Secretary of State the opportunity to gear up for true central filing.

The revisions specifically provide that the change in the law does not affect an action, case, or proceeding commenced before the effective date of the Act.

Revised 9 does not render ineffective a financing statement filed before the Act takes effect that satisfied the applicable requirements for perfection at the time it was filed. The financing statement ceases to be effective at the earlier of: (a) the time the financing statement would have ceased to be effective under the law at the time it was filed, or (b) June 30, 2006. The filing of a continuation statement after the effective date of Revised 9 does not continue the effectiveness of a financing statement filed before the effective date.

Financing statements filed locally, that must be continued after the effective date of Revised 9, must be continued with the filing of an "initial financing statement" in the office of the Secretary of State. An initial financing statement that is filed as a continuation statement must satisfy all of the requirements under Part 5 for an initial financing statement and must also identify the pre-effective date financing statement by identifying the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement with respect to the financing statement, and indicate that the pre-effective date financing statement remains effective.

KRS 355.9-706(4) authorizes a secured party, when it files an initial financing statement with the Secretary of State to continue an existing local filing, to send a copy of the initial financing statement to the county clerk in which the pre-effective date financing statement was filed, and subsequently, to send copies of continuation statements filed with the Secretary of State. The county clerk is instructed to "append" these documents to the file existing in the clerk’s office. The intent of this section is to ease the transition from a purely local filing statute to a central file. The county clerk is not authorized to charge a fee for this service.
Revised Article 9 will determine the priority of conflicting claims to collateral unless the priorities were established under prior Article 9, in which case the former version will determine priority.

Additional transition provisions for Kentucky include directions to county clerks who receive statements under former Part 4, prior to the effective date of Revised 9, but who have not filed or indexed the statements as of the effective date, to file and index the statements as soon as practical. County clerks are additionally directed to maintain all records filed under Part 4 of Article 9 until the later of one year after the lapse of the initial financing statement or July 1, 2008. County clerks are also directed, at the request of a secured party, to search the records that they continue to maintain.

In order to make the Secretary of State’s system for electronic filing and searching available to all Kentuckians, one of our transition rules directs that county clerks provide a means within their office by which the Secretary of State’s system can be searched and through which electronic filings can be made. To avoid any confusion the sub-section specifies that it shall not be construed to require filing through the means provided by a county clerk.

**TITLE LIENS.**

The title lien system remains at the local level. The fee for filing a title lien is increased from $8 to $12. It is through this means that the change in the law is kept revenue neutral as to Kentucky’s county clerks.

A title lien now remains effective forever unless it is released by a secured party. This has caused a problem for Kentuckians when the secured party is out of business or for other reasons cannot be located. Hence, at the suggestion of Kentucky’s county clerks, a seven year sunset is placed on the effectiveness of title liens, except for manufactured homes, for which the initial period is 14 years. However, a continuation statement may be filed within the last six months preceding the expiration of the title lien that extends the expiration date for an additional seven years for all titled property. A special noncodified transition rule provides that the sunset provision is retroactive. The effectiveness of existing notations that would otherwise expire on July 1, 2001, or within the first six months following that date, is automatically extended for six months after July 1, 2001. For those notations, the filing of a continuation statement within the first six months after July 1, 2001, extends the expiration date for seven years from the date that the title lien notation would have otherwise expired. County clerks will receive no additional fee for handling the continuation process which must be administered through the AVIS system or its successor.

For the purposes of determining in what county to file a title lien, the provisions of former KRS 355.9-401 are adopted as part of KRS 186A-190.

An oversight dating to 1986 is corrected by repealing subsection 1 of KRS 186.045. The subsection required an assignor of a title lien to file a statement of assignment with the county clerk. This provision inhibited the securitization of automobile paper. The mandated filing of an assignment was in contrast to the permissive filing under former Part 4 and is repealed effective July 1, 2001.
SENATE BILL 11

SB 11 (BR 810) - D. Karem

AN ACT providing for the adoption of revised articles of the Uniform Commercial Code and making changes incidental thereto.


SB 11 - AMENDMENTS

SCA (1, G. Neal) - Make technical corrections.
SFA (2, A. Kerr) - Incorporate technical and corrective amendments to the official text from the National Conference of Commissioners on Uniform State Laws and the American Law Institute issued subsequent to the preparation of the bill; preserve the substance of the current KRS 355.9-109(3)(b) by adding "equine interests" into the revised Article 9 definition of "farm products;" preserve the substance of the current KRS 355.9-307(6) relating to the ability of recognized horse sale auctions to sell horses and interests in horses clear of liens; create a new section of KRS Chapter 413 to preserve the current KRS 355.9-319 relating to the availability of remedies for parties holding liens and security interests in equine interests; exempt certain statutes involving the Department of Insurance from the application of specific provisions of revised Article 9; establish transition provisions from the current local filing of financing statements with the county clerks to the new centralized filing with the Secretary of State, including distribution of filing fees from the revised Article 9, record retention requirements, and eventual searching and optional electronic filing at county clerks' offices.
HCS - Make technical corrections; amend proposed KRS 355.9-710 to delete fee splitting between Secretary of State and county clerks; further amend KRS 64.012 to provide for a $12 fee for the county clerk for noting a security interest on a certificate of title under KRS Chapter 186A; add a section to amend KRS 186A.190 to provide for expiration of notations for undischarged security interests after specified periods, if not extended by a continuation statement, and to make a conforming amendment to preserve material not retained in revised Article 9, and to transfer fee language to KRS 64.012's listing of fees; amend KRS 142.010 to transfer material being deleted by amendment from KRS 186A.190(7); add sections making conforming amendments to existing KRS 6.787, 186A.193, 382.200, and 425.011, and further amend KRS 186.045 to make conforming amendments; add KRS 186A.196, 186A.197, 355.11-102, 355.11-103, 355.11-104, 355.11-105, 355.11-106, 355.11-107, and 355.11-108; provide by noncodified section for retroactive application of expiration of notations on certificates of title.
HFA (1, S. Cave) - Amend to reduce fee from $12 to $7.50.
HFA (2/P, S. Westrom) - Attach provisions of HB 67.
HFA (3/Title, S. Westrom) - Make title amendment.

(Prefiled by the sponsor(s))

Jan 4-introduced in Senate; to Judiciary (S)
Feb 2-reported favorably, 1st reading, to Calendar with committee amendment (1)
Feb 3-2nd reading, to Rules
Feb 8-posted for passage in the Regular Orders of the Day for Thursday, February 10, 2000;
floor amendment (2) filed
Feb 10-passed over and retained in the Orders of the Day
Feb 15-3rd reading, passed 36-0 with committee amendment (1), floor amendment (2)
Feb 16-received in House
Feb 17-to Judiciary (H)
Mar 7-posted in committee
Mar 16-reported favorably, 1st reading, to Calendar with Committee Substitute
Mar 17-2nd reading, to Rules; floor amendment (1) filed to Committee Substitute
Mar 20-posted for passage in the Regular Orders of the Day for Tuesday, March 21, 2000
Mar 22-floor amendment (2) filed to Committee Substitute, floor amendment (3-title) filed
Mar 24-floor amendments (2) and (3-title) withdrawn
Mar 27-3rd reading, passed 97-0 with Committee Substitute
Mar 28-received in Senate
Mar 29-posted for passage for concurrence in House Committee Substitute ; Senate concurred
in House Committee Substitute ; passed 38-0
GENERAL ASSEMBLY
COMMONWEALTH OF KENTUCKY
2000 REGULAR SESSION

SENATE BILL 11
Sections Pertaining to UCC Article 9
SEGMENT C
REVISED ARTICLE 9
(SECURED TRANSACTIONS)
PART 1
GENERAL PROVISIONS
SUBPART 1 SHORT TITLE, DEFINITIONS
AND GENERAL CONCEPTS

SECTION 21. KRS 355.9-101 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

This Article may be cited as Uniform Commercial Code – Secured Transactions.

SECTION 22. KRS 355.9-102 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) In this article:

(a) “Accession” means goods that are physically united with other goods in such a manner that the identity of the original goods is not lost.

(b) 1. “Account,” except as used in “account for,” means a right to payment of a monetary obligation, whether or not earned by performance:
   a. For property that has been or is to be sold, leased, licensed, assigned, or otherwise disposed of;
   b. For services rendered or to be rendered;
   c. For a policy of insurance issued or to be issued;
   d. For a secondary obligation incurred or to be incurred;
   e. For energy provided or to be provided;
   f. For the use or hire of a vessel under a charter or other contract;
   g. Arising out of the use of a credit or charge card or information contained on or for use with the card; or
   h. As winnings in a lottery or other game of chance operated or sponsored by a state, governmental unit of a state, or person licensed or authorized to operate the game by a state or governmental unit of a state.

2. The term includes health-care-insurance receivables.

3. The term does not include:
   a. Rights to payment evidenced by chattel paper or an instrument;
   b. Commercial tort claims;
   c. Deposit accounts;
   d. Investment property;
   e. Letter-of-credit rights or letters of credit; or
   f. Rights to payment for money or funds advanced or sold, other than rights arising out of the use of a credit or charge card or information contained on or for use with the card.

(c) “Account debtor” means a person obligated on an account, chattel paper, or general intangible. The term does not include persons obligated to pay a negotiable instrument, even if the instrument constitutes part of chattel paper.

(d) “Accounting,” except as used in “accounting for,” means a record:

1. Authenticated by a secured party;

2. Indicating the aggregate unpaid secured obligations as of a date not more than thirty-five (35) days earlier or thirty-five (35) days later than the date of the record; and

3. Identifying the components of the obligations in reasonable detail.

(e) “Agricultural lien” means an interest, other than a security interest, in farm products:
1. Which secures payment or performance of an obligation for:
   a. Goods or services furnished in connection with a debtor's farming operation; or
   b. Rent on real property leased by a debtor in connection with its farming operation;

2. Which is created by statute in favor of a person that:
   a. In the ordinary course of its business furnished goods or services to a debtor in connection with a
      debtor's farming operation; or
   b. Leased real property to a debtor in connection with the debtor's farming operation; and
   c. Whose effectiveness does not depend on the person's possession of the personal property.

(f) "As-extracted collateral" means:
   1. Oil, gas, or other minerals that are subject to a security interest that:
      a. Is created by a debtor having an interest in the minerals before extraction; and
      b. Attaches to the minerals as extracted; or
   2. Accounts arising out of the sale at the wellhead or minehead of oil, gas, or other minerals in which the debtor
      had an interest before extraction.

(g) "Authenticate" means:
   1. To sign; or
   2. To execute or otherwise adopt a symbol, or encrypt or similarly process a record in whole or in part, with the
      present intent of the authenticating person to identify the person and adopt or accept a record.

(b) "Bank" means an organization that is engaged in the business of banking. The term includes savings banks, savings
    and loan associations, credit unions, and trust companies.

(i) "Cash proceeds" means proceeds that are money, checks, deposit accounts, or the like.

(i) "Certificate of title" means a certificate of title with respect to which a statute provides for the security interest in
    question to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the
    rights of a lien creditor with respect to the collateral.

(k) "Chattel paper" means a record or records that evidence both a monetary obligation and a security interest in specific
    goods, a security interest in specific goods and software used in the goods, a security interest in specific goods and
    license of software used in the goods, a lease of specific goods, or a lease of specific goods and license of software used
    in the goods. In this paragraph, "monetary obligation" means a monetary obligation secured by the goods or owed
    under a lease of the goods and includes a monetary obligation with respect to software used in the goods. The term does
    not include:
   1. Charters or other contracts involving the use or hire of a vessel; or
   2. Records that evidence a right of payment arising out of the use of a credit or charge card or information
      contained on or for use with the card.

If a transaction is evidenced by records that include an instrument or series of instruments, the group of records taken
    together constitutes chattel paper.

(l) "Collateral" means the property subject to a security interest or agricultural lien. The term includes:
   1. Proceeds to which a security interest attaches;
   2. Accounts, chattel paper, payment intangibles, and promissory notes that have been sold; and
   3. Goods that are the subject of a consignment.

(m) "Commercial tort claim" means a claim arising in tort with respect to which:
   1. The claimant is an organization; or
   2. The claimant is an individual and the claim:
      a. Arose in the course of the claimant's business or profession; and
      b. Does not include damages arising out of personal injury to or the death of an individual.

(n) "Commodity account" means an account maintained by a commodity intermediary in which a commodity contract is
    carried for a commodity customer.
(o) "Commodity contract" means a commodity futures contract, an option on a commodity futures contract, a commodity option, or another contract if the contract or option is:
1. Traded on or subject to the rules of a board of trade that has been designated as a contract market for such a contract pursuant to federal commodities laws; or
2. Traded on a foreign commodity board of trade, exchange, or market, and is carried on the books of a commodity intermediary for a commodity customer.

(p) "Commodity customer" means a person for which a commodity intermediary carries a commodity contract on its books.

(q) "Commodity intermediary" means a person that:
1. Is registered as a futures commission merchant under federal commodities law; or
2. In the ordinary course of its business provides clearance or settlement services for a board of trade that has been designated as a contract market pursuant to federal commodities law.

(r) "Communicate" means:
1. To send a written or other tangible record;
2. To transmit a record by any means agreed upon by the persons sending and receiving the record; or
3. In the case of transmission of a record to or by a filing office, to transmit a record by any means prescribed by filing-office rule.

(s) "Consignee" means a merchant to which goods are delivered in a consignment.

(t) "Consignment" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:
1. The merchant:
   a. Deals in goods of that kind under a name other than the name of the person making delivery;
   b. Is not an auctioneer; and
   c. Is not generally known by its creditors to be substantially engaged in selling the goods of others;
2. With respect to each delivery, the aggregate value of the goods is one thousand dollars ($1,000) or more at the time of delivery;
3. The goods are not consumer goods immediately before delivery; and
4. The transaction does not create a security interest that secures an obligation.

(u) "Consignor" means a person that delivers goods to a consignee in a consignment.

(v) "Consumer debtor" means a debtor in a consumer transaction.

(w) "Consumer goods" means goods that are used or bought for use primarily for personal, family, or household purposes.

(x) "Consumer-goods transaction" means a consumer transaction in which:
1. An individual incurs an obligation primarily for personal, family, or household purposes; and
2. A security interest in consumer goods secures the obligation.

(y) "Consumer obligor" means an obligor who is an individual and who incurred the obligation as part of a transaction entered into primarily for personal, family, or household purposes.

(z) "Consumer transaction" means a transaction in which:
1. An individual incurs an obligation primarily for personal, family, or household purposes;
2. A security interest secures the obligation; and
3. The collateral is held or acquired primarily for personal, family, or household purposes.

(aa) "Continuation statement" means an amendment of a financing statement which:
1. Identifies, by its file number, the initial financing statement to which it relates; and
2. Indicates that it is a continuation statement for, or that it is filed to continue the effectiveness of, the identified financing statement.
(ab) "Debtor" means:

1. A person having an interest, other than a security interest or other lien, in the collateral, whether or not the person is an obligor;
2. A seller of accounts, chattel paper, payment intangibles, or promissory notes; or
3. A consignee.

(ac) "Deposit account" means a demand, time, savings, passbook, or similar account maintained with a bank. The term does not include investment property or accounts evidenced by an instrument.

(ad) "Document" means a document of title or a receipt of the type described in KRS 355.7-201(2).

(ae) "Electronic chattel paper" means chattel paper evidenced by a record or records consisting of information stored in an electronic medium.

(af) "Encumbrance" means a right, other than an ownership interest, in real property. The term includes mortgages and other liens on real property.

(ag) "Equipment" means goods other than inventory, farm products, or consumer goods.

(ah) "Farm products" means goods, other than standing timber, with respect to which the debtor is engaged in a farming operation and which are:

1. Crops grown, growing, or to be grown, including:
   a. Crops produced on trees, vines, and bushes; and
   b. Aquatic goods produced in aquacultural operations;
2. Livestock, born or unborn, including aquatic goods produced in aquacultural operations;
3. Supplies used or produced in a farming operation;
4. Products of crops or livestock in their unmanufactured states; or
5. Equine interests, including, but not limited to, interests in horses, mares, yearlings, foals, weanlings, stallions, syndicated stallions, and stallion shares (including seasons and other rights in connection therewith), whether or not the debtor is engaged in farming operations and without regard to the use thereof. If goods are farm products, they are neither equipment nor inventory.

(ai) "Farming operation" means raising, cultivating, propagating, fattening, grazing, or any other farming, livestock, or aquacultural operation.

(aj) "File number" means the number assigned to an initial financing statement pursuant to subsection (1) of Section 110 of this Act.

(ak) "Filing office" means an office designated in Section 92 of this Act as the place to file a financing statement.

(al) "Filing-office rule" means a rule adopted pursuant to Section 117 of this Act.

(am) "Financing statement" means a record or records composed of an initial financing statement and any filed record relating to the initial financing statement.

(an) "Fixture filing" means the filing of a financing statement covering goods that are or are to become fixtures and satisfying subsections (1) and (2) of Section 93 of this Act. The term includes the filing of a financing statement covering goods of a transmitting utility which are or are to become fixtures.

(aa) "Fixtures" means goods that have become so related to particular real property that an interest in them arises under real property law.

(ab) "General intangible" means any personal property, including things in action, other than accounts, chattel paper, commercial tort claims, deposit accounts, documents, goods, instruments, investment property, letter-of-credit rights, letters of credit, money, and oil, gas, or other minerals before extraction. The term includes payment intangibles and software.

(ac) "Good faith" means honesty in fact and the observance of reasonable commercial standards of fair dealing.

(ad) "Goods" means all things that are movable when a security interest attaches.

1. The term includes:
   a. Fixtures;
   b. Standing timber that is to be cut and removed under a conveyance or contract for sale;
c. The unborn young of animals;
d. Crops grown, growing, or to be grown, even if the crops are produced on trees, vines, or bushes; and
e. Manufactured homes.

2. The term also includes a computer program embedded in goods and any supporting information provided in connection with a transaction relating to the program if:
   a. The program is associated with the goods in such a manner that it customarily is considered part of the goods; or
   b. By becoming the owner of the goods, a person acquires a right to use the program in connection with the goods.

3. The term does not include a computer program embedded in goods that consist solely of the medium in which the program is embedded.

4. The term also does not include accounts, chattel paper, commercial tort claims, deposit accounts, documents, general intangibles, instruments, investment property, letter-of-credit rights, letters of credit, money, or oil, gas, or other minerals before extraction.

   (as) "Governmental unit" means a subdivision, agency, department, county, parish, municipality, or other unit of the government of the United States, a State, or a foreign country. The term includes an organization having a separate corporate existence if the organization is eligible to issue debt on which interest is exempt from income taxation under the laws of the United States.

   (ai) "Health-care-insurance receivable" means an interest in or claim under a policy of insurance which is a right to payment of a monetary obligation for health-care goods or services provided.

   (aii) "Instrument" means a negotiable instrument or any other writing that evidences a right to the payment of a monetary obligation, is not itself a security agreement or lease, and is of a type that in ordinary course of business is transferred by delivery with any necessary indorsement or assignment. The term does not include:

   1. Investment property;
   2. Letters of credit; or
   3. Writings that evidence a right to payment arising out of the use of a credit or charge card or information contained on or for use with the card.

   (aiii) "Inventory" means goods, other than farm products, which:

   1. Are leased by a person as lessor;
   2. Are held by a person for sale or lease or to be furnished under a contract of service;
   3. Are furnished by a person under a contract of service; or
   4. Consist of raw materials, work in process, or materials used or consumed in a business.

   (aiiiv) "Investment property" means a security, whether certificated or uncertificated, security entitlement, securities account, commodity contract, or commodity account.

   (aii) "Jurisdiction of organization," with respect to a registered organization, means the jurisdiction under whose law the organization is organized.

   (aii) "Letter-of-credit right" means a right to payment or performance under a letter of credit, whether or not the beneficiary has demanded or is at the time entitled to demand payment or performance. The term does not include the right of a beneficiary to demand payment or performance under a letter of credit.

   (aii) "Lien creditor" means:

   1. A creditor that has acquired a lien on the property involved by attachment, levy, or the like;
   2. An assignee for benefit of creditors from the time of assignment;
   3. A trustee in bankruptcy from the date of the filing of the petition; or
   4. A receiver in equity from the time of appointment.

   (aii) "Manufactured home" means a structure, transportable in one (1) or more sections, which, in the traveling mode, is eight (8) body feet or more in width or forty (40) body feet or more in length, or, when erected on site, is three hundred twenty (320) or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-
conditioning, and electrical systems contained therein. The term includes any structure that meets all of the
requirements of this paragraph except the size requirements and with respect to which the manufacturer voluntarily
files a certification required by the United States Secretary of Housing and Urban Development and complies with the
standards established under Title 42 of the United States Code.

(bb) "Manufactured-home transaction" means a secured transaction:

1. That creates a purchase-money security interest in a manufactured home, other than a manufactured home
   held as inventory; or
2. In which a manufactured home, other than a manufactured home held as inventory, is the primary collateral.

(bc) "Mortgage" means a consensual interest in real property, including fixtures, which secures payment or performance of
an obligation.

(bd) "New debtor" means a person that becomes bound as debtor under subsection (4) of Section 33 of this Act by a security
agreement previously entered into by another person.

(be) "New value" means:

1. Money;
2. Money's worth in property, services, or new credit; or
3. Release by a transferee of an interest in property previously transferred to the transferee.

The term does not include an obligation substituted for another obligation.

(bf) "Noncash proceeds" means proceeds other than cash proceeds.

(bg) "Obligor" means a person that, with respect to an obligation secured by a security interest in or an agricultural lien on
the collateral:

1. Owes payment or other performance of the obligation;
2. Has provided property other than the collateral to secure payment or other performance of the obligation; or
3. Is otherwise accountable in whole or in part for payment or other performance of the obligation.

The term does not include issuers or nominated persons under a letter of credit.

(bh) "Original debtor," except as used in subsection (3) of Section 50 of this Act, means a person that, as debtor, entered
into a security agreement to which a new debtor has become bound under subsection (4) of Section 33 of this Act.

(bi) "Payment intangible" means a general intangible under which the account debtor's principal obligation is a monetary
obligation.

(bj) "Person related to," with respect to an individual, means:

1. The spouse of the individual;
2. A brother, brother-in-law, sister, or sister-in-law of the individual;
3. An ancestor or lineal descendant of the individual or the individual's spouse; or
4. Any other relative, by blood or marriage, of the individual or the individual's spouse who shares the same home
   with the individual.

(bk) "Person related to," with respect to an organization, means:

1. A person directly or indirectly controlling, controlled by, or under common control with the organization;
2. An officer or director of, or a person performing similar functions with respect to, the organization;
3. An officer or director of, or a person performing similar functions with respect to, a person described in
   subparagraph 1. of this paragraph;
4. The spouse of an individual described in subparagraph 1., 2., or 3. of this paragraph; or
5. An individual who is related by blood or marriage to an individual described in subparagraph 1., 2., 3., or 4. of
   this paragraph and shares the same home with the individual.

(bl) "Proceeds," except as used in subsection (2) of Section 127 of this Act, means the following property:

1. Whatever is acquired upon the sale, lease, license, exchange, or other disposition of collateral;
2. Whatever is collected on, or distributed on account of, collateral;
3. Rights arising out of collateral:

4. To the extent of the value of collateral, claims arising out of the loss, nonconformity, or interference with the use of, defects or infringement of rights in, or damage to, the collateral; or

5. To the extent of the value of collateral and to the extent payable to the debtor or the secured party, insurance payable by reason of the loss or nonconformity of, defects or infringement of rights in, or damage to, the collateral.

(bm) "Promissory note" means an instrument that evidences a promise to pay a monetary obligation, does not evidence an order to pay, and does not contain an acknowledgment by a bank that the bank has received for deposit a sum of money or funds.

(bn) "Proposal" means a record authenticated by a secured party which includes the terms on which the secured party is willing to accept collateral in full or partial satisfaction of the obligation it secures pursuant to Sections 138, 139, and 140 of this Act.

(ba) "Public-finance transaction" means a secured transaction in connection with which:

1. Debt securities are issued;

2. All or a portion of the securities issued have an initial stated maturity of at least twenty (20) years; and

3. The debtor, obligor, secured party, account debtor or other person obligated on collateral, assignor or assignee of a secured obligation, or assignor or assignee of a security interest is a state or a governmental unit of a state.

(bp) "Pursuant to commitment," with respect to an advance made or other value given by a secured party, means pursuant to the secured party's obligation, whether or not a subsequent event of default or other event not within the secured party's control has relieved or may relieve the secured party from its obligation.

(bq) "Record," except as used in "for record," "of record," "record or legal title," and "record owner," means information that is inscribed on a tangible medium or which is stored in an electronic or other medium and is retrievable in perceivable form.

(br) "Registered organization" means an organization organized solely under the law of a single state or the United States and as to which the state or the United States must maintain a public record showing the organization to have been organized.

(bs) "Secondary obligor" means an obligor to the extent that:

1. The obligor's obligation is secondary; or

2. The obligor has a right of recourse with respect to an obligation secured by collateral against the debtor, another obligor, or property of either.

(bu) "Secured party" means:

1. A person in whose favor a security interest is created or provided for under a security agreement, whether or not any obligation to be secured is outstanding;

2. A person that holds an agricultural lien;

3. A consignor;

4. A person to which accounts, chattel paper, payment intangibles, or promissory notes have been sold;

5. A trustee, indenture trustee, agent, collateral agent, or other representative in whose favor a security interest or agricultural lien is created or provided for; or

6. A person that holds a security interest arising under KRS 355.2-401, 355.2-505, 355.2-711(3), 355.2A-508(5), 355.4-210, or 355.5-118.

(bv) "Security agreement" means an agreement that creates or provides for a security interest.

(bv) "Send," in connection with a record or notification, means:

1. To deposit in the mail, deliver for transmission, or transmit by any other usual means of communication, with postage or cost of transmission provided for, addressed to any address reasonable under the circumstances; or

2. To cause the record or notification to be received within the time that it would have been received if properly sent under subparagraph 1. of this paragraph.

(bw) "Software" means a computer program and any supporting information provided in connection with a transaction relating to the program. The term does not include a computer program that is included in the definition of goods.
(bx) “State” means a state of the United States, the District of Columbia, Puerto Rico, the United States Virgin Islands, or any territory or insular possession subject to the jurisdiction of the United States.

(by) “Supporting obligation” means a letter-of-credit right or secondary obligation that supports the payment or performance of an account, chattel paper, a document, a general intangible, an instrument, or investment property.

(bz) “Tangible chattel paper” means chattel paper evidenced by a record or records consisting of information that is inscribed on a tangible medium.

(ca) “Termination statement” means an amendment of a financing statement which:
1. Identifies, by its file number, the initial financing statement to which it relates; and
2. Indicates either that it is a termination statement or that the identified financing statement is no longer effective.

(cb) “Transmitting utility” means a person primarily engaged in the business of:
1. Operating a railroad, subway, street railway, or trolley bus;
2. Transmitting communications electrically, electromagnetically, or by light;
3. Transmitting goods by pipeline or sewer; or
4. Transmitting or producing and transmitting electricity, steam, gas, or water.

The following definitions in other articles apply to this article:

“Applicant” KRS 355.5-102.

“Beneficiary” KRS 355.5-102.

“Broker” KRS 355.5-102.

“Certificated security” KRS 355.8-102.

“Check” KRS 355.3-104.

“Clearing corporation” KRS 355.8-102.

“Contract for sale” KRS 355.2-106.

“Customer” KRS 355.4-104.

“Entitlement holder” KRS 355.8-102.

“Financial asset” KRS 355.8-102.

“Holder in due course” KRS 355.2-102.

“Issuer” (with respect to a letter of credit or letter-of-credit right) KRS 355.5-102.

“Issuer” (with respect to a security) KRS 355.8-201.

“Lease” KRS 355.2A-103.

“Lease agreement” KRS 355.2A-103.

“Lease contract” KRS 355.2A-103.

“Leasehold interest” KRS 355.2A-103.

“Lessor” KRS 355.2A-103.

“Lessor’s residual interest” KRS 355.2A-103.

“Letter of credit” KRS 355.5-102.

“Merchant” KRS 355.2-104.

“Negotiable instrument” KRS 355.3-104.

“Nominated person” KRS 355.5-102.
“Note” KRS 355.3-104.

“Proceeds of a letter of credit” KRS 355.5-114.

“Prove” KRS 355.3-103.

“Sale” KRS 355.2-106.

“Securities account” KRS 355.8-501.

“Securities intermediary” KRS 355.8-102.

“Security” KRS 355.8-102.

“Security certificate” KRS 355.8-102.

“Security entitlement” KRS 355.8-102.

“Uncertificated security” KRS 355.8-102.

(3) Article 1 of this chapter contains general definitions and principles of construction and interpretation applicable throughout this article.

SECTION 23. KRS 355.9-103 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) In this section:

(a) “Purchase-money collateral” means goods or software that secures a purchase-money obligation incurred with respect to that collateral; and

(b) “Purchase-money obligation” means an obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used.

(2) A security interest in goods is a purchase-money security interest:

(a) To the extent that the goods are purchase-money collateral with respect to that security interest;

(b) If the security interest is in inventory that is or was purchase-money collateral, also to the extent that the security interest secures a purchase-money obligation incurred with respect to other inventory in which the secured party holds or held a purchase-money security interest; and

(c) Also to the extent that the security interest secures a purchase-money obligation incurred with respect to software in which the secured party holds or held a purchase-money security interest.

(3) A security interest in software is a purchase-money security interest to the extent that the security interest also secures a purchase-money obligation incurred with respect to goods in which the secured party holds or held a purchase-money security interest if:

(a) The debtor acquired its interest in the software in an integrated transaction in which it acquired an interest in the goods; and

(b) The debtor acquired its interest in the software for the principal purpose of using the software in the goods.

(4) The security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.

(5) In a transaction other than a consumer-goods transaction, if the extent to which a security interest is a purchase-money security interest depends on the application of a payment to a particular obligation, the payment must be applied:

(a) In accordance with any reasonable method of application to which the parties agree;

(b) In the absence of the parties' agreement to a reasonable method, in accordance with any intention of the obligor manifested at or before the time of payment; or

(c) In the absence of an agreement to a reasonable method and a timely manifestation of the obligor's intention, in the following order:

1. To obligations that are not secured; and

2. If more than one (1) obligation is secured, to obligations secured by purchase-money security interests in the order in which those obligations were incurred.

(6) In a transaction other than a consumer-goods transaction, a purchase-money security interest does not lose its status as such, even if:

(a) The purchase-money collateral also secures an obligation that is not a purchase-money obligation;
In a transaction other than a consumer-goods transaction, a secured party claiming a purchase-money security interest has the burden of establishing the extent to which the security interest is a purchase-money security interest.

The limitation of the rules in subsections (5), (6), and (7) of this section to transactions other than consumer-goods transactions is intended to leave to the court the determination of the proper rules in consumer-goods transactions. The court may not infer from that limitation the nature of the proper rule in consumer-goods transactions and may continue to apply established approaches.

SECTION 24. KRS 355.9-104 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A secured party has control of a deposit account if:

(a) The secured party is the bank with which the deposit account is maintained;

(b) The debtor, secured party, and bank have agreed in an authenticated record that the bank will comply with instructions originated by the secured party directing disposition of the funds in the deposit account without further consent by the debtor; or

(c) The secured party becomes the bank’s customer with respect to the deposit account.

(2) A secured party that has satisfied subsection (1) of this section has control, even if the debtor retains the right to direct the disposition of funds from the deposit account.

SECTION 25. KRS 355.9-105 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

A secured party has control of electronic chattel paper if the record or records comprising the chattel paper are created, stored, and assigned in such a manner that:

(1) A single authoritative copy of the record or records exists which is unique, identifiable and, except as otherwise provided in subsections (4), (5), and (6) of this section, unalterable;

(2) The authoritative copy identifies the secured party as the assignee of the record or records;

(3) The authoritative copy is communicated to and maintained by the secured party or its designated custodian;

(4) Copies or revisions that add or change an identified assignee of the authoritative copy can be made only with the participation of the secured party;

(5) Each copy of the authoritative copy and any copy of a copy is readily identifiable as a copy that is not the authoritative copy; and

(6) Any revision of the authoritative copy is readily identifiable as an authorized or unauthorized revision.

SECTION 26. KRS 355.9-106 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A person has control of a certificated security, uncertificated security, or security entitlement as provided in Section 1680U of this Act.

(2) A secured party has control of a commodity contract if:

(a) The secured party is the commodity intermediary with which the commodity contract is carried; or

(b) The commodity customer, secured party, and commodity intermediary have agreed that the commodity intermediary will apply any value distributed on account of the commodity contract as directed by the secured party without further consent by the commodity customer.

(3) A secured party having control of all security entitlements or commodity contracts carried in a securities account or commodity account has control over the securities account or commodity account.

SECTION 27. KRS 355.9-107 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

A secured party has control of a letter-of-credit right to the extent of any right to payment or performance by the issuer or any nominated person if the issuer or nominated person has consented to an assignment of proceeds of the letter of credit under subsection (3) of Section 14 of this Act or otherwise applicable law or practice.

SECTION 28. KRS 355.9-108 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsections (3), (4), and (5) of this section, a description of personal or real property is sufficient, whether or not it is specific, if it reasonably identifies what is described.

(2) Except as otherwise provided in subsection (4) of this section, a description of collateral reasonably identifies the collateral if it identifies the collateral by:
(a) Specific listing;
(b) Category;
(c) Except as otherwise provided in subsection (5) of this section, a type of collateral defined in this chapter;
(d) Quantity;
(e) Computational or allocational formula or procedure; or
(f) Except as otherwise provided in subsection (3) of this section, any other method, if the identity of the collateral is objectively determinable.

(3) A description of collateral as “all the debtor’s assets” or “all the debtor’s personal property” or using words of similar import does not reasonably identify the collateral.

(4) Except as otherwise provided in subsection (5) of this section, a description of a security entitlement, securities account, or commodity account is sufficient if it describes:
(a) The collateral by those terms or as investment property; or
(b) The underlying financial asset or commodity contract.

(5) A description only by type of collateral defined in this chapter is an insufficient description of:
(a) A commercial tort claim; or
(b) In a consumer transaction, consumer goods, a security entitlement, a securities account, or a commodity account.

SUBPART 2. APPLICABILITY OF ARTICLE

SECTION 29. KRS 355.9-109 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsections (3) and (4) of this section, this article applies to:
(a) A transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract;
(b) An agricultural lien;
(c) A sale of accounts, chattel paper, payment intangibles, or promissory notes;
(d) A consignment;
(e) A security interest arising under KRS 355.2-401, 355.2-505, 355.2-711(3), or 355.2A-508(5), as provided in Section 30 of this Act; and
(f) A security interest arising under Section 18 of this Act or Section 165 of this Act.

(2) The application of this article to a security interest in a secured obligation is not affected by the fact that the obligation is itself secured by a transaction or interest to which this article does not apply.

(3) This article does not apply to the extent that:
(a) A statute, regulation, or treaty of the United States preempts this article;
(b) Another statute of this Commonwealth expressly governs the creation, perfection, priority, or enforcement of a security interest created by this Commonwealth or a governmental unit of this Commonwealth;
(c) A statute of another state, a foreign country, or a governmental unit of another state or a foreign country, other than a statute generally applicable to security interests, expressly governs creation, perfection, priority, or enforcement of a security interest created by the state, country, or governmental unit; or
(d) The rights of a transferee beneficiary or nominated person under a letter of credit are independent and superior under Section 14 of this Act.

(4) This article does not apply to:
(a) A landlord’s lien, other than an agricultural lien;
(b) A lien, other than an agricultural lien, given by statute or other rule of law for services or materials, but Section 73 of this Act applies with respect to priority of the lien;
(c) An assignment of a claim for wages, salary, or other compensation of an employee, or for workers’ compensation benefits payable to an individual;
(d) A sale of accounts, chattel paper, payment intangibles, or promissory notes as part of a sale of the business out of which they arose;
(e) An assignment of accounts, chattel paper, payment intangibles, or promissory notes which is for the purpose of collection only;

(f) An assignment of a right to payment under a contract to an assignee that is also obligated to perform under the contract;

(p) An assignment of a single account, payment intangible, or promissory note to an assignee in full or partial satisfaction of a preexisting indebtedness;

(h) A transfer of an interest in or an assignment of a claim under a policy of insurance, other than an assignment by or to a health-care provider of a health-care-insurance receivable and any subsequent assignment of the right to payment, but Sections 55 and 62 of this Act apply with respect to proceeds and priorities in proceeds;

(i) An assignment of a right represented by a judgment, other than a judgment taken on a right to payment that was collateral;

(i) A right of recoupment or set-off, but:

1. Section 80 of this Act applies with respect to the effectiveness of rights of recoupment or set-off against deposit accounts; and

2. Section 86 of this Act applies with respect to defenses or claims of an account debtor;

(k) The creation or transfer of an interest in or lien on real property, including a lease or rents thereunder, except to the extent that provision is made for:

1. Liens on real property in Sections 33 and 48 of this Act;

2. Fixtures in Section 74 of this Act;

3. Fixture filings in Sections 92, 93, 103, 107, and 110 of this Act; and

4. Security agreements covering personal and real property in Section 122 of this Act;

(l) An assignment of a claim arising in tort, other than a commercial tort claim, but Sections 55 and 62 of this Act apply with respect to proceeds and priorities in proceeds;

(m) An assignment of a deposit account in a consumer transaction, but Sections 55 and 62 of this Act apply with respect to proceeds and priorities in proceeds;

(a) A claim or right to receive compensation for injuries or sickness as described in 26 U.S.C. sec. 104(a)(1) or (2), as amended from time to time;

(o) A claim or right to receive benefits under a special needs trust as described in 42 U.S.C. sec 1396p(d)(4), as amended from time to time; or

(p) A right to receive money under a structured settlement as defined by KRS 454.430.

SECTION 30. KRS 355.9-110 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

A security interest arising under KRS 355.2-401, 355.2-505, 355.2-711(3), or 355.2A-508(5) is subject to this article. However, until the debtor obtains possession of the goods:

(1) The security interest is enforceable, even if subsection (2)(c) of Section 33 of this Act has not been satisfied;

(2) Filing is not required to perfect the security interest;

(3) The rights of the secured party after default by the debtor are governed by Article 2 or 2A of this chapter; and

(4) The security interest has priority over a conflicting security interest created by the debtor.

PART 2

EFFECTIVENESS OF SECURITY AGREEMENT; ATTACHMENT OF SECURITY INTEREST; RIGHTS OF PARTIES TO SECURITY AGREEMENT

SUBPART 1. EFFECTIVENESS AND ATTACHMENT

SECTION 31. KRS 355.9-201 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in this chapter, a security agreement is effective according to its terms between the parties, against purchasers of the collateral, and against creditors.

(2) A transaction subject to this article is subject to any applicable rule of law, statute, or regulation that establishes a different rule for consumers.
(3) In case of conflict between this article and a rule of law, statute, or regulation described in subsection (2) of this section, the rule of law, statute, or regulation controls. Failure to comply with a statute or regulation described in subsection (2) of this section has only the effect the statute or regulation specifies.

(4) This article does not:

(a) Validate any rate, charge, agreement, or practice that violates a rule of law, statute, or regulation described in subsection (2) of this section; or

(b) Extend the application of the rule of law, statute, or regulation to a transaction not otherwise subject to it.

SECTION 32. KRS 355.9-202 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

Except as otherwise provided with respect to consignments or sales of accounts, chattel paper, payment intangibles, or promissory notes, the provisions of this article with regard to rights and obligations apply whether title to collateral is in the secured party or the debtor.

SECTION 33. KRS 355.9-203 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A security interest attaches to collateral when it becomes enforceable against the debtor with respect to the collateral, unless an agreement expressly postpones the time of attachment.

(2) Except as otherwise provided in subsections (3) to (9) of this section, a security interest is enforceable against the debtor and third parties with respect to the collateral only if:

(a) Value has been given;

(b) The debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party; and

(c) One (1) of the following conditions is met:

1. The debtor has authenticated a security agreement that provides a description of the collateral and, if the security interest covers timber to be cut, a description of the land concerned;

2. The collateral is not a certificated security and is in the possession of the secured party under Section 53 of this Act pursuant to the debtor's security agreement;

3. The collateral is a certificated security in registered form and the security certificate has been delivered to the secured party under Section 170 of this Act pursuant to the debtor's security agreement; or

4. The collateral is deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights, and the secured party has control under Section 24, 25, 26, or 27 of this Act pursuant to the debtor's security agreement.

(3) Subsection (2) of this section is subject to Section 165 of this Act on the security interest of a collecting bank, Section 18 of this Act on the security interest of a letter-of-credit issuer or nominated person, Section 30 of this Act on security interest arising under Article 2 or 2A of this chapter, and Section 36 of this Act on security interests in investment property.

(4) A person becomes bound as debtor by a security agreement entered into by another person if, by operation of law other than this article or by contract:

(a) The security agreement becomes effective to create a security interest in the person's property; or

(b) The person becomes generally obligated for the obligations of the other person, including the obligation secured under the security agreement, and acquires or succeeds to all or substantially all of the assets of the other person.

(5) If a new debtor becomes bound as debtor by a security agreement entered into by another person:

(a) The agreement satisfies subsection (2)(c) of this section with respect to existing or after-acquired property of the new debtor to the extent the property is described in the agreement; and

(b) Another agreement is not necessary to make a security interest in the property enforceable.

(6) The attachment of a security interest in collateral gives the secured party the rights to proceeds provided by Section 55 of this Act and is also attachment of a security interest in a supporting obligation for the collateral.

(7) The attachment of a security interest in a right to payment or performance secured by a security interest or other lien on personal or real property is also attachment of a security interest in the security interest, mortgage, or other lien.

(8) The attachment of a security interest in a securities account is also attachment of a security interest in the security entitlements carried in the securities account.

(9) The attachment of a security interest in a commodity account is also attachment of a security interest in the commodity contracts carried in the commodity account.

SECTION 34. KRS 355.9-204 IS REPEALED AND REENACTED TO READ AS FOLLOWS:
(1) Except as otherwise provided in subsection (2) of this section, a security agreement may create or provide for a security interest in after-acquired collateral.

(2) A security interest does not attach under a term constituting an after-acquired property clause to:

(a) Consumer goods, other than an accession when given as additional security, unless the debtor acquires rights in them within ten (10) days after the secured party gives value; or

(b) A commercial tort claim.

(3) A security agreement may provide that collateral secures, or that accounts, chattel paper, payment intangibles, or promissory notes are sold in connection with, future advances or other value, whether or not the advances or value are given pursuant to commitment.

SECTION 35. KRS 355.9-205 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A security interest is not invalid or fraudulent against creditors solely because:

(a) The debtor has the right or ability to:

1. Use, commingle, or dispose of all or part of the collateral, including returned or repossessed goods;

2. Collect, compromise, enforce, or otherwise deal with collateral;

3. Accept the return of collateral or make repossessions; or

4. Use, commingle, or dispose of proceeds; or

(b) The secured party fails to require the debtor to account for proceeds or replace collateral.

(2) This section does not relax the requirements of possession if attachment, perfection, or enforcement of a security interest depends upon possession of the collateral by the secured party.

SECTION 36. KRS 355.9-206 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A security interest in favor of a securities intermediary attaches to a person's security entitlement if:

(a) The person buys a financial asset through the securities intermediary in a transaction in which the person is obligated to pay the purchase price to the securities intermediary at the time of the purchase; and

(b) The securities intermediary credits the financial asset to the buyer's securities account before the buyer pays the securities intermediary.

(2) The security interest described in subsection (1) of this section secures the person's obligation to pay for the financial asset.

(3) A security interest in favor of a person that delivers a certificated security or other financial asset represented by a writing attaches to the security or other financial asset if:

(a) The security or other financial asset:

1. In the ordinary course of business is transferred by delivery with any necessary indorsement or assignment; and

2. Is delivered under an agreement between persons in the business of dealing with such securities or financial assets; and

(b) The agreement calls for delivery against payment.

(4) The security interest described in subsection (3) of this section secures the obligation to make payment for the delivery.

SUBPART 2. RIGHTS AND DUTIES

SECTION 37. KRS 355.9-207 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (4) of this section, a secured party shall use reasonable care in the custody and preservation of collateral in the secured party's possession. In the case of chattel paper or an instrument, reasonable care includes taking necessary steps to preserve rights against prior parties unless otherwise agreed.

(2) Except as otherwise provided in subsection (4) of this section, if a secured party has possession of collateral:

(a) Reasonable expenses, including the cost of insurance and payment of taxes or other charges, incurred in the custody, preservation, use, or operation of the collateral are chargeable to the debtor and are secured by the collateral;

(b) The risk of accidental loss or damage is on the debtor to the extent of a deficiency in any effective insurance coverage;

(c) The secured party shall keep the collateral identifiable, but fungible collateral may be commingled; and

(d) The secured party may use or operate the collateral.
1. For the purpose of preserving the collateral or its value;
2. As permitted by an order of a court having competent jurisdiction; or
3. Except in the case of consumer goods, in the manner and to the extent agreed by the debtor.

(3) Except as otherwise provided in subsection (4) of this section, a secured party having possession of collateral or control of collateral under Section 24, 25, 26, or 27 of this Act:

(a) May hold as additional security any proceeds, except money or funds, received from the collateral;
(b) Shall apply money or funds received from the collateral to reduce the secured obligation, unless remitted to the debtor; and
(c) May create a security interest in the collateral.

(4) If the secured party is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor:

(a) Subsection (1) of this section does not apply unless the secured party is entitled under an agreement:
1. To charge back uncollected collateral; or
2. Otherwise to full or limited recourse against the debtor or a secondary obligor based on the nonpayment or other default of an account debtor or other obligor on the collateral; and
(b) Subsections (2) and (3) of this section do not apply.

SECTION 38. KRS 355.9-208 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) This section applies to cases in which there is no outstanding secured obligation and the secured party is not committed to make advances, incur obligations, or otherwise give value.

(2) Within ten (10) days after receiving an authenticated demand by the debtor:

(a) A secured party having control of a deposit account under subsection (1)(b) of Section 24 of this Act shall send to the bank with which the deposit account is maintained an authenticated statement that releases the bank from any further obligation to comply with instructions originated by the secured party;
(b) A secured party having control of a deposit account under subsection (1)(c) of Section 24 of this Act shall:
1. Pay the debtor the balance on deposit in the deposit account; or
2. Transfer the balance on deposit into a deposit account in the debtor's name;
(c) A secured party, other than a buyer, having control of electronic chattel paper under Section 25 of this Act shall:
1. Communicate the authoritative copy of the electronic chattel paper to the debtor or its designated custodian;
2. If the debtor designates a custodian that is the designated custodian with which the authoritative copy of the electronic chattel paper is maintained for the secured party, communicate to the custodian an authenticated record releasing the designated custodian from any further obligation to comply with instructions originated by the secured party and instructing the custodian to comply with instructions originated by the debtor; and
3. Take appropriate action to enable the debtor or its designated custodian to make copies of or revisions to the authoritative copy which add or change an identified assignee of the authoritative copy without the consent of the secured party;
(d) A secured party having control of investment property under subsection (4)(b) of Section 168 of this Act or subsection (2) of Section 26 of this Act shall send to the securities intermediary or commodity intermediary with which the security entitlement or commodity contract is maintained an authenticated record that releases the securities intermediary or commodity intermediary from any further obligation to comply with entitlement orders or directions originated by the secured party; and
(e) A secured party having control of a letter-of-credit right under Section 27 of this Act shall send to each person having an unfulfilled obligation to pay or deliver proceeds of the letter of credit to the secured party an authenticated release from any further obligation to pay or deliver proceeds of the letter of credit to the secured party.

SECTION 39. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-209:

(1) Except as otherwise provided in subsection (3) of this section, this section applies if:

(a) There is no outstanding secured obligation; and
(b) The secured party is not committed to make advances, incur obligations, or otherwise give value.
Within ten (10) days after receiving an authenticated demand by the debtor, a secured party shall send to an account debtor that has received notification of an assignment to the secured party as assignee under subsection (1) of Section 88 of this Act an authenticated record that releases the account debtor from any further obligation to the secured party.

This section does not apply to an assignment constituting the sale of an account, chattel paper, or payment intangible.

SECTION 40. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-210:

(1) In this section:

(a) "Request" means a record of a type described in paragraph (b), (c), or (d) of this subsection.

(b) "Request for an accounting" means a record authenticated by a debtor requesting that the recipient provide an accounting of the unpaid obligations secured by collateral and reasonably identifying the transaction or relationship that is the subject of the request.

(c) "Request regarding a list of collateral" means a record authenticated by a debtor requesting that the recipient approve or correct a list of what the debtor believes to be the collateral securing an obligation and reasonably identifying the transaction or relationship that is the subject of the request.

(d) "Request regarding a statement of account" means a record authenticated by a debtor requesting that the recipient approve or correct a statement indicating what the debtor believes to be the aggregate amount of unpaid obligations secured by collateral as of a specified date and reasonably identifying the transaction or relationship that is the subject of the request.

(2) Subject to subsections (3), (4), (5), and (6) of this section, a secured party, other than a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor, shall comply with a request within fourteen (14) days after receipt:

(a) In the case of a request for an accounting, by authenticating and sending to the debtor a request for an accounting; and

(b) In the case of a request regarding a list of collateral or a request regarding a statement of account, by authenticating and sending to the debtor an approval or correction.

(3) A secured party that claims a security interest in all of a particular type of collateral owned by the debtor may comply with a request regarding a list of collateral by sending to the debtor an authenticated record including a statement to that effect within fourteen (14) days after receipt.

(4) A person that receives a request regarding a list of collateral, claims no interest in the collateral when it receives the request, and claimed an interest in the collateral at an earlier time shall comply with the request within fourteen (14) days after receipt by sending to the debtor an authenticated record:

(a) Disclaiming any interest in the collateral; and

(b) If known to the recipient, providing the name and mailing address of any assignee or successor to the recipient's interest in the collateral.

(5) A person that receives a request for an accounting or a request regarding a statement of account, claims no interest in the obligations when it receives the request, and claimed an interest in the obligations at an earlier time shall comply with the request within fourteen (14) days after receipt by sending to the debtor an authenticated record:

(a) Disclaiming any interest in the obligations; and

(b) If known to the recipient, providing the name and mailing address of any assignee or successor to the recipient's interest in the obligations.

(6) A debtor is entitled without charge to one (1) response to a request under this section during any six (6) month period. The secured party may require payment of a charge not exceeding twenty-five dollars ($25) for each additional response.

PART 3

PERFECTION AND PRIORITY

SUBPART 1. LAW GOVERNING PERFECTION AND PRIORITY

SECTION 41. KRS 355.9-301 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

Except as otherwise provided in Sections 43 to 46 of this Act, the following rules determine the law governing perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral:

(1) Except as otherwise provided in this section, while a debtor is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in collateral.

(2) While collateral is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a possessory security interest in that collateral.
Except as otherwise provided in subsection (4) of this section, while negotiable documents, goods, instruments, money, or tangible chattel paper is located in a jurisdiction, the local law of that jurisdiction governs:

(a) Perfection of a security interest in the goods by filing a fixture filing;
(b) Perfection of a security interest in timber to be cut; and
(c) The effect of perfection or nonperfection and the priority of a nonpossessory security interest in the collateral.

The local law of the jurisdiction under which the wellhead or minehead is located governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in as-extracted collateral.

SECTION 42. KRS 355.9-302 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

While farm products are located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of an agricultural lien on the farm products.

SECTION 43. KRS 355.9-303 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

This section applies to goods covered by a certificate of title, even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.

Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority. Goods cease to be covered by a certificate of title at the earlier of the time the certificate of title ceases to be effective under the law of the issuing jurisdiction or the time the goods become covered subsequently by a certificate of title issued by another jurisdiction.

The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title.

SECTION 44. KRS 355.9-304 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

The local law of a bank's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a deposit account maintained with that bank.

The following rules determine a bank's jurisdiction for purposes of this part of this article:

(a) If an agreement between the bank and the debtor governing the deposit account expressly provides that a particular jurisdiction is the bank's jurisdiction for purposes of this part of this article, this article, or this chapter, that jurisdiction is the bank's jurisdiction.
(b) If paragraph (a) of this subsection does not apply and an agreement between the bank and its customer governing the deposit account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the bank's jurisdiction.
(c) If neither paragraph (a) nor paragraph (b) of this subsection applies and an agreement between the bank and its customer governing the deposit account expressly provides that the deposit account is maintained at an office in a particular jurisdiction, that jurisdiction is the bank's jurisdiction.
(d) If none of the preceding paragraphs applies, the bank's jurisdiction is the jurisdiction in which the office serving the customer's account is located.
(e) If none of the preceding paragraphs applies, the bank's jurisdiction is the jurisdiction in which the chief executive office of the bank is located.

SECTION 45. KRS 355.9-305 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

Except as otherwise provided in subsection (3) of this section, the following rules apply:

(a) While a security certificate is located in a jurisdiction, the local law of that jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in the certificated security represented thereby.
(b) The local law of the issuer's jurisdiction as specified in subsection (4) of Section 169 of this Act governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in an uncertificated security.
(c) The local law of the securities intermediary's jurisdiction as specified in subsection (5) of Section 169 of this Act governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a security entitlement or securities account.
(d) The local law of the commodity intermediary's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a commodity contract or commodity account.

The following rules determine a commodity intermediary's jurisdiction for purposes of this part of this article:
(a) If an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that a particular jurisdiction is the commodity intermediary's jurisdiction for purposes of this part of this article, this article, or this chapter, that jurisdiction is the commodity intermediary's jurisdiction.

(b) If paragraph (a) of this subsection does not apply and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(c) If neither paragraph (a) nor paragraph (b) of this subsection applies and an agreement between the commodity intermediary and commodity customer governing the commodity account expressly provides that the commodity account is maintained at an office in a particular jurisdiction, that jurisdiction is the commodity intermediary's jurisdiction.

(d) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the office identified in an account statement as the office serving the commodity customer's account is located.

(e) If none of the preceding paragraphs applies, the commodity intermediary's jurisdiction is the jurisdiction in which the chief executive office of the commodity intermediary is located.

(3) The local law of the jurisdiction in which the debtor is located governs:

(a) Perfection of a security interest in investment property by filing;

(b) Automatic perfection of a security interest in investment property created by a broker or securities intermediary; and

(c) Automatic perfection of a security interest in a commodity contract or commodity account created by a commodity intermediary.

SECTION 46. KRS 355.9-306 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Subject to subsection (3) of this section, the local law of the issuer's jurisdiction or a nominated person's jurisdiction governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in a letter-of-credit right if the issuer's jurisdiction or nominated person's jurisdiction is a state.

(2) For purposes of this part of this article, an issuer's jurisdiction or nominated person's jurisdiction is the jurisdiction whose law governs the liability of the issuer or nominated person with respect to the letter-of-credit right as provided in Section 16 of this Act.

(3) This section does not apply to a security interest that is perfected only under subsection (4) of Section 48 of this Act.

SECTION 47. KRS 355.9-307 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) In this section, "place of business" means a place where a debtor conducts its affairs.

(2) Except as otherwise provided in this section, the following rules determine a debtor's location:

(a) A debtor who is an individual is located at the individual's principal residence.

(b) A debtor that is an organization and has only one (1) place of business is located at its place of business.

(c) A debtor that is an organization and has more than one (1) place of business is located at its chief executive office.

(3) Subsection (2) of this section applies only if a debtor's residence, place of business, or chief executive office, as applicable, is located in a jurisdiction whose law generally requires information concerning the existence of a nonpossessory security interest to be made generally available in a filing, recording, or registration system as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the collateral. If subsection (2) of this section does not apply, the debtor is located in the District of Columbia.

(4) A person that ceases to exist, have a residence, or have a place of business continues to be located in the jurisdiction specified by subsections (2) and (3) of this section.

(5) A registered organization that is organized under the law of a state is located in that state.

(6) Except as otherwise provided in subsection (9) of this section, a registered organization that is organized under the law of the United States and a branch or agency of a bank that is not organized under the law of the United States or a state are located:

(a) In the state that the law of the United States designates, if the law designates a state of location;

(b) In the state that the registered organization, branch, or agency designates, if the law of the United States authorizes the registered organization, branch, or agency to designate its state of location; or

(c) In the District of Columbia, if neither paragraph (a) nor paragraph (b) of this subsection applies.

(7) A registered organization continues to be located in the jurisdiction specified by subsection (5) or (6) of this section notwithstanding:
(a) The suspension, revocation, forfeiture, or lapse of the registered organization's status as such in its jurisdiction of organization; or

(b) The dissolution, winding up, or cancellation of the existence of the registered organization.

(8) The United States is located in the District of Columbia.

(9) A branch or agency of a bank that is not organized under the law of the United States or a state is located in the state in which the branch or agency is licensed, if all branches and agencies of the bank are licensed in only one (1) state.

(10) A foreign air carrier under the Federal Aviation Act of 1958, as amended, is located at the designated office of the agent upon which service of process may be made on behalf of the carrier.

(11) This section applies only for purposes of this part of this article.

SUBPART 2. PERFECTION

SECTION 48. KRS 355.9-308 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in this section and Section 49 of this Act, a security interest is perfected if it has attached and all of the applicable requirements for perfection in Sections 50 to 56 of this Act have been satisfied. A security interest is perfected when it attaches if the applicable requirements are satisfied before the security interest attaches.

(2) An agricultural lien is perfected if it has become effective and all of the applicable requirements for perfection in Section 50 of this Act have been satisfied. An agricultural lien is perfected when it becomes effective if the applicable requirements are satisfied before the agricultural lien becomes effective.

(3) A security interest or agricultural lien is perfected continuously if it is originally perfected by one (1) method under this article and is later perfected by another method under this article, without an intermediate period when it was unperfected.

(4) Perfection of a security interest in collateral also perfects a security interest in a supporting obligation for the collateral.

(5) Perfection of a security interest in a right to payment or performance also perfects a security interest in a security interest, mortgage, or other lien on personal or real property securing the right.

(6) Perfection of a security interest in a securities account also perfects a security interest in the security entitlements carried in the securities account.

(7) Perfection of a security interest in a commodity account also perfects a security interest in the commodity contracts carried in the commodity account.

SECTION 49. KRS 355.9-309 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

The following security interests are perfected when they attach:

(1) A purchase-money security interest in consumer goods, except as otherwise provided in subsection (2) of Section 51 of this Act with respect to consumer goods that are subject to a statute or treaty described in subsection (1) of Section 51 of this Act;

(2) An assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles;

(3) A sale of a payment intangible;

(4) A sale of a promissory note;

(5) A security interest created by the assignment of a health-care-insurance receivable to the provider of the health-care goods or services;

(6) A security interest arising under KRS 355.2-401, 355.2-505, 355.2-711(3), or 355.2A-508(5), until the debtor obtains possession of the collateral;

(7) A security interest of a collecting bank arising under Section 165 of this Act;

(8) A security interest of an issuer or nominated person arising under Section 18 of this Act;

(9) A security interest arising in the delivery of a financial asset under subsection (3) of Section 36 of this Act;

(10) A security interest in investment property created by a broker or securities intermediary;

(11) A security interest in a commodity contract or a commodity account created by a commodity intermediary;

(12) An assignment for the benefit of all creditors of the transferor and subsequent transfers by the assignee thereunder; and

(13) A security interest created by an assignment of a beneficial interest in a decedent's estate.

SECTION 50. KRS 355.9-310 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

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(1) Except as otherwise provided in subsection (2) of this section and subsection (2) of Section 52 of this Act, a financing statement must be filed to perfect all security interests and agricultural liens.

(2) The filing of a financing statement is not necessary to perfect a security interest:

(a) That is perfected under subsection (4), (5), (6), or (7) of Section 48 of this Act;

(b) That is perfected under Section 49 of this Act when it attaches;

(c) In property subject to a statute, regulation, or treaty described in subsection (1) of Section 51 of this Act;

(d) In goods in possession of a bailee which is perfected under subsection (4)(a) or (b) of Section 52 of this Act;

(e) In certificated securities, documents, goods, or instruments which is perfected without filing or possession under subsection (5), (6), or (7) of Section 52 of this Act;

(f) In collateral in the secured party's possession under Section 53 of this Act;

(g) In a certificated security which is perfected by delivery of the security certificate to the secured party under Section 53 of this Act;

(h) In deposit accounts, electronic chattel paper, investment property, or letter-of-credit rights which is perfected by control under Section 54 of this Act;

(i) In proceeds which is perfected under Section 55 of this Act; or

(j) That is perfected under Section 56 of this Act.

(3) If a secured party assigns a perfected security interest or agricultural lien, a filing under this article is not required to continue the perfected status of the security interest against creditors of and transferees from the original debtor.

SECTION 51. KRS 355.9-311 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (4) of this section, the filing of a financing statement is not necessary or effective to perfect a security interest in property subject to:

(a) A statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt subsection (1) of Section 50 of this Act;

(b) KRS Chapter 1864; or

(c) A certificate-of-title statute of another jurisdiction which provides for a security interest to be indicated on the certificate as a condition or result of the security interest's obtaining priority over the rights of a lien creditor with respect to the property.

(2) Compliance with the requirements of a statute, regulation, or treaty described in subsection (1) of this section for obtaining priority over the rights of a lien creditor is equivalent to the filing of a financing statement under this article. Except as otherwise provided in subsection (4) of this section and Section 53 and subsections (4) and (5) of Section 56 of this Act for goods covered by a certificate of title, a security interest in property subject to a statute, regulation, or treaty described in subsection (1) of this section may be perfected only by compliance with those requirements, and a security interest so perfected remains perfected notwithstanding a change in the use or transfer of possession of the collateral.

(3) Except as otherwise provided in subsection (4) of this section and subsections (4) and (5) of Section 56 of this Act, duration and renewal of perfection of a security interest perfected by compliance with the requirements prescribed by a statute, regulation, or treaty described in subsection (1) of this section are governed by the statute, regulation, or treaty. In other respects, the security interest is subject to this article.

(4) During any period in which collateral subject to a statute specified in subsection (1)(b) of this section is inventory held for sale or lease by a person or leased by that person as lessor and that person is in the business of selling goods of that kind, this section does not apply to a security interest in that collateral created by that person.

SECTION 52. KRS 355.9-312 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A security interest in chattel paper, negotiable documents, instruments, or investment property may be perfected by filing;

(2) Except as otherwise provided in subsections (3) and (4) of Section 55 of this Act for proceeds:

(a) A security interest in a deposit account may be perfected only by control under Section 54 of this Act;

(b) And except as otherwise provided in subsection (4) of Section 48 of this Act, a security interest in a letter-of-credit right may be perfected only by control under Section 54 of this Act; and

(c) A security interest in money may be perfected only by the secured party's taking possession under Section 53 of this Act;

(3) While goods are in the possession of a bailee that has issued a negotiable document covering the goods:
A security interest in the goods may be perfected by perfecting a security interest in the document; and

A security interest perfected in the document has priority over any security interest that becomes perfected in the goods by another method during that time.

While goods are in the possession of a bailee that has issued a nonnegotiable document covering the goods, a security interest in the goods may be perfected by:

- Issuance of a document in the name of the secured party;
- The bailee's receipt of notification of the secured party's interest; or
- Filing as to the goods.

A security interest in certificated securities, negotiable documents, or instruments is perfected without filing or the taking of possession for a period of twenty (20) days from the time it attaches to the extent that it arises for new value given under an authenticated security agreement.

A perfected security interest in a negotiable document or goods in possession of a bailee, other than one that has issued a negotiable document for the goods, remains perfected for twenty (20) days without filing if the secured party makes available to the debtor the goods or documents representing the goods for the purpose of:

- Ultimate sale or exchange; or
- Loading, unloading, storing, shipping, transshipping, manufacturing, processing, or otherwise dealing with them in a manner preliminary to their sale or exchange.

A perfected security interest in a certificated security or instrument remains perfected for twenty (20) days without filing if the secured party delivers the security certificate or instrument to the debtor for the purpose of:

- Ultimate sale or exchange; or
- Presentation, collection, enforcement, renewal, or registration of transfer.

After the twenty (20) day period specified in subsection (5), (6), or (7) of this section expires, perfection depends upon compliance with this article.

SECTION 53. KRS 355.9-313 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

Except as otherwise provided in subsection (2) of this section, a secured party may perfect a security interest in negotiable documents, goods, instruments, money, or tangible chattel paper by taking possession of the collateral. A secured party may perfect a security interest in certificated securities by taking delivery of the certificated securities under Section 170 of this Act.

With respect to goods covered by a certificate of title issued by this Commonwealth, a secured party may perfect a security interest in the goods by taking possession of the goods only in the circumstances described in subsection (4) of Section 56 of this section.

With respect to collateral other than certificated securities and goods covered by a document, a secured party takes possession of collateral in the possession of a person other than the debtor, the secured party, or a lessee of the collateral from the debtor in the ordinary course of the debtor's business, when:

- The person in possession authenticates a record acknowledging that it holds possession of the collateral for the secured party's benefit; or
- The person takes possession of the collateral after having authenticated a record acknowledging that it will hold possession of collateral for the secured party's benefit.

If perfection of a security interest depends upon possession of the collateral by a secured party, perfection occurs no earlier than the time the secured party takes possession and continues only while the secured party retains possession.

A security interest in a certificated security in registered form is perfected by delivery when delivery of the certificated security occurs under Section 170 of this Act and remains perfected by delivery until the debtor obtains possession of the security certificate.

A person in possession of collateral is not required to acknowledge that it holds possession for a secured party's benefit.

If a person acknowledges that it holds possession for the secured party's benefit:

- The acknowledgment is effective under subsection (3) of this section or subsection (1) of Section 170 of this Act, even if the acknowledgment violates the rights of a debtor; and
- Unless the person otherwise agrees or law other than this article otherwise provides, the person does not owe any duty to the secured party and is not required to confirm the acknowledgment to another person.

A secured party having possession of collateral does not relinquish possession by delivering the collateral to a person other than
the debtor or a lessee of the collateral from the debtor in the ordinary course of the debtor's business if the person was instructed before the delivery or is instructed contemporaneously with the delivery:

(a) To hold possession of the collateral for the secured party's benefit; or

(b) To redeliver the collateral to the secured party.

(9) A secured party does not relinquish possession, even if a delivery under subsection (8) of this section violates the rights of a debtor. A person to which collateral is delivered under subsection (8) of this section does not owe any duty to the secured party and is not required to confirm the delivery to another person unless the person otherwise agrees or law other than this article otherwise provides.

SECTION 54. KRS 355.9-314 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A security interest in investment property, deposit accounts, letter-of-credit rights, or electronic chattel paper may be perfected by control of the collateral under Section 24, 25, 26, or 27 of this Act.

(2) A security interest in deposit accounts, electronic chattel paper, or letter-of-credit rights is perfected by control under Section 24, 25, or 27 of this Act when the secured party obtains control and remains perfected by control only while the secured party retains control.

(3) A security interest in investment property is perfected by control under Section 26 of this Act from the time the secured party obtains control and remains perfected by control until:

(a) The secured party does not have control; and

(b) One (1) of the following occurs:

1. If the collateral is a certificated security, the debtor has or acquires possession of the security certificate;

2. If the collateral is an uncertificated security, the issuer has registered or registers the debtor as the registered owner;

3. If the collateral is a security entitlement, the debtor is or becomes the entitlement holder.

SECTION 55. KRS 355.9-315 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in this article and in KRS 355.2-403(2):  

(a) A security interest or agricultural lien continues in collateral notwithstanding sale, lease, license, exchange, or other disposition thereof unless the secured party authorized the disposition free of the security interest or agricultural lien; and

(b) A security interest attaches to any identifiable proceeds of collateral.

(2) Proceeds that are commingled with other property are identifiable proceeds:

(a) If the proceeds are goods, to the extent provided by Section 76 of this Act; and

(b) If the proceeds are not goods, to the extent that the secured party identifies the proceeds by a method of tracing, including application of equitable principles, that is permitted under law other than this article with respect to commingled property of the type involved.

(3) A security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected.

(4) A perfected security interest in proceeds becomes unperfected on the twenty-first day after the security interest attaches to the proceeds unless:

(a) The following conditions are satisfied:

1. A filed financing statement covers the original collateral;

2. The proceeds are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and

3. The proceeds are not acquired with cash proceeds;

(b) The proceeds are identifiable cash proceeds; or

(c) The security interest in the proceeds is perfected other than under subsection (3) of this section when the security interest attaches to the proceeds or within twenty (20) days thereafter.

(5) If a filed financing statement covers the original collateral, a security interest in proceeds which remains perfected under subsection (4)(a) of this section becomes unperfected at the later of:

(a) When the effectiveness of the filed financing statement lapses under Section 106 of this Act or is terminated under
Section 104 of this Act; or

(b) The twenty-first day after the security interest attaches to the proceeds.

SUBPART 3. PRIORITY

SECTION 56. KRS 355.9-316 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A security interest perfected pursuant to the law of the jurisdiction designated in subsection (1) of Section 41 of this Act or subsection (3) of Section 45 of this Act remains perfected until the earliest of:

(a) The time perfection would have ceased under the law of that jurisdiction;

(b) The expiration of four (4) months after a change of the debtor's location to another jurisdiction; or

(c) The expiration of one (1) year after a transfer of collateral to a person that thereby becomes a debtor and is located in another jurisdiction.

(2) If a security interest described in subsection (1) of this section becomes perfected under the law of the other jurisdiction before the earliest time or event described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earliest time or event, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

(3) A possessory security interest in collateral, other than goods covered by a certificate of title and as-extracted collateral consisting of goods, remains continuously perfected if:

(a) The collateral is located in one jurisdiction and subject to a security interest perfected under the law of that jurisdiction;

(b) Thereafter the collateral is brought into another jurisdiction; and

(c) Upon entry into the other jurisdiction, the security interest is perfected under the law of the other jurisdiction.

(4) Except as otherwise provided in subsection (5) of this section, a security interest in goods covered by a certificate of title which is perfected by any method under the law of another jurisdiction when the goods become covered by a certificate of title from this Commonwealth remains perfected until the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered.

(5) A security interest described in subsection (4) of this section becomes unperfected as against a purchaser of the goods for value and is deemed never to have been perfected as against a purchaser of the goods for value if the applicable requirements for perfection under subsection (2) of Section 51 of this Act or Section 53 of this Act are not satisfied before the earlier of:

(a) The time the security interest would have become unperfected under the law of the other jurisdiction had the goods not become so covered;

(b) The expiration of four (4) months after the goods had become so covered.

(6) A security interest in deposit accounts, letter-of-credit rights, or investment property which is perfected under the law of the bank's jurisdiction, the issuer's jurisdiction, a nominated person's jurisdiction, the securities intermediary's jurisdiction, or the commodity intermediary's jurisdiction, as applicable, remains perfected until the earliest of:

(a) The time the security interest would have become unperfected under the law of that jurisdiction;

(b) The expiration of four (4) months after a change of the applicable jurisdiction to another jurisdiction.

(7) If a security interest described in subsection (6) of this section becomes perfected under the law of the other jurisdiction before the earlier of the time or the end of the period described in that subsection, it remains perfected thereafter. If the security interest does not become perfected under the law of the other jurisdiction before the earlier of that time or the end of that period, it becomes unperfected and is deemed never to have been perfected as against a purchaser of the collateral for value.

SECTION 57. KRS 355.9-317 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A security interest or agricultural lien is subordinate to the rights of:

(a) A person entitled to priority under Section 62 of this Act; and

(b) Except as otherwise provided in subsection (5) of this section, a person that becomes a lien creditor before the earlier of the time:

   1. The security interest or agricultural lien is perfected; or

   2. One (1) of the conditions specified in subsection (2)(c) of Section 33 of this Act is met and a financing statement covering the collateral is filed.

(2) Except as otherwise provided in subsection (5) of this section, a buyer, other than a secured party, of tangible chattel paper, documents, goods, instruments, or a security certificate takes free of a security interest or agricultural lien if the buyer gives
value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(3) Except as otherwise provided in subsection (5) of this section, a lessee of goods takes free of a security interest or agricultural lien if the lessee gives value and receives delivery of the collateral without knowledge of the security interest or agricultural lien and before it is perfected.

(4) A licensee of a general intangible or a buyer, other than a secured party, of accounts, electronic chattel paper, general intangibles, or investment property other than a certificated security takes free of a security interest if the licensee or buyer gives value without knowledge of the security interest and before it is perfected.

(5) Except as otherwise provided in Sections 60 and 61 of this Act, if a person files a financing statement with respect to a purchase-money security interest before or within twenty (20) days after the debtor receives delivery of the collateral, the security interest takes priority over the rights of a buyer, lessee, or lien creditor which arise between the time the security interest attaches and the time of filing.

SECTION 58. KRS 355.9-318 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A debtor that has sold an account, chattel paper, payment intangible, or promissory note does not retain a legal or equitable interest in the collateral sold.

(2) For purposes of determining the rights of creditors of, and purchasers for value of an account or chattel paper from, a debtor that has sold an account or chattel paper, while the buyer's security interest is unperfected, the debtor is deemed to have rights and title to the account or chattel paper identical to those the debtor sold.

SECTION 59. KRS 355.9-319 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (2) of this section, for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.

(2) For purposes of determining the rights of a creditor of a consignee, law other than this article determines the rights and title of a consignee while goods are in the consignee's possession if, under this part of this article, a perfected security interest held by the consignor would have priority over the rights of the creditor.

SECTION 60. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-320:

(1) Except as otherwise provided in subsection (5) of this section, a buyer in ordinary course of business, other than a person buying farm products from a person engaged in farming operations, takes free of a security interest created by the buyer's seller, even if the security interest is perfected and the buyer knows of its existence.

(2) Except as otherwise provided in subsection (5) of this section, a buyer of goods from a person who used or bought the goods for use primarily for personal, family, or household purposes takes free of a security interest, even if perfected, if the buyer buys:

(a) Without knowledge of the security interest;

(b) For value;

(c) Primarily for the buyer's personal, family, or household purposes; and

(d) Before the filing of a financing statement covering the goods.

(3) To the extent that it affects the priority of a security interest over a buyer of goods under subsection (2) of this section, the period of effectiveness of a filing made in the jurisdiction in which the seller is located is governed by subsections (1) and (2) of Section 56 of this Act.

(4) A buyer in ordinary course of business buying oil, gas, or other minerals at the wellhead or minehead or after extraction takes free of an interest arising out of an encumbrance.

(5) Subsections (1) and (2) of this section do not affect a security interest in goods in the possession of the secured party under Section 53 of this Act.

(6) If any horse of a registered breed, the racing of which is regulated by KRS Chapter 230, or any interest in such a horse (including stallion shares and seasons), is subject to a lien or a security interest and that horse or interest is sold at public auction in the ordinary course of business by an organization engaged in the business of selling these horses or interests at public auction, a bona fide purchaser for value of the horse or interest takes title to the horse or interest free and clear of the lien or security interest, and the organization selling the horse or interest is not liable in any manner to the holder of the lien or security interest, except to the extent provided by the Federal Food Security Act, 7 U.S.C. sec. 1631. However, the lien or security interest attaches to the proceeds from the sale to the extent provided in subsection (1)(b) of Section 55 of this Act.

SECTION 61. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-321:
In this section, "licensee in ordinary course of business" means a person that becomes a licensee of a general intangible in good faith, without knowledge that the license violates the rights of another person in the general intangible, and in the ordinary course from a person in the business of licensing general intangibles of that kind. A person becomes a licensee in the ordinary course if the license to the person comports with the usual or customary practices in the kind of business in which the licensor is engaged or with the licensor's own usual or customary practices.

A licensee in ordinary course of business takes its rights under a nonexclusive license free of a security interest in the general intangible created by the licensor, even if the security interest is perfected and the licensee knows of its existence.

A lessee in ordinary course of business takes its leasehold interest free of a security interest in the goods created by the lessor, even if the security interest is perfected and the lessee knows of its existence.

SECTION 62. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-322:

(1) Except as otherwise provided in this section, priority among conflicting security interests and agricultural liens in the same collateral is determined according to the following rules:

(a) Conflicting perfected security interests and agricultural liens rank according to priority in time of filing or perfection. Priority dates from the earlier of the time a filing covering the collateral is first made or the security interest or agricultural lien is first perfected, if there is no period thereafter when there is neither filing nor perfection. A perfected security interest or agricultural lien has priority over a conflicting unperfected security interest or agricultural lien.

(b) The first security interest or agricultural lien to attach or become effective has priority if conflicting security interests and agricultural liens are unperfected.

(2) For the purposes of subsection (1)(a) of this section:

(a) The time of filing or perfection as to a security interest in collateral is also the time of filing or perfection as to a security interest in proceeds; and

(b) The time of filing or perfection as to a security interest in collateral supported by a supporting obligation is also the time of filing or perfection as to a security interest in the supporting obligation.

(3) Except as otherwise provided in subsection (6) of this section, a security interest in collateral which qualifies for priority over a conflicting security interest under Section 67, 68, 69, 70, or 71 of this Act also has priority over a conflicting security interest in:

(a) Any supporting obligation for the collateral; and

(b) Proceeds of the collateral if:

1. The security interest in proceeds is perfected;

2. The proceeds are cash proceeds or of the same type as the collateral; and

3. In the case of proceeds that are proceeds of proceeds, all intervening proceeds are cash proceeds, proceeds of the same type as the collateral, or an account relating to the collateral.

(4) Subject to subsection (5) of this section and except as otherwise provided in subsection (6) of this section, if a security interest in chattel paper, deposit accounts, negotiable documents, instruments, investment property, or letter-of-credit rights is perfected by a method other than filing, conflicting perfected security interests in proceeds of the collateral rank according to priority in time of filing.

(5) Subsection (4) of this section applies only if the proceeds of the collateral are not cash proceeds, chattel paper, negotiable documents, instruments, investment property, or letter-of-credit rights.

(6) Subsections (1) to (5) of this section are subject to:

(a) Subsection (7) of this section and the other provisions of this part of this article;

(b) Section 165 of this Act with respect to a security interest of a collecting bank;

(c) Section 18 of this Act with respect to a security interest of an issuer or nominated person; and

(d) Section 30 of this Act with respect to a security interest arising under Article 2 or 2A of this chapter.

(7) A perfected agricultural lien on collateral has priority over a conflicting security interest in or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.

SECTION 63. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-323:

(1) Except as otherwise provided in subsection (3) of this section, for purposes of determining the priority of a perfected security interest or agricultural lien on the same collateral if the statute creating the agricultural lien so provides.
interest under subsection (1)(a) of Section 62 of this Act, perfection of the security interest dates from the time an advance is made to the extent that the security interest secures an advance that:

(a) Is made while the security interest is perfected only:
   1. Under Section 49 of this Act when it attaches; or
   2. Temporarily under subsection (5), (6), or (7) of Section 52 of this Act; and

(b) Is not made pursuant to a commitment entered into before or while the security interest is perfected by a method other than under Section 49 of this Act or subsection (5), (6), or (7) of Section 52 of this Act.

(2) Except as otherwise provided in subsection (3) of this section, a security interest is subordinate to the rights of a person that becomes a lien creditor to the extent that the security interest secures an advance made more than forty-five (45) days after the person becomes a lien creditor unless the advance is made:

(a) Without knowledge of the lien; or

(b) Pursuant to a commitment entered into without knowledge of the lien.

(3) Subsections (1) and (2) of this section do not apply to a security interest held by a secured party that is a buyer of accounts, chattel paper, payment intangibles, or promissory notes or a consignor.

(4) Except as otherwise provided in subsection (5) of this section, a buyer of goods other than a buyer in ordinary course of business takes free of a security interest to the extent that it secures advances made after the earlier of:

(a) The time the secured party acquires knowledge of the buyer’s purchase; or

(b) Forty-five (45) days after the purchase.

(5) Subsection (4) of this section does not apply if the advance is made pursuant to a commitment entered into without knowledge of the buyer’s purchase and before the expiration of the forty-five (45) day period.

(6) Except as otherwise provided in subsection (7) of this section, a lessee of goods, other than a lessee in ordinary course of business, takes the leasehold interest free of a security interest to the extent that it secures advances made after the earlier of:

(a) The time the secured party acquires knowledge of the lease; or

(b) Forty-five (45) days after the lease contract becomes enforceable.

(7) Subsection (6) of this section does not apply if the advance is made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the forty-five (45) day period.

SECTION 64. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-324:

(1) Except as otherwise provided in subsection (7) of this section, a perfected purchase-money security interest in goods other than inventory or livestock has priority over a conflicting security interest in the same goods, and, except as otherwise provided in Section 67 of this Act, a perfected security interest in its identifiable proceeds also has priority, if the purchase-money security interest is perfected when the debtor receives possession of the collateral or within twenty (20) days thereafter.

(2) Subject to subsection (3) of this section and except as otherwise provided in subsection (7) of this section, a perfected purchase-money security interest in inventory has priority over a conflicting security interest in the same inventory, has priority over a conflicting security interest in chattel paper or an instrument constituting proceeds of the inventory and in proceeds of the chattel paper, if so provided in Section 70 of this Act, and, except as otherwise provided in Section 67 of this Act, also has priority in identifiable cash proceeds of the inventory to the extent the identifiable cash proceeds are received on or before the delivery of the inventory to a buyer, if:

(a) The purchase-money security interest is perfected when the debtor receives possession of the inventory;

(b) The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(c) The holder of the conflicting security interest receives the notification within five (5) years before the debtor receives possession of the inventory; and

(d) The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in inventory of the debtor and describes the inventory.

(3) Subsections (2)(b) to (d) of this section apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of inventory:

(a) If the purchase-money security interest is perfected by filing, before the date of the filing; or

(b) If the purchase-money security interest is temporarily perfected without filing or possession under subsection (6) of Section 52 of this Act, before the beginning of the twenty (20) day period thereunder.
(4) Subject to subsection (5) of this section and except as otherwise provided in subsection (7) of this section, a perfected purchase-money security interest in livestock that are farm products has priority over a conflicting security interest in the same livestock, and, except as otherwise provided in Section 67 of this Act, a perfected security interest in their identifiable proceeds and identifiable products in their unmanufactured states also has priority, if:

(a) The purchase-money security interest is perfected when the debtor receives possession of the livestock;

(b) The purchase-money secured party sends an authenticated notification to the holder of the conflicting security interest;

(c) The holder of the conflicting security interest receives the notification within six (6) months before the debtor receives possession of the livestock; and

(d) The notification states that the person sending the notification has or expects to acquire a purchase-money security interest in livestock of the debtor and describes the livestock.

(5) Subsections (4)(b) to (d) of this section apply only if the holder of the conflicting security interest had filed a financing statement covering the same types of livestock:

(a) If the purchase-money security interest is perfected by filing, before the date of the filing; or

(b) If the purchase-money security interest is temporarily perfected without filing or possession under subsection (6) of Section 52 of this Act, before the beginning of the twenty (20) day period thereunder.

(6) Except as otherwise provided in subsection (7) of this section, a perfected purchase-money security interest in software has priority over a conflicting security interest in the same collateral, and, except as otherwise provided in Section 67 of this Act, a perfected security interest in its identifiable proceeds also has priority, to the extent that the purchase-money security interest in the goods in which the software was acquired for use has priority in the goods and proceeds of the goods under this section.

(7) If more than one security interest qualifies for priority in the same collateral under subsection (1), (2), (4), or (6) of this section:

(a) A security interest securing an obligation incurred as all or part of the price of the collateral has priority over a security interest securing an obligation incurred for value given to enable the debtor to acquire rights in or the use of collateral; and

(b) In all other cases, subsection (1) of Section 62 of this Act applies to the qualifying security interests.

SECTION 65. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-325:

(1) Except as otherwise provided in subsection (2) of this section, a security interest created by a debtor is subordinate to a security interest in the same collateral created by another person if:

(a) The debtor acquired the collateral subject to the security interest created by the other person;

(b) The security interest created by the other person was perfected when the debtor acquired the collateral; and

(c) There is no period thereafter when the security interest is unperfected.

(2) Subsection (1) of this section subordinates a security interest only if the security interest:

(a) Otherwise would have priority solely under subsection (1) of Section 62 of this Act or Section 64 of this Act; or

(b) Arose solely under KRS 355.2-711(3) or 355.24-588(5).

SECTION 66. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-326:

(1) Subject to subsection (2) of this section, a security interest created by a new debtor which is perfected by a filed financing statement that is effective solely under Section 99 of this Act in collateral in which a new debtor has or acquires rights is subordinate to a security interest in the same collateral which is perfected other than by a filed financing statement that is effective solely under Section 99 of this Act.

(2) The other provisions of this part of this article determine the priority among conflicting security interests in the same collateral perfected by filed financing statements that are effective solely under Section 99 of this Act. However, if the security agreements to which a new debtor became bound as debtor were not entered into by the same original debtor, the conflicting security interests rank according to priority in time of the new debtor's having become bound.

SECTION 67. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-327:

The following rules govern priority among conflicting security interests in the same deposit account:

(1) A security interest held by a secured party having control of the deposit account under Section 24 of this Act has priority over a conflicting security interest held by a secured party that does not have control.
(2) Except as otherwise provided in subsections (3) and (4) of this section, security interests perfected by control under Section 54 of this Act rank according to priority in time of obtaining control.

(3) Except as otherwise provided in subsection (4) of this section, a security interest held by the bank with which the deposit account is maintained has priority over a conflicting security interest held by another secured party.

(4) A security interest perfected by control under subsection (1)(c) of Section 24 of this Act has priority over a security interest held by the bank with which the deposit account is maintained.

SECTION 68. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-328:

The following rules govern priority among conflicting security interests in the same investment property:

(1) A security interest held by a secured party having control of investment property under Section 26 of this Act has priority over a security interest held by a secured party that does not have control of the investment property.

(2) Except as otherwise provided in subsections (3) and (4) of this section, conflicting security interests held by secured parties each of which has control under Section 26 of this Act rank according to priority in time of:

(a) If the collateral is a security, obtaining control;

(b) If the collateral is a security entitlement carried in a securities account and:

1. If the secured party obtained control under subsection (4)(a) of Section 168 of this Act, the secured party's becoming the person for which the securities account is maintained;

2. If the secured party obtained control under subsection (4)(b) of Section 168 of this Act, the securities intermediary's agreement to comply with the secured party's entitlement orders with respect to security entitlements carried or to be carried in the securities account; or

3. If the secured party obtained control through another person under subsection (4)(c) of Section 168 of this Act, the time on which priority would be based under this paragraph if the other person were the secured party; or

(c) If the collateral is a commodity contract carried with a commodity intermediary, the satisfaction of the requirement for control specified in subsection (2)(b) of Section 26 of this Act with respect to commodity contracts carried or to be carried with the commodity intermediary.

(3) A security interest held by a securities intermediary in a security entitlement or a securities account maintained with the securities intermediary has priority over a conflicting security interest held by another secured party.

(4) A security interest held by a commodity intermediary in a commodity contract or a commodity account maintained with the commodity intermediary has priority over a conflicting security interest held by another secured party.

(5) A security interest in a certificated security in registered form which is perfected by taking delivery under subsection (1) of Section 53 of this Act and not by control under Section 54 of this Act has priority over a conflicting security interest perfected by a method other than control.

(6) Conflicting security interests created by a broker, securities intermediary, or commodity intermediary which are perfected without control under Section 26 of this Act rank equally.

(7) In all other cases, priority among conflicting security interests in investment property is governed by Sections 62 and 63 of this Act.

SECTION 69. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-329:

The following rules govern priority among conflicting security interests in the same letter-of-credit right:

(1) A security interest held by a secured party having control of the letter-of-credit right under Section 27 of this Act has priority to the extent of its control over a conflicting security interest held by a secured party that does not have control.

(2) Security interests perfected by control under Section 54 of this Act rank according to priority in time of obtaining control.

SECTION 70. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-330:

(1) A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory subject to a security interest if:

(a) In good faith and in the ordinary course of the purchaser's business, the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under Section 25 of this Act; and

(b) The chattel paper does not indicate that it has been assigned to an identified assignee other than the purchaser.
(2) A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed other than merely as proceeds of inventory subject to a security interest if the purchaser gives new value and takes possession of the chattel paper or obtains control of the chattel paper under Section 25 of this Act in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party.

(3) Except as otherwise provided in Section 67 of this Act, a purchaser having priority in chattel paper under subsection (1) or (2) of this section also has priority in proceeds of the chattel paper to the extent that:
   (a) Section 62 of this Act provides for priority in the proceeds; or
   (b) The proceeds consist of the specific goods covered by the chattel paper or cash proceeds of the specific goods, even if the purchaser's security interest in the proceeds is unperfected.

(4) Except as otherwise provided in subsection (1) of Section 71 of this Act, a purchaser of an instrument has priority over a security interest in the instrument perfected by a method other than possession if the purchaser gives value and takes possession of the instrument in good faith and without knowledge that the purchase violates the rights of the secured party.

(5) For purposes of subsections (1) and (2) of this section, the holder of a purchase-money security interest in inventory gives new value for chattel paper constituting proceeds of the inventory.

(6) For purposes of subsections (2) and (4) of this section, if chattel paper or an instrument indicates that it has been assigned to an identified secured party other than the purchaser, a purchaser of the chattel paper or instrument has knowledge that the purchase violates the rights of the secured party.

SECTION 71. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-331:

(1) This article does not limit the rights of a holder in due course of a negotiable instrument, a holder to which a negotiable document of title has been duly negotiated, or a perfected purchaser of a security. These holders or purchasers take priority over an earlier security interest, even if perfected, to the extent provided in Articles 5, 7, and 8 of this chapter.

(2) This article does not limit the rights of or impose liability on a person to the extent that the person is protected against the assertion of a claim under Article 8 of this chapter.

(3) Filing under this article does not constitute notice of a claim or defense to the holders, or purchasers, or persons described in subsections (1) and (2) of this section.

SECTION 72. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-332:

(1) A transferee of money takes the money free of a security interest unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

(2) A transferee of funds from a deposit account takes the funds free of a security interest in the deposit account unless the transferee acts in collusion with the debtor in violating the rights of the secured party.

SECTION 73. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-333:

(1) In this section, "possessory lien" means an interest, other than a security interest or an agricultural lien:
   (a) Which secures payment or performance of an obligation for services or materials furnished with respect to goods by a person in the ordinary course of the person's business;
   (b) Which is created by statute or rule of law in favor of the person, and
   (c) Whose effectiveness depends on the person's possession of the goods.

(2) A possessory lien on goods has priority over a security interest in the goods unless the lien is created by a statute that expressly provides otherwise.

SECTION 74. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-334:

(1) A security interest under this article may be created in goods that are fixtures or may continue in goods that become fixtures. A security interest does not exist under this article in ordinary building materials incorporated into an improvement on land.

(2) This article does not prevent creation of an encumbrance upon fixtures under real property law.

(3) In cases not governed by subsections (4) to (8) of this section, a security interest in fixtures is subordinate to a conflicting interest of an encumbrancer or owner of the related real property other than the debtor.

(4) Except as otherwise provided in subsection (8) of this section, a perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property and:
(a) The security interest is a purchase-money security interest;
(b) The interest of the encumbrancer or owner arises before the goods become fixtures; and
(c) The security interest is perfected by a fixture filing before the goods become fixtures or within twenty (20) days thereafter.

(5) A perfected security interest in fixtures has priority over a conflicting interest of an encumbrancer or owner of the real property if:
(a) The debtor has an interest of record in the real property or is in possession of the real property and the security interest:
   1. Is perfected by a fixture filing before the interest of the encumbrancer or owner is of record; and
   2. Has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner;
(b) Before the goods become fixtures, the security interest is perfected by any method permitted by this article and the fixtures are readily removable:
   1. Factory or office machines;
   2. Equipment that is not primarily used or leased for use in the operation of the real property; or
   3. Replacements of domestic appliances that are consumer goods;
(c) The conflicting interest is a lien on the real property obtained by legal or equitable proceedings after the security interest was perfected by any method permitted by this article; or
(d) The security interest is:
   1. Created in a manufactured home in a manufactured-home transaction; and
   2. Perfected pursuant to a statute described in subsection (1)(b) of Section 51 of this Act.

(6) A security interest in fixtures, whether or not perfected, has priority over a conflicting interest of an encumbrancer or owner of the real property if:
(a) The encumbrancer or owner has, in an authenticated record, consented to the security interest or disclaimed an interest in the goods as fixtures; or
(b) The debtor has a right to remove the goods as against the encumbrancer or owner.

(7) The priority of the security interest under subsection (6)(b) of this section continues for a reasonable time if the debtor's right to remove the goods as against the encumbrancer or owner terminates.

(8) A mortgage is a construction mortgage to the extent that it secures an obligation incurred for the construction of an improvement on land, including the acquisition cost of the land, if a recorded record of the mortgage so indicates. Except as otherwise provided in subsections (5) and (6) of this section, a security interest in fixtures is subordinate to a construction mortgage if a record of the mortgage is recorded before the goods become fixtures and the goods become fixtures before the completion of the construction. A mortgage has this priority to the same extent as a construction mortgage to the extent that it is given to refinance a construction mortgage.

(9) A perfected security interest in crops growing on real property has priority over a conflicting interest of an encumbrancer or owner of the real property if the debtor has an interest of record in or is in possession of the real property.

SECTION 75. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-335:

(1) A security interest may be created in an accession and continues in collateral that becomes an accession.
(2) If a security interest is perfected when the collateral becomes an accession, the security interest remains perfected in the collateral.
(3) Except as otherwise provided in subsection (4) of this section, the other provisions of this part of this article determine the priority of a security interest in an accession.
(4) A security interest in an accession is subordinate to a security interest in the whole which is perfected by compliance with the requirements of a certificate-of-title statute under subsection (2) of Section 51 of this Act.
(5) After default, subject to Part 6 of this article, a secured party may remove an accession from other goods if the security interest in the accession has priority over the claims of everyone having an interest in the whole.
(6) A secured party that removes an accession from other goods under subsection (5) of this section shall promptly reimburse any holder of a security interest or other lien on, or owner of, the whole or of the other goods, other than the debtor, for the cost of repair of any physical injury to the whole or the other goods. The secured party need not reimburse the holder or owner for any
diminution in value of the whole or the other goods caused by the absence of the accession removed or by any necessity for replacing it. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

SECTION 76. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-336:

(1) In this section, "commingled goods" means goods that are physically united with other goods in such a manner that their identity is lost in a product or mass.

(2) A security interest does not exist in commingled goods as such. However, a security interest may attach to a product or mass that results when goods become commingled goods.

(3) If collateral becomes commingled goods, a security interest attaches to the product or mass.

(4) If a security interest in collateral is perfected before the collateral becomes commingled goods, the security interest that attaches to the product or mass under subsection (3) of this section is perfected.

(5) Except as otherwise provided in subsection (6) of this section, the other provisions of this part of this article determine the priority of a security interest that attaches to the product or mass under subsection (3) of this section.

(6) If more than one (1) security interest attaches to the product or mass under subsection (3) of this section, the following rules determine priority:

(a) A security interest that is perfected under subsection (4) of this section has priority over a security interest that is unperfected at the time the collateral becomes commingled goods.

(b) If more than one (1) security interest is perfected under subsection (4) of this section, the security interests rank equally in proportion to the value of the collateral at the time it became commingled goods.

SECTION 77. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-337:

If, while a security interest in goods is perfected by any method under the law of another jurisdiction, this Commonwealth issues a certificate of title that does not show that the goods are subject to the security interest or contain a statement that they may be subject to security interests not shown on the certificate:

(1) A buyer of the goods, other than a person in the business of selling goods of that kind, takes free of the security interest if the buyer gives value and receives delivery of the goods after issuance of the certificate and without knowledge of the security interest; and

(2) The security interest is subordinate to a conflicting security interest in the goods that attaches and is perfected under subsection (2) of Section 51 of this Act, after issuance of the certificate and without the conflicting secured party's knowledge of the security interest.

SECTION 78. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-338:

If a security interest or agricultural lien is perfected by a filed financing statement providing information described in subsection (2)(e) of Section 107 of this Act which is incorrect at the time the financing statement is filed:

(1) The security interest or agricultural lien is subordinate to a conflicting perfected security interest in the collateral to the extent that the holder of the conflicting security interest gives value in reasonable reliance upon the incorrect information; and

(2) A purchaser, other than a secured party, of the collateral takes free of the security interest or agricultural lien to the extent that, in reasonable reliance upon the incorrect information, the purchaser gives value and, in the case of chattel paper, documents, goods, instruments, or a security certificate, receives delivery of the collateral.

SUBPART 4. RIGHTS OF BANK

SECTION 79. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-339:

This article does not preclude subordination by agreement by a person entitled to priority.

SECTION 80. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-340:

(1) Except as otherwise provided in subsection (3) of this section, a bank with which a deposit account is maintained may exercise any right of recoupment or set-off against a secured party that holds a security interest in the deposit account.

(2) Except as otherwise provided in subsection (3) of this section, the application of this article to a security interest in a deposit account does not affect a right of recoupment or set-off of the secured party as to a deposit account maintained with the secured party.
The exercise by a bank of a set-off against a deposit account is ineffective against a secured party that holds a security interest in the deposit account which is perfected by control under subsection (1)(c) of Section 24 of this Act, if the set-off is based on a claim against the debtor.

SECTION 81. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-341:

Except as otherwise provided in subsection (3) of Section 80 of this Act, and unless the bank otherwise agrees in an authenticated record, a bank's rights and duties with respect to a deposit account maintained with the bank are not terminated, suspended, or modified by:

1. The creation, attachment, or perfection of a security interest in the deposit account;
2. The bank's knowledge of the security interest; or
3. The bank's receipt of instructions from the secured party.

SECTION 82. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-342:

This article does not require a bank to enter into an agreement of the kind described in subsection (1)(b) of Section 24 of this Act, even if its customer so requests or directs. A bank that has entered into such an agreement is not required to confirm the existence of the agreement to another person unless requested to do so by its customer.

PART 4

RIGHTS OF THIRD PARTIES

SECTION 83. KRS 355.9-401 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (2) of this section and Sections 88, 89, 90, and 91 of this Act, whether a debtor's rights in collateral may be voluntarily or involuntarily transferred is governed by law other than this article.

(2) An agreement between the debtor and secured party which prohibits a transfer of the debtor's rights in collateral or makes the transfer a default does not prevent the transfer from taking effect.

SECTION 84. KRS 355.9-402 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

The existence of a security interest, agricultural lien, or authority given to a debtor to dispose of or use collateral, without more, does not subject a secured party to liability in contract or tort for the debtor's acts or omissions.

SECTION 85. KRS 355.9-403 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) In this section, "value" has the meaning provided in KRS 355.3-303(1).

(2) Except as otherwise provided in this section, an agreement between an account debtor and an assignor not to assert against an assignee any claim or defense that the account debtor may have against the assignor is enforceable by an assignee that takes an assignment:

(a) For value;
(b) In good faith;
(c) Without notice of a claim of a property or possessory right to the property assigned; and
(d) Without notice of a defense or claim in recoupment of the type that may be asserted against a person entitled to enforce a negotiable instrument under KRS 355.3-305(1).

(3) Subsection (2) of this section does not apply to defenses of a type that may be asserted against a holder in due course of a negotiable instrument under KRS 355.3-305(2).

(4) In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the rights of an assignee are subject to claims or defenses that the account debtor could assert against the original obligee, and the record does not include such a statement:

(a) The record has the same effect as if the record included such a statement; and
(b) The account debtor may assert against an assignee those claims and defenses that would have been available if the record included such a statement.

(5) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(6) Except as otherwise provided in subsection (4) of this section, this section does not displace law other than this article which gives effect to an agreement by an account debtor not to assert a claim or defense against an assignee.

SECTION 86. KRS 355.9-404 IS REPEALED AND REENACTED TO READ AS FOLLOWS:
(1) Unless an account debtor has made an enforceable agreement not to assert defenses or claims, and subject to subsections (2) to (5) of this section, the rights of an assignee are subject to:

(a) All terms of the agreement between the account debtor and assignor and any defense or claim in recoupment arising from the transaction that gave rise to the contract; and

(b) Any other defense or claim of the account debtor against the assignor which accrues before the account debtor receives a notification of the assignment authenticated by the assignor or the assignee.

(2) Subject to subsection (3) of this section and except as otherwise provided in subsection (4) of this section, the claim of an account debtor against an assignor may be asserted against an assignee under subsection (1) of this section only to reduce the amount the account debtor owes.

(3) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(4) In a consumer transaction, if a record evidences the account debtor's obligation, law other than this article requires that the record include a statement to the effect that the account debtor's recovery against an assignee with respect to claims and defenses against the assignor may not exceed amounts paid by the account debtor under the record, and the record does not include such a statement, the extent to which a claim of an account debtor against the assignor may be asserted against an assignee is determined as if the record included such a statement.

(5) This section does not apply to an assignment of a health-care-insurance receivable.

SECTION 87. KRS 355.9-405 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A modification of or substitution for an assigned contract is effective against an assignee if made in good faith. The assignee acquires corresponding rights under the modified or substituted contract. The assignment may provide that the modification or substitution is a breach of contract by the assignor. This subsection is subject to subsections (2) to (4) of this section.

(2) Subsection (1) of this section applies to the extent that:

(a) The right to payment or a part thereof under an assigned contract has not been fully earned by performance; or

(b) The right to payment or a part thereof has been fully earned by performance and the account debtor has not received notification of the assignment under subsection (1) of Section 88 of this Act.

(3) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(4) This section does not apply to an assignment of a health-care-insurance receivable.

SECTION 88. KRS 355.9-406 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Subject to subsections (2) to (9) of this section, an account debtor on an account, chattel paper, or a payment intangible may discharge its obligation by paying the assignor until, but not after, the account debtor receives a notification, authenticated by the assignor or the assignee, that the amount due or to become due has been assigned and that payment is to be made to the assignee. After receipt of the notification, the account debtor may discharge its obligation by paying the assignee and may not discharge the obligation by paying the assignor.

(2) Subject to subsection (8) of this section, notification is ineffective under subsection (1) of this section:

(a) If it does not reasonably identify the rights assigned;

(b) To the extent that an agreement between an account debtor and a seller of a payment intangible limits the account debtor's duty to pay a person other than the seller and the limitation is effective under law other than this article; or

(c) At the option of an account debtor, if the notification notifies the account debtor to make less than the full amount of any installment or other periodic payment to the assignee, even if:

1. Only a portion of the account, chattel paper, or payment intangible has been assigned to that assignee;

2. A portion has been assigned to another assignee; or

3. The account debtor knows that the assignment to that assignee is limited.

(3) Subject to subsection (8) of this section, if requested by the account debtor, an assignee shall reasonably furnish reasonable proof that the assignment has been made. Unless the assignee complies, the account debtor may discharge its obligation by paying the assignor, even if the account debtor has received a notification under subsection (1) of this section.

(4) Except as otherwise provided in subsection (5) of this section and Sections 89 and 162 of this Act, and subject to subsection (8) of this section, a term in an agreement between an account debtor and an assignor or in a promissory note is ineffective to the extent that it:

(a) Prohibits, restricts, or requires the consent of the account debtor or person obligated on the promissory note to the
assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, the account, chattel paper, payment intangible, or promissory note; or

(b) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account, chattel paper, payment intangible, or promissory note.

(5) Subsection (4) of this section does not apply to the sale of a payment intangible or promissory note.

(6) Except as otherwise provided in Sections 89 and 162 of this Act and subject to subsections (8) and (9) of this section, a rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, or account debtor to the assignment or transfer of, or creation of a security interest in, an account or chattel paper is ineffective to the extent that the rule of law, statute, or regulation:

(a) Prohibits, restricts, or requires the consent of the government, governmental body or official, or account debtor to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in the account or chattel paper; or

(b) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the account or chattel paper.

(7) Subject to subsection (8) of this section, an account debtor may not waive or vary its option under subsection (2)(c) of this section.

(8) This section is subject to law other than this article which establishes a different rule for an account debtor who is an individual and who incurred the obligation primarily for personal, family, or household purposes.

(9) This section does not apply to an assignment of a health-care-insurance receivable.

SECTION 89. KRS 355.9-407 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (2) of this section, a term in a lease agreement is ineffective to the extent that it:

(a) Prohibits, restricts, or requires the consent of a party to the lease to the assignment or transfer of, or the creation, attachment, perfection, or enforcement of a security interest in, an interest of a party under the lease contract or in the lessor's residual interest in the goods; or

(b) Provides that the assignment or transfer or the creation, attachment, perfection, or enforcement of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the lease.

(2) Except as otherwise provided in subsection (7) of Section 162 of this Act, a term described in subsection (1)(b) of this section is effective to the extent that there is:

(a) A transfer by the lessor of the lessee's right of possession or use of the goods in violation of the term; or

(b) A delegation of a material performance of either party to the lease contract in violation of the term.

(3) The creation, attachment, perfection, or enforcement of a security interest in the lessor's interest under the lease contract or the lessor's residual interest in the goods is not a transfer that materially impedes the lessee's prospect of obtaining return performance or materially changes the duty of or materially increases the burden or risk imposed on the lessee within the purview of subsection (4) of Section 162 of this Act unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the lessor.

SECTION 90. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-408:

(1) Except as otherwise provided in subsection (2) of this section, a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or a general intangible, including a contract, permit, license, or franchise, and which term prohibits, restricts, or requires the consent of the person obligated on the promissory note or the account debtor to, the assignment or transfer of, or creation, attachment, or perfection of a security interest in, the promissory note, health-care-insurance receivable, or general intangible, is ineffective to the extent that the term:

(a) Would impair the creation, attachment, or perfection of a security interest; or

(b) Provides that the assignment or transfer or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(2) Subsection (1) of this section applies to a security interest in a payment intangible or promissory note only if the security interest arises out of a sale of the payment intangible or promissory note.
(3) A rule of law, statute, or regulation that prohibits, restricts, or requires the consent of a government, governmental body or official, person obligated on a promissory note, or account debtor to the assignment or transfer of, or creation of a security interest in, a promissory note, health-care-insurance receivable, or general intangible, including a contract, permit, license, or franchise between an account debtor and a debtor, is ineffective to the extent that the rule of law, statute, or regulation:

(a) Would impair the creation, attachment, or perfection of a security interest; or

(b) Provides that the assignment or transfer of the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the promissory note, health-care-insurance receivable, or general intangible.

(4) To the extent that a term in a promissory note or in an agreement between an account debtor and a debtor which relates to a health-care-insurance receivable or general intangible or a rule of law, statute, or regulation described in subsection (3) of this section would be effective under law other than this article but is ineffective under subsection (1) or (3) of this section, the creation, attachment, or perfection of a security interest in the promissory note, health-care-insurance receivable, or general intangible:

(a) Is not enforceable against the person obligated on the promissory note or the account debtor;

(b) Does not impose a duty or obligation on the person obligated on the promissory note or the account debtor;

(c) Does not require the person obligated on the promissory note or the account debtor to recognize the security interest, pay or render performance to the secured party, or accept payment or performance from the secured party;

(d) Does not entitle the secured party to use or assign the debtor's rights under the promissory note, health-care-insurance receivable, or general intangible, including any related information or materials furnished to the debtor in the transaction giving rise to the promissory note, health-care-insurance receivable, or general intangible;

(e) Does not entitle the secured party to use, assign, possess, or have access to any trade secrets or confidential information of the person obligated on the promissory note or the account debtor; and

(f) Does not entitle the secured party to enforce the security interest in the promissory note, health-care-insurance receivable, or general intangible.


(6) Subsection (3) of this section does not apply to the following statutes and to administrative regulations promulgated under the authority of those statutes: KRS 304.2-260, KRS 304.24-420, Subtitle 33 of KRS Chapter 304, and Subtitle 37 of KRS Chapter 364.

SECTION 91. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-409:

(1) A term in a letter of credit or a rule of law, statute, regulation, custom, or practice applicable to the letter of credit which prohibits, restricts, or requires the consent of an applicant, issuer, or nominated person to a beneficiary's assignment of or creation of a security interest in a letter-of-credit right is ineffective to the extent that the term or rule of law, statute, regulation, custom, or practice:

(a) Would impair the creation, attachment, or perfection of a security interest in the letter-of-credit right; or

(b) Provides that the assignment or the creation, attachment, or perfection of the security interest may give rise to a default, breach, right of recoupment, claim, defense, termination, right of termination, or remedy under the letter-of-credit right.

(2) To the extent that a term in a letter of credit is ineffective under subsection (1) of this section but would be effective under law other than this article or a custom or practice applicable to the letter of credit, to the transfer of a right to draw or otherwise demand performance under the letter of credit, or to the assignment of a right to proceeds of the letter of credit, the creation, attachment, or perfection of a security interest in the letter-of-credit right:

(a) Is not enforceable against the applicant, issuer, nominated person, or transferee beneficiary;

(b) Imposes no duties or obligations on the applicant, issuer, nominated person, or transferee beneficiary; and

(c) Does not require the applicant, issuer, nominated person, or transferee beneficiary to recognize the security interest, pay or render performance to the secured party, or accept payment or other performance from the secured party.

(3) Subsection (1) of this section does not apply to the following statutes and to administrative regulations promulgated under the authority of those statutes: KRS 304.2-260, KRS 304.24-420, Subtitle 33 of KRS Chapter 304, and Subtitle 37 of KRS Chapter 364.
PART 5

FILING

SUBPART 1. FILING OFFICE; CONTENTS AND EFFECTIVENESS OF FINANCING STATEMENT

SECTION 92. KRS 355.9-501 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in subsection (2) of this section, if the local law of this Commonwealth governs perfection of a security interest or agricultural lien, the office in which to file a financing statement to perfect the security interest or agricultural lien is:

(a) The office designated for the filing or recording of a record of a mortgage on the related real property, if:
   1. The collateral is as-extracted collateral or timber to be cut; or
   2. The financing statement is filed as a fixture filing and the collateral is goods that are or are to become fixtures; or

(b) The office of the Secretary of State, in all other cases, including a case in which the collateral is goods that are or are to become fixtures and the financing statement is not filed as a fixture filing.

(2) The office in which to file a financing statement to perfect a security interest in collateral, including fixtures, of a transmitting utility is the office of the Secretary of State. The financing statement also constitutes a fixture filing as to the collateral indicated in the financing statement which is or is to become fixtures.

SECTION 93. KRS 355.9-502 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Subject to subsection (2) of this section, a financing statement is sufficient only if it:

(a) Provides the name of the debtor;

(b) Provides the name of the secured party or a representative of the secured party; and

(c) Indicates the collateral covered by the financing statement.

(2) Except as otherwise provided in subsection (2) of Section 92 of this Act, to be sufficient, a financing statement that covers as-extracted collateral or timber to be cut, or which is filed as a fixture filing and covers goods that are or are to become fixtures, must satisfy subsection (1) of this section and also:

(a) Indicate that it covers this type of collateral;

(b) Indicate that it is to be filed in the real property records;

(c) Provide a description of the real property to which the collateral is related; and

(d) If the debtor does not have an interest of record in the real property, provide the name of a record owner.

(3) A record of a mortgage is effective, from the date of recording, as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut only if:

(a) The record indicates the goods or accounts that it covers;

(b) The goods are or are to become fixtures related to the real property described in the record or the collateral is related to the real property described in the record and is as-extracted collateral or timber to be cut;

(c) The record satisfies the requirements for a financing statement in this section other than an indication that it is to be filed in the real property records; and

(d) The record is recorded.

(4) A financing statement may be filed before a security agreement is made or a security interest otherwise attaches.

SECTION 94. KRS 355.9-503 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A financing statement sufficiently provides the name of the debtor:

(a) If the debtor is a registered organization, only if the financing statement provides the name of the debtor indicated on the public record of the debtor's jurisdiction of organization which shows the debtor to have been organized;

(b) If the debtor is a decedent's estate, only if the financing statement provides the name of the decedent and indicates that the debtor is an estate;

(c) If the debtor is a trust or a trustee acting with respect to property held in trust, only if the financing statement:
   1. Provides the name specified for the trust in its organic documents or, if no name is specified, provides the name...
of the settlor and additional information sufficient to distinguish the debtor from other trusts having one or
more of the same settlors; and

2. Indicates, in the debtor's name or otherwise, that the debtor is a trust or is a trustee acting with respect to
property held in trust; and

(d) In other cases:

1. If the debtor has a name, only if it provides the individual or organizational name of the debtor; and

2. If the debtor does not have a name, only if it provides the names of the partners, members, associates, or other
persons comprising the debtor.

(2) A financing statement that provides the name of the debtor in accordance with subsection (1) of this section is not rendered
ineffective by the absence of:

(a) A trade name or other name of the debtor; or

(b) Unless required under subsection (1)(d)(2), of this section, names of partners, members, associates, or other
persons comprising the debtor.

(3) A financing statement that provides only the debtor's trade name does not sufficiently provide the name of the debtor.

(4) Failure to indicate the representative capacity of a secured party or representative of a secured party does not affect the
sufficiency of a financing statement.

(5) A financing statement may provide the name of more than one (1) debtor and the name of more than one (1) secured party.

SECTION 95. KRS 355.9-504 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

A financing statement sufficiently indicates the collateral that it covers if the financing statement provides:

(1) A description of the collateral pursuant to Section 28 of this Act; or

(2) An indication that the financing statement covers all assets or all personal property.

SECTION 96. KRS 355.9-505 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A consignor, lessor, or other bailor of goods, a licensor, or a buyer of a payment intangible or promissory note may file a
financing statement, or may comply with a statute or treaty described in subsection (1) of Section 51 of this Act, using the terms
"buyer," "seller," or words of similar import, instead of the terms "secured party" and "debtor."

(2) This part of this article applies to the filing of a financing statement under subsection (1) of this section and, as appropriate, to
compliance that is equivalent to filing a financing statement under subsection (2) of Section 51 of this Act, but the filing or
compliance is not of itself a factor in determining whether the collateral secures an obligation. If it is determined for another
reason that the collateral secures an obligation, a security interest held by the consignor, lessor, bailor, licensor, owner, or
buyer which attaches to the collateral is perfected by the filing or compliance.

SECTION 97. KRS 355.9-506 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A financing statement substantially satisfying the requirements of this part of this article is effective, even if it has minor errors
or omissions, unless the errors or omissions make the financing statement seriously misleading.

(2) Except as otherwise provided in subsection (1) of this section, a financing statement that fails sufficiently to provide the name of
the debtor in accordance with subsection (1) of Section 94 of this Act is seriously misleading.

(3) If a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, if
any, would disclose a financing statement that fails sufficiently to provide the name of the debtor in accordance with subsection
(1) of Section 94 of this Act, the name provided does not make the financing statement seriously misleading.

(4) For purposes of subsection (2) of Section 99 of this Act, the "debtor's correct name" in subsection (3) of this section means the
correct name of the new debtor.

SECTION 98. KRS 355.9-507 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A filed financing statement remains effective with respect to collateral that is sold, exchanged, leased, licensed, or otherwise
disposed of and in which a security interest or agricultural lien continues, even if the secured party knows of or consents to the
disposition.

(2) Except as otherwise provided in subsection (3) of this section and Section 99 of this Act, a financing statement is not rendered
ineffective if, after the financing statement is filed, the information provided in the financing statement becomes seriously
misleading under Section 97 of this Act.

(3) If a debtor so changes its name that a filed financing statement becomes seriously misleading under Section 97 of this Act:
(a) The financing statement is effective to perfect a security interest in collateral acquired by the debtor before, or within four (4) months after, the change; and

(b) The financing statement is not effective to perfect a security interest in collateral acquired by the debtor more than four (4) months after the change, unless an amendment to the financing statement which renders the financing statement not seriously misleading is filed within four (4) months after the change.

SECTION 99. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-508:

(1) Except as otherwise provided in this section, a filed financing statement naming an original debtor is effective to perfect a security interest in collateral in which a new debtor has or acquires rights to the extent that the financing statement would have been effective had the original debtor acquired rights in the collateral.

(2) If the difference between the name of the original debtor and that of the new debtor causes a filed financing statement that is effective under subsection (1) of this section to be seriously misleading under Section 97 of this Act:

(a) The financing statement is effective to perfect a security interest in collateral acquired by the new debtor before, and within four (4) months after, the new debtor becomes bound under subsection (4) of Section 33 of this Act; and

(b) The financing statement is not effective to perfect a security interest in collateral acquired by the new debtor more than four (4) months after the new debtor becomes bound under subsection (4) of Section 33 of this Act unless an initial financing statement providing the name of the new debtor is filed before the expiration of that time.

(3) This section does not apply to collateral as to which a filed financing statement remains effective against the new debtor under subsection (1) of Section 98 of this Act.

SECTION 100. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-509:

(1) A person may file an initial financing statement, amendment that adds collateral covered by a financing statement, or amendment that adds a debtor to a financing statement only if:

(a) The debtor authorizes the filing in an authenticated record or pursuant to subsection (1) or (2) of this section; or

(b) The person holds an agricultural lien that has become effective at the time of filing and the financing statement covers only collateral in which the person holds an agricultural lien.

(2) By authenticating or becoming bound as debtor by a security agreement, a debtor or new debtor authorizes the filing of an initial financing statement, and an amendment, covering:

(a) The collateral described in the security agreement; and

(b) Property that becomes collateral under subsection (1)(b) of Section 55 of this Act, whether or not the security agreement expressly covers proceeds.

(3) By acquiring collateral in which a security interest or agricultural lien continues under subsection (1)(a) of Section 55 of this Act, a debtor authorizes the filing of an initial financing statement, and an amendment, covering the collateral and property that becomes collateral under subsection (1)(b) of Section 55 of this Act.

(4) A person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if:

(a) The secured party of record authorizes the filing; or

(b) The amendment is a termination statement for a financing statement as to which the secured party of record has failed to file or send a termination statement as required by subsection (1) or (3) of Section 104 of this Act, the debtor authorizes the filing, and the termination statement indicates that the debtor authorized it to be filed.

(5) If there is more than one (1) secured party of record for a financing statement, each secured party of record may authorize the filing of an amendment under subsection (4) of this section.

SECTION 101. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-510:

(1) A filed record is effective only to the extent that it was filed by a person that may file it under Section 100 of this Act.

(2) A record authorized by one secured party of record does not affect the financing statement with respect to another secured party of record.

(3) A continuation statement that is not filed within the six (6) month period prescribed by subsection (4) of Section 106 of this Act is ineffective.

SECTION 102. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AT KRS 355.9-511:
A secured party of record with respect to a financing statement is a person whose name is provided as the name of the secured party or a representative of the secured party in an initial financing statement that has been filed. If an initial financing statement is filed under subsection (1) of Section 105 of this Act, the assignee named in the initial financing statement is the secured party of record with respect to the financing statement.

If an amendment of a financing statement which provides the name of a person as a secured party or a representative of a secured party is filed, the person named in the amendment is a secured party of record. If an amendment is filed under subsection (2) of Section 105 of this Act, the assignee named in the amendment is a secured party of record.

A person remains a secured party of record until the filing of an amendment of the financing statement which deletes the person.

A financing statement that is amended by an amendment that adds collateral is effective as to the added collateral only from the date of the filing of the amendment.

A financing statement that is amended by an amendment that adds a debtor is effective as to the added debtor only from the date of the filing of the amendment.

An amendment is ineffective to the extent it:

(a) Purports to delete all debtors and fails to provide the name of a debtor to be covered by the financing statement; or

(b) Purports to delete all secured parties of record and fails to provide the name of a new secured party of record.

A secured party shall cause the secured party of record for a financing statement to file a termination statement for the financing statement if the financing statement covers consumer goods and:

(a) There is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(b) The debtor did not authorize the filing of the initial financing statement.

To comply with subsection (1) of this section, a secured party shall cause the secured party of record to file the termination statement:

(a) Within one (1) month after there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value; or

(b) If earlier, within twenty (20) days after the secured party receives an authenticated demand from a debtor.

In cases not governed by subsection (1) of this section, within twenty (20) days after a secured party receives an authenticated demand from a debtor, the secured party shall cause the secured party of record for a financing statement to send to the debtor a termination statement for the financing statement or file the termination statement in the filing office if:

(a) Except in the case of a financing statement covering accounts or chattel paper that has been sold or goods that are the subject of a consignment, there is no obligation secured by the collateral covered by the financing statement and no commitment to make an advance, incur an obligation, or otherwise give value;

(b) The financing statement covers accounts or chattel paper that has been sold but as to which the account debtor or other person obligated has discharged its obligation;

(c) The financing statement covers goods that were the subject of a consignment to the debtor but are not in the debtor's possession; or

(d) The debtor did not authorize the filing of the initial financing statement.

Except as otherwise provided in Section 101 of this Act, upon the filing of a termination statement with the filing office, the
financing statement to which the termination statement relates ceases to be effective. Except as otherwise provided in Section 101 of this Act, for purposes of Sections 110(7), 113(1), and 114(3), the filing with the filing office of a termination statement relating to a financing statement that indicates that the debtor is a transmitting utility also causes the effectiveness of the financing statement to lapse.

SECTION 105. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-514:

(1) Except as otherwise provided in subsection (3) of this section, an initial financing statement may reflect an assignment of all of the secured party’s power to authorize an amendment to the financing statement by providing the name and mailing address of the assignee as the name and address of the secured party.

(2) Except as otherwise provided in subsection (3) of this section, a secured party of record may assign all or part of its power to authorize an amendment to a financing statement by filing in the filing office an amendment of the financing statement which:

(a) Identifies, by its file number, the initial financing statement to which it relates;

(b) Provides the name of the assignor; and

(c) Provides the name and mailing address of the assignee.

(3) An assignment of record of a security interest in a fixture covered by a record of a mortgage which is effective as a financing statement filed as a fixture filing under subsection (3) of Section 93 of this Act may be made only by an assignment of record of the mortgage in the manner provided by law of this Commonwealth other than this chapter.

SECTION 106. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-515:

(1) Except as otherwise provided in subsections (2), (5), (6), and (7) of this section, a filed financing statement is effective for a period of five (5) years after the date of filing.

(2) Except as otherwise provided in subsections (5), (6); and (7) of this section, an initial financing statement filed in connection with a public-finance transaction or manufactured-home transaction is effective for a period of thirty (30) years after the date of filing if it indicates that it is filed in connection with a public-finance transaction or manufactured-home transaction.

(3) The effectiveness of a filed financing statement lapses on the expiration of the period of its effectiveness unless before the lapse a continuation statement is filed pursuant to subsection (4) of this section. Upon lapse, a financing statement ceases to be effective and any security interest or agricultural lien that was perfected by the financing statement becomes unperfected, unless the security interest is perfected otherwise. If the security interest or agricultural lien becomes unperfected upon lapse, it is deemed never to have been perfected as against a purchaser of the collateral for value.

(4) A continuation statement may be filed only within six (6) months before the expiration of the five (5) year period specified in subsection (1) of this section or the thirty (30) year period specified in subsection (2) of this section, whichever is applicable.

(5) Except as otherwise provided in Section 101 of this Act, upon timely filing of a continuation statement, the effectiveness of the initial financing statement continues for a period of five (5) years commencing on the day on which the financing statement would have become ineffective in the absence of the filing. Upon the expiration of the five (5) year period, the financing statement lapses in the same manner as provided in subsection (3) of this section, unless, before the lapse, another continuation statement is filed pursuant to subsection (4) of this section. Succeeding continuation statements may be filed in the same manner to continue the effectiveness of the initial financing statement.

(6) If a debtor is a transmitting utility and a filed financing statement so indicates, the financing statement is effective until a termination statement is filed.

(7) A record of a mortgage that is effective as a financing statement filed as a fixture filing under subsection (3) of Section 93 of this Act remains effective as a financing statement filed as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real property.

SECTION 107. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-516:

(1) Except as otherwise provided in subsection (2) of this section, communication of a record to a filing office and tender of the filing fee or acceptance of the record by the filing office constitutes filing.

(2) Filing does not occur with respect to a record that a filing office refuses to accept because:

(a) The record is not communicated by a method or medium of communication authorized by the filing office;

(b) An amount equal to or greater than the applicable filing fee is not tendered;

(c) The filing office is unable to index the record because:

1. In the case of an initial financing statement, the record does not provide a name for the debtor.
2. In the case of an amendment or correction statement, the record:
   a. Does not identify the initial financing statement as required by Section 103 or 109 of this Act, as applicable; or
   b. Identifies an initial financing statement whose effectiveness has lapsed under Section 106 of this Act;
3. In the case of an initial financing statement that provides the name of a debtor identified as an individual or an amendment that provides a name of a debtor identified as an individual which was not previously provided in the financing statement to which the record relates, the record does not identify the debtor's last name; or
4. In the case of a record filed in the filing office described in subsection (1)(a) of Section 92 of this Act, the record does not provide a sufficient description of the real property to which it relates;
   d. In the case of an initial financing statement or an amendment that adds a secured party of record, the record does not provide a name and mailing address for the secured party of record;
   e. In the case of an initial financing statement or an amendment that provides a name of a debtor which was not previously provided in the financing statement to which the amendment relates, the record does not:
      1. Provide a mailing address for the debtor;
      2. Indicate whether the debtor is an individual or an organization; or
      3. If the financing statement indicates that the debtor is an organization, provide:
         a. A type of organization for the debtor;
         b. A jurisdiction of organization for the debtor; or
         c. An organizational identification number for the debtor or indicate that the debtor has none;
   f. In the case of an assignment reflected in an initial financing statement under subsection (1) of Section 105 of this Act or an amendment filed under subsection (2) of Section 105 of this Act, the record does not provide a name and mailing address for the assignee; or
   g. In the case of a continuation statement, the record is not filed within the six (6) month period prescribed by subsection (4) of Section 106 of this Act.

For purposes of subsection (2) of this section:
   a. A record does not provide information if the filing office is unable to read or decipher the information; and
   b. A record that does not indicate that it is an amendment or identify an initial financing statement to which it relates, as required by Section 103, 105, or 109 of this Act, is an initial financing statement.
   d. A record that is communicated to the filing office with tender of the filing fee, but which the filing office refuses to accept for a reason other than one set forth in subsection (2) of this section, is effective as a filed record except as against a purchaser of the collateral which gives value in reasonable reliance upon the absence of the record from the files.

SECTION 108. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-517:
The failure of the filing office to index a record correctly does not affect the effectiveness of the filed record.

SECTION 109. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-518:
(1) A person may file in the filing office a correction statement with respect to a record indexed there under the person's name if the person believes that the record is inaccurate or was wrongfully filed.
(2) A correction statement must:
   (a) Identify the record to which it relates by the file number assigned to the initial financing statement to which the record relates;
   (b) Indicate that it is a correction statement; and
   (c) Provide the basis for the person's belief that the record is inaccurate and indicate the manner in which the person believes the record should be amended to cure any inaccuracy or provide the basis for the person's belief that the record was wrongfully filed.
(3) The filing of a correction statement does not affect the effectiveness of an initial financing statement or other filed record.

SECTION 110. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO
BE NUMBERED AS KRS 355.9-519:

(1) For each record filed in a filing office, the filing office shall:
(a) Assign a unique number to the filed record;
(b) Create a record that bears the number assigned to the filed record and the date and time of filing;
(c) Maintain the filed record for public inspection; and
(d) Index the filed record in accordance with subsections (3), (4), and (5) of this subsection.

(2) A file number must include a digit that:
(a) Is mathematically derived from or related to the other digits of the file number; and
(b) Aids the filing office in determining whether a number communicated as the file number includes a single-digit or transpositional error.

(3) Except as otherwise provided in subsections (4) and (5) of this section, the filing office shall:
(a) Index an initial financing statement according to the name of the debtor and index all filed records relating to the initial financing statement in a manner that associates with one another an initial financing statement and all filed records relating to the initial financing statement; and
(b) Index a record that provides a name of a debtor which was not previously provided in the financing statement to which the record relates also according to the name that was not previously provided.

(4) If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index it:
(a) Under the names of the debtor and of each owner of record shown on the financing statement as if they were the mortgagors under a mortgage of the real property described; and
(b) To the extent that the law of this Commonwealth provides for indexing of records of mortgages under the name of the mortgagor, under the name of the secured party as if the secured party were the mortgagee thereunder, or, if indexing is by description, as if the financing statement were a record of a mortgage of the real property described.

(5) If a financing statement is filed as a fixture filing or covers as-extracted collateral or timber to be cut, the filing office shall index an assignment filed under subsection (1) of Section 105 of this Act or an amendment filed under subsection (2) of Section 105 of this Act:
(a) Under the name of the assignor as grantor; and
(b) To the extent that the law of this Commonwealth provides for indexing a record of the assignment of a mortgage under the name of the assignee, under the name of the assignee.

(6) The filing office shall maintain a capability:
(a) To retrieve a record by the name of the debtor and by the file number assigned to the initial financing statement to which the record relates; and
(b) To associate and retrieve with one another an initial financing statement and each filed record relating to the initial financing statement.

(7) The filing office may not remove a debtor's name from the index until one (1) year after the effectiveness of a financing statement naming the debtor lapses under Section 106 of this Act with respect to all secured parties of record.

(8) The filing office shall perform the acts required by subsections (1) to (5) of this section at the time and in the manner prescribed by filing-office rule, but not later than two (2) business days after the filing office receives the record in question.

(9) Subsection (2) of this section does not apply to a filing office described in subsection (1)(a) of Section 92 of this Act.

SECTION III. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-520:

(1) A filing office shall refuse to accept a record for filing for a reason set forth in subsection (2) of Section 107 of this Act and may refuse to accept a record for filing only for a reason set forth in subsection (2) of Section 107 of this Act.

(2) If a filing office refuses to accept a record for filing, it shall communicate to the person that presented the record the fact of and reason for the refusal and the date and time the record would have been filed had the filing office accepted it. The communication must be made at the time and in the manner prescribed by filing-office rule but in no event more than two (2) business days after the filing office receives the record.

(3) A filed financing statement satisfying subsections (1) and (2) of Section 93 of this Act is effective, even if the filing office is
required to refuse to accept it for filing under subsection (1) of this section. However, Section 78 of this Act applies to a filed financing statement providing information described in subsection (3)(e) of Section 107 of this Act which is incorrect at the time the financing statement is filed.

(4) If a record communicated to a filing office provides information that relates to more than one (1) debtor, this part of this article applies as to each debtor separately.

SECTION 112. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-521:

(1) A filing office that accepts written records may not refuse to accept a written initial financing statement in the form and format set forth as Form UCC1 and Form UCC1Ad in the final official text of the 1999 revisions to Article 9 of the Uniform Commercial Code promulgated by The American Law Institute and the National Conference of Commissioners on Uniform State Laws, except for a reason set forth in subsection (2) of Section 107 of this Act.

(2) A filing office that accepts written records may not refuse to accept a written record in the form and format set forth as Form UCC3 and Form UCC3Ad in the final official text of the 1999 revisions to Article 9 of the Uniform Commercial Code promulgated by The American Law Institute and the National Conference of Commissioners on Uniform State Laws, except for a reason set forth in subsection (2) of Section 107 of this Act.

SECTION 113. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-522:

(1) The filing office shall maintain a record of the information provided in a filed financing statement for at least one (1) year after the effectiveness of the financing statement has lapsed under Section 106 of this Act with respect to all secured parties of record. The record must be retrievable by using the name of the debtor and by using the file number assigned to the initial financing statement to which the record relates.

(2) Except to the extent that a statute governing disposition of public records provides otherwise, the filing office immediately may destroy any written record evidencing a financing statement. However, if the filing office destroys a written record, it shall maintain another record of the financing statement which complies with subsection (1)(a) of this section.

SECTION 114. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-523:

(1) If a person that files a written record requests an acknowledgment of the filing, the filing office shall send to the person an image of the record showing the number assigned to the record pursuant to subsection (1)(a) of Section 110 of this Act and the date and time of the filing of the record. However, if the person furnishes a copy of the record to the filing office, the filing office may instead:

(a) Note upon the copy the number assigned to the record pursuant to subsection (1)(a) of Section 110 of this Act and the date and time of the filing of the record; and

(b) Send the copy to the person.

(2) If a person files a record other than a written record, the filing office shall communicate to the person an acknowledgment that provides:

(a) The information in the record;

(b) The number assigned to the record pursuant to subsection (1)(a) of Section 110 of this Act; and

(c) The date and time of the filing of the record.

(3) The filing office shall communicate or otherwise make available in a record the following information to any person that requests it:

(a) Whether there is on file on a date and time specified by the filing office, but not a date earlier than three (3) business days before the filing office receives the request, any financing statement that:

1. Designates a particular debtor;

2. Has not lapsed under Section 106 of this Act with respect to all secured parties of record; and

3. If the request so states, has lapsed under Section 106 of this Act and a record of which is maintained by the filing office under subsection (1) of Section 113 of this Act;

(b) The date and time of filing of each financing statement; and

(c) The information provided in each financing statement.

(4) In complying with its duty under subsection (3) of this section, the filing office may communicate information in any medium. However, if requested, the filing office shall communicate information by issuing its written certificate.

(5) The filing office shall perform the acts required by subsections (1) to (4) of this section at the time and in the manner prescribed...
by filing-office rule, but not later than two (2) business days after the filing office receives the request.

(6) At least weekly, the Secretary of State shall offer to sell or license to the public on a nonexclusive basis, in bulk, copies of all records filed in it under this part of this article, in every medium from time to time available to the filing office.

SECTION 115. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-524:

Delay by the filing office beyond a time limit prescribed by this part of this article is excused if:

(1) The delay is caused by interruption of communication or computer facilities, war, emergency conditions, failure of equipment, or other circumstances beyond control of the filing office; and

(2) The filing office exercises reasonable diligence under the circumstances.

SECTION 116. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-525:

(1) Except as otherwise provided in subsection (4) of this section, the fee for filing and indexing a record under this part of this article is:

(a) Ten dollars ($10) if the record is communicated in writing and consists of one (1) or two (2) pages;

(b) Twenty dollars ($20) if the record is communicated in writing and consists of more than two (2) pages; and

(c) Five dollars ($5) if the record is communicated by another medium authorized by filing-office rule.

(2) The number of names required to be indexed does not affect the amount of the fee in subsection (1) of this section.

(3) The fee for issuing a certificate showing whether there is on file any financing statement naming a particular debtor is five dollars ($5).

(4) This section does not require a fee with respect to a record of a mortgage which is effective as a financing statement filed as a fixture filing or as a financing statement covering as-extracted collateral or timber to be cut under subsection (3) of Section 93 of this Act. However, the recording and satisfaction fees that otherwise would be applicable to the record of the mortgage apply.

SECTION 117. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-526:

(1) The Secretary of State shall promulgate administrative regulations to implement this article as it relates to the Secretary of State. The filing-office administrative regulations must be:

(a) Consistent with this article; and

(b) Promulgated in accordance with KRS Chapter 13A.

(2) To keep the filing-office administrative regulations and practices of the filing office in harmony with the rules and practices of filing offices in other jurisdictions that enact substantially this part of this article, and to keep the technology used by the filing office compatible with the technology used by filing offices in other jurisdictions that enact substantially this part of this article, The Secretary of State, so far as is consistent with the purposes, policies, and provisions of this article, in promulgating, amending, and repealing filing-office administrative regulations, shall:

(a) Consult with filing offices in other jurisdictions that enact substantially this part of this article; and

(b) Consult the most recent version of the model rules promulgated by the International Association of Corporate Administrators or any successor organization; and

(c) Take into consideration the rules and practices of, and the technology used by, filing offices in other jurisdictions that enact substantially this part of this article.

SECTION 118. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-527:

(1) The filing-office administrative regulations are not in harmony with the rules of filing offices in other jurisdictions that enact substantially this part of this article and the reasons for these variations; and

(2) The filing-office administrative regulations are not in harmony with the most recent version of the Model Rules promulgated by the International Association of Corporate Administrators, or any successor organization, and the reasons for these variations.
ENFORCEMENT OF SECURITY INTEREST

SECTION 119. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-601:

(1) After default, a secured party has the rights provided in this part of this article and, except as otherwise provided in Section 120 of this Act, those provided by agreement of the parties. A secured party:
   (a) May reduce a claim to judgment, foreclose, or otherwise enforce the claim, security interest, or agricultural lien by any available judicial procedure; and
   (b) If the collateral is documents, may proceed either as to the documents or as to the goods they cover.

(2) A secured party in possession of collateral or control of collateral under Section 24, 25, 26, or 27 of this Act has the rights and duties provided in Section 37 of this Act.

(3) The rights under subsections (1) and (2) of this section are cumulative and may be exercised simultaneously.

(4) Except as otherwise provided in subsection (7) of this section and Section 123 of this Act, after default, a debtor and an obligor have the rights provided in this part of this article and by agreement of the parties.

(5) If a secured party has reduced its claim to judgment, the lien of any levy that may be made upon the collateral by virtue of an execution based upon the judgment relates back to the earliest of:
   (a) The date of perfection of the security interest or agricultural lien in the collateral;
   (b) The date of filing a financing statement covering the collateral; or
   (c) Any date specified in a statute under which the agricultural lien was created.

A sale pursuant to an execution is a foreclosure of the security interest or agricultural lien by judicial procedure within the meaning of this section. A secured party may purchase at the sale and thereafter hold the collateral free of any other requirements of this article.

(7) Except as otherwise provided in subsection (3) of Section 125 of this Act, this part of this article imposes no duties upon a secured party that is a consignor or is a buyer of accounts, chattel paper, payment intangibles, or promissory notes.

SECTION 120. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-602:

Except as otherwise provided in Section 142 of this Act, to the extent that they give rights to a debtor or obligor and impose duties on a secured party, the debtor or obligor may not waive or vary the rules stated in the following listed sections:

(1) Subsection (2)(d)3 of Section 37 of this Act, which deals with use and operation of the collateral by the secured party;

(2) Section 40 of this Act, which deals with requests for an accounting and requests concerning a list of collateral and statement of account;

(3) Subsection (3) of Section 125 of this Act, which deals with collection and enforcement of collateral;

(4) Subsection (1) of Section 126 of this Act and subsection (3) of Section 133 of this Act to the extent that they deal with application or payment of noncash proceeds of collection, enforcement, or disposition;

(5) Subsection (1) of Section 126 of this Act and subsection (4) of Section 133 of this Act to the extent that they require accounting for or payment of surplus proceeds of collateral;

(6) Section 127 of this Act to the extent that it imposes upon a secured party that takes possession of collateral without judicial process the duty to do so without breach of the peace;

(7) Subsection (2) of Section 128 and Sections 129, 131, and 132 of this Act, which deal with disposition of collateral;

(8) Subsection (6) of Section 133 of this Act, which deals with calculation of a deficiency or surplus when a disposition is made to the secured party, a person related to the secured party, or a secondary obligor;

(9) Section 134 of this Act, which deals with explanation of the calculation of a surplus or deficiency;

(10) Sections 138, 139, and 140 of this Act, which deal with acceptance of collateral in satisfaction of obligation;

(11) Section 141 of this Act, which deals with redemption of collateral;

(12) Section 142 of this Act, which deals with permissible waivers; and

(13) Sections 143 and 144 of this Act, which deal with the secured party’s liability for failure to comply with this article.

SECTION 121. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-603:
SECTION 123. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-605:

(1) If a security agreement covers both personal and real property, a secured party may proceed:
   (a) Under this part of this article as to the personal property without prejudicing any rights with respect to the real property; or
   (b) As to both the personal property and the real property in accordance with the rights with respect to the real property, in which case the other provisions of this part of this article do not apply.

(2) Subject to subsection (3) of this section, if a security agreement covers goods that are or become fixtures, a secured party may proceed:
   (a) Under this part of this article; or
   (b) In accordance with the rights with respect to real property, in which case the other provisions of this part of this article do not apply.

(3) Subject to the other provisions of this part of this article, if a secured party holding a security interest in fixtures has priority over all owners and encumbrances of the real property, the secured party, after default, may remove the collateral from the real property.

(4) A secured party that removes collateral shall promptly reimburse any encumbrancer or owner of the real property, other than the debtor, for the cost of repair of any physical injury caused by the removal. The secured party need not reimburse the encumbrancer or owner for any diminution in value of the real property caused by the absence of the goods removed or by any necessity of replacing them. A person entitled to reimbursement may refuse permission to remove until the secured party gives adequate assurance for the performance of the obligation to reimburse.

SECTION 124. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-606:

A secured party does not owe a duty based on its status as secured party:

(1) To a person that is a debtor or obligor, unless the secured party knows:
   (a) That the person is a debtor or obligor;
   (b) The identity of the person; and
   (c) How to communicate with the person; or

(2) To a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:
   (a) That the person is a debtor; and
   (b) The identity of the person.

SECTION 125. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-607:

For purposes of this part of this article, a default occurs in connection with an agricultural lien at the time the secured party becomes entitled to enforce the lien in accordance with the statute under which it was created.

SECTION 126. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-608:

(1) If so agreed, and in any event after default, a secured party:
   (a) May notify an account debtor or other person obligated on collateral to make payment or otherwise render performance to or for the benefit of the secured party;
   (b) May take any proceeds to which the secured party is entitled under Section 55 of this Act;
   (c) May enforce the obligations of an account debtor or other person obligated on collateral and exercise the rights of the debtor with respect to the obligation of the account debtor or other person obligated on collateral to make payment or otherwise render performance to the debtor, and with respect to any property that secures the obligations of the account debtor or other person obligated on the collateral;
   (d) If it holds a security interest in a deposit account perfected by control under subsection (1)(a) of Section 24 of this Act, may apply the balance of the deposit account to the obligation secured by the deposit account; and
(c) If it holds a security interest in a deposit account perfected by control under subsection (1)(b) or (c) of Section 24 of this Act, may instruct the bank to pay the balance of the deposit account to or for the benefit of the secured party.

(2) If necessary to enable a secured party to exercise under subsection (1)(c) of this section the right of a debtor to enforce a mortgage nonjudicially, the secured party may record in the office in which a record of the mortgage is recorded:

(a) A copy of the security agreement that creates or provides for a security interest in the obligation secured by the mortgage; and

(b) The secured party’s sworn affidavit in recordable form stating that:
   1. A default has occurred; and
   2. The secured party is entitled to enforce the mortgage nonjudicially.

(3) A secured party shall proceed in a commercially reasonable manner if the secured party:

(a) Undertakes to collect from or enforce an obligation of an account debtor or other person obligated on collateral; and

(b) Is entitled to charge back uncollected collateral or otherwise to full or limited recourse against the debtor or a secondary obligor.

(4) A secured party may deduct from the collections made pursuant to subsection (2) of this section reasonable expenses of collection and enforcement, including reasonable attorney’s fees and legal expenses incurred by the secured party.

(5) This section does not determine whether an account debtor, bank, or other person obligated on collateral owes a duty to a secured party.

SECTION 126. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-608:

(1) If a security interest or agricultural lien secures payment or performance of an obligation, the following rules apply:

(a) A secured party shall apply or pay over for application the cash proceeds of collection or enforcement under Section 125 of this Act in the following order to:
   1. The reasonable expenses of collection and enforcement and, to the extent provided for by agreement and not prohibited by law, reasonable attorney’s fees and legal expenses incurred by the secured party;
   2. The satisfaction of obligations secured by the security interest or agricultural lien under which the collection or enforcement is made; and
   3. The satisfaction of obligations secured by any subordinate security interest in or other lien on the collateral subject to the security interest or agricultural lien under which the collection or enforcement is made if the secured party receives an authenticated demand for proceeds before distribution of the proceeds is completed.

(b) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder complies, the secured party need not comply with the holder’s demand under paragraph (a)3. of this subsection.

(c) A secured party need not apply or pay over for application noncash proceeds of collection and enforcement under Section 125 of this Act unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(d) A secured party shall account to and pay a debtor for any surplus, and the obligor is liable for any deficiency.

SECTION 127. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-609:

(1) After default, a secured party:

(a) May take possession of the collateral; and

(b) Without removal, may render equipment unusable and dispose of collateral on a debtor’s premises under Section 128 of this Act.

(2) A secured party may proceed under subsection (1) of this section:

(a) Pursuant to judicial process; or

(b) Without judicial process, if it proceeds without breach of the peace.

(3) If so agreed, and in any event after default, a secured party may require the debtor to assemble the collateral and make it
available to the secured party at a place to be designated by the secured party which is reasonably convenient to both parties.

SECTION 128. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-610:

(1) After default, a secured party may sell, lease, license, or otherwise dispose of any or all of the collateral in its present condition or following any commercially reasonable preparation or processing.

(2) Every aspect of a disposition of collateral, including the method, manner, time, place, and other terms, must be commercially reasonable. If commercially reasonable, a secured party may dispose of collateral by public or private proceedings, by one (1) or more contracts, as a unit or in parcels, and at any time and place and on any terms.

(3) A secured party may purchase collateral:

(a) At a public disposition; or

(b) At a private disposition only if the collateral is of a kind that is customarily sold on a recognized market or the subject of widely distributed standard price quotations.

(4) A contract for sale, lease, license, or other disposition includes the warranties relating to title, possession, quiet enjoyment, and the like which by operation of law accompany a voluntary disposition of property of the kind subject to the contract.

(5) A secured party may disclaim or modify warranties under subsection (4) of this section:

(a) In a manner that would be effective to disclaim or modify the warranties in a voluntary disposition of property of the kind subject to the contract of disposition; or

(b) By communicating to the purchaser a record evidencing the contract for disposition and including an express disclaimer or modification of the warranties.

(6) A record is sufficient to disclaim warranties under subsection (5) of this section if it indicates "There is no warranty relating to title, possession, quiet enjoyment, or the like in this disposition" or uses words of similar import.

(7) The acquisition of a repossession title by a secured party shall not be deemed a disposition of collateral under this section.

SECTION 129. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-611:

(1) In this section, "notification date" means the earlier of the date on which:

(a) A secured party sends to the debtor and any secondary obligor an authenticated notification of disposition; or

(b) The debtor and any secondary obligor waive the right to notification.

(2) Except as otherwise provided in subsection (4) of this section, a secured party that disposes of collateral under Section 128 of this Act shall send to the persons specified in subsection (3) of this section a reasonable authenticated notification of disposition.

(3) To comply with subsection (2) of this section, the secured party shall send an authenticated notification of disposition to:

(a) The debtor;

(b) Any secondary obligor; and

(c) If the collateral is other than consumer goods:

1. Any other person from which the secured party has received, before the notification date, an authenticated notification of a claim of an interest in the collateral;

2. Any other secured party or lienholder that, ten (10) days before the notification date, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

   a. Identified the collateral;

   b. Was indexed under the debtor's name as of that date; and

   c. Was filed in the office in which to file a financing statement against the debtor covering the collateral as of that date; and

3. Any other secured party that, ten (10) days before the notification date, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in subsection (1) of Section 51 of this Act.

(4) Subsection (2) of this section does not apply if the collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market.
A secured party complies with the requirement for notification prescribed by subsection (3)(c)(2) of this section if:

(a) Not later than twenty (20) days or earlier than thirty (30) days before the notification date, the secured party requests, in a commercially reasonable manner, information concerning financing statements indexed under the debtor's name in the office indicated in subsection (3)(c)(2) of this section; and

(b) Before the notification date, the secured party:
   1. Did not receive a response to the request for information; or
   2. Received a response to the request for information and sent an authenticated notification of disposition to each secured party or other lienholder named in that response whose financing statement covered the collateral.

SECTION 130. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-612:

(1) Except as otherwise provided in subsection (2) of this section, whether a notification is sent within a reasonable time is a question of fact.

(2) In a transaction other than a consumer transaction, a notification of disposition sent after default and ten (10) days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition.

SECTION 131. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-613:

Except in a consumer-goods transaction, the following rules apply:

(1) The contents of a notification of disposition are sufficient if the notification:
   (a) Describes the debtor and the secured party;
   (b) Describes the collateral that is the subject of the intended disposition;
   (c) States the method of intended disposition;
   (d) States that the debtor is entitled to an accounting of the unpaid indebtedness and states the charge, if any, for an accounting; and
   (e) States the time and place of a public disposition or the time after which any other disposition is to be made.

(2) Whether the contents of a notification that lacks any of the information specified in subsection (1) of this section are nevertheless sufficient is a question of fact.

(3) The contents of a notification providing substantially the information specified in subsection (1) of this section are sufficient, even if the notification includes:
   (a) Information not specified by that subsection; or
   (b) Minor errors that are not seriously misleading.

(4) A particular phrasing of the notification is not required.

(5) The following form of notification and the form appearing in subsection (3) of Section 132 of this Act, when completed, each provides sufficient information:

"NOTIFICATION OF DISPOSITION OF COLLATERAL"

To:  <Name of debtor, obligor, or other person to which the notification is sent>

From:  <Name, address, and telephone number of secured party>

Name of Debtor(s):  <Include only if debtor(s) are not an addressee>

<For a public disposition:>

We will sell <or lease or license, as applicable> the <describe collateral> <to the highest qualified bidder> in public as follows:

Day and Date:  

Time:  

Place:  

<For a private disposition:>

We will sell <or lease or license, as applicable> the <describe collateral> privately sometime after <day and date>,

You are entitled to an accounting of the unpaid indebtedness secured by the property that we intend to sell <or lease or license,
as applicable> <for a charge of $.... >. You may request an accounting by calling us at <telephone number>”.

SECTION 132. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-614:

In a consumer-goods transaction, the following rules apply:

(1) A notification of disposition must provide the following information:

(a) The information specified in subsection (1) of Section 131 of this Act;

(b) A description of any liability for a deficiency of the person to which the notification is sent;

(c) A telephone number from which the amount that must be paid to the secured party to redeem the collateral under Section 141 of this Act is available; and

(d) A telephone number or mailing address from which additional information concerning the disposition and the obligation secured is available.

(2) A particular phrasing of the notification is not required.

(3) The following form of notification, when completed, provides sufficient information:

NOTICE OF OUR PLAN TO SELL PROPERTY

<Name and address of secured party>

Subject: <Identification of Transaction>

We have your _______ <describe collateral>, because YOU broke promises in our agreement.

<For a public disposition:>

We will sell _______ <describe collateral> at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: _______

Time: _______

Place: _______

You may attend the sale and bring bidders if you want.

<For a private disposition:>

We will sell _______ <describe collateral> at private sale sometime after _______ <date>. A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you _______ <will or will not, as applicable> still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else.

You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at _______ <telephone number>.

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at _______ <telephone number> or write us at _______ <secured party’s address> and request a written explanation. We will charge you $ _______ for the explanation if we sent you another written explanation of the amount you owe us within the last six (6) months.

If you need more information about the sale call us at _______ <telephone number> or write us at _______ <secured party’s address>.

We are sending this notice to the following other people who have an interest in _______ <describe collateral> or who owe money under your agreement:

<Names of all other debtors and obligors, if any>”

(4) A notification in the form of subsection (3) of this section is sufficient, even if additional information appears at the end of the form.

(5) A notification in the form of subsection (3) of this section is sufficient, even if it includes errors in information not required by subsection (1) of this section, unless the error is misleading with respect to rights arising under this article.

(6) If a notification under this section is not in the form of subsection (3) of this section, law other than this article determines the
SECTION 133. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-615:

(1) A secured party shall apply or pay over for application the cash proceeds of disposition under Section 128 of this Act in the following order to:

(a) The reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing, and, to the extent provided for by agreement and not prohibited by law, reasonable attorney's fees and legal expenses incurred by the secured party;

(b) The satisfaction of obligations secured by the security interest or agricultural lien under which the disposition is made;

(c) The satisfaction of obligations secured by any subordinate security interest in or other subordinate lien on the collateral if:

1. The secured party receives from the holder of the subordinate security interest or other lien an authenticated demand for proceeds before distribution of the proceeds is completed; and

2. In a case in which a consignor has an interest in the collateral, the subordinate security interest or other lien is senior to the interest of the consignor; and

(d) A secured party that is a consignor of the collateral if the secured party receives from the consignor an authenticated demand for proceeds before distribution of the proceeds is completed.

(2) If requested by a secured party, a holder of a subordinate security interest or other lien shall furnish reasonable proof of the interest or lien within a reasonable time. Unless the holder does so, the secured party need not comply with the holder's demand under subsection (1)(c) of this section.

(3) A secured party need not apply or pay over for application noncash proceeds of disposition under Section 128 of this Act unless the failure to do so would be commercially unreasonable. A secured party that applies or pays over for application noncash proceeds shall do so in a commercially reasonable manner.

(4) If the security interest under which a disposition is made secures payment or performance of an obligation, after making the payments and applications required by subsection (1) of this section and permitted by subsection (3) of this section:

(a) Unless subsection (1)(d) of this section requires the secured party to apply or pay over cash proceeds to a consignor, the secured party shall account to and pay a debtor for any surplus; and

(b) The obligor is liable for any deficiency.

(5) If the underlying transaction is a sale of accounts, chattel paper, payment intangibles, or promissory notes:

(a) The debtor is entitled to any surplus; and

(b) The obligor is not liable for any deficiency.

(6) The surplus or deficiency following a disposition is calculated based on the amount of proceeds that would have been realized in a disposition complying with this article to a transferee other than the secured party, a person related to the secured party, or a secondary obligor if:

(a) The transferee in the disposition is the secured party, a person related to the secured party, or a secondary obligor; and

(b) The amount of proceeds of the disposition is significantly below the range of proceeds that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(7) A secured party that receives cash proceeds of a disposition in good faith and without knowledge that the receipt violates the rights of the holder of a security interest or other lien that is not subordinate to the security interest or agricultural lien under which the disposition is made:

(a) Takes the cash proceeds free of the security interest or other lien;

(b) Is not obligated to apply the proceeds of the disposition to the satisfaction of obligations secured by the security interest or other lien; and

(c) Is not obligated to account to or pay the holder of the security interest or other lien for any surplus.

SECTION 134. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-616:

(1) In this section:

(a) "Explanation" means a writing that:

1. States the amount of the surplus or deficiency:
(b) "Request" means a record:
1. Authenticated by a debtor or consumer obligor;
2. Requesting that the recipient provide an explanation; and
3. Sent after disposition of the collateral under Section 128 of this Act.

(2) In a consumer-goods transaction in which the debtor is entitled to a surplus or a consumer obligor is liable for a deficiency under Section 133 of this Act, the secured party shall:
(a) Send an explanation to the debtor or consumer obligor, as applicable, after the disposition and:
   1. Before or when the secured party accounts to the debtor and pays any surplus or first makes written demand on the consumer obligor after the disposition for payment of the deficiency; and
   2. Within fourteen (14) days after receipt of a request; or
(b) In the case of a consumer obligor who is liable for a deficiency, within fourteen (14) days after receipt of a request, send to the consumer obligor a record waiving the secured party’s right to a deficiency.

(3) To comply with subsection (1)(a)2. of this section, a writing must provide the following information in the following order:
(a) The aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:
   1. If the secured party takes or receives possession of the collateral after default, not more than thirty-five (35) days before the secured party takes or receives possession; or
   2. If the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than thirty-five (35) days before the disposition;
(b) The amount of proceeds of the disposition;
(c) The aggregate amount of the obligations after deducting the amount of proceeds;
(d) The amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and attorney’s fees secured by the collateral which are known to the secured party and relate to the current disposition;
(e) The amount, in the aggregate or by type, and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in paragraph (a) of this subsection; and
(f) The amount of the surplus or deficiency.

(4) A particular phrasing of the explanation is not required. An explanation complying substantially with the requirements of subsection (1) of this section is sufficient, even if it includes minor errors that are not seriously misleading.

(5) A debtor or consumer obligor is entitled without charge to one (1) response to a request under this section during any six (6) month period in which the secured party did not send to the debtor or consumer obligor an explanation pursuant to subsection (2)(a) of this section. The secured party may require payment of a charge not exceeding twenty-five dollars ($25) for each additional response.

SECTION 135. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-617:

(1) A secured party’s disposition of collateral after default:
   (a) Transfers to a transferee for value all of the debtor’s rights in the collateral;
   (b) Discharges the security interest under which the disposition is made; and
   (c) Discharges any subordinate security interest or other subordinate lien.

(2) A transferee that acts in good faith takes free of the rights and interests described in subsection (1) of this section, even if the
If a transferee does not take free of the rights and interests described in subsection (1) of this section, the transferee takes the collateral subject to:
(a) The debtor's rights in the collateral;
(b) The security interest or agricultural lien under which the disposition is made; and
(c) Any other security interest or other lien.

SECTION 136. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-618:

(1) A secondary obligor acquires the rights and becomes obligated to perform the duties of the secured party after the secondary obligor:
(a) Receives an assignment of a secured obligation from the secured party;
(b) Receives a transfer of collateral from the secured party and agrees to accept the rights and assume the duties of the secured party; or
(c) Is subrogated to the rights of a secured party with respect to collateral.
(2) An assignment, transfer, or subrogation described in subsection (1) of this section:
(a) Is not a disposition of collateral under Section 128 of this Act; and
(b) Relieves the secured party of further duties under this article.

SECTION 137. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-619:

(1) In this section, "transfer statement" means a record authenticated by a secured party stating:
(a) That the debtor has defaulted in connection with an obligation secured by specified collateral;
(b) That the secured party has exercised its post-default remedies with respect to the collateral;
(c) That, by reason of the exercise, a transferee has acquired the rights of the debtor in the collateral; and
(d) The name and mailing address of the secured party, debtor, and transferee.
(2) A transfer statement entitles the transferee to the transfer of record of all rights of the debtor in the collateral specified in the statement in any official filing, recording, registration, or certificate-of-title system covering the collateral. If a transfer statement is presented with the applicable fee and request form to the official or office responsible for maintaining the system, the official or office shall:
(a) Accept the transfer statement;
(b) Promptly amend its records to reflect the transfer; and
(c) If applicable, issue a new appropriate certificate of title in the name of the transferee.
(3) A transfer of the record or legal title to collateral to a secured party under subsection (2) of this section or otherwise is not of itself a disposition of collateral under this article and does not of itself relieve the secured party of its duties under this article.

SECTION 138. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-620:

(1) Except as otherwise provided in subsection (7) of this section, a secured party may accept collateral in full or partial satisfaction of the obligation it secures only if:
(a) The debtor consents to the acceptance under subsection (3) of this section;
(b) The secured party does not receive, within the time set forth in subsection (4) of this section, a notification of objection to the proposal authenticated by:
   1. A person to which the secured party was required to send a proposal under Section 139 of this Act; or
   2. Any other person, other than the debtor, holding an interest in the collateral subordinate to the security interest that is the subject of the proposal;
(c) If the collateral is consumer goods, the collateral is not in the possession of the debtor when the debtor consents to the acceptance; and
(d) Subsection (5) of this section does not require the secured party to dispose of the collateral or the debtor waives the

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For purposes of this section:

(2) A purported or apparent acceptance of collateral under this section is ineffective unless:

(a) The secured party consents to the acceptance in an authenticated record or sends a proposal to the debtor;

(b) The conditions of subsection (1) of this section are met.

(3) For purposes of this section:

(a) A debtor consents to an acceptance of collateral in partial satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default;

(b) A debtor consents to an acceptance of collateral in full satisfaction of the obligation it secures only if the debtor agrees to the terms of the acceptance in a record authenticated after default or the secured party:

1. Sends to the debtor after default a proposal that is unconditional or subject only to a condition that collateral not in the possession of the secured party be preserved or maintained;

2. In the proposal, proposes to accept collateral in full satisfaction of the obligation it secures; and

3. Does not receive a notification of objection authenticated by the debtor within twenty (20) days after the proposal is sent.

(4) To be effective under subsection (1)(b) of this section, a notification of objection must be received by the secured party:

(a) In the case of a person to which the proposal was sent pursuant to Section 139 of this Act, within twenty (20) days after notification was sent to that person; and

(b) In other cases:

1. Within twenty (20) days after the last notification was sent pursuant to Section 139 of this Act; or

2. If a notification was not sent, before the debtor consents to the acceptance under subsection (3) of this section.

(5) A secured party that has taken possession of collateral shall dispose of the collateral pursuant to Section 128 of this Act within the time specified in subsection (6) of this section if:

(a) Sixty percent (60%) of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

(b) Sixty percent (60%) of the principal amount of the obligation secured has been paid in the case of a non-purchase-money security interest in consumer goods.

(6) To comply with subsection (5) of this section, the secured party shall dispose of the collateral:

(a) Within ninety (90) days after taking possession; or

(b) Within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

(7) In a consumer transaction, a secured party may not accept collateral in partial satisfaction of the obligation it secures.

SECTION 139. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS 355.9-621:

(1) A secured party that desires to accept collateral in full or partial satisfaction of the obligation it secures shall send its proposal to:

(a) Any person from which the secured party has received, before the debtor consented to the acceptance, an authenticated notification of a claim of an interest in the collateral;

(b) Any other secured party or lienholder that, ten (10) days before the debtor consented to the acceptance, held a security interest in or other lien on the collateral perfected by the filing of a financing statement that:

1. Identified the collateral;

2. Was indexed under the debtor's name as of that date; and

3. Was filed in the office or offices in which to file a financing statement against the debtor covering the collateral as of that date; and

(c) Any other secured party that, ten (10) days before the debtor consented to the acceptance, held a security interest in the collateral perfected by compliance with a statute, regulation, or treaty described in subsection (1) of Section 51 of this Act.

(2) A secured party that desires to accept collateral in partial satisfaction of the obligation it secures shall send its proposal to any
secondary obligor in addition to the persons described in subsection (1) of this section.

SECTION 140. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-622:

(1) A secured party's acceptance of collateral in full or partial satisfaction of the obligation it secures:

(a) Discharges the obligation to the extent consented to by the debtor;

(b) Transfers to the secured party all of a debtor's rights in the collateral;

(c) Discharges the security interest or agricultural lien that is the subject of the debtor's consent and any subordinate security interest or other subordinate lien; and

(d) Terminates any other subordinate interest.

(2) A subordinate interest is discharged or terminated under subsection (1) of this section, even if the secured party fails to comply with this article.

SECTION 141. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-623:

(1) A debtor, any secondary obligor, or any other secured party or lienholder may redeem collateral.

(2) To redeem collateral, a person shall tender:

(a) Fulfillment of all obligations secured by the collateral; and

(b) The reasonable expenses and attorney's fees described in subsection (1)(a) of Section 133 of this Act.

(3) A redemption may occur at any time before a secured party:

(a) Has collected collateral under Section 125 of this Act;

(b) Has disposed of collateral or entered into a contract for its disposition under Section 128 of this Act; or

(c) Has accepted collateral in full or partial satisfaction of the obligation it secures under Section 140 of this Act.

SECTION 142. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-624:

(1) A debtor or secondary obligor may waive the right to notification of disposition of collateral under Section 129 of this Act only by an agreement to that effect entered into and authenticated after default.

(2) A debtor may waive the right to require disposition of collateral under subsection (5) of Section 138 of this Act only by an agreement to that effect entered into and authenticated after default.

(3) Except in a consumer-goods transaction, a debtor or secondary obligor may waive the right to redeem collateral under Section 141 of this Act only by an agreement to that effect entered into and authenticated after default.

SUBPART 2. NONCOMPLIANCE WITH ARTICLE

SECTION 143. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-625:

(1) If it is established that a secured party is not proceeding in accordance with this article, a court may order or restrain collection, enforcement, or disposition of collateral on appropriate terms and conditions.

(2) Subject to subsections (3), (4), and (6) of this section, a person is liable for damages in the amount of any loss caused by a failure to comply with this article. Loss caused by a failure to comply may include loss resulting from the debtor's inability to obtain, or increased costs of, alternative financing.

(3) Except as otherwise provided in Section 146 of this Act:

(a) A person that, at the time of the failure, was a debtor, was an obligor, or held a security interest in or other lien on the collateral may recover damages under subsection (2) of this section for its loss; and

(b) If the collateral is consumer goods, a person that was a debtor or a secondary obligor at the time a secured party failed to comply with this part of this article may recover for that failure in any event an amount not less than the credit service charge plus ten percent (10%) of the principal amount of the obligation or the time-price differential plus ten percent (10%) of the cash price.

(4) A debtor whose deficiency is eliminated under Section 144 of this Act may recover damages for the loss of any surplus. However, a debtor or secondary obligor whose deficiency is eliminated or reduced under Section 144 of this Act may not otherwise recover under subsection (2) of this section for noncompliance with the provisions of this part of this article relating to collection, enforcement, disposition, or acceptance.
(5) In addition to any damages recoverable under subsection (2) of this section, the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, may recover five hundred dollars ($500) in each case from a person that:

(a) Fails to comply with Section 38 of this Act;
(b) Fails to comply with Section 39 of this Act;
(c) Files a record that the person is not entitled to file under subsection (1) of Section 100 of this Act;
(d) Fails to cause the secured party of record to file or send a termination statement as required by subsection (1) or (3) of Section 104 of this Act;
(e) Fails to comply with subsection (2)(a) of Section 134 of this Act and whose failure is part of a pattern, or consistent with a practice, of noncompliance; or
(f) Fails to comply with subsection (2)(b) of Section 134 of this Act.

(6) A debtor or consumer obligor may recover damages under subsection (2) of this section and, in addition, five hundred dollars ($500) in each case from a person that, without reasonable cause, fails to comply with a request under Section 40 of this Act. A recipient of a request under Section 40 of this Act which never claimed an interest in the collateral or obligations that are the subject of a request under that section has a reasonable excuse for failure to comply with the request within the meaning of this subsection if: the determination of the proper rules in consumer transactions and may continue to apply established approaches.

SECTION 144. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-626:

(1) In an action arising from a transaction, other than a consumer transaction, in which the amount of a deficiency or surplus is in issue, the following rules apply:

(a) A secured party need not prove compliance with the provisions of this part of this article relating to collection, enforcement, disposition, or acceptance unless the debtor or a secondary obligor places the secured party's compliance in issue.
(b) If the secured party's compliance is placed in issue, the secured party has the burden of establishing that the collection, enforcement, disposition, or acceptance was conducted in accordance with this part of this article.
(c) Except as otherwise provided in Section 146 of this Act, if a secured party fails to prove that the collection, enforcement, disposition, or acceptance was conducted in accordance with the provisions of this part of this article relating to collection, enforcement, disposition, or acceptance, the liability of a debtor or a secondary obligor for a deficiency is limited to an amount by which the sum of the secured obligation, expenses, and attorney's fees exceeds the greater of:

1. The proceeds of the collection, enforcement, disposition, or acceptance; or
2. The amount of proceeds that would have been realized had the noncomplying secured party proceeded in accordance with the provisions of this part of this article relating to collection, enforcement, disposition, or acceptance.
(d) For purposes of paragraph (c)(2) of this subsection, the amount of proceeds that would have been realized is equal to the sum of the secured obligation, expenses, and attorney's fees unless the secured party proves that the amount is less than that sum.
(e) If a deficiency or surplus is calculated under subsection (6) of Section 133 of this Act, the debtor or obligor has the burden of establishing that the amount of proceeds of the disposition is significantly below the range of prices that a complying disposition to a person other than the secured party, a person related to the secured party, or a secondary obligor would have brought.

(2) The limitation of the rules in subsection (1) of this section to transactions other than consumer transactions is intended to leave to the court the determination of the proper rules in consumer transactions. The court may not infer from that limitation the nature of the proper rule in consumer transactions and may continue to apply established approaches.

SECTION 145. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-627:

(1) The fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.

(2) A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(a) In the usual manner on any recognized market;
(b) At the price current in any recognized market at the time of the disposition; or
(c) Otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(3) A collection, enforcement, disposition, or acceptance is commercially reasonable if it has been approved:

(a) In a judicial proceeding;
(b) By a bona fide creditors' committee;
(c) By a representative of creditors; or
(d) By an assignee for the benefit of creditors.

(4) Approval under subsection (3) of this section need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable.

SECTION 146. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-628:

(1) Unless a secured party knows that a person is a debtor or obligor, knows the identity of the person, and knows how to communicate with the person:

(a) The secured party is not liable to the person, or to a secured party or lienholder that has filed a financing statement against the person, for failure to comply with this article; and

(b) The secured party's failure to comply with this article does not affect the liability of the person for a deficiency.

(2) A secured party is not liable because of its status as secured party:

(a) To a person that is a debtor or obligor, unless the secured party knows:
   1. That the person is a debtor or obligor;
   2. The identity of the person; and
   3. How to communicate with the person; or

(b) To a secured party or lienholder that has filed a financing statement against a person, unless the secured party knows:
   1. That the person is a debtor; and
   2. The identity of the person.

(3) A secured party is not liable to any person, and a person's liability for a deficiency is not affected, because of any act or omission arising out of the secured party's reasonable belief that a transaction is not a consumer-goods transaction or a consumer transaction or that goods are not consumer goods, if the secured party's belief is based on its reasonable reliance on:

(a) A debtor's representation concerning the purpose for which collateral was to be used, acquired, or held; or

(b) An obligor's representation concerning the purpose for which a secured obligation was incurred.

(4) A secured party is not liable to any person under subsection (3)(b) of Section 143 of this Act for its failure to comply with Section 134 of this Act.

(5) A secured party is not liable under subsection (3)(b) of Section 143 of this Act more than once with respect to any one (1) secured obligation.

PART 7

TRANSITION

SECTION 147. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS 355.9-701:

This article takes effect on July 1, 2001.

SECTION 148. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-702:

(1) Except as otherwise provided in this part of this article, the revision of Article 9 in this Act applies to a transaction or lien within its scope, even if the transaction or lien was entered into or created before this Act takes effect.

(2) Except as otherwise provided in subsection (3) of this section and Sections 149 to 155 of this Act:

(a) Transactions and liens that were not governed by the former Article 9 of this chapter, were validly entered into or created before the revision of Article 9 in this Act takes effect, and would be subject to the revision of Article 9 in this
Act if they had been entered into or created after this Act takes effect, and the rights, duties, and interests flowing from those transactions and liens remain valid after this Act takes effect; and

(b) The transactions and liens may be terminated, completed, consummated, and enforced as required or permitted by the revision of Article 9 in this Act or by the law that otherwise would apply if this Act had not taken effect.

(3) The revision of Article 9 in this Act does not affect an action, case, or proceeding commenced before this Act takes effect.

SECTION 149. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-703:

(1) A security interest that is enforceable immediately before this Act takes effect and would have priority over the rights of a person that becomes a lien creditor at that time is a perfected security interest under the revision of Article 9 in this Act if, when this Act takes effect, the applicable requirements for enforceability and perfection under the revision of Article 9 in this Act are satisfied without further action.

(2) Except as otherwise provided in Section 151 of this Act, if, immediately before this Act takes effect, a security interest is enforceable and would have priority over the rights of a person that becomes a lien creditor at that time, but the applicable requirements for enforceability or perfection under the revision of Article 9 in this Act are not satisfied when this Act takes effect, the security interest:

(a) Is a perfected security interest for one (1) year after this Act takes effect;

(b) Remains enforceable thereafter only if the security interest becomes enforceable under Section 33 of this Act before the year expires; and

(c) Remains perfected thereafter only if the applicable requirements for perfection under the revision of Article 9 in this Act are satisfied before the year expires.

SECTION 150. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-704:

A security interest that is enforceable immediately before this Act takes effect but which would be subordinate to the rights of a person that becomes a lien creditor at that time:

(1) Remains an enforceable security interest for one (1) year after this Act takes effect;

(2) Remains enforceable thereafter if the security interest becomes enforceable under Section 33 of this Act when this Act takes effect or within one (1) year thereafter; and

(3) Becomes perfected:

(a) Without further action, when this Act takes effect if the applicable requirements for perfection under the revision of Article 9 in this Act are satisfied before or at that time; or

(b) When the applicable requirements for perfection are satisfied if the requirements are satisfied after that time.

SECTION 151. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-705:

(1) If action, other than the filing of a financing statement, is taken before this Act takes effect and the action would have resulted in priority of a security interest over the rights of a person that becomes a lien creditor had the security interest become enforceable before this Act takes effect, the action is effective to perfect a security interest that attaches under the revision of Article 9 in this Act within one (1) year after this Act takes effect. An attached security interest becomes unperfected one (1) year after this Act takes effect unless the security interest becomes a perfected security interest under the revision of Article 9 in this Act before the expiration of that period.

(2) The filing of a financing statement before this Act takes effect is effective to perfect a security interest to the extent the filing would satisfy the applicable requirements for perfection under the revision of Article 9 in this Act.

(3) The revision of Article 9 in this Act does not render ineffective an effective financing statement that, before this Act takes effect, is filed and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in the former KRS 355.9-101, or law determining the place of filing as provided in the former KRS 355.9-401. However, except as otherwise provided in subsections (4) and (5) of this section and Section 152 of this Act, the financing statement ceases to be effective at the earlier of:

(a) The time the financing statement would have ceased to be effective under the law of the jurisdiction in which it is filed; or

(b) June 30, 2006.

(4) The filing of a continuation statement after this Act takes effect does not continue the effectiveness of the financing statement filed before this Act takes effect. However, upon the timely filing of a continuation statement after this Act takes effect and in accordance with the law of the jurisdiction governing perfection as provided in Part 3 of this article, the effectiveness of a
financing statement filed in the same office in that jurisdiction before this Act takes effect continues for the period provided by the law of that jurisdiction.

(5) Subsection (3)(b) of this section applies to a financing statement that, before this Act takes effect, is filed against a transmitting utility and satisfies the applicable requirements for perfection under the law of the jurisdiction governing perfection as provided in the former KRS 355.9-103 only to the extent that Part 3 of this article provides that the law of a jurisdiction other than the jurisdiction in which the financing statement is filed governs perfection of a security interest in collateral covered by the financing statement.

(6) A financing statement that includes a financing statement filed before this Act takes effect and a continuation statement filed after this Act takes effect is effective only to the extent that it satisfies the requirements of Part 5 of this article for an initial financing statement.

SECTION 152. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-706:

(1) The filing of an initial financing statement in the office specified in Section 92 of this Act continues the effectiveness of a financing statement filed before this Act takes effect if:

(a) The filing of an initial financing statement in that office would be effective to perfect a security interest under the revision of Article 9 in this Act;

(b) The pre-effective-date financing statement was filed in an office in another state or another office in this Commonwealth; and

(c) The initial financing statement satisfies subsection (3) of this section.

(2) The filing of an initial financing statement under subsection (1) of this section continues the effectiveness of the pre-effective-date financing statement:

(a) If the initial financing statement is filed before this Act takes effect, for the period provided in the former KRS 355.9-403 with respect to a financing statement; and

(b) If the initial financing statement is filed after this Act takes effect, for the period provided in Section 106 of this Act with respect to an initial financing statement.

(3) To be effective for purposes of subsection (1) of this section, an initial financing statement must:

(a) Satisfy the requirements of Part 5 of this article for an initial financing statement;

(b) Identify the pre-effective-date financing statement by indicating the office in which the financing statement was filed and providing the dates of filing and file numbers, if any, of the financing statement and of the most recent continuation statement filed with respect to the financing statement; and

(c) Indicate that the pre-effective-date financing statement remains effective.

(4) When a secured party files an initial financing statement with the Secretary of State under subsection (1) of this section or under Section 153 of this Act, the secured party may send a copy of the initial financing statement to the county clerk of the county in which the pre-effective-date financing statement was filed, and, additionally, may send to the county clerk copies of any continuation statement subsequently filed with the Secretary of State that relates to an initial financing statement filed under subsection (1) of this section or under Section 153 of this Act. The secured party's election not to send a copy of an initial financing statement or a continuation statement to the county clerk does not affect in any way the perfection of the secured party's security interest. The county clerk shall append to the pre-effective-date financing statement the copy of any initial financing statement or continuation statement received from a secured party and shall retain the entire file as required by Section 156 of this Act.

SECTION 153. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-707:

(1) In this section, "pre-effective-date financing statement" means a financing statement filed before the effective date of this Act.

(2) After the effective date of this Act, a person may add or delete collateral covered by, continue or terminate the effectiveness of, or otherwise amend information provided in, a pre-effective-date financing statement only in accordance with the law of the jurisdiction governing perfection as provided in Part 3 of this Article. However, the effectiveness of a pre-effective-date financing statement also may be terminated in accordance with the law of the jurisdiction in which the financing statement is filed.

(3) Except as otherwise provided in subsection (4) of this section, if the law of this Commonwealth governs perfection of a security interest, the information in a pre-effective-date financing statement may be amended after the effective date of this Act only if:

(a) The pre-effective-date financing statement and an amendment are filed in the office specified in Section 92 of this Act;

(b) An amendment is filed in the office specified in Section 92 of this Act concurrently with, or after the filing in that office
of an initial financing statement that satisfies subsection (3) of Section 152 of this Act; or

(c) An initial financing statement that provides the information as amended and satisfies subsection (3) of Section 152 of this Act is filed in the office specified in Section 92 of this Act.

(4) If the law of this Commonwealth governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement may be continued only under subsections (4) and (6) of Section 151 of this Act or Section 152 of this Act.

(5) Whether or not the law of this Commonwealth governs perfection of a security interest, the effectiveness of a pre-effective-date financing statement filed in this Commonwealth may be terminated after the effective date of this Act by filing a termination statement in the office in which the pre-effective-date financing statement is filed, unless an initial financing statement that satisfies subsection (3) of Section 152 of this Act has been filed in the office specified by the law of the jurisdiction governing perfection as provided in Part 3 of this Article as the office in which to file a financing statement.

SECTION 154. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-708:

A person may file an initial financing statement or a continuation statement under this part of this article if:

(1) The secured party of record authorizes the filing; and

(2) The filing is necessary under this part of this article:

(a) To continue the effectiveness of a financing statement filed before this Act takes effect; or

(b) To perfect or continue the perfection of a security interest.

SECTION 155. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-709:

(1) The revision of Article 9 in this Act determines the priority of conflicting claims to collateral. However, if the relative priorities of the claims were established before this Act takes effect, the former Article 9 of this chapter determines priority.

(2) For purposes of subsection (1) of Section 62 of this Act, the priority of a security interest that becomes enforceable under Section 33 of this Act dates from the time this Act takes effect if the security interest is perfected under the revision of Article 9 in this Act by the filing of a financing statement before this Act takes effect which would not have been effective to perfect the security interest under the former Article 9 of this chapter. This subsection does not apply to conflicting security interests each of which is perfected by the filing of such a financing statement.

SECTION 156. A NEW SECTION OF ARTICLE 9 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.9-710:

(1) A county clerk who receives a statement tendered by a secured party under Part 4 of the former Article 9, prior to the effective date of this Act, that has not been filed or indexed on the effective date of this Act, shall file and index the statement as soon as practicable.

(2) Every county clerk shall append to the pre-effective-date financing statement the copies of any initial financing statement or continuation statement received from a secured party under subsection (4) of Section 152 of this Act.

(3) The county clerk shall maintain all records filed under Part 4 of the former Article 9 and subsection (2) of this section until the later of:

(a) One (1) year after the lapse of the initial financing statement;

(b) July 1, 2008; or

(c) Such other record-retention requirement as may be applicable under other Kentucky law or administrative regulations.

(4) The county clerk shall respond to requests for information with respect to records maintained under this Article in accordance with subsections (3) and (4) of Section 114 of this Act and may charge the fee for issuing certificates authorized in Section 116 of this Act.

(5) When Internet access is available through the AVIS system or its successor, every county clerk shall provide a means within his or her office by which the Secretary of State's filing system for this Article can be searched and through which electronic filings under this Article can be made with the Secretary of State. This subsection shall not be construed to require a secured party to file through the means provided by a county clerk. The county clerk shall neither be required to conduct a search of the Secretary of State's filing system nor to issue a certificate as to the contents of the system.

CONFORMING AMENDMENTS FOR REVISED ARTICLE 9

Section 157. KRS 355.1-201 is amended to read as follows:

Subject to additional definitions contained in the subsequent articles of this chapter which are applicable to specific articles or parts thereof,
and unless the context otherwise requires, in this chapter:

(1) "Action" in the sense of a judicial proceeding includes recoupment, counterclaim, set-off, suit in equity and any other proceedings in which rights are determined.

(2) "Aggrieved party" means a party entitled to resort to a remedy.

(3) "Agreement" means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this chapter (KRS 355.1-205 and 355.2-208). Whether an agreement has legal consequences is determined by the provisions of this chapter, if applicable; otherwise by the law of contracts (KRS 355.1-103). (Compare "Contract.")

(4) "Bank" means any person engaged in the business of banking.

(5) "Bearer" means the person in possession of an instrument, document of title, or certificated security payable to bearer or indorsed in blank.

(6) "Bill of lading" means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods, and includes an airbill. "Airbill" means a document serving for air transportation as a bill of lading does for marine or rail transportation, and includes an air consignment note or air waybill.

(7) "Branch" includes a separately incorporated foreign branch of a bank.

(8) "Burden of establishing" a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its nonexistence.

(9) "Buyer in ordinary course of business" means a person that buys goods without knowledge that the sale violates the ownership rights or security interest of another person in the goods, and which buy in the ordinary course from a person other than a pawnbroker, in the business of selling goods of that kind (but does not include a pawnbroker). A person buys goods in the ordinary course if the sale to the person comport with the usual or customary practices in the kind of business in which the seller is engaged or with the seller's own usual or customary practices. A person that sells oil, gas, or other minerals at the wellhead or minehead is a person. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. A buyer in ordinary course of business may buy for cash or by exchange of other property or on secured or unsecured credit, and may acquire goods or documents of title under a preexisting contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt. Only a buyer that takes possession of the goods or has a right to recover the goods from the seller under Article 2 of this chapter may be a buyer in ordinary course of business. A person that acquires goods in a transfer in bulk or as security for or in total or partial satisfaction of a money debt is not a buyer in ordinary course of business.

(10) "Conspicuous": A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NONNEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type or color. But in a telegram any stated term is "conspicuous." Whether a term or clause is "conspicuous" or not is for decision by the court.

(11) "Contract" means the total legal obligation which results from the parties' agreement as affected by this chapter and any other applicable rules of law. (Compare "Agreement.")

(12) "Creditor" includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor's or assignor's estate.

(13) "Defendant" includes a person in the position of defendant in a cross-action or counterclaim.

(14) "Delivery" with respect to instruments, documents of title, chattel paper or certificated securities means voluntary transfer of possession.

(15) "Document of title" includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

(16) "Fault" means wrongful act, omission or breach.

(17) "Fungible" with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, equivalent of any other like unit. Goods which are not fungible shall be deemed fungible for the purposes of this chapter to the extent that under a particular agreement or document unlike units are treated as equivalents.

(18) "Genuine" means free of forgery or counterfeiting.

(19) "Good faith" means honesty in fact or in the conduct or transaction concerned.

(20) "Holder" with respect to a negotiable instrument, means the person in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession. "Holder" with respect to a document of title means the person in possession if the goods are deliverable to bearer or to the order of the person in possession.
(21) To "honor" is to pay or to accept and pay, or where a credit so engages to purchase or discount a draft complying with the terms of the credit.

(22) "Insolvency proceedings" includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved.

(23) A person is "insolvent" who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law.

(24) "Money" means a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two (2) or more nations.

(25) A person has "notice" of a fact when
(a) He has actual knowledge of it; or
(b) He has received a notice or notification of it; or
(c) From all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person "knows" or has "knowledge" of a fact when he has actual knowledge of it. "Discover" or "learn" or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this chapter.

(26) A person "notifies" or "gives" a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person "receives" a notice or notification when
(a) It comes to his attention; or
(b) It is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

(28) "Organization" includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two (2) or more persons having a joint or common interest, or any other legal or commercial entity.

(29) "Party," as distinct from "third party," means a person who has engaged in a transaction or made an agreement within this chapter.

(30) "Person" includes an individual or an organization (See KRS 355.1-102).

(31) "Presumption" or "presumed" means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its nonexistence.

(32) "Purchase" includes taking by sale, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, gift or any other voluntary transaction creating an interest in property.

(33) "Purchaser" means a person who takes by purchase.

(34) "Remedy" means any remedial right to which an aggrieved party is entitled with or without resort to tribunal.

(35) "Representative" includes an agent, an officer of a corporation or association, and a trustee, executor or administrator of an estate, or any other person empowered to act for another.

(36) "Rights" includes remedies.

(37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. (The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (KRS 355.2-401) is limited in effect to a reservation of a "security interest." The term also includes any interest of a consignor and a buyer of accounts,[or] chattel paper, a payment intangible, or a promissory note in a transaction that which is subject to Article 9 of this chapter. The special property interest of a buyer of goods on identification of those goods to a contract for sale under KRS 355.2-401 is not a "security interest," but a buyer may also acquire a "security interest" by complying with Article 9 of this chapter. Except as otherwise provided in KRS 355.2-505, the right of a seller or lessor of goods under Article 2 or 2A of this chapter to retain or acquire possession of the goods is not a "security interest," but a seller or lessor may also acquire a "security interest" by complying with Article 9 of this chapter. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (KRS 355.2-401) is limited in effect to a reservation of a "security interest." [Unless a consignment is intended as security, reservation of title thereunder is not a "security interest," but a consignment in any event is subject to the provisions on consignment sales (KRS 355.2-326).]

Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee; and
(a) The original term of the lease is equal to or greater than the remaining economic life of the goods;
(b) The lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;
(c) The lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement; or
(d) The lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that:
(a) The present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;
(b) The lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods;
(c) The lessee has an option to renew the lease or to become the owner of the goods;
(d) The lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods for the term of the renewal at the time the option is to be performed; or
(e) The lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

For purposes of this subsection (37):
(x) Additional consideration is not nominal if (i) when the option to renew the lease is granted to the lessee the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or (ii) when the option to become the owner of the goods is granted to the lessee the price is stated to be the fair market value of the goods determined at the time the option is to be performed. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised;
(y) "Reasonably predictable" and "remaining economic life of the goods" are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and
(z) "Present value" means the amount as of a date certain of one (1) or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(38) "Send" in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending.

(39) "Signed" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

(40) "Surety" includes guarantor.

(41) "Telegram" includes a message transmitted by radio, teletype, cable, any mechanical method of transmission, or the like.

(42) "Term" means that portion of an agreement which relates to a particular matter.

(43) "Unauthorized" signature means one made without actual, implied, or apparent authority and includes a forgery.

(44) "Value," except as otherwise provided with respect to negotiable instruments and bank collections (KRS 355.3-303, 355.4-210, and 355.4-211) a person gives "value" for rights if he acquires them
(a) In return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; or
(b) As security for or in total or partial satisfaction of a pre-existing claim; or
(c) By accepting delivery pursuant to a pre-existing contract for purchase; or
(d) Generally, in return for any consideration sufficient to support a simple contract.

(45) "Warehouse receipt" means a receipt issued by a person engaged in the business of storing goods for hire.

(46) "Written" or "writing" includes printing, typewriting or any other intentional reduction to tangible form.

Section 158. KRS 355.2-103 is amended to read as follows:

(1) In this article unless the context otherwise requires
(a) "Buyer" means a person who buys or contracts to buy goods.
(b) "Good faith" in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.
"Receipt" of goods means taking physical possession of them.

"Seller" means a person who sells or contracts to sell goods.

(2) Other definitions applying to this article or to specified parts thereof, and the sections in which they appear are:

"Acceptance." KRS 355.2-606.

"Banker's credit." KRS 355.2-325.

"Between merchants." KRS 355.2-104.

"Cancellation." KRS 355.2-106 (4).

"Commercial unit." KRS 355.2-105.

"Confirmed credit." KRS 355.2-325.

"Conforming to contract." KRS 355.2-106.

"Contract for sale." KRS 355.2-106.

"Cover." KRS 355.2-712.

"Entrusting." KRS 355.2-403.

"Financing agency." KRS 355.2-104.

"Future goods." KRS 355.2-105.

"Goods." KRS 355.2-105.

"Identification." KRS 355.2-501.

"Installment contract." KRS 355.2-612.

"Letter of credit." KRS 355.2-325.

"Lot." KRS 355.2-105.

"Merchant." KRS 355.2-104.

"Overseas." KRS 355.2-323.

"Person in position of seller." KRS 355.2-707.

"Present sale." KRS 355.2-106.

"Sale." KRS 355.2-106.

"Sale on approval." KRS 355.2-326.

"Sale or return." KRS 355.2-326.

"Termination." KRS 355.2-106.

(3) The following definitions in other articles apply to this article:

"Check." KRS 355.3-104.

"Consignee." KRS 355.7-102.

"Consignor." KRS 355.7-102.

"Consumer goods." Section 22 of this Act (KRS 355.9-109).

"Dishonor." KRS 355.3-502 (355.3-507).

"Draft." KRS 355.3-104.

(4) In addition Article I contains general definitions and principles of construction and interpretation applicable throughout this article.

Section 159. KRS 355.2-210 is amended to read as follows:

(1) A party may perform his duty through a delegate unless otherwise agreed or unless the other party has a substantial interest in having his original promisor perform or control the acts required by the contract. No delegation of performance relieves the party delegating of any duty to perform or any liability for breach.

(2) Except as otherwise provided in Section 38 of this Act, unless otherwise agreed, all rights of either seller or buyer can be assigned except where the assignment would materially change the duty of the other party, or increase materially the burden or risk imposed on him by his contract, or impair materially his chance of obtaining return performance. A right to damages for breach of the whole contract or a right arising out of the assignor's due performance of his entire obligation can be assigned despite agreement otherwise.

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The creation, attachment, perfection, or enforcement of a security interest in the seller's interest under a contract is not a transfer that materially changes the duty of or increases materially the burden or risk imposed on the buyer or impairs materially the buyer's chance of obtaining return performance within the purview of subsection (2) of this section unless, and then only to the extent that, enforcement actually results in a delegation of material performance of the seller. Even in that event, the creation, attachment, perfection, and enforcement of the security interest remain effective, but:

(a) The seller is liable to the buyer for damages caused by the delegation to the extent that the damages could not reasonably be prevented by the buyer; and

(b) A court having jurisdiction may grant other appropriate relief, including cancellation of the contract for sale or an injunction against enforcement of the security interest or consummation of the enforcement.

(4) Unless the circumstances indicate the contrary a prohibition of assignment of "the contract" is to be construed as barring only the delegation to the assignee of the assignor's performance.

(5)(4) An assignment of "the contract" or of "all my rights under the contract" or an assignment in similar general terms is an assignment of rights and unless the language or the circumstances (as in an assignment for security) indicate the contrary, it is a delegation of performance of the duties of the assignor and its acceptance by the assignee constitutes a promise by him to perform those duties. This promise is enforceable by either the assignor or the other party to the original contract.

(6)(5) The other party may treat any assignment which delegates performance as creating reasonable grounds for insecurity and may without prejudice to his rights against the assignor demand assurances from the assignee (KRS 355.2-609).

Section 160. KRS 355.2-326 is amended to read as follows:

(1) Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to the contract, the transaction is

(a) a "sale on approval" if the goods are delivered primarily for use, and

(b) a "sale or return" if the goods are delivered primarily for resale.

(2) [Except as provided in subsection (3),] Goods held on approval are not subject to the claims of the buyer's creditors until acceptance; goods held on sale or return are subject to such claims while in the buyer's possession.

(3)(1) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum." However, this subsection is not applicable if the person making delivery

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others;
or

(c) complies with the filing provisions of the article on secured transactions (Article 9).

(4)(2) Any "or return" term of a contract for sale is to be treated as a separate contract for sale within the statute of frauds section of this article (KRS 355.2-201) and as contradicting the sale aspect of the contract within the provisions of this article on parol or extrinsic evidence (KRS 355.2-202).

Section 161. KRS 355.2-502 is amended to read as follows:

(1) Subject to subparts (2) and (3) of this section and even though the goods have not been shipped a buyer who has paid a part or all of the price of goods in which he has a special property under the provisions of the immediately preceding section may on making and keeping good a tender of any unpaid portion of their price recover them from the seller if:

(a) In the case of goods bought for personal, family, or household purposes, the seller repudiates or fails to deliver as required by contract; or

(b) In all cases, the seller becomes insolvent within ten (10) days after receipt of the first installment on their price.

(2) The buyer's right to recover the goods under subsection (1)(a) of this section vests upon acquisition of a special property, even if the seller had not then repudiated or failed to deliver.

(3) If the identification creating his special property has been made by the buyer he acquires the right to recover the goods only if they conform to the contract for sale.

Section 162. KRS 355.2-716 is amended to read as follows:

(1) Specific performance may be decreed where the goods are unique or in other proper circumstances.

(2) The decree for specific performance may include such terms and conditions as to payment of the price, damages, or other relief as the court may deem just.

(3) The buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such effort will be unavailing or if the goods have been shipped under
In this article unless the context otherwise requires:

Section 163. KRS 355.2A-103 is amended to read as follows:

(1) In this article unless the context otherwise requires:

(a) "Buyer in ordinary course of business" means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods, buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. "Buying" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(b) "Cancellation" occurs when either party puts an end to the lease contract for default by the other party.

(c) "Commercial unit" means such a unit of goods as by commercial usage is a single whole for purposes of lease and division of which materially impairs its character or value on the market or in use. A commercial unit may be a single article, as a machine, or a set of articles, as a suite of furniture or a line of machinery, or a quantity, as a gross or carload, or any other unit treated in use or in the relevant market as a single whole.

(d) "Conforming" goods or performance under a lease contract means goods or performance that are in accordance with the obligations under the lease contract.

(e) "Consumer lease" means a lease that a lessor regularly engaged in the business of leasing or selling makes to a lessee who is an individual and who takes under the lease primarily for a personal, family, or household purpose.

(f) "Fault" means wrongful act, omission, breach, or default.

(g) "Finance lease" means a lease with respect to which:

1. The lessor does not select, manufacture, or supply the goods;

2. The lessor acquires the goods or the right to possession and use of the goods in connection with the lease; and

3. One of the following occurs:

   a. The lessee receives a copy of the contract by which the lessor acquired the goods or the right to possession and use of the goods before signing the lease contract;

   b. The lessee's approval of the contract by which the lessor acquired the goods or the right to possession and use of the goods is a condition to effectiveness of the lease contract;

   c. The lessee, before signing the lease contract, receives an accurate and complete statement designating the promises and warranties, and any disclaimers of warranties, limitations or modifications of remedies, or liquidated damages, including those of a third party, such as the manufacturer of the goods, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods; or

   d. If the lease is not a consumer lease, the lessor, before the lessee signs the lease contract, informs the lessee in writing (a) of the identity of the person supplying the goods to the lessor, unless the lessee has selected that person and directed the lessor to acquire the goods or the right to possession and use of the goods from that person, (b) that the lessee is entitled under this article to the promises and warranties, including those of any third party, provided to the lessor by the person supplying the goods in connection with or as part of the contract by which the lessor acquired the goods or the right to possession and use of the goods, and (c) that the lessee may communicate with the person supplying the goods to the lessor and receive an accurate and complete statement of those promises and warranties, including any disclaimers and limitations of them or of remedies.

(h) "Goods" means all things that are movable at the time of identification to the lease contract, or are fixtures (KRS 355.2A-309), but the term does not include money, documents, instruments, accounts, chattel paper, general intangibles, or minerals or the like, including oil and gas, before extraction. The term also includes the unborn young of animals.

(i) "Installment lease contract" means a lease contract that authorizes or requires the delivery of goods in separate lots to be separately accepted, even though the lease contract contains a clause "each delivery is a separate lease" or its equivalent.

(j) "Lease" means a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease. Unless the context clearly indicates otherwise, the term includes a sublease.

(k) "Lease agreement" means the bargain, with respect to the lease, of the lessor and the lessee in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this article. Unless the context clearly indicates otherwise, the term includes a sublease agreement.

(l) "Lease contract" means the total legal obligation that results from the lease agreement as affected by this article and any other applicable rules of law. Unless the context clearly indicates otherwise, the term includes a sublease contract.
(m) "Leasehold interest" means the interest of the lessor or the lessee under a lease contract.
(n) "Lessee" means a person who acquires the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessee.
(o) "Lessee in ordinary course of business" means a person who in good faith and without knowledge that the lease to him is in violation of the ownership rights or security interest or leasehold interest of a third party in the goods leases in ordinary course from a person in the business of selling or leasing goods of that kind but does not include a pawnbroker. "Leasing" may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing lease contract but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.
(p) "Lessor" means a person who transfers the right to possession and use of goods under a lease. Unless the context clearly indicates otherwise, the term includes a sublessor.
(q) "Lessor's residual interest" means the lessor's interest in the goods after expiration, termination, or cancellation of the lease contract.
(r) "Lien" means a charge against or interest in goods to secure payment of a debt or performance of an obligation, but the term does not include a security interest.
(s) "Lot" means a parcel or a single article that is the subject matter of a separate lease or delivery, whether or not it is sufficient to perform the lease contract.
(t) "Merchant lessee" means a lessee that is a merchant with respect to goods of the kind subject to the lease.
(u) "Present value" means the amount as of a date certain of one (1) or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate was not manifestly unreasonable at the time the transaction was entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.
(v) "Purchase" includes taking by sale, lease, mortgage, security interest, pledge, gift, or any other voluntary transaction creating an interest in goods.
(w) "Sublease" means a lease of goods the right to possession and use of which was acquired by the lessor as a lessee under an existing lease.
(x) "Supplier" means a person from whom a lessor buys or leases goods to be leased under a finance lease.
(y) "Supply contract" means a contract under which a lessor buys or leases goods to be leased.
(z) "Termination" occurs when either party pursuant to a power created by agreement or law puts an end to the lease contract otherwise than for default.

2 Other definitions applying to this article and the sections in which they appear are:
"Accessions." KRS 355.2A-310(1).
"Encumbrance." KRS 355.2A-309(1)(e).
"Fixtures." KRS 355.2A-309(1)(a).
"Fixture filing." KRS 355.2A-309(1)(b).
"Purchase money lease." KRS 355.2A-309(1)(c).

3 The following definitions in other articles apply to this article:
"Account." Subsection (1)(b) of Section 22 of this Act[KRS 355.9-106].
"Between merchants." KRS 355.2-104(3).
"Buyer." KRS 355.2-103(1)(a).
"Chattel paper." Subsection (1)(k) of Section 22 of this Act[KRS 355.9-105(1)(b)].
"Consumer goods." Subsection (1)(w) of Section 22 of this Act[KRS 355.9-109(1)].
"Document." Subsection (1)(ad) of Section 22 of this Act[KRS 355.9-105(1)(a)].
"Entrusting." KRS 355.2-403(3).
"General intangible." Subsection (1)(ad) of Section 22 of this Act[KRS 355.9-106].
"Good faith." KRS 355.2-103(1)(b).
"Instrument." Subsection (1)(au) of Section 22 of this Act[KRS 355.9-105(1)(j)].
"Merchant." KRS 355.2-104(1).
"Mortgage." Subsection (1)(bc) of Section 22 of this Act [KRS 355.2-106(4)(a)].

"Pursuant to commitment." Subsection (1)(bp) of Section 22 of this Act [KRS 355.2-106(1)(i)].

"Receipt." KRS 355.2-103(1)(c).

"Sale." KRS 355.2-106(1).

"Sale on approval." KRS 355.2-326.

"Sale or return." KRS 355.2-326.

"Seller." KRS 355.2-103(1)(d).

(4) In addition Article 1 contains general definitions and principles of construction and interpretation applicable throughout this article. Section 164. KRS 355.2A-303 is amended to read as follows:

(1) As used in this section, "creation of a security interest" includes the sale of a lease contract that is subject to Article 9, Secured Transactions, by reason of subsection (1)(c) of Section 29 of this Act [KRS 355.2-102(1)(b)].

(2) Except as provided in subsection [subsections] (3) of this section and Section 89 of this Act [44], a provision in a lease agreement which (i) prohibits the voluntary or involuntary transfer, including a transfer by sale, sublease, creation, or enforcement of a security interest, or attachment, levy, or other judicial process, of an interest of a party under the lease contract or of the lessor's residual interest in the goods, or (ii) makes such a transfer an event of default, gives rise to the rights and remedies provided in subsection (4) of this section (45), but a transfer that is prohibited or is an event of default under the lease agreement is otherwise effective.

(3) A provision in a lease agreement which (i) prohibits the creation or enforcement of a security interest in an interest of a party under the lease contract or in the lessee's residual interest in the goods, or (ii) makes such a transfer an event of default, is not enforceable, unless, and only to the extent that, there are a transfer by the lessee of the lessor's right of possession or use of the goods in violation of the provision or an actual delegation of a material performance of either party to the lease contract in violation of the provision. Neither the granting nor the enforcement of a security interest in (i) the lessee's interest under the lease contract or (ii) the lessor's residual interest in the goods is a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, materially increases the burden or risk imposed on, the lessee within the purview of subsection (5) unless, and then only to the extent that, there is an actual delegation of a material performance of the lessor.

(4) A provision in a lease agreement which (i) prohibits a transfer of a right to damages for default with respect to the whole lease contract or of a right to payment arising out of the transferor's due performance of the transferor's entire obligation, or (ii) makes such a transfer an event of default, is not enforceable, and such a transfer is not a transfer that materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract unless (i) the transferor is liable to the other party for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the other party not making the transfer and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

(45) Subject to subsection [subsections] (3) of this section and Section 89 of this Act [44]:

(a) If a transfer is made which is a made an event of default under a lease agreement, the party to the lease contract not making the transfer, unless that party waives the default or otherwise agrees, has the rights and remedies described in KRS 355.2A-501(2);

(b) If paragraph (a) is not applicable and if a transfer is made that (i) is prohibited under a lease agreement or (ii) materially impairs the prospect of obtaining return performance by, materially changes the duty of, or materially increases the burden or risk imposed on, the other party to the lease contract, unless the party not making the transfer agrees at any time to the transfer in the lease contract or otherwise, then, except as limited by contract, (i) the transferor is liable to the party not making the transfer for damages caused by the transfer to the extent that the damages could not reasonably be prevented by the party not making the transfer and (ii) a court having jurisdiction may grant other appropriate relief, including cancellation of the lease contract or an injunction against the transfer.

(56) A transfer of "the lease" or of "all my rights under the lease", or a transfer in similar general terms, is a transfer of rights and, unless the language or the circumstances, as in a transfer for security, indicate the contrary, is a delegation of duties by the transferor to the transferee. Acceptance by the transferee constitutes a promise by the transferee to perform those duties. The promise is enforceable by either the transferor or the other party to the lease contract.

(67) Unless otherwise agreed by the lessor and the lessee, a delegation of performance does not relieve the transferor as against the other party of any duty to perform or of any liability for default.

(78) In a consumer lease, to prohibit the transfer of an interest of a party under the lease contract or to make a transfer an event of default, the language must be specific, by a writing, and conspicuous.

Section 165. KRS 355.2A-307 is amended to read as follows:

(1) Except as otherwise provided in KRS 355.2A-306, a creditor of a lessee takes subject to the lease contract.

(2) Except as otherwise provided in subsection [subsections] (3) and (4) of this section and in KRS 355.2A-306 and 355.2A-308, a creditor of a lessor takes subject to the lease contract unless:

(a) the creditor holds a lien that attached to the goods before the lease contract became enforceable;

(b) The creditor holds a security interest in the goods and the lessee did not give value and receive delivery of the goods.
without knowledge of the security interest; or

(c) The creditor holds a security interest in the goods which was perfected (KRS 355.9-303) before the lease contract became enforceable.

(3) Except as otherwise provided in Sections 57, 61, and 63 of this Act, a lessee takes a leasehold interest subject to a security interest held by a creditor of the lessor. A lessee in the ordinary course of business takes the leasehold interest free of a security interest in the goods created by the lessee even though the security interest is perfected (KRS 355.9-303) and the lessee knows of its existence.

(4) A lessee other than a lessee in the ordinary course of business takes the leasehold interest free of a security interest to the extent that it secures future advances made after the secured party acquires knowledge of the lease or more than forty-five (45) days after the lease contract becomes enforceable, whichever first occurs, unless the future advances are made pursuant to a commitment entered into without knowledge of the lease and before the expiration of the forty-five (45) day period.

Section 166. KRS 355.2A-309 is amended to read as follows:

(1) In this section:

(a) Goods are "fixtures" when they become so related to particular real estate that an interest in them arises under real estate law;

(b) A "fixture filing" is the filing, in the office where a record of a mortgage on the real estate would be filed or recorded, of a financing statement covering goods that are or are to become fixtures and conforming to the requirements of subsections (1) and (2) of Section 93 of this Act (KRS 355.9-402(5));

(c) A lease is a "purchase money lease" unless the lessee has possession or use of the goods or the right to possession or use of the goods before the lease agreement is enforceable;

(d) A mortgage is a "construction mortgage" to the extent it secures an obligation incurred for the construction of an improvement on land including the acquisition cost of the land, if the recorded writing so indicates; and

(e) "Encumbrance" includes real estate mortgages and other liens on real estate and all other rights in real estate that are not ownership interests.

(2) Under this article a lease may be of goods that are fixtures or may continue in goods that become fixtures, but no lease exists under this article of ordinary building materials incorporated into an improvement on land.

(3) This article does not prevent creation of a lease of fixtures pursuant to real estate law.

(4) The perfected interest of a lessor of fixtures has priority over a conflicting interest of an encumbrancer or owner of the real estate if:

(a) The lease is a purchase money lease, the conflicting interest of the encumbrancer or owner arises before the goods become fixtures, the interest of the lessor is perfected by a fixture filing before the goods become fixtures or within ten (10) days thereafter, and the lessee has an interest of record in the real estate or is in possession of the real estate; or

(b) The interest of the lessor is perfected by a fixture filing before the interest of the encumbrancer or owner is of record, the lessor's interest has priority over any conflicting interest of a predecessor in title of the encumbrancer or owner, and the lessee has an interest of record in the real estate or is in possession of the real estate.

(5) The interest of a lessor of fixtures, whether or not perfected, has priority over the conflicting interest of an encumbrancer or owner of the real estate if:

(a) The fixtures are readily removable factory or office machines, readily removable equipment that is not primarily used or leased for use in the operation of the real estate, or readily removable replacements of domestic appliances that are goods subject to a consumer lease, and before the goods become fixtures the lease contract is enforceable; or

(b) The conflicting interest is a lien on the real estate obtained by legal or equitable proceedings after the lease contract is enforceable; or

(c) The encumbrancer or owner has consented in writing to the lease or has disclaimed an interest in the goods as fixtures; or

(d) The lessee has a right to remove the goods as against the encumbrancer or owner. If the lessee's right to remove terminates, the priority of the interest of the lessor continues for a reasonable time.

(6) Notwithstanding subsection (4)(a) but otherwise subject to subsections (4) and (5), the interest of a lessor of fixtures, including the lessor's residual interest, is subordinate to the conflicting interest of an encumbrancer of the real estate under a construction mortgage recorded before the goods become fixtures if the goods become fixtures before the completion of the construction. To the extent given to refinance a construction mortgage, the conflicting interest of an encumbrancer of the real estate under a mortgage has this priority to the same extent as the encumbrancer of the real estate under the construction mortgage.

(7) In cases not within the preceding subsections, priority between the interest of a lessor of fixtures, including the lessor's residual interest, and the conflicting interest of an encumbrancer or owner of the real estate who is not the lessee is determined by the priority rules governing conflicting interests in real estate.

(8) If the interest of a lessor of fixtures including the lessor's residual interest, has priority over all conflicting interests of all owners and encumbrancers of the real estate, the lessor or the lessee may:

(a) On default, expiration, termination, or cancellation of the lease agreement but subject to the lease agreement and this
A document of title confers no right in goods against a person who before issuance of the document had a legal interest or a perfected security interest in them and who neither
(a) delivered or entrusted them or any document of title covering them to the bailor or his nominee with actual or apparent authority to ship, store or sell or with power to obtain delivery under this article (KRS 355.7-403) or with power of disposition under this chapter (KRS 355.2-403 and Section 60 of this Act [KRS 355.9-307(3)]; or
(b) acquiesced in the procurement by the bailor or his nominee of any document of title.

Title to goods based upon an unaccepted delivery order is subject to the rights of anyone to whom a negotiable warehouse receipt or bill of lading covering the goods has been duly negotiated. Such a title may be defeated under KRS 355.7-504 to the same extent as the rights of the issuer or a transferee from the issuer.

Title to goods based upon a bill of lading issued to a freight forwarder is subject to the rights of anyone to whom a bill issued by the freight forwarder is duly negotiated; but delivery by the carrier in accordance with part 4 of this article pursuant to its own bill of lading discharges the carrier's obligation to deliver.

An "investment company security" is a security. "Investment company security" means a share or similar equity interest issued by an entity that is registered as an investment company under the federal investment company laws, an interest in a unit investment trust that is so registered, or a face-amount certificate issued by a face-amount certificate company that is so registered. Investment company security does not include an insurance policy or endowment policy or annuity contract issued by an insurance company.

An interest in a partnership or limited liability company is not a security unless it is dealt in or traded on securities exchanges or in securities markets, its terms expressly provide that it is a security governed by this article, or it is an investment company security. However, an interest in a partnership or limited liability company is a financial asset if it is held in a securities account.

A writing that is a security certificate is governed by this article and not by Article 3 of this chapter, even though it also meets the requirements of that article. However, a negotiable instrument governed by Article 3 of this chapter is a financial asset if it is held in a securities account.

An option or similar obligation issued by a clearing corporation to its participants is not a security, but is a financial asset.
(6) A commodity contract, as defined in subsection (1)(a) of Section 22 of this Act, is not a security or a financial asset.

Section 170. KRS 355.8-106 is amended to read as follows:

(1) A purchaser has "control" of a certificated security in bearer form if the certificated security is delivered to the purchaser.

(2) A purchaser has "control" of a certificated security in registered form if the certificated security is delivered to the purchaser, and:

(a) The certificate is indorsed to the purchaser or in blank by an effective indorsement; or
(b) The certificate is registered in the name of the purchaser, upon original issue or registration of transfer by the issuer.

(3) A purchaser has "control" of an uncertificated security if:

(a) The uncertificated security is delivered to the purchaser; or
(b) The issuer has agreed that it will comply with instructions originated by the purchaser without further consent by the registered owner.

(4) A purchaser has "control" of a security entitlement if:

(a) The purchaser becomes the entitlement holder; or
(b) The securities intermediary has agreed that it will comply with entitlement orders originated by the purchaser without further consent by the entitlement holder.

(c) Another person has control of the security entitlement on behalf of the purchaser or, having previously acquired control of the security entitlement, acknowledges that it has control on behalf of the purchaser.

(5) If an interest in a security entitlement is granted by the entitlement holder to the entitlement holder's own securities intermediary, the securities intermediary has control.

(6) A purchaser who has satisfied the requirements of subsection (3)(b) or (4)(b) of this section has control, even if the registered owner in the case of subsection (3)(b) of this section or the entitlement holder in the case of subsection (4)(b) of this section retains the right to make substitutions for the uncertificated security or security entitlement, to originate instructions or entitlement orders to the issuer or securities intermediary, or otherwise to deal with the uncertificated security or security entitlement.

(7) An issuer or a securities intermediary may not enter into an agreement of the kind described in subsection (3)(b) or (4)(b) of this section without the consent of the registered owner or entitlement holder, but an issuer or a securities intermediary is not required to enter into such an agreement even though the registered owner or entitlement holder so directs. An issuer or securities intermediary that has entered into such an agreement is not required to confirm the existence of the agreement to another party unless requested to do so by the registered owner or entitlement holder.

Section 171. KRS 355.8-110 is amended to read as follows:

(1) The local law of the issuer's jurisdiction, as specified in subsection (4) of this section, governs:

(a) The validity of a security;
(b) The rights and duties of the issuer with respect to registration of transfer;
(c) The effectiveness of registration of transfer by the issuer;
(d) Whether the issuer owes any duties to an adverse claimant to a security; and
(e) Whether an adverse claim can be asserted against a person to whom transfer of a certificated or uncertificated security is registered or a person who obtains control of an uncertificated security.

(2) The local law of the securities intermediary's jurisdiction, as specified in subsection (5) of this section, governs:

(a) Acquisition of a security entitlement from the securities intermediary;
(b) The rights and duties of the securities intermediary and entitlement holder arising out of a security entitlement;
(c) Whether the securities intermediary owes any duties to an adverse claimant to a security entitlement; and
(d) Whether an adverse claim can be asserted against a person who acquires a security entitlement from the securities intermediary or a person who purchases a security entitlement or interest therein from an entitlement holder.

(3) The local law of the jurisdiction in which a security certificate is located at the time of delivery governs whether an adverse claim can be asserted against a person to whom the security certificate is delivered.

(4) "Issuer's jurisdiction" means the jurisdiction under which the issuer of the security is organized or, if permitted by the law of that jurisdiction, the law of another jurisdiction specified by the issuer. An issuer organized under the law of this Commonwealth may specify the law of another jurisdiction as the law governing the matters specified in subsection (1)(b) to (e) of this section.

(5) The following rules determine a "securities intermediary's jurisdiction" for purposes of this section:

(a) If an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that a particular jurisdiction is the securities intermediary's jurisdiction for purposes of this part of this article,
(b) If paragraph (a) of this subsection does not apply and an agreement between the securities intermediary and its entitlement holder governing the securities account expressly provides that the agreement is governed by the law of a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(c) If neither paragraph (a) nor paragraph (b) applies and an agreement between the securities intermediary and its entitlement holder does not specify the governing law as provided in paragraph (a) of this subsection, but expressly provides [specifies] that the securities account is maintained at an office in a particular jurisdiction, that jurisdiction is the securities intermediary's jurisdiction.

(d) If none of the preceding paragraphs of this subsection applies an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (a) or (b) of this subsection, the securities intermediary's jurisdiction is the jurisdiction in which [is located] the office identified in an account statement as the office serving the entitlement holder's account is located.

(e) If none of the preceding paragraphs of this subsection applies an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (a) or (b) of this subsection and an account statement does not identify an office serving the entitlement holder's account—[as provided in paragraph (a) of this subsection], the securities intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the securities intermediary is located.

(6) If none of the preceding paragraphs of this subsection applies and an agreement between the securities intermediary and its entitlement holder does not specify a jurisdiction as provided in paragraph (a) or (b) of this subsection and an account statement does not identify an office serving the entitlement holder's account—[as provided in paragraph (a) of this subsection], the securities intermediary's jurisdiction is the jurisdiction in which is located the chief executive office of the securities intermediary is located.

A securities intermediary's jurisdiction is not determined by the physical location of certificates representing financial assets, or by the jurisdiction in which is organized the issuer of the financial asset with respect to which an entitlement holder has a security entitlement, or by the location of facilities for data processing or other record keeping concerning the account.

Section 172. KRS 355.8-301 is amended to read as follows:

(1) Delivery of a certificated security to a purchaser occurs when:

(a) The purchaser acquires possession of the security certificate;

(b) Another person, other than a securities intermediary, either acquires possession of the security certificate on behalf of the purchaser or, having previously acquired possession of the certificate, acknowledges that it holds for the purchaser;

(c) A securities intermediary acting on behalf of the purchaser acquires possession of the security certificate, only if the certificate is in registered form and is:

1. Registered in the name of the purchaser;

2. Payable to the order of the purchaser; or

3. Has been specially indorsed to the purchaser by an effective indorsement and has not been indorsed to the securities intermediary or in blank.

(2) Delivery of an uncertificated security to a purchaser occurs when:

(a) The issuer registers the purchaser as the registered owner, upon original issue or registration of transfer; or

(b) Another person, other than a securities intermediary, either becomes the registered owner of the uncertificated security on behalf of the purchaser or, having previously become the registered owner, acknowledges that it holds for the purchaser.

Section 173. KRS 355.8-302 is amended to read as follows:

(1) Except as otherwise provided in subsections (2) and (3) of this section, a purchaser upon delivery of a certificated or uncertificated security[ to a purchaser, the purchaser] acquires all rights in the security that the transferor had or had power to transfer.

(2) A purchaser of a limited interest acquires rights only to the extent of the interest purchased.

(3) A purchaser of a certificated security who as a previous holder had notice of an adverse claim does not improve its position by taking from a protected purchaser.

Section 174. KRS 355.8-510 is amended to read as follows:

(1) In a case not covered by the priority rules in Article 9 of this chapter or the rules stated in subsection (3) of this section, an action based on an adverse claim to a financial asset or security entitlement, whether framed in conversion, replevin, constructive trust, equitable lien, or other theory, may not be asserted against a person who purchases a security entitlement, or an interest therein, from an entitlement holder if the purchaser gives value, does not have notice of the adverse claim, and obtains control.

(2) If an adverse claim could not have been asserted against an entitlement holder under KRS 355.8-502, the adverse claim cannot be asserted against a person who purchases a security entitlement, or an interest therein, from the entitlement holder.

(3) In a case not covered by the priority rules in Article 9 of this chapter, a purchaser for value of a security entitlement, or an interest therein, who obtains control has priority over a purchaser of a security entitlement, or an interest therein, who does not obtain control. Except as otherwise provided in subsection (4) of this section, purchasers who have control rank according to priority in
time of:

(a) The purchaser’s becoming the person for whom the securities account, in which the security entitlement is carried, is maintained, if the purchaser obtained control under subsection (4)(a) of Section 170 of this Act;

(b) The securities intermediary’s agreement to comply with the purchaser’s entitlement orders with respect to security entitlements carried or to be carried in the securities account in which the security entitlement is carried, if the purchaser obtained control under subsection (4)(b) of Section 170 of this Act; or

(c) If the purchaser obtained control through another person under subsection (4)(c) of Section 170 of this Act, the time on which priority would be based under this subsection if the other person were the secured party.

(4) [equally, except that—] A securities intermediary as purchaser has priority over a conflicting purchaser who has control unless otherwise agreed by the securities intermediary.

Section 175. KRS 6.787 is amended to read as follows:

(1) The statement of financial interests required by KRS 6.781 shall be filed on a form prescribed by the commission. The commission shall provide copies of the form without charge to any person required to file.

(2) The statement shall include the following information for the preceding calendar year:

(a) Name, business address, business telephone number, and home address of the filer;

(b) Title of the filer’s public position or office sought;

(c) Any other occupations of filer and spouse;

(d) Positions held by the filer or his spouse in any business, partnership, corporation for profit, or corporation not for profit from which the filer receives compensation, and the name of that business, partnership, or corporation;

(e) Names and addresses of all businesses, investments, or securities in which the filer, his spouse, or children has or had at any time during the preceding year an interest of ten thousand dollars ($10,000) at fair market value or five percent (5%) ownership interest or more;

(f) Sources of gross income of the filer and his spouse, information concerning the source, and the form of the income;

(g) All positions of a fiduciary nature in a business;

(h) A designation as commercial, residential, or rural, and the location of all real property, other than the filer’s primary residence, in which there is an interest of ten thousand dollars ($10,000) or more held by the filer, his spouse, or children;

(i) Sources of gifts of money or property with a retail value of more than two hundred dollars ($200) to the filer or the filer’s immediate family, except those from a member of the filer’s family;

(j) The name of any creditor owed more than ten thousand dollars ($10,000), except debts arising from the purchase of consumer goods. As used in this paragraph, the term “consumer goods” has the same meaning as in Section 22 of this Act[KRS 355.9-109];

(k) The name of any legislative agent who is:

1. A member of the filer’s immediate family;

2. A partner of the filer, or a partner of a member of the filer’s immediate family;

3. An officer or director of the filer’s employer;

4. An employer of the filer or an employer of a member of the filer’s immediate family; or

5. A business associate of the filer or a business associate of a member of the filer’s immediate family;

(l) The names of any of the filer’s clients who are legislative agents or employers; and

(m) An answer to the question, “If you have held a professional license during the filing period, has a properly licensed partner of yours engaged in the practice of cases or other matters which you are prohibited from practicing under KRS 6.744?” If the filer responds affirmatively, he shall also list the names of the clients represented and list the agencies before which the partner made an appearance. These lists shall be separate and need not identify which client was represented before a specific agency.

(3) Paragraphs (a) to (j) of subsection (2) of this section shall not require disclosure of specific dollar amounts. Paragraph (f) shall not require the disclosure of the names of clients or customers of business entities listed as sources of income.

Section 176. KRS 64.012 is amended to read as follows:

The county clerk shall receive for the following services the following fees:

- Recording deed of trust or assignment for the benefit of creditors, provided the entire thereof does not exceed three (3) pages .................................................. $8.00

- Exceeding three (3) pages, for each page .......................................................................................................................... 2.00
Copy and certification of same when ordered ................................................................. 5.00
Each bond required to be taken or prepared by the clerk ........................................ 3.00
Copy of any bond when ordered ................................................................................. 2.00
Recording a bond, each bond .................................................................................. 8.00
Receiving the acknowledgment or proof of any deed, mortgage, or agreement, power of attorney, or other written instrument required by law to be done and certifying same ................................................................. 2.00
Taking the acknowledgment or proof of a deed of real estate, certifying and recording the same and recording his own certificate, provided the entire record thereof does not exceed three (3) pages ................................................................. 8.00
Exceeding three (3) pages, for each page ................................................................ 2.00
Certified copy of deed ............................................................................................... 5.00
Recording a mortgage of real estate, certificates, and all services connected with the same, provided the entire record thereof does not exceed three (3) pages ................................................................. 8.00
Exceeding three (3) pages, for each page ................................................................ 2.00
Certified copy of real estate mortgage ..................................................................... 5.00
Recording deed of assignment of real estate mortgage ........................................ 8.00
Noting release of any lien, mortgage, or redemption other than a deed of release ......................................................................................................................... 3.00
Receiving the acknowledgment, recording, and certifying each deed of release of a mortgage or lien under KRS 382.360 ................................................................. 8.00
Each additional marginal notation relating to same instrument ................................ 3.00
Making a record for the establishment of a city, recording the plan or plat thereof, and all other services incident ................................................................. 8.00
Recording survey of a city, or any part thereof, or any addition to or extensions of the boundary of a city ......................................................................................... 8.00
Every order concerning the establishment, changing, closing, or discontinuing of roads, to be paid out of the county levy when the road is established, changed, closed, or discontinued, and by the applicant when it is not ................................................................. 2.00
Administering an oath and certificate thereof .......................................................... 2.00
Issuing license for which no other fee is fixed by law .............................................. 5.00
Marriage license, bond, certificate and recording .................................................... 24.00
For filing and indexing an original or continuation financing statement, \[and noting the security interest on the required receipt for one (1)-motor vehicle\] ................................................................. 8.00
For noting a security interest on a certificate of title under KRS Chapter 186A ................................................................. 12.00
For filing and indexing an assignment of a financing statement ............................ 8.00
For filing and noting a statement of release of collateral under a financing statement ................................................................. 5.00
Issuance of a certification as provided in KRS 355.9-407 .......................................... 5.00
Certified copy of financing statement or statement of assignment
  
  as provided in KRS 355.9-407 ...................................................... 5.00

Recording real estate options, provided the entire record thereof
  
  does not exceed three (3) pages .............................................. 8.00
  Exceeding three (3) pages, for each page ..................................... 2.00

Recording power of attorney or revocation of power of attorney,
  
  provided the entire record thereof does not exceed three (3) pages .... 8.00
  Exceeding three (3) pages, for each page ..................................... 2.00

Recording plats, maps and surveys, not exceeding 24 inches
  
  by 36 inches, per page ............................................................. 15.00

Recording all leases which are recordable by law, provided the
  
  entire record thereof does not exceed three (3) pages ...................... 8.00
  Exceeding three (3) pages, for each page ..................................... 2.00

Marginal notation to same instrument ........................................... 3.00

Filing or recording of certification of intention to operate a
  
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Filing a lien on a delinquent motor vehicle or trailer bill ................ 8.00

Releasing a lien on a delinquent motor vehicle or trailer bill ............. 2.00

Filing or recording of mechanic's and artisan's liens
  
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Filing or recording of notice of lien issued
  
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Filing or recording of notice of lien discharges issued
  
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Filing or recording United States liens, provided the entire record
  
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  Exceeding three (3) pages, for each page ..................................... 2.00

Filing or recording release of a United States lien, provided the entire
  
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  Exceeding three (3) pages, for each page ..................................... 2.00

Filing or recording state tax or other state liens, other than liens on
  
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Filing release of a state tax or other state lien, other than a lien
  
  on a delinquent motor vehicle or trailer .................................... 5.00

Filing notification and declaration and petition of candidates
  
  for Commonwealth's attorney, District Court, and Circuit Court ....... 200.00

Filing notification and declaration and petition of candidates for office
  
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  independent boards of education ............................................. 20.00
Filing notification and declaration and petition of candidates for boards of soil and water conservation districts ........................................ 20.00
Filing notification and declaration and petition of candidates for other offices 50.00
Filing declaration of intent to be a write-in candidate for office other than municipal office in a city of the fifth or sixth class 50.00
Filing declaration of intent to be a write-in candidate for municipal office in a city of the fifth or sixth class ........................................ 20.00
Recording wills or other probate documents under KRS 394.300 ........................................ 8.00
Registration of licenses for professional persons required to register with the county clerk ........................................ 8.00
Recording and issuing articles, statements, or reports of corporations pursuant to KRS Chapters 271B, 272 and 273, including articles of incorporation, amendment, restatement of incorporation, merger, consolidation, or dissolution and statements of establishment of a series of shares, cancellation of a series of shares, reduction of capital, intent to dissolve, revocation of voluntary dissolution, or any other statement or report of a foreign or domestic corporation, provided the entire record thereof does not exceed three (3) pages ........................................ 8.00
Exceeding three (3) pages, for each page ........................................ 2.00
Miscellaneous recordings for which no specific fee is set, provided the entire record thereof does not exceed three (3) pages (except military discharges) ........................................ 8.00
Exceeding three (3) pages, each additional page ........................................ 2.00
Filing miscellaneous documents for which no specific fee is set, provided the entire record thereof does not exceed three (3) pages ........................................ 8.00
Exceeding three (3) pages, each additional page ........................................ 2.00
Filing petitions other than nominating petitions, provided the petition does not exceed three (3) pages ........................................ 8.00
Exceeding three (3) pages, each additional page, except that the total fee for filing a petition other than a nominating petition shall not exceed $50.00 ........................................ 2.00
Filing certification required by KRS 65.070(1)(a) ........................................ 5.00
Certification of franchise tax assessment ........................................ 5.00

Section 177. KRS 142.010 is amended to read as follows:

(1) The following taxes shall be paid:

(a) A tax of three dollars and fifty cents ($3.50) on each marriage license;
(b) A tax of three dollars ($3) on each power of attorney to convey real or personal property;
(c) A tax of three dollars ($3) on each mortgage, financing statement, or security agreement and on each notation of a security interest on a certificate of title under Section 179 of this Act;
(d) A tax of three dollars ($3) on each conveyance of real property; and
Section 178. KRS 186.045 is amended to read as follows:

(1) Whenever a perfected security interest is assigned, the assignor shall immediately give a statement of assignment to the assignee and at the same time deliver another copy of the statement to the debtor. The assignee shall, within thirty (30) days thereafter, present a copy of the statement of assignment to the county clerk in whose office the security interest was noted on the certificate of title. Upon receipt of the assignment, the county clerk shall mark the same as provided in subsection (2) of KRS 335.9-405 and attach it to the title lien statement. The county clerk shall enter the assignment of the perfected security interest into the automated vehicle information system. For this service the county clerk shall collect a fee pursuant to KRS 64.012.

(2) Whenever a security interest has been discharged, other than by proceedings under Part 6 of Article 9 of KRS Chapter 354 or KRS 355.9-501 to 355.9-507 or similar proceedings, the secured party shall, within ten (10) days thereafter, deliver a termination statement in the manner required by Section 104 of this Act (KRS 335.9-404) to the county clerk of the county in which the title lien statement was submitted. The secured party shall also deliver a copy of the termination statement to the debtor or the debtor's transferee. For failure to file the termination statement within the allowable time, the secured party shall be subject to the penalty provided in KRS 186.990(1). Within five (5) days after the receipt of such documents, the county clerk shall note the filing in the index, in language prescribed by the cabinet, that the termination statement has been filed. Upon presentation of the owner's title showing such security interest to the county clerk where the termination statement was submitted, and with the copy of the termination statement submitted by the secured party, the clerk shall discharge the security interest by noting on such title that the termination statement has been filed and place the seal of the county clerk thereon. The clerk shall return the owner's title to the owner. The county clerk shall then file the termination statement in the place from which the title lien statement was removed. Termination statements must be retained in the clerk's files for a period of two (2) years subsequent to the date of filing such statement, at which time they may be destroyed. The fee for these services are included in the provisions of KRS 186A.190.

(3) Upon presentation of the owner's title showing such security interest to the county clerk of a county where the termination statement was not delivered, the county clerk of that county shall access the automated system to determine whether a record of termination of the security interest has been entered into the automated system by the county clerk where the termination statement was delivered by the secured party as provided in KRS 186A.210. If such record of termination has been entered into the automated system, the county clerk of the county where the termination statement was not delivered, shall note the discharge of the security interest on the certificate of title by noting that the termination statement has been delivered, the county where it was delivered, and placing the seal of the county clerk thereon and may rely on the automated system to do so. If such record of termination has not been entered into the automated system, in no case shall the county clerk of the county other than where the termination statement was delivered, make any notation upon the certificate of title that the security interest has been discharged or that a termination statement has been delivered to the county where the title lien statement was submitted.

(4) Whenever any secured party repossesses a vehicle titled in this Commonwealth, for which a security interest is in existence at the time of repossession, and disposes of such vehicle pursuant to the provisions of KRS Chapter 355, he must present, within fifteen (15) days after such disposition, an affidavit in form prescribed by the department and a termination statement in the manner required by Section 104 of this Act (KRS 335.9-404) to the county clerk where the termination statement was submitted. The new owner shall pay all applicable fees for titling and transferring the vehicle to the owner. The county clerk shall then file the termination statement in the place from which the title lien statement was submitted.

(5) Whenever any vehicle brought into this Commonwealth is required to be titled in this Commonwealth and such vehicle is then subject to a security interest in another state as shown by the out-of-state documents presented to the clerk, the county clerk is prohibited from processing the application for title on the vehicle unless the owner obtains from the secured party a financing statement or title lien statement and presents same to the clerk along with the fees required in KRS 186A.190. The clerk shall note the out-of-state security interest on the certificate of title. This provision does not apply to vehicles required to be registered in Kentucky under forced registration provisions under KRS 186.145.

(6) The fees provided for in this section are in addition to any state fee provided for by law.

(7) Any person violating any provision of this section or any person refusing to surrender a certificate of title registration and ownership or transfer certificate upon request of any person entitled thereto, is subject to the penalties provided in subsection (1) of KRS 186.990.

(8) The county clerk is prohibited from noting any security interest on a certificate of title on any vehicle subject to the provisions of KRS Chapter 186A if a certificate of title thereof is presented to him which has all the spaces provided thereon for noting security interests fully exhausted. The owner must see to it that a discharge is noted on the certificate of title for each security interest and
Security interests in vehicles sold to or owned by residents of other states must be perfected in the state of such nonresident and repossessions of the vehicle must be taken pursuant to the laws of such state, unless the vehicle is principally operated in Kentucky and is properly titled herein under KRS Chapter 186A and the security interest is authorized to be noted on the certificate of title by the county clerk under KRS Chapter 186A.

Section 179. KRS 186A.190 is amended to read as follows:

(1) Except as provided in subsection (4) of this section, the perfection and discharge of a security interest in any property for which has been issued a Kentucky certificate of title shall be by notation on the certificate of title. The notation of the security interest on the certificate of title shall be in accordance with this chapter and shall remain effective from the date on which the security interest is noted on the certificate of title for a period of seven (7) years, or, in the case of a manufactured home, for a period of fourteen (14) years, or until discharged under this chapter and KRS Chapter 186. The filing of a continuation statement within the six (6) months preceding the expiration of the initial period of a notation's effectiveness extends the expiration date for seven (7) additional years. The perfection of an assignment of a security interest which has been noted on the certificate of title shall be in accordance with the provisions of KRS 186.045(1).

(2) Except as provided in subsection (4) of this section, the notation of security interests relating to property required to be titled in Kentucky through the county clerk shall be done in the office of the county clerk of the county in which the debtor resides. If the debtor is other than a natural person, the following provisions of KRS 355.9.401(5)(b) to (k) shall govern the determination of the county of the debtor's residence:

(a) A partnership shall be deemed a resident of the county in which its principal place of business in this state is located. If the debtor does not have a place of business in the state, then the debtor shall be deemed a nonresident for purposes of filing in this state;

(b) A limited partnership organized under KRS Chapter 362 shall be deemed a resident of the county in which its office is located, as set forth in its certificate of limited partnership or most recent amendment thereto filed pursuant to KRS Chapter 362. If such office is not located in this state, the debtor shall be deemed a nonresident for purposes of filing in this state;

(c) A limited partnership not organized under the laws of this state and authorized to do business in this state under KRS Chapter 362 shall be deemed a resident of the county in which the office of its process agent is located, as set forth in the designation or most recent amendment thereto filed with the Secretary of State of the Commonwealth of Kentucky;

(d) A corporation organized under KRS Chapter 271B, 273, or 274 or a limited liability company organized under KRS Chapter 275 shall be deemed a resident of the county in which its registered office is located, as set forth in its most recent corporate filing with the Secretary of State which officially designates its current registered office;

(e) A corporation not organized under the laws of this state, but authorized to transact or do business in this state under KRS Chapter 271B, 273, or 274, or a limited liability company not organized under the laws of this state, but authorized to transact business in this state under KRS Chapter 275, shall be deemed a resident of the county in which its registered office is located, as set forth in its most recent filing with the Secretary of State which officially designates its current registered office;

(f) A cooperative corporation or association organized under KRS Chapter 272 shall be deemed a resident of the county in which its principal business is transacted, as set forth in its articles of incorporation or most recent amendment thereto filed with the Secretary of State of the Commonwealth of Kentucky;

(g) A cooperative corporation organized under KRS Chapter 279 shall be deemed a resident of the county in which its principal office is located, as set forth in its articles of incorporation or most recent amendment thereto filed with the Secretary of State of the Commonwealth of Kentucky;

(h) A business trust organized under KRS Chapter 386 shall be deemed a resident of the county in which its principal place of business is located, as evidenced by the recordation of its declaration of trust in that county pursuant to KRS Chapter 386;

(i) A credit union organized under KRS Chapter 299 shall be deemed a resident of the county in which its principal place of business is located, as set forth in its articles of incorporation or most recent amendment thereto filed with the Secretary of State of the Commonwealth of Kentucky; and

(j) Any other organization (defined in Section 157 of this Act) shall be deemed a resident of the county in which its principal place of business in this state is located, except that any limited partnership or corporation not organized under the laws of this state and not authorized to transact or do business in this state shall be deemed nonresident for purposes of filing in this state. If the organization does not have a place of business in this state, then it shall be deemed a nonresident for purposes of filing in this state.

If the debtor does not reside in the Commonwealth, the notation of the security interest shall be done in the office of the county clerk in which the property is principally situated or operated. Notwithstanding the existence of any filed financing statement under the provisions of KRS Chapter 355 relating to any property registered or titled in Kentucky, the sole means of perfecting and discharging a security interest in property for which a certificate of title is required by this chapter is by notation on such property's
certificate of title. In other respects the security interest is governed by the provisions of KRS Chapter 355.

(3) Except as provided in subsection (4) of this section, before ownership of property subject to a lien evidenced by notation on the certificate of title may be transferred, the transferor shall obtain the release of the prior liens in his name against the property being transferred. Once a security interest has been noted on the owner’s title, no subsequent title may be issued by any county clerk free of such notation unless the owner’s title is presented to the clerk and it has been noted thereon, that the security interest has been discharged. If this requirement is met, information relating to any security interest shown on the title as having been discharged may be omitted from the title to be issued by the clerk.

(4) Notwithstanding subsections (1), (2), and (3) of this section, a county clerk shall, following inspection of the vehicle by the sheriff, to determine that the vehicle has not been stolen, issue a new title to a vehicle, clear of all prior liens, to a person after he provides to the county clerk an affidavit devised by the Transportation Cabinet and completed by the person. In the affidavit, the person shall attest that:

(a) He possesses the vehicle;
(b) A debt on the vehicle was owed him for more than thirty (30) days before he provided the notices required by paragraphs (c) and (d) of this subsection;
(c) More than fourteen (14) days before presenting the affidavit to the county clerk, the person attempted to notify the owner of the vehicle and all known lienholders, including those noted on the title, by certified mail, return receipt requested, of his name, address, and telephone number as well as his intention to obtain a new title, clear of all prior liens, unless the owner or a lienholder objected in writing;
(d) More than fourteen (14) days before presenting the affidavit to the county clerk, the person had published a legal notice stating his intention to obtain title to the vehicle. The legal notice appeared at least twice in a seven (7) day period in a newspaper published, and with a statewide circulation, in Kentucky. The legal notice stated:
1. The person’s name, address, and telephone number;
2. The owner’s name;
3. The names of all known lienholders, including those noted on the title;
4. The vehicle’s make, model, and year; and
5. The person’s intention to obtain title to the vehicle unless the owner or a lienholder objects in writing within fourteen (14) days after the last publication of the legal notice; and
(c) Neither the owner nor a lienholder has objected in writing to the person’s right to obtain title to the vehicle.

(5) No more than two (2) active security interests may be noted upon a certificate of title.

(6) In noting a security interest upon a certificate of title, the county clerk shall ensure that the certificate of title bears the lienholder’s name, mailing address and zip code, the date the lien was noted, the notation number, and the county in which the security interest was noted. The clerk shall obtain the information required by this subsection for notation upon the certificate of title from the title lien statement described in KRS 186A.195 to be provided to the county clerk by the secured party.

(7) For all the costs incurred in the notation and discharge of a security interest on the certificate of title, the county clerk shall receive the fee prescribed by Section 176 of this Act ($10.50) of which seven dollars and fifty cents ($7.50) shall be retained by the clerk and three dollars ($3) transmitted to the State Treasurer. The fee prescribed by this subsection shall be paid at the time of submittal of the title lien statement described in KRS 186A.195.

(8) A copy of the application, certified by the county clerk, indicating the lien will be noted on the certificate of title shall be forwarded to the lienholder.

Section 180. KRS 186A.193 is amended to read as follows:

The title lien statement, provided for in KRS 186A.195, shall be developed by January 1, 1987 by the Transportation Cabinet, in cooperation with county clerks, financial institutions and auto dealers. The Transportation Cabinet shall ensure that the title lien statement is in a similar form and contains the same information as that provided for in subsection (1) of Section 93 of this Act [KRS 355.9-402] and, where applicable, include the year, make, [motor number] and identification number of the titled property [a motor vehicle].

Section 181. KRS 186A.195 is amended to read as follows:

(1) As used in this chapter, a title lien statement is a document to be submitted by the secured party to the county clerk. Upon submission of the title lien statement, the county clerk shall use the information contained therein to note the security interest on the certificate of title. The county clerk may make title lien statements available to the general public. However, public availability of such statements is not necessary or effective to perfect a security interest in property required to be registered or titled in accordance with this chapter.

(2) If a title lien statement and the required fees accompany the application for first title of any property in the name of an owner, the county clerk shall enter the information required by KRS 186A.190(6) into the automated system so as to produce a certificate of title in Frankfort bearing in addition to any other required information, the information designated by KRS 186A.190(6). The clerk shall thereby produce, in accordance with design of the automated system, a certificate of registration, if required.

(3) If a title lien statement and the required fees are not received at the time of application for first title of any property in the name of the owner due to owner’s residency in another county, or if the form prescribed by KRS 186A.060 indicates a pending lien but the
title lien statement does not accompany the application for title, the county clerk shall enter into the Automated Vehicle Information System (AVIS) the name and address of the lienholder and the county where the lien is to be noted or that a lien is pending. The clerk shall indicate a title is not to be issued until the lien has been noted and fees, according to KRS 186A.190, paid in the county of the owner's residence or in thirty (30) days. The county clerk shall then issue the registration. The county clerk in the county of the owner's residence shall, after receiving the title lien statement and fees contained in KRS 186A.190, enter into the Automated Vehicle Information System (AVIS) the date of lien notation and the notation number, thus enabling the system to produce the title in Frankfort.

(4) Should a certificate of title be issued after the thirty (30) day period has expired without the notation of a security interest thereon, or there be no provision made for a lien to be noted in the county of residence of the debtor within thirty (30) days and the title issued within that time, the secured party shall request from the debtor, and the debtor shall submit to the secured party, the certificate of title. The secured party shall submit the certificate of title along with the title lien statement to the county clerk of the county of the debtor's residence. The county clerk shall then enter the information required by KRS 186A.190(6) into the Automated Vehicle Information System (AVIS) and note on the certificate of title in the appropriate section the information described in that section. Following the notation of the appropriate information on the certificate of title, the county clerk shall return the title to the debtor.

(5) The security interest noted on the certificate of title shall be deemed perfected at the time the security interest attaches (KRS 355.9-203) if the secured party tenders the required fees and submits a properly completed title lien statement and application for first title or, in the case of property previously titled in the name of its debtor, the certificate of title to the appropriate county clerk within twenty (20) ten (10) days of attachment. Otherwise, the security interest shall be deemed perfected at the time that such fees are tendered and such documents are submitted to the appropriate county clerk.

Section 182. KRS 186A.200 is amended to read as follows:

(1) With respect to a vehicle previously titled in the name of its debtor, the secured party shall, within twenty (20) fifteen (15) days after execution of the security agreement, obtain the current certificate of title in the name of the debtor, with no more than one (1) prior lien indicated thereon, and present to the county clerk the certificate of title, which the secured party shall have the right to obtain from the debtor, together with the title lien statement and the required fees in KRS 186A.190 to the county clerk.

(2) For failure to present both the title and title lien statement within the time prescribed by subsection (1) of this section, the secured party shall pay a penalty of two dollars ($2) to the county clerk as a prerequisite for noting the security interest on the title.

(3) The county clerk shall enter the information required by KRS 186A.190(6) into the automated system.

(4) The county clerk shall record upon the title in the appropriate section the information designated by KRS 186A.190(6).

Section 183. KRS 382.200 is amended to read as follows:

(1) Except as provided in subsection (2) of this section, each county clerk shall make and keep an alphabetical cross-index of all conveyances recorded in his office, and when a mortgage or deed of trust, or any other conveyance, lease or contract is lodged in his office for record, he shall, at once and before attending to any other business, place the names of the parties to the instrument upon the cross-index in his office, and when a mortgage or deed of trust, or any other conveyance, lease or contract is lodged in his office for record, he shall, at once and before attending to any other business, place the names of the parties to the instrument upon the cross-index in his office, and shall within six (6) days thereafter record the instrument.

(2) Chattel mortgages, financing statements or security agreements shall be filed and recorded in the manner set out in Section 110 of this Act(KRS 355.9-403).

SECTION 184. A NEW SECTION OF KRS CHAPTER 413 IS CREATED TO READ AS FOLLOWS:

Before a party possessing a security interest or lien against an equine interest that has been sold without the debt to the party being discharged may bring an action against the purchaser or selling agent of the equine interest, the secured party shall pursue a remedy against the debtor to the point where a judgment is rendered on the merits or the suit is dismissed with prejudice.

Section 185. KRS 425.011 is amended to read as follows:

(1) Upon filing of the complaint or at any time prior to judgment, in an action to recover the possession of specific personal property, the plaintiff may apply pursuant to this chapter for a writ of possession by filing a written motion for the writ with the court in which the action is brought.

(2) The motion shall be executed under oath and shall include all of the following:

(a) A showing of the basis of the plaintiff's claim and that the plaintiff is entitled to possession of the property claimed. If the basis of the plaintiff's claim is a written instrument, a copy of the instrument shall be attached.

(b) A showing that the property is wrongfully detained by the defendant, of the manner in which the defendant came into possession of the property, and, according to the best knowledge, information, and belief of the plaintiff the reason for the detention.

(c) A particular description of the property and a statement of its value. A description of property sufficient under Section 28 of this Act(KRS 355.9-110) shall meet the requirement of this section. The statement of value may be as to the worth of the property as a whole.

(d) A statement, according to the best knowledge, information and belief of the plaintiff, of the location of the property and if the property, or some part of it, is within a private place which may have to be entered to take possession a showing that there is probable cause to believe that such property is located there. Although such showing may be based on information and belief the judicial officer at the hearing herein provided must be presented with facts sufficient to show that the information and the informant are credible and reliable.
(e) A statement that the property has not been taken for a tax assessment, or fine, pursuant to a statute; or seized under an execution against the property of the plaintiff; or if so seized, that it is by statute exempt from such seizure.

(3) The requirements of subsection (2) of this section may be satisfied by one (1) or more affidavits filed with the application.

Section 186. The following KRS sections are repealed:

186A.196 Validity of existing lien.
186A.197 Issuance of certificate of title noting existing liens.
355.9-112 Where collateral is not owned by debtor.
355.9-113 Security interest arising under article on sales or article on leases.
355.9-114 Consignment.
355.9-115 Investment property.
355.9-116 Security interest arising in purchase or delivery of financial asset.
355.11-102 Use of terminology.
355.11-103 Transition to new code — General rule.
355.11-104 Transition provision on change of requirement of filing.
355.11-105 Transition provision on change of place of filing.
355.11-106 Required refilings.
355.11-107 Transition provisions as to priorities.
355.11-108 Presumption that rule of law continues unchanged.

Section 187. The following KRS section is repealed:

355.9-401A Filing of financing statement and related documents with Secretary of State.

Section 188. Sections 1 to 18 of this Act applies to a letter of credit that is issued on or after the effective date of Sections 1 to 18 of this Act. Sections 1 to 18 of this Act do not apply to a transaction, event, obligation, or duty arising out of or associated with a letter of credit that was issued before the effective date of Sections 1 to 18 of this Act.

Section 189. A transaction arising out of or associated with a letter of credit that was issued before the effective date of Sections 1 to 18 of this Act and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this Act as if repeal or amendment had not occurred and may be terminated, completed, consummated, or enforced under that statute or other law.

Section 190. The amendment to KRS 186A.190(1) contained in Section 179 of this Act shall be retroactive in nature and apply to notations on certificates of titles already in existence on the effective date of Sections 21 to 156 of this Act. The effectiveness of those existing notations that would otherwise expire on the effective date of Sections 21 to 156 of this Act, or within the first six months following that date, is hereby extended until six months after the effective date of Sections 21 to 156 of this Act. For these notations, the filing of a continuation statement within the first six months following the effective date of Sections 21 to 156 of this Act shall operate to extend the expiration date of the notation for seven (7) additional years from the date that the notation would have expired under KRS 186A.190(1), as amended in Section 179 of this Act.

Section 191. Sections 1 to 186, 188, 189, and 190 of this Act become effective on July 1, 2001.
UNIFORM COMMERCIAL CODE UPDATE

REVISED ARTICLE 5 - LETTERS OF CREDIT

Frances B. Jones Berry
Bank of Louisville
Louisville, Kentucky

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SECTION M
# NEW ARTICLE 5 OF THE UNIFORM COMMERCIAL CODE

## LETTERS OF CREDIT

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ATTACHMENT B: SENATE BILL 11—2000 KENTUCKY GENERAL ASSEMBLY; Adoption of Revised Article 5 of the Uniform Commercial Code M-41
NEW ARTICLE 5 OF THE UNIFORM COMMERCIAL CODE
LETTERS OF CREDIT

I. WHY A REVISED ARTICLE 5?

A. Modernization

Revised Article 5 modernizes the law to align it with current means of doing business, thus avoiding lawsuits caused by a gap between the law and standard practice. Revised Article 5 in many places adopts current standards of practice as the legal way to behave. Revised Section 5-108 provides the issuer's standard for determining whether a presentation conforms as "standard practice." At the same time, Revised Section 5-108, just as existing Section 5-108, requires that presentations "strictly comply." In the definition of "document" (Revised Section 5-102(a)(6)) and "record" (Revised Section 5-102(a)(14)) and the description of formal requirements in Revised Section 5-104, Revised Article 5 recognizes the electronic transmission of letters of credit and contemplates electronic or other-than-paper presentation.

References herein are to sections of Revised Article 5 unless otherwise noted.

B. Intersection with ISP and UCP

Revised Article 5 meshes with International Standby Practices (the "ISP") and Uniform Customs and Practice for Documentary Credits 500 (the "UCP"), so as to give letter of credit parties confidence in following the rules set forth in of these. Accommodation of the UCP is especially important to the state of New York, home to most of the commercial letter of credit issuers, which adopted a non-uniform provision (Section 5-102(4)) to exempt the application of existing Article 5 from letters of credit which expressly invoke the UCP. Historically this has been a problem because New York issuers could not avail themselves of the gap filling provisions of existing Article 5.

C. Guidance

Revised Article 5 provides improved guidance in domestic letter of credit transactions and conforms to standard practices for deferred payment obligations, prescribes a time limit for document examination, return of documents and preclusion.

D. Miscellaneous

Fortunately, most of the changes are in the nature of fine-tuning and simplifying existing rules, leaving room for existing and evolving business practices, explicitly referring in some places to "standard practice." The basic structure of Article 5 remains intact, however.

Article 5 is limited to letters of credit, and so excludes other business arrangement, such as suretyship and guaranty arrangements and banker's acceptances. Accordingly, parties can't choose whether to opt into Article 5. Article 5 governs letters of credit, even if the parties name them something else. Revised Article 5 doesn't distinguish between commercial and standby letters of credit.

II. WHAT IS A LETTER OF CREDIT?

Usually a three-party instrument with three underlying contracts:

A. Parties,

(1) Applicant

The person obligated to reimburse the issuer for draws on the letter of credit.

(2) Issuer

Usually a bank.

Excludes individuals acting for personal, family, or household purposes. The consumer exclusion is in place to prevent an overreaching creditor from compelling its consumer customer to make an unconditional promise to pay instead of a guaranty, and waive its defenses under non-letter of credit law. Under Section 5-103(c) this prohibition is not variable.
(3) **Beneficiary**

One who is entitled to receive payment upon a conforming presentation, and includes transferees of letters of credit. Section 5-102(a)(3). Revised Article 5 explicitly permits a financial institution to be both the issuer and the beneficiary. Section 5-102(a)(10) and Section 5-103(c).

(4) **Optional parties**

(a) **Confirmer**

One, usually a bank, who takes on the issuer’s obligations under the letter of credit and may also provide a place to which the beneficiary may present documents. This arrangement usually arises with a remote seller who is unfamiliar with the buyer’s bank (the issuer). A confirmer then has a direct payment obligation to the beneficiary and a right of reimbursement against the issuer.

(b) **Nominated Person**

An issuer may also permit its letter of credit to be paid by any bank, or a nominated bank, in the seller’s country, then permit the paying bank to obtain reimbursement from the issuer. This is usually less expensive than obtaining a formal confirmation, because the paying bank has no pre-existing duty to pay draws on the letter of credit, and so may choose at the time of presentment whether it will accept the documents and pay against them. Sellers like this structure because it gives them a local bank at which to make their presentment, which may be critical to receiving payment if the letter of credit expiry date is looming.

(c) **Advisor**

One, usually a bank, who advises the beneficiary that a letter of credit has been issued, confirmed or amended. This assures the beneficiary that the letter of credit is valid, but the advisor in not liable to pay the letter of credit.

B. **Commercial Letter of Credit**

The commercial letter of credit is the customary means of payment in international trade transactions. The UCP 500 provides a set of rules that govern such international credits. A single standard in dealing with such credits promotes predictability and stability in international trade transactions, thereby assuring foreign merchants of payment on certain terms.

(1) **Three-Contract Arrangement**

(a) contract between the applicant (buyer) and the beneficiary (seller), governed by sales law

(b) reimbursement contract between the applicant and the issuer, governed by letter of credit law (state law, usually Article 5)

(c) letter of credit as contract between the issuer and the beneficiary. Bank will pay to beneficiary at its instruction the specified purchase price of the goods.

(2) **Typical Procedure**

Beneficiary ships the goods, and presents the required documents to the issuer (usually including the bill of original letter of credit, a draft, bill of lading, and may also include customs documentation), who pays the beneficiary, gets reimbursed by the applicant and then turns over the title and importation documentation to the applicant.

(3) **Use of a letter of credit facilitates international transactions by protecting the buyer and the seller**

(a) **Seller protections**

(i) assures payment before seller begins to manufacture goods (particularly helpful when goods are manufactured specially and are hard to resell)

(ii) shifts from seller to issuer the risk of buyer insolvency

(iii) ensures prompt payment from issuer
(b) **Buyer Protections**
   - buyer doesn’t have to make payment before the goods are manufactured and shipped
   - buyer’s credit is evaluated only by its bank, which saves time (credit analysis often already done before the letter of credit is requested, or can be done quickly because banks have credit decision making procedures in place)
   - risk that goods are nonconforming is still a risk, but would be even if the purchase contract specified COD or payment against documents. Although theoretically the buyer could require the seller to submit a third party inspection certificate with its presentation of documents to the bank, this is an added cost and time commitment that the parties may be willing to forego.

(c) **Independence Principle**
   The three contracts are separate, meaning that the bank will pay on its letter of credit, upon presentation of conforming documents, regardless of the status of the underlying sales contract between the buyer and seller. Likewise, the seller’s obligation to sell the goods to the buyer and the buyer’s obligation to reimburse the bank for draws under the letter of credit are independent of one another.

(d) **Credit Enhancement of the Letter of Credit**
   Because the buyer’s bank is willing to issue a letter of credit, the seller may be more willing to grant favorable payment terms to the buyer, rather than require immediate payment. In addition, the buyer’s letter of credit for the seller’s benefit will enhance the seller’s credit with its bank, at least in terms of demonstrating the collectability of the seller’s account debtor (the buyer) and perhaps in assigning the letter of credit proceeds to the seller’s financier.

C. **Standby Letter of Credit**

   Generally speaking, standby letters of credit are usually (but not always) used to ensure payment when the applicant has defaulted on an obligation. Typically, in commercial letters of credit the parties expect the letter of credit to be drawn upon, while on standby letters of credit the parties hope that a draw will not be necessary.

   1. Use of standby letters of credit is on the increase in the United States, and in an international trade context too, where after a seller and buyer become comfortable in their business relationship, the seller may stop requiring a commercial letter of credit on each transaction, and instead accept a standby letter of credit covering the relationship.

   2. Less commonly, the buyer may wish for the seller to back its warranty obligations on the shipped goods with a standby letter of credit.

   3. The hallmark of a standby letter of credit is that the documents usually required from presentation are a draft, the original letter of credit and the beneficiary’s certificate to the effect that the applicant has defaulted on an obligation to the beneficiary, entitling the beneficiary to payment. Impliedly, though not necessarily, the beneficiary is expected to have made an unsatisfied demand on the applicant before seeking payment on a standby letter of credit. Use of a draft is merely customary and is not required by Article 5.

   4. New with Revised Article 5 is confirmation that if the issuer is a financial institution, the issuer may also be the beneficiary under the letter of credit. A standby letter of credit where a loan obligor (usually a guarantor) is required to provide a letter of credit to enhance the guarantor’s credit could be issued by the same bank who is the obligee of the guaranty. Revised Section 5-102(a)(10). Bank regulators may frown on this arrangement, so exercise caution.

III. **LETTER OF CREDIT LAW AS DISTINCT FROM OTHER LAW**

A. **Restatement**

   1. Because letters of credit were developed in a trade context, and assure payment, the law governing them is not guaranty and suretyship law. In fact the 1995 Restatement Third, Suretyship and Guaranty specifically excludes letters of credit from coverage. This difference is seen most vividly in the fact that a letter of credit issuer may not assert against the beneficiary the applicants defenses to payment, because of the independence principle.

   2. Terminology can be important. A letter of credit may “back” or “support” the applicant’s obligation, but the letter of credit does not “guaranty” or “secure” that obligation.
B. **UCP 500 and ISP**

(1) The International Chamber of Commerce, with chief executive office in France, is one of a number of organizations of international letter of credit issuers and business people who attempt to publish the state of international commercial practice. This has the effect of establishing standards and answering questions for parties in such transactions. The UCP 500, speaks to commercial letters of credit.

(2) The International Standby Practices (the “ISP”) gives more guidance than the UCP 500 regarding standby letter of credit practices. The ISP was first published in 1998.

(3) Existing Article 5 was originally drafted in the 1950’s to codify existing letter of credit law and guide issuers and judges in the status of the law as distinct from guaranty and suretyship law. At first, some courts and letter of credit issuers believed that Article 5 conflicted with the UCP, so New York, and some other states adopted non-uniform provisions to Article 5 to cause it to be inapplicable to letters of credit expressly subject to the UCP. This because a chief reason to revise Article 5 so as to be more consistent with UCP and international trade practice. Most commercial letters of credit incorporate the UCP. This is a way to emphasize the document-based nature of the precondition to payment. To the extent the incorporated practice rules conflict with the non-variable provisions of Article 5, Article 5 controls.

IV. **REVISED ARTICLE 5**

A. **Issuance, Amendment and Duration**

(1) Even though there is almost always an underlying contract between the beneficiary and the applicant, remember the independence principle: the issuer’s obligation to pay under the letter of credit once the conditions to draw are satisfied is irrevocable. Where a standby letter of credit is used as a means of payment, if a draw is not honored, the beneficiary retains a right of action against the applicant on the underlying contract.

(2) Documentation consists of an application in which the applicant requests the terms required for the letter of credit, and also signs a reimbursement agreement in which the applicant promises to repay the issuer for any draws on the letter of credit, and also indemnifies the issuer, provides for issuer’s compensation and any collateral security for the letter of credit.

(3) Section 5.08 covers the issuer’s rights and obligations concerning honor and payment or dishonor, and limitation on issuer’s liability for the acts of others. Although generally speaking the obligations of the applicant and beneficiary can be modified by agreement, Section 5-103(c) provides that a general disclaimer of liability or limitation of remedies will not be sufficient to vary the obligations prescribed in Article 5. Accordingly, issuers need to review their reimbursement agreement forms to craft more specific limitations of liability that will be effective.

(4) The issuer will want indemnification for any injury suffered in issuing the letter of credit.

B. **Reimbursement Obligation**

(1) Section 5-108(a) provides that an issuer will honor a conforming presentation, but “except as provided as otherwise provided in Section 5-113 (Transfers by Operation of Law), and unless otherwise agreed by the applicant” an issuer shall dishonor a non-conforming draw.

(2) If the applicant will agree (and, often the applicant will, because the applicant wants payment to be made under the letter of credit) to waive minor discrepancies in presentation, the issuer may honor an otherwise discrepant presentation. The issuer is not under an obligation to seek a waiver of discrepancies, however.

(3) Be alert to the tension that may arise between the issuer and the applicant, where the applicant’s ability to reimburse the obligation is in question, but the draw is conforming. The code provides that if the draw is conforming, the issuer will pay it but that if nonconforming, the issuer will not pay it, unless agreed with the applicant. This means that the issuer never has to pay over a nonconforming draw.

C. **Issuer’s Matters**

(1) **Acceptance**

The issuer has no obligation to provide a letter of credit for any of its customers, just as it generally has no obligation to extend any other kind of credit. Applications for letters of credit are usually only signed by the
applicant, whereas the issuer accepts the offer contained in the application by performance – issuing the letter of credit.

(2) Compensation
The compensation to the issuer is typically a fee based on the face amount of the letter of credit, plus various fees for each action (negotiation, amendment etc.) and out of pocket expenses.

(3) Issuance
The letter of credit must be signed or otherwise authenticated by the issuer Section 5-104 and becomes enforceable when sent to the beneficiary Section 5-106. No consideration, acceptance or receipt is required for enforceability.

D. Labeling
It's not a letter of credit unless it meets the definition set forth in Section 5-102(10): an undertaking by an issuer to a beneficiary for the account of an applicant, to honor a documentary presentation by payment or delivery of an item of value. To be sure it's a letter of credit, and not something else, review the issuer's obligation in light of Section 5-102(a)(10).

(1) The undertaking must be "definite" and authenticated (not necessarily "signed") by the issuer,
(2) The letter of credit must be for the account of an applicant, to "honor a documentary presentation" and by "payment or delivery of an item of value".
(3) Incorporation of practice rules is evidence, though not conclusive proof, that it is a letter of credit.

E. Overzealous Applicant
Beware of the overzealous applicant, who may want the issuer to agree to an investigation of the facts precipitating the draw. To be a letter of credit, the issuer must undertake to pay upon a documentary presentation. That is, the issuer should not undertake to investigate anything beyond the four corners of the documents presented, and in fact under Revised Article 5 must ignore non-documentary provisions. See Section 5-108(g).

F. Time for Document Review
Even if the letter of credit limits the payment obligation to conforming presentation, the applicant may still want to argue with the issuer not to pay on the letter of credit. Under the independence principle, the issuer is obligated to pay upon a conforming presentation. The prudent issuer may use the time allotted for document review to permit the applicant to seek to enjoin the issuer from paying. That way, the issuer, and by extension the applicant, can hold the money during the pendency of a dispute between the applicant and the beneficiary.

G. Beneficiary Acceptance
Typically, the underlying contract between the applicant and the beneficiary will call for the applicant to cause a letter of credit to be issued in favor of the beneficiary. If the letter of credit supplied to the beneficiary does not contain acceptable terms, the beneficiary has no legal right to force the issuer to change the term. Rather, the beneficiary would work with the applicant to request a new letter of credit (issued upon surrender and cancellation of the original, unsatisfactory letter) or an amendment to the original letter of credit. If the letter supplied is so defective as to fail to satisfy the applicant's obligation to deliver the letter of credit, then the beneficiary has an action against the applicant (but not the issuer) for breach of the underlying contract.

H. Irrevocability; Amendment
(1) Unless otherwise provided, a letter of credit is irrevocable. Section 5-106(a). Of course, many letters of credit provide that over time the face amount will be reduced, and also provide for cancellation by the issuer upon the issuer's timely notice to the beneficiary.
(2) The amendment is effective against the issuer once sent to the beneficiary, even if the beneficiary doesn't receive it or doesn't agree to it. So, a draw presented after the amendment is sent could be in accordance with the terms of the unamended, or amended, letter of credit, at the beneficiary's option.

I. Expiry Date
(1) Most letters of credit state an expiry date or provide that it is "evergreen" that is, automatically
renewable unless the issuer gives the beneficiary notice of non-renewal within the agreed upon time frame set forth in the letter of credit.

(2) Article 5 provides gap-fillers in the unlikely event that the letter of credit doesn’t state an expiration date: Section 5-106(c) makes the expiry one year from the date of issuance. For any letter of credit that states its duration as “perpetual” Section 5-106(d) mandates a five year limit on duration. Letters of credit can state a duration of longer than five years, and an evergreen letter of credit isn’t “perpetual” in duration because of the possibility of non-renewal.

J. Presentation, Examination and Honor

(1) Documents Required
Presentation must be made by “documents” which are susceptible to examination. Revised Article 5 permits submission of these documents by any medium permitted by the letter of credit, provided that a promise to pay upon oral instructions is outside the scope of Article 5. See Section 5-102(a)(6), (10) and (12).

(b) Place of Presentation
Although not specified in Article 5, issuers typically provide in the letter of credit for presentation of documents at the office which issued the letter of credit documents. When the beneficiary is concerned about the safe conduct of the documents required for presentation, the beneficiary may have in him town a nominee who will accept the documents and assume responsibility for transmitting them to the issuer, in accordance with the letter of credit.

(c) Time for Presentation
(i) Not only will the letter of credit usually state an expiry date, there may also be other dates in the letter of credit, such as the “ship by” date and “invoice no later than” date. The beneficiary is required to comply strictly with these dates to be entitled to draw on the letter of credit.

(ii) Since the 1993 revision of Article 5 it has been the case that if presentation has been made to a nominee on or before the expiry date, the nominee is permitted a reasonable time thereafter to make presentation to the issuer, even if it is after the expiry date. This can be a “gotcha” if the issuer releases its collateral under the false notion that the letter of credit can no longer be drawn upon.

(d) Time for Examination
Section 5-108(b) provides the issuer a “reasonable time” not to exceed seven business days after receipt of the documents in which to examine a presentation to initiate honor or to notify the presenter (usually, but not always, the beneficiary) of discrepancies. The definition of “reasonable time” depends on international practice and varies depending on the kind of letter of credit and the review required. This is one example of Revised Article 5’s movement toward the UCP, leaving behind existing Section 5-112’s three day rule.

(2) Issuer’s Obligation to Beneficiary
(a) Under Section 5-108(a) the issuer is obliged to honor a presentation that complies with all of the requirements set forth in the letter of credit, in accordance with customary practice. To protect the issuer, and by extension, the beneficiary, the issuer must carefully review all of the documents to be sure that the presentation is conforming. The issuer has the option of accepting or rejecting certain documents. For example, the issuer may accept an invoice the total amount of which exceeds the letter of credit, so long as the draw request is not excessive.

(b) Issuers like to look at standard practice to determine what is acceptable and discrepant, and so often will carefully follow published standards, found in the UCP. The UCP by its terms only covers presentations of “commercial invoice”, transport documentation and “insurance documents”, suggesting that one should look elsewhere for a collection of standard practices for standby letters of credit.

(3) Issuer’s Obligation to Applicant
(a) As noted above, strict compliance protects the issuer and the applicant. Related to that is the notion that the applicant’s reimbursement obligation does not arise until the issuer has honored a strictly comply-
ing presentation, unless a standard other than strict compliance is agreed to in the application and reimbursement agreement.

(b) Often the issuer will ask the beneficiary to waive discrepancies. The issuer is not required to seek this and the applicant is not required to give this consent. This request and consent usually arise in a commercial letter of credit context in which the applicant/buyer needs to receive the goods, and so likely will waive the discrepancies, thus clearing the way for the issuer to honor the draw, so that the applicant/buyer can get the title documents and claim the goods.

(c) When documents are presented for honor, the issuer reviews the documents submitted, and may even send a copy of them to the applicant for a second review, then if necessary seek from the applicant a waiver of discrepancies before honoring the draw.

(4) **Nondocumentary Conditions**

Revised Section 5-108(g) furthers the independence principle. The issuer is bound only to consider the terms of the documents presented against the terms of the documents required. The issuer is prohibited from independently investigating any of the facts asserted in the presented documents. The packing slip may, for example show that 20 seat cushions have been shipped. The issuer may not go to the dock and inspect the goods to be sure that 20 seat cushions have actually arrived. Even if the order is short or in some other way fails to comply with the underlying purchase contract, as long as the documents conform, honor must still be given, and the applicant is left to work out with the beneficiary the beneficiary's performance problems.

(5) **Preclusion**

(a) The issuer's work is time sensitive. The issuer is "precluded" from raising discrepancies or even dishonor if notice of the discovery of a discrepancy or dishonor is made outside the time provided by standard practice, using Revised Section 5-108(b)'s seven business days as an absolute limit. The code has displaced equitable concepts of estoppel and reasonable reliance by focusing on the issuer's action or inaction, and in doing so adopts the UCP standard which punishes issuers for untimely notice of deficiencies. Preclusion is the compensating concept to the beneficiary for the requirement of strict compliance.

(b) Preclusion only goes to the mechanics of honor and dishonor, so does not cut off the issuer's defense that a letter of credit was not issued, or that the person seeking payment is not the legal beneficiary, or that there was fraud in procuring payment under the letter of credit. Preclusion also doesn't apply to invalidate the defense based on a presentation made after the letter of credit's expiry date.

(6) **Disposition of Dishonored Documents**

Dishonored documents may be returned to the presenter or held for the presenter to retrieve them, and under Section 5-108(h) the issuer must notify the presenter which action the issuer has taken.

(7) **Cure and Re-Presentation**

Article 5 doesn't speak to curing and re-presenting documents, but it is standard practice to permit cure and representation to take place, as long as these events occur before the letter of credit expiry date or some other deadline in the letter of credit.

(8) **Honor**

To know how to honor a letter of credit, look to the letter of credit itself (under Section 5-102(a)(2)) and any other instructions that may be on the draft.

Letters of credit may be drawn upon by means of a sight draft (meaning, pay as soon as is reasonable but within seven business days) or at some time after sight (in which case the letter of credit is not "honored" until payment is rendered on that future date under Section 5-108(b)).

Payment on a letter of credit discharges the issuer's payment obligations and precludes any action by the issuer against the beneficiary for recourse on a beneficiary's draft and for any defense based upon a discrepant presentation according to Section 5-108(i). If, however the issuer pays over a forged beneficiary's signature, the true beneficiary may still collect against the issuer, but the issuer may pursue the beneficiary for fraud or forgery in the draw and is also subrogated to the applicant's rights against the beneficiary on the underlying contract, pursuant to Sections 5-108(i), Section 5-110 and Section 5-117.

M-7
K. Nomination and Confirmation

Often, particularly in commercial trade transactions, there will be third parties, usually banks, participating in
the issuing, presentation and honor of letters of credit.

(1) Nominated Persons

(a) Usually requested by the beneficiary for its convenience, a nominated person is one whom the letter of
credit by its terms permits to give value to the beneficiary on the documents, thus “negotiating” the
documents. See Section 5-102(a)(11).

(b) Although the nominee may examine the documents presented, the examination is for the benefit of the
nominee only, and does not bind the issuer, who will make its own determination whether the presentation
complies.

(c) Presumably, then, if the nominated person gives value for the documents, then presents them to the
issuer, and the presentation is validly not honored, the nominated person may seek recovery from the
beneficiary of the moneys paid to the beneficiary.

(d) A person who is not nominated under the letter of credit gives value for the documents and then
presents them to the issuer for honor, acts as the beneficiary’s agent in making the presentation unless it
convinces the issuer to treat the presenter as if it is the assignee of the beneficiary.

(2) Confirmation

(a) Confirmation is a form of credit or credibility enhancement for the issuer. This usually arises when the
beneficiary is unfamiliar with the issuer (or the issuer is not of sufficient size to have obtained a Moody’s or
Standard and Poors’ rating), and so requires a second bank which is know to the issuer, or which has the
requisite rating to undertake to pay the letter of credit if the issuer is unable or unwilling to honor a con­
forming presentation.

(b) Another way to describe a confirmer is a nominated person who has the issuer’s permission to confirm
the credit. The confirming bank is, like the issuer, bound by any payment it has made against nonconform­
ing documents. Section 5-107 and Section 5-108.

(c) The confirmer may seek reimbursement only from the issuer, not from the applicant under Section 5­
107(a) and Section 5-102(a)(4) which compares the confirmer-issuer relationship to the issuer- applicant
relationship. The confirmer is bound only by the amendments to which it consents. Section 5-107(a)
provides that the obligations of the confirmer are the same as those of the issuer.

(3) Transfer and Assignment

(a) The beneficiary has limited rights to transfer a letter of credit. Section 5-102(a) provides that the terms
of the letter of credit control who may draw on it, and if assignment is not expressly permitted, then it is
forbidden pursuant to Section 5-112. Non-transferability is for the applicant’s protection, because, presum­
ably the applicant expects the beneficiary to perform the underlying contract. Non-transferability also
protects the issuer and the applicant from fraud, because it keeps the issuer from having to determine the
whether an assignment actually occurred and the authenticity of the documents presented by an assignee
who is a complete stranger to the issuer. The risk of forgery falls on the applicant, whose reimbursement
obligation is not excused because of forgery. Likewise, absent evidence that the beneficiary aided and
abetted the fraud, the applicant does not have recourse against the beneficiary for fraud, but rather on the
underlying contract. See Section 5-108(i)(5).

(b) Strict compliance means that the issuer must dishonor the presentation for even a slight deviation. So,
having the wrong person make the presentment is a discrepancy justifying dishonor.

(c) Transferable of Letters of Credit. When talking about transferability we really mean transferability of
the beneficiary’s right to draw. Occasionally the beneficiary convinces the applicant to have the issuer
issue a letter of credit that specifies persons to whom the letter of credit may be transferred. This may
constitute a significant convenience to the beneficiary because the beneficiary may use the letter of credit
as a sort of collateral to “secure” a loan. The issuer can dictate additional draw conditions for transferees,
and can impose additional fees on negotiation by transferees under Section 5-112.
(d) The issuer or advising bank usually notifies the transferee that it is permitted to draw under the letter of credit by reiterating the terms of the credit. This may also be accomplished by amendment to the letter of credit, changing the name of the beneficiary to the that of the transferee. Transferable commercial letters of credit often incorporate the transfer terms of the UCP, which contemplates partial transfer from the original beneficiary to its supplier in the amount that the supplier is charging the original beneficiary. In these circumstances, the original beneficiary retains the right to present to the issuer the full amount of the beneficiary’s invoice so as to collect the full amount of the letter of credit, so long as the transferee has not drawn upon the letter of credit.

(e) Occasionally standby letters of credit will be transferable, in connection with a novation of the parties. Usually these credits exclude the UCP transfer rules.

(4) (a) Assignees of the beneficiary’s rights under article 5 have independent rights in the letter of credit proceeds to those of the original beneficiary. So, Article 9 does not govern the transfer of letter of credit rights.

(b) Successor may use the original beneficiary’s name under Section 5-113(a) where a “successor of the beneficiary” (defined in Section 5-102(a)(15) to include transferees by operation of law) may act in the named beneficiary’s name without disclosure. Accordingly, the transferee by operation of law can make presentation in the name of the beneficiary under the letter of credit without fear of committing forgery. The same rule applies to beneficiaries who undergo a name change. Such beneficiaries may make a presentation in the former name. Section 5-113.

(c) If the successor uses its own name, the draw would appear on its face not to comply unless the letter of credit provides that it could be drawn on by successors. Such draws are governed by Section 5-113 (b) through (e) which generally permits successors to make presentations in their name, so long as they take steps to protect the issuer.

(5) Assignment (vs. Transfer) of Letter of Credit Proceeds

(a) Beneficiary’s Power to Assign Proceeds

Transfer means to convey drawing rights (Section 5-112) while assignment is of the proceeds of the letter of credit, as a payment or security device under Section 5-114. So even if the letter of credit is not transferable, the proceeds are generally assignable in the sense that the beneficiary may direct to whom the proceeds will be paid.

(b) Issuer’s Option to Accept or Ignore Assignment

Under Revised Section 5-114, an issuer doesn’t always have to honor the original beneficiary’s order to pay the proceeds of a letter of credit elsewhere. In contrast, if the original letter of credit has been transferred, the proceeds must be paid either to the original beneficiary (not to his assignee of the proceeds) or to the transferee or its assign under Section 5-114(e). The issuer may ignore a notice of assignment unless the assignee possesses and exhibits the original letter of credit, and if possession and submission of the original credit is required for honor. Revised Sections 5-114(c) and (d).

(c) Assignee’s Inferior Rights

Even if the issuer consents to the beneficiary’s assignment of the proceeds, an assignee does not have the right to draw under the letter of credit. Further, transferee beneficiaries’ and nominated persons’ rights are superior to those of assignees. The beneficiary may never draw on the letter of credit, or may transfer it, or permit amendment or cancellation, and the assignee is bound by those acts under Section 5-114(d).

(d) Effect on Article 9

Assignments of letter of credit proceeds is usually a security device, so Article 9 governs security interests in the proceeds of letters of credit to the extent not covered by Article 5. See Section 5-114(f), Section 5-116(d). Because article 9 priority rules apply, the recipient of letter of credit proceeds may have to pay them over to another.
L. Forgery and Fraud

(1) **Defense Against Honor**

Because of the independence principle, defenses available to the applicant under the underlying contract are not available to the issuer on payment on the letter of credit. According to Professor James White, the drafters of revised Article 5 were more concerned that the applicant would argue fraud or forgery, than that a fraud or forgery would actually be perpetrated. Under Section 5-109 the issuer doesn’t have to honor a draw if procured by the beneficiary’s fraud, but the issuer then bears the risk in proving that defense. Moreover, the issuer cannot delay honor while it determines the presence of absence of fraud, because delay in honor is tantamount to dishonor under Section 5-102(a)(5).

(2) **Materially Fraudulent Drawing**

Revised Section 5-109 deals only with the beneficiary’s fraud, not that of the applicant or any other person, and applies only in the case of “material fraud” within the meaning of that section. Examples of material fraud would be one in which the purchase contract called for new goods, but garbage was actually delivered, or the beneficiary improperly declared a default and attempted to draw on the standby letter of credit. The materiality standard of Revised Section 5-109 is a little higher than the “mere fraud” standard of existing law. Misrepresentations in the presentment documents may not be “material” if they are not made in an effort to conceal a material fact.

(3) **Effect of Fraud on Reimbursement Right**

Issuers who act in good faith (“honesty in fact under Section 5-102(a)(7)”) may honor draws on a letter of credit and are entitled to reimbursement, even if the fraud defense had been available. Section 5-109(a)(2). Because most issuers do not want the responsibility of proving the fraud defense, they have an incentive to pay draws, even where there is a suspicion of fraud. This is one of the reasons that the code provides issuers a reasonable time in which to pay: the applicant has a short time in which to have the issuer enjoined from paying such draws, under Section 5-109(b), by at least preliminarily proving to the court the presence of fraud. Applicants may also seek relief after the draws have been honored under Section 5-110 for money damages.

(4) **Protected Parties**

(a) **Confirmers**

Because confirmers are treated like issuers, the fraud defense accorded issuers may also be used by confirmers, subject to the same limitations. An applicant seeking to enjoin payment should be sure to have both the issuer and confirmor enjoined.

(b) **Nominated Persons**

The nominated person’s defense under Section 5-109(a)(1)(i) is narrower than that of the issuer and confirmor. The nominated person is protected to the extent that the person gave value in good faith without notice (that includes knowledge of evidence) of the fraud.

(c) **Post Honor Holders and Assignees**

If the terms of the letter of credit and draw provide a time lag between the date of honor and the date of payment, as in presentations involving time drafts, any holder in due course of an accepted draft is protected against fraud that’s asserted after the presentation has been accepted and payment is actually made. As provided in Section 5-109(a)(1)(iii) and (iv), this protects the market for banker’s acceptances and obligations incurred under deferred payment credits.

(d) **Miscellaneous**

As expected, beneficiaries are the least protected from fraud in presentation. Even if the beneficiary didn’t perpetrate the fraud, it has to bear the risk of dishonor based upon the authenticity of the documents in the presentation. Moreover, beneficiaries are still subject to the issuer’s assertion of a fraud defense even during the time between the issuer’s acceptance of a presentation and the time at which the time draft is actually paid. See Section 5-109(a)(1) and Section 5-102(a)(8). An assignee of the letter of credit proceeds has no better defenses than the beneficiary unless it qualifies as a protected
party under Section 5-109(a)(1).

(5) **Injunctive Relief**

Because of the independence principle, the applicant can protect itself against improper draws on the letter of credit is by obtaining an injunction against payment or by obtaining a damage award against the beneficiary. The standard for awarding a temporary restraining order is high. The proceedings are almost always ex parte, in which the applicant must show that it will likely prevail on the fraud issue at trial (Section 5-109(b)(4), and show that it will be irreparably harmed if the draw is honored. At each stage thereafter, the applicant must prove that it will probably succeed in proving the fraud. Revised Section 5-109(b)(2) requires the applicant seeking the injunction to take steps (by posting a bond) to protect any party who would be injured if the injunction is granted.

M. **Remedies**

(1) **Applicable Law and Forum**

Can be agreed upon pursuant to Section 5-116(a) and (e), or if none chosen, the law of the issuer’s location governs the issuer, and the law of the confirmer and nominated persons locations govern them. Interestingly, the transaction need not bear any relation to the jurisdiction whose law is chosen. This is a departure from common law and restatement conflict rules. Revised Section 5-116 is new with this Article 5 revision.

(2) **Jurisdiction**

Not addressed in Article 5. Look to the specifics of the letter of credit transaction rather than that governing the underlying transaction.

(3) **Statute of Limitations**

The later of one year after the Article 5 breach occurs or one year after the expiry date. Revised Section 5-115. This is new with this revision of Article 5.

(4) **Loser Pays Attorneys Fees**

Revised Section 5-111(e). This compensates beneficiaries who are the victim of wrongful dishonor by putting them in the position they should have enjoyed had the letter of credit been timely honored. It also provides a disincentive to the issuer to wrongfully dishonor in those cases in which it would be cheaper for the issuer to dishonor and litigate, where the beneficiary cannot afford to pay an attorney to pursue its rights. This also saves applicants from having to reimburse issuers who act properly, and saves the issuer from a beneficiary’s frivolous claims. This provision is also new with this revision of Article 5

(5) **Court Determination of Standard Practice**

Section 5-108 provides that determination of standard practice is a matter for the court, not the jury. As stated above, the court may look to the UCP and the ISP for guidance.

(6) **Summary Judgment**

Often granted in letter of credit cases. Facilitated by the Article 5 provisions on strict compliance, preclusion and finality of honor.

(7) **Wrongful Dishonor Remedies**

Section 5-111(a), (d) and (e) provide that a beneficiary whose draw has been wrongfully dishonored is entitled to specific performance plus incidental but not consequential damages, interest from the date of dishonor and reasonable attorney’s fees and expenses incurred in litigation. The beneficiary is not required to mitigate damages.

(8) **Wrongful Honor Remedies**

Remedies the applicant may obtain against an issuer for wrongfully paying on a letter of credit are money damages including incidental, but not consequential damages, attorney’s fees and costs, minus any amount the applicant saved because of the breach. Applicants are required to mitigate damages, which usually is accomplished by suing the beneficiary on the underlying contract.

M-11
(9) **Liquidated Damages**

Under Section 5-111(f) an issuer may limit its damages, but this is rare. Instead, issuers typically limit the scope of their obligations. Advising banks may find it easier to bargain for a damage limitation of their fee, rather than attempt to negotiate a limitation on their statutory responsibilities.

(10) **Warranty and Subrogation**

(a) **Warranty**

(i) Revised Article 5 beneficiary warranties only arise upon payment on the letter of credit. Payment on a letter of credit is usually final, unless there’s proof of forgery or fraud. Section 5-108(i). Section 5-110 covers beneficiary warranties (no forgery or material fraud; no violation of the underlying agreement, which survives honor; other UCC warranties under Articles 3, 4, 7 and 8); and Section 5-117 covers subrogation. These two sections rarely come into play because of the extensive protections issuers include in their reimbursement agreements, and the protections the buyer builds into its underlying contract with the beneficiary.

(ii) Revised Section 5-110 corrects a problem created by the imprecise language of existing Section 5-111 in which the beneficiary warranted that “the necessary conditions of the credit have been complied with.” The better view is that the beneficiary need only bear the burden of proving that presentation complied with the letter of credit’s requirements, and that will likely arise in an action by the applicant against the beneficiary. The issuer should not have a defense to payment under existing Section 5-111, based on the beneficiary’s breach of the underlying contract. This is because such a defense undermines the independence principle. So, if a draw requirement is the beneficiary’s certification that a default has occurred under the underlying contract, and the beneficiary falsely certifies, the issuer should pay as long as the presented documents conform. This would give rise to the applicant’s suit against the beneficiary, based not on the false certification, but rather on the breach of the underlying contract, which no doubt called for the applicant to provide the letter of credit which would be drawn upon only in the event of the applicant’s default.

(b) **Subrogation**

(i) **By the Issuer**

Arises only after the issuer pays. If the applicant fails to reimburse the issuer, the issuer has a right of action against the party benefitted by the payment – usually the applicant in a commercial letter of credit context (because it obtained the goods). If, however the beneficiary drew too much, the issuer may under Section 5-117(a) be subrogated to the applicant’s rights against the beneficiary to recover the overpayment. To distinguish the issuer’s undertaking under a letter of credit from a suretyship arrangement, the issuer’s subrogation right arises only upon the issuer’s payment on a letter of credit. Accordingly, the issuer does not have a right of set-off or counterclaim in the beneficiary’s action for wrongful dishonor.

(ii) **By the Nominated Person**

Arises only upon payment. The nominated person may be subrogated to the rights of the issuer, the beneficiary or the applicant, under the view that the nominated person is a guarantor of the obligations owed to any of these parties.

(iii) **By the Applicant**

Arises upon the applicant’s reimbursement of the issuer under Section 5-117(b) and (d). The applicant is then subrogated to the rights of the issuer and any nominated person or presenter.

(11) **Non-Article 5 Remedies**

Letter of credit law is merchant law. As such, Article 5, supplemented by the UCP and the ISP and by general standard letter of credit practice, governs. There is no overlay of equitable concepts such as waiver and estoppel.
ATTACHMENTS:

* A. Revised Article 5
* B. SB 11 as introduced in the Kentucky General Assembly

A copy of the UCP may be obtained from the International Chamber of Commerce, ICC Publishing, Inc. 156 Fifth Avenue, New York, New York 10010, 212-206-1150.

A copy of the ISP may be obtained from the Institute of International Banking Law and Practice, Inc., 20405 Ryecroft Court, P.O. Box 2235, Montgomery Village, Maryland 20886, 301-869-9840.

SOURCES:

Barnes, James G. and Byrne, James E., "Revision of U.C.C. Article 5, The Business Lawyer, vol. 50, August 1995, Section of Business Law, American Bar Association


UNIFORM COMMERCIAL CODE
THE AMERICAN LAW INSTITUTE
NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS

REVISED ARTICLE 5. LETTERS OF CREDIT
(With Conforming and Miscellaneous Amendments to Articles 1, 2, and 9)

1995 OFFICIAL TEXT WITH COMMENTS
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Approved by the American Bar Association
Baltimore, Maryland, February 5, 1996
UNIFORM COMMERCIAL CODE
REVISED ARTICLE 5. LETTERS OF CREDIT

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UNIFORM COMMERCIAL CODE
REVISED ARTICLE 5. LETTERS OF CREDIT

PREFATORY NOTE

Reason for Revision

When the original Article 5 was drafted 40 years ago, it was written for paper transactions and before many innovations in letters of credit. Now electronic and other media are used extensively. Since the 50's, standby letters of credit have developed and now nearly $500 billion per year are issued annually worldwide, of which $250 billion are issued in the United States. The use of deferred payment letters of credit has also greatly increased. The customs and practices for letters of credit have evolved and are reflected in the Uniform Customs and Practice (UCP), usually incorporated into letters of credit, particularly international letters of credit, which have seen four revisions since the 1950's; the current version became effective in 1994 (UCP 500). Lastly, in a number of areas, court decisions have resulted in conflicting rules.

Prior to the appointment of a drafting committee, the ABA UCC Committee appointed a Task Force composed of knowledgeable practitioners and academics. The ABA Task Force studied the case law, evolving technologies and the changes in customs and practices. The Task Force identified a large number of issues which they discussed at some length, and made recommendations for revisions to Article 5. The Task Force stated in a foreword:

"As a result of these increases and changes in usage, practice, players, and pressure, it comes as no surprise that there has been a sizable increase in litigation. Indeed, the approximate 72 cases reported in the United States in 1987 constituted double the cumulative reported cases up to 1965 ... ."

Moreover, almost forty years of hard use have revealed weaknesses, gaps and errors in the original statute which compromise its relevance. U.C.C. Article 5 was one of the few areas of the Uniform Commercial Code which did not benefit from prior codification and it should come as no surprise that it may require some revision ...

Measured in terms of these areas which are vital to any system of commercial law, the current combination of statute and case law is found wanting in major respects both as to predictability and certainty. What is at issue here are not matters of sophistry but important issues of substance which have not been resolved by the current case law/ code method and which admit of little likelihood of such resolution." (45 Bus. Lawyer 1521, at 1532, 1535-6)

The Drafting Committee began its deliberations with the Task Force Report in hand. The final work of the Drafting Committee varies from many of the suggestions of the Task Force.

The Task Force members were: Professor James E. Byrne (George Mason University School of Law), Chair; Professor Boris Kozolchyk (University of Arizona College of Law); Michael Evan Avidon (Moses & Singer); James G. Barnes (Baker & McKenzie); Arthur G. Lloyd (Citibank N.A.); Janis S. Penion (Rosen, Wachtell & Gilbert); Richard F. Purcell (Connell, Rice & Sugar Co.); Alan L. Bloodgood (Morgan Guaranty Trust Co.); Charles del Busto (Manufacturers Hanover Trust Co.); Vincent Naukina (Manufacturers Hanover Trust Co.).

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Need for Uniformity

Letters of Credit are a major instrument in international trade, as well as domestic transactions. To facilitate its usefulness and competitiveness, it is essential that U.S. law be in harmony with international rules and practices, as well as flexible enough to accommodate changes in technology and practices that have, and are, evolving. Not only should the rules be consistent within the United States, but they need to be substantively and procedurally consistent with international practices.

Thus, the goals of the drafting effort were:

- conforming the Article 5 rules to current customs and practices;
- accommodating new forms of Letters of Credit, changes in customs and practices, and evolving technology, particularly the use of electronic media;
- maintaining Letters of Credit as an inexpensive and efficient instrument facilitating trade; and
- resolving conflicts among reported decisions.

Process of Achieving Uniformity

The essence of uniform law revision is to obtain a sufficient consensus and balance among the interests of the various participants so that universal and uniform enactment by the various States may be achieved.

In part this is accomplished by extensive consultation on and broad circulation of the drafts from 1990, when the project began, until approval of the final draft by the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL).

Hundreds of groups were invited to participate in the drafting process. Twenty Advisors were appointed, representing a cross-section of interested parties. In addition 20 Observers regularly attended drafting meetings and over 100 were on the mailing list to receive all drafts of the revision.

The Drafting Committee meetings were open and all those who attended were afforded full opportunity to express their views and participate in the dialogue. The Advisors and Observers were a balanced group with ten representatives of users (Beneficiaries and Applicants); five representatives of governmental agencies; five representatives of the U.S. Council on International Banking (USCIB); seven from major banks in letter of credit transactions; eight from regional banks; and seven law professors who teach and write on Letters of Credit.

Nine Drafting Committee meetings were held that began Friday morning and ended Sunday noon. In addition, the draft was twice debated in full by NCCUSL, once by the ALI Council, once considered by the ALI Consultative Group and once by an ad hoc Committee of the Council; and reviewed and discussed by the ABA Subcommittee on Letters of Credit semi-annually and by several state and city bar association committees.

The drafts were regularly reviewed and discussed in The Business Lawyer, Letter of Credit Update, and in other publications.

The consensus, balance and quality achieved in this lengthy deliberative process is a product of not only its Reporter and the Drafting Committee, but also the faithful and energetic participation of the following Advisors and active participants:

Advisors

Professor Gerald T. McLaughlin, Loyola Law School, ABA, Section of Business Law
Professor John Dolan, original ABA Advisor
Harold S. Burnman, U.S. Department of State

James E. Byrne, George Mason University, Institute of International Banking Law and Practice Inc.
Henry N. Dyhouse, U.S. Central Credit Union
David P. Goch, Treasury Management Association
Thomas J. Greco, American Bankers Association
Henry Harfield, Shearman & Sterling
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Balance of Benefits

Uniform laws can be enacted only if there is a consensus that the benefits achieved advance the public interest in a manner that can be embraced by all users of the law. It appears that as drafted, Revised Article 5 will enjoy substantial support by the participating interests in letter of credit transactions.

Benefits of Revised Article 5 in General

Independence Principle. Revised Article 5 clearly and forcefully states the independence of the letter of credit obligations from the underlying transactions that was unexpressed in, but was a fundamental predicate for, the original Article 5 (Sections 5-103(d) and 5-108(f)). Certainty of payment, independent of other claims, setoffs or other causes of action, is a core element of the commercial utility of letters of credit.

Clarifications. The revisions authorize the use of electronic technology (Sections 5-102(a)(14) and 5-104); expressly permits deferred payment letters of credit (Section 5-102(a)(6)); and two party letters of credit (Section 5-102(a)(10)); provides rules for unstated expiry dates (Section 5-106(c)); perpetual letters of credit (Section 5-106(d)). and non-documentary conditions (Section 5-108(g)); clarifies and establishes rules for successors by operation of law (Sections 5-102(a)(15) and 5-113); conforms to existing practice for assignment of proceeds (Section 5-114); and clarifies the rules where decisions have been in conflict (Section 5-106, Comment 1; Section 5-108, Comments 1, 3, 4, 7, and 9; Section 5-109, Comments 1 and 3; Section 5-113, Comment 1; and Section 5-117, Comment 1).

Harmonization with International Practice

The UCP is used in most international letters of credit and in many domestic letters of credit. These international practices are well known and employed by the major issuers and users of letters of credit. Revisions have been made to Article 5 to coordinate the Article 5 rules with current international practice (e.g., deferred payment obligations, reasonable time to examine documents, preclusion, non-documentary conditions, return of documents, and irrevocable unless stated to be revocable).

Benefits of Revised Article 5 to Issuers

Consequential Damages. Section 5-111 precludes consequential and punitive damages. It, however, provides strong incentives for issuers to honor, including provisions for attorneys fees and expenses of litigation, interest, and specific performance. If consequential and punitive damages were allowed, the cost of letters of credit could rise substantially.

Statute of Limitations. Section 5-115 establishes a one year statute of limitation from the expiration date or from accrual of the cause of action, whichever occurs later. Because it is usually obvious to all when there has been a breach, a short limitation period is fair to potential plaintiffs.

Choice of Law. Section 5-116 permits the issuer (or nominated party or adviser) to choose the law of the jurisdiction that will govern even if that law bears no relation to the transaction. Absent agreement, Section 5-116 states choice of law rules.

Assignment of Proceeds. Section 5-114 conforms more fully to existing practice and provides an orderly procedure for recording and accommodating assignments by consent of the issuer (or nominated party).

Subrogation. Section 5-117 clarifies the subrogation rights of an issuer who has honored a letter of credit. These rights of subrogation also extend to an applicant who reimburses and a nominated party who pays or gives value.

Recognition of UCP. Section 5-116(c) expressly recognizes that if the UCP is incorporated by reference into the letter of credit, the agreement varies the provisions of Article 5 with which it may conflict except for the non-variable provisions of Article 5.

Benefits of Revised Article 5 to Applicants

Warranties. Section 5-110 specifies the warranties made by a beneficiary. It gives the applicant on a letter of credit which has been honored a direct cause of action if a drawing is fraudulent or forged or if a drawing violates any agreement augmented by a letter of credit.

Strict Compliance. Absent agreement to the contrary, the issuer must discharge a presentation that does not strictly comply under standard practice with the terms and conditions of the letter of credit (Section 5-108).

Subrogation. New Section 5-117 clarifies the parties' rights of subrogation if the letter of credit is honored.

Limitations on General Disclaimers and Waivers. Section 5-103(c) limits the effect of general disclaimers and waivers in a letter of credit, or reimbursement or other agreement.

Benefits of Revised Article 5 to Beneficiaries

Irrevocable. A letter of credit is irrevocable unless the letter of credit expressly provides it is revocable (Section 5-106(a)).

Preclusion. Section 5-108(c) now provides that the issuer is precluded from asserting any discrepancy not stated in its notice timely given, except for fraud, forgery or expiration.

Timely Examination. Section 5-108(b) requires examination and notice of any discrepancies within a reasonable time not to exceed the 7th business day after presentation of the documents.

Transfers by Operation of Law. New Section 5-113 allows a successor to a beneficiary by operation of law to make presentation and receive payment or acceptance.

Damages. The damages provided are expanded and clarified. They include attorneys fees and expenses of litigation and payment of the full amount of the wrongfully dishonored or repudiated demand, with interest, without an obligation of the beneficiary to mitigate damages (Section 5-111).

Revisions for Article 9 and Transition Provisions

The draft includes suggested revisions to conform Article 9 to the Article 5 changes. Article 9 itself is under revision and the interface with Revised Article 5 will be more fully examined by the Article 9 drafting committee, as well, in light of changes to Article 9. The Article 9 revisions will probably not be completed until 1998-9. Revised Article 8 (1994) also makes changes to Article 9 so care should be taken to coordinate the changes of both Revised Articles 5 and 8 within each State.

The draft also includes transition provisions and some cross reference changes in other Articles of the UCC.

Lastly, there follows a table showing the changes from the original Article 5 made by the revisions to Article 5.
UNIFORM COMMERCIAL CODE
REVISED ARTICLE 5. LETTERS OF CREDIT

Table of Disposition of Sections in Former Article 5

The reference to a section in revised Article 5 is to the section that refers to the issue addressed by the section in former Article 5. If there is no comparable section in Revised Article 5 to a section in former Article 5, that fact is indicated by the word "Omitted" and a reason is stated.

Former Article 5 Section  
Revised Article 5 Section

5-101  
5-101

5-102(1)  
5-103(a)

5-102(2)  
Omitted (inherent in 5-103(a) and definitions)

5-103(1)  
5-103(b)

5-103(1)(a)  
5-102(a)(10); 5-106(a); 5-102(a)(1)

5-103(1)(b)  
5-102(a)(6) ("Document") and 5-102(a)(14) ("Record"); "Documentary" draft or demand not used

5-102(1)(c)  
5-102(a)(9)

5-102(1)(d)  
5-102(a)(3)

5-102(1)(e)  
5-102(a)(1)

5-102(1)(f)  
5-102(a)(4)

5-102(1)(g)  
("Applicant" rather than "Customer")

5-103(1)(a)  
5-102(a)(2)

5-103(1)(b)  
5-102(a)(4)

5-103(1)(c)  
("Applicant" rather than "Customer") 5-102(a)(2)

5-103(1)(d)  
5-102(b)

5-103(1)(e)  
5-102(c)

5-103(1)(f)  
5-102(d)

5-103(1)(g)  
5-102(e)

5-103(1)(h)  
5-102(f)

5-105  
5-105

5-106(1)  
5-106(a)

5-106(2)  
5-106(b)

5-106(3)  
5-106(c)

5-106(4)  
5-106(d)

5-107(1)  
5-107(c)

5-107(2)  
5-107(d)

5-107(3)  
5-107(e)

5-107(4)  
5-107(f)

5-108  
Omitted as inadvisable default rule

5-109(1)  
5-108

5-109(2)  
5-108

5-109(3)  
Omitted (all issuers required to observe standard practices)

5-110(1)  
Omitted (covered in definitions and comments)

5-110(2)  
Omitted (covered in definitions and comments)

5-111(1)  
5-110(a)

5-111(2)  
5-110(b)

5-112(1)  
5-108(b) and (c)

5-112(2)  
5-108(b)

5-112(3)  
5-102(a)(12)

5-113  
Omitted (covered by other contract law)

5-114(1)  
5-109(a)(1)

5-114(2)(a)  
5-109(a)(2)

5-114(2)(b)  
5-109(a)(3)

5-114(3)  
5-108(i)

5-114(4)(i)  
5-111

5-115(1)  
5-111

5-115(2)  
5-112

5-116(1)  
5-114

5-116(2)  
5-114

5-116(3)  
5-114

5-117  
Omitted (covered by other law)

Table of New Provisions

(Provisions which were not included in former Article 5 and subjects not addressed in former Article 5.)

Subject  
Revised Article 5 Section

"Successor to a beneficiary"  
5-102(15)

Non-variable terms  
5-103(c)

Independence principle  
5-103(d)

Unstated expiry date  
5-106(c)

Perpetual letter of credit  
5-106(d)

Preclusion of unstated deficiencies  
5-108(e)

Standard practice  
5-108(f)

Independence of obligation  
5-108(g)

Non-documentary conditions  
5-108(h)

Standards for issuing injunction  
5-109(b)

Transfer by operation of law  
5-113

Statute of Limitation  
5-115

Choice of law  
5-116

Subrogation  
5-117
UNIFORM COMMERCIAL CODE
REVISED ARTICLE 5, LETTERS OF CREDIT

SECTION 5-101. SHORT TITLE
This article may be cited as Uniform Commercial Code—Letters of Credit.

Official Comment

The Official Comment to the original Section 5-101 was a remarkably brief inaugural address. Noting that letters of credit had not been the subject of statutory enactment and that the law concerning them had been developed in the cases, the Comment stated that Article 5 was intended "within its limited scope" to set an independent theoretical frame for the further development of letters of credit. That statement addressed accurately conditions as they existed when the statement was made, nearly half a century ago. Since Article 5 was originally drafted, the use of letters of credit has expanded and developed, and the case law concerning these developments is, in some respects, discordant.

Revision of Article 5 therefore has required reappraisal both of the statutory goals and of the extent to which particular statutory provisions further or adversely affect achievement of those goals.

The statutory goal of Article 5 was originally stated to be: (1) to set a substantive theoretical frame that describes the function and legal nature of letters of credit; and (2) to preserve procedural flexibility in order to accommodate further development of the efficient use of letters of credit. A letter of credit is an idiosyncratic form of undertaking that supports performance of an obligation incurred in a separate financial, mercantile, or other transaction or arrangement. The objectives of the original and revised Article 5 are best achieved (1) by defining the peculiar characteristics of a letter of credit that distinguishes it and the legal consequences of its use from other forms of assurance such as secondary guarantees, performance bonds, and insurance policies, and from ordinary contracts, fiduciary engagements, and escrow arrangements; and (2) by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute. No statute can, however, prescribe the manner in which such substantive rights and duties are to be enforced or imposed without risking stultification of wholesome developments in the letter of credit mechanism. Letter of credit law should remain responsive to commercial reality and in particular to the customs and expectations of the international banking and mercantile community. Courts should read the terms of this article in a manner consistent with these customs and expectations.

The subject matter in Article 5, letters of credit, may also be governed by an international convention that is now being drafted by UNCITRAL, the draft Convention on Independent Guarantees and Standby Letters of Credit. The Uniform Customs and Practice is an international body of trade practice that is commonly adopted by international and domestic letters of credit and as such is the "law of the transaction" by agreement of the parties. Article 5 is consistent with and was influenced by the rules in the existing version of the UCP. In addition to the UCP and the international convention, other bodies of law apply to letters of credit. For example, the federal bankruptcy law applies to letters of credit with respect to applicants and beneficiaries that are in bankruptcy; regulations of the Federal Reserve Board and the Comptroller of the Currency lay out requirements for banks that issue letters of credit and describe how letters of credit are to be treated for calculating asset risk and for the purpose of loan limitations. In addition there is an array of anti-boycott and other similar laws that may affect the issuance and performance of letters of credit. All of these laws are beyond the scope of Article 5, but in certain circumstances they will override Article 5.

SECTION 5-102. DEFINITIONS.
(a) In this article:

(1) "Adviser" means a person who, at the request of the issuer, a confirmer, or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(2) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(3) "Beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(4) "Consignor" means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(5) "Dishonor" of a letter of credit means failure timely to honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(6) "Document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion (i) which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in Section 5-108(c) and (ii) which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(7) "Good faith" means honesty in fact in the conduct or transaction concerned.

(8) "Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs

(i) upon payment,

(ii) if the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment, or

(iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(9) "Issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household
purposes.

10. "Letter of credit" means a definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

11. "Nominated person" means a person whom the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

12. "Presentation" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

13. "Presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person.

14. "Record" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.

15. "Successor of a beneficiary" means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

(b) Definitions in other Articles applying to this article and the sections in which they appear are:

"Accept" or "Acceptance" Section 3-409
"Value" Sections 3-303, 4-211

(c) Article 1 contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

Official Comment

1. Since no one can be a confirmor unless that person is a nominated person as defined in Section 5-102(a)(11), those who agree to "confirm" without the designation or authorization of the issuer are not confirmers under Article 5. Nonetheless, the undertakings to the beneficiary of such persons may be enforceable by the beneficiary as letters of credit issued by the "confirmor" for its own account or as guarantees or contracts outside of Article 5.

2. The definition of "document" contemplates and facilitates the growing recognition of electronic and other nonpaper media as "documents," however, for the time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it and the letter did not prohibit it, or the agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted a "document." A facsimile or SWIFT message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (or an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Where electronic transmissions are authorized by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a confirming presentation.

3. "Good faith" continues in revised Article 5 to be defined as "honesty in fact." "Observance of reasonable standards of fair dealing" has not been added to the definition. The narrower definition of "honesty in fact" reinforces the "independence principle" in the treatment of "fraud," "strict compliance," "preclusion," and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition—which does not include "fair dealing"—is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 where greater certainty of obligations is necessary and consistent with the goals of speed and low cost. It is important that U.S. letters of credit have continuing vitality and competitiveness in international transactions.

For example, it would be inconsistent with the "independence" principle if any of the following occurred: (i) the beneficiary's failure to adhere to the standard of "fair dealing" in the underlying transaction or otherwise in presenting documents to provide applicants and issuers with an "unfairness" defense to dishonor even when the documents complied with the terms of the letter of credit; (ii) the issuer's obligation to honor in "strict compliance" in accordance with standard practice" were changed to "reasonable compliance" by use of the "fair dealing" standard, or (iii) the preclusion against the issuer (Section 5-108(d) were modified under the "fair dealing" standard to enable the issuer later to raise additional deficiencies in the presentation. The rights and obligations arising from presentation, honor, dishonor and reimbursement, are independent and strict, and thus "honesty in fact" is an appropriate standard.

The contract between the applicant and beneficiary is not governed by Article 5, but by applicable contract law, such as Article 2 or the general law of contracts. "Good faith" in that contract is defined by other law, such as Section 2-103(1)(b) of Restatement of Contracts 2d, § 205, which incorporate the principle of "fair dealing" in most states, or a State's common law or other statutory provisions that may apply to that contract.

The contract between the applicant and the issuer (sometimes called the "reimbursement agreement") is governed in part by this article (e.g., Sections 5-108(i), 5-111(b), and 5-103(e) and partly by other law (e.g., the general law of contracts). The definition of good faith in Section 5-102(a)(7) applies only to the extent that the reimbursement contract is governed by provisions in this article; for other purposes good faith is defined by other law.

4. Payment and acceptance are familiar modes of honor. A third mode of honor, incuring an unconditional obligation, has legal effects similar to an acceptance of a time draft but does not technically constitute an acceptance. The practice of making letters of credit available by "deferred payment undertaking," as now provided in UCP 500 has grown up in other countries and spread to the United States. The definition of "honor" will accommodate that practice.

5. The exclusion of consumers from the definition of "issuer" is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16CFR Part 433. In a consumer transaction, an individual cannot be an issuer where
that person would otherwise be either the principal debtor or a guarantor.

6. The label on a document is not conclusive; certain documents labelled "guarantees" in accordance with European (and occasionally, American) practice are letters of credit. On the other hand, even documents that are labelled "letter of credit" may not constitute letters of credit under the definition in Section 5-102(a). When a document labelled a letter of credit requires the issuer to pay not upon the presentation of documents, but upon the determination of an extrinsic fact such as applicant's failure to perform a construction contract, and where that condition appears on its face to be fundamental and would, if ignored, leave no obligation to the issuer under the document labelled letter of credit, the issuer's undertaking is not a letter of credit. It is probably some form of suretyship or other contractual arrangement and may be enforceable as such. See Sections 5-102(a)(10) and 5-103(d). Therefore, undertakings whose fundamental term requires an issuer to look beyond documents and beyond conventional reference to the clock, calendar, and practices concerning the form of various documents are not governed by Article 5. Although Section 5-108(g) recognizes that certain nondocumentary conditions can be included in a letter of credit without denying the undertaking the status of letter of credit, that section does not apply to cases where the nondocumentary condition is fundamental to the issuer's obligation. The rules in Sections 5-102(a)(10), 5-103(d), and 5-108(g) approve the conclusion in Wiichita Eagle & Beacon Publishing Co. v. Pacific Nat. Bank, 493 F.2d 1283 (9th Cir. 1974).

The adjective "define" is taken from the UCP. It approves cases that deny letter of credit status to documents that are unduly vague or incomplete. See, e.g., Transparent Products Corp. v. Payaswe Credit Union, 864 F.2d 60 (7th Cir. 1988). Note, however, that no particular phrase or label is necessary to establish a letter of credit. It is sufficient if the undertaking of the issuer shows that it is intended to be a letter of credit. In most cases the parties' intention will be indicated by a label on the undertaking itself indicating that it is a "letter of credit," but no such language is necessary.

A financial institution may be both the issuer and the applicant or the issuer and the beneficiary. Such letters are sometimes issued by a bank in support of the bank's own lease obligations or on behalf of one of its divisions as an applicant or to one of its divisions as beneficiary, such as an overseas branch. Because wide use of letters of credit in which the issuer and the applicant or the issuer and the beneficiary are the same would endanger the unique status of letters of credit, only financial institutions are authorized to issue them.

In almost all cases the ultimate performance of the issuer under a letter of credit is the payment of money. In rare cases the issuer's obligation is to deliver stock certificates or the like. The definition of letter of credit in Section 5-102(a)(10) contemplates those cases.

7. Under the UCP any bank is a nominated bank where the letter of credit is "freely negotiable." A letter of credit might also nominate by the following: "We hereby engage with the drawer, indorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same will be freely honored on due presentation" or "available with any bank by negotiation." A restricted negotiation credit might be "available with a bank by negotiation" or the like.

Several legal consequences may attach to the status of nominated person. First, when the issuer nominates a person, it is authorizing that person to pay or give value and is authorizing the beneficiary to make presentation to that person. Unless the letter of credit provides otherwise, the beneficiary need not present the documents to the issuer before the letter of credit expires; it need only present those documents to the nominated person.

Secondly, a nominated person that gives value in good faith has a right to payment from the issuer despite fraud. Section 5-109(a)(1).

8. A "record" must be in or capable of being converted to a perceivable form. For example, an electronic message recorded in a computer memory that could be printed from that memory could constitute a record. Similarly, a tape recording of an oral conversation could be a record.

9. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under the letter of credit to which they refer, and any payment or value given for them is considered to be made under that letter of credit. As the court held in Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 820 (2d Cir. 1992), it takes a "significant showing" to make the presentation of a beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

SECTION 5-103. SCOPE.

(a) This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.

(b) The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.

(c) With the exception of this subsection, subsections (a) and (d), Sections 5-102(a)(9) and (10), 5-106(d), and 5-114(d), and except to the extent prohibited in Sections 1-102(3) and 5-117(d), the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

(d) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

Official Comment

1. Sections 5-102(a)(10) and 5-103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are "secondary," "accessory," or "suretyship" guarantees.
Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically used to describe a suretyship transaction in which the "guarantor" is only secondarily liable and has the right to assert the underlying debtor's defenses. This article does not apply to secondary or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5-108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP are adopted but conflict with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-102(2) and 5-103(c). See Section 5-116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a State of the United States or state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is irrevocable under Section 1-102(2). Section 5-103(c) and Comment 1 to Section 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (e) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

3. Parties should generally avoid modifying the definitions in Section 5-102. The effect of such an agreement is almost inevitably unclear. To say that something is a "guarantee" in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a "letter of credit," the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

4. Section 5-102(2) and (3) of Article 5 are omitted as unnecessary; the omission does not change the law.

SECTION 5-104. FORMAL REQUIREMENTS. A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e).

Official Comment

1. Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5. For example, a letter of credit will typically specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Undertakings that have the formalities required by Section 5-104 and meet the conditions specified in Section 5-102(a)(10) will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

2. The authentication specified in this section is authentication only of the identity of the issuer, confirmor, or adviser. An authentication agreement may be by system rule, by standard practice, or by direct agreement between the parties. The reference to practice is intended to incorporate future developments in the UCP and other practice rules as well as those that may arise spontaneously in commercial practice.

3. Many banking transactions, including the issuance of many letters of credit, are now
conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted may be printed at the advising bank, stamped "original" and provided to the beneficiary in that form. The printed document may then be used as a way of controlling and recording payments and of recording and authorizing assignments of proceeds or transfers of rights under the letter of credit. Nothing in this section should be construed to conflict with that practice. To be a record sufficient to serve as a letter of credit or other undertaking under this section, data must have a durability consistent with that function. Because consideration is not required for a binding letter of credit or similar undertaking (Section 5-105) yet those undertakings are to be strictly construed (Section 5-108), parties to a letter of credit transaction are especially dependent on the continued availability of the terms and conditions of the letter of credit or other undertaking. By declining to specify any particular medium in which the letter of credit must be established or communicated, Section 5-104 leaves room for future developments.

SECTION 5-105. CONSIDERATION. Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

Official Comment

It may not be expected that any issuer will issue its letter of credit without some form of remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration was or whether in fact there was any identifiable remuneration in a given case. And it might be difficult for the beneficiary to prove the issuer's remuneration. This section dispenses with this proof and is consistent with the position of Lord Mansfield in *Pillans v. Van Mierop*, 97 Eng.Rep. 1035 (K.B. 1765) in making consideration irrelevant.

SECTION 5-106. ISSUANCE, AMENDMENT, CANCELLATION, AND DURATION.

(a) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if so provided.

(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued.

1. This section adopts the position taken by several courts, namely that letters of credit that are silent as to revocability are irrevocable. See, e.g., *Weyerhaeuser Co. v. First Nat. Bank*, 27 UCC Rep. Serv. 777 (S.D. Iowa 1979); *West Va. Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107 (W.D. Pa. 1976). This is the position of the current UCP (500). Given the usual commercial understanding and purpose of letters of credit, revocable letters of credit offer unhappy possibilities for misleading the parties who deal with them.

2. A person can consent to an amendment by implication. For example, a beneficiary that tenders documents for honor that conform to an amended letter of credit but not to the original letter of credit has probably consented to the amendment. By the same token an applicant that has procured the issuance of a transferable letter of credit has consented to its transfer and to performance under the letter of credit by a person to whom the beneficiary's rights are duly transferred. If some, but not all of the persons involved in a letter of credit transaction consent to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other nonconsenting persons may insist on strict compliance with the original letter of credit. Under subsection (b) those not consenting are not bound. For example, an issuer might agree to amend its letter of credit or honor documents presented after the expiration date in the belief that the applicant has consented or will consent to the amendment or will waive presentation after the original expiration date. If that belief is mistaken, the issuer is bound to the beneficiary by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant. In general, the rights of a recognized transferee beneficiary cannot be altered without the transferee's consent, but the same is not true of the rights of assignees of proceeds from the beneficiary. When the beneficiary makes a complete transfer of its interest that is effective under the terms for transfer established by the issuer, adviser, or other party controlling transfers, the beneficiary no longer has an interest in the letter of credit, and the transferee steps into the shoes of the beneficiary as the one with rights under the letter of credit. Section 5-102(a)(3). When there is a partial transfer, both the original beneficiary and the transferee beneficiary have an interest in performance of the letter of credit and each expects that its rights will not be altered by amendment unless it consents.

The assignee of proceeds under a letter of credit from the beneficiary enjoys no such expectation. Notwithstanding an assignee's notice to the issuer of the assignment of proceeds, the assignee is not a person protected by subsection (b). An assignee of proceeds should understand that its rights can be changed or completely extinguished by amendment or cancellation of the letter of credit. An assignee's claim is precarious, for it depends entirely upon the continued existence of the letter of credit and upon the beneficiary's preparation and presentation of documents that would entitle the beneficiary to honor under Section 5-108.

3. The issuer's right to cancel a revocable letter of credit does not free it from a duty to reimburse a nominated person who has honored, accepted, or undertaken a deferred obligation prior to receiving notice of the amendment or cancellation. Compare UCP Article 8.

4. Although all letters of credit should specify the date on which the issuer's engagement expires, the failure to specify an expiration date does not invalidate the letter of credit, or diminish or relieve the obligation of any party with respect to the letter of credit. A letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not "perpetual."
SECTION 5-107. CONFIRMER, NOMINATED PERSON, AND ADVISER.

(a) A confirmor is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmor also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmor had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person who is not a confirmor is not obligated to honor or otherwise give value for a presentation.

(c) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmor is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

(d) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (c). The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

Official Comment

1. A confirmor has the rights and obligations identified in Section 5-108. Accordingly, unless the context otherwise requires, the terms "confirmor" and "confirmation" should be read into this article wherever the terms "issuer" and "letter of credit" appear.

A confirmor that has paid in accordance with the terms and conditions of the letter of credit is entitled to reimbursement by the issuer even if the beneficiary committed fraud (see Section 5-109(a)(1)(ii)) and, in that sense, has greater rights against the issuer than the beneficiary has. To be entitled to reimbursement from the issuer under the typical confirmed letter of credit, the confirmor must submit conforming documents, but the confirmor's presentation to the issuer need not be made before the expiration date of the letter of credit.

A letter of credit confirmation has been analogized to a guarantee of issuer performance, to a parallel letter of credit issued by the confirmor for the account of the issuer or the letter of credit applicant or both, and to a back-to-back letter of credit in which the confirmor is a kind of beneficiary of the original issuer's letter of credit. Like letter of credit undertakings, confirmations are both unique and flexible, so that no one of these analogies is perfect, but unless otherwise indicated in the letter of credit or confirmation, a confirmor should be viewed by the letter of credit issuer and the beneficiary as an issuer of a parallel letter of credit for the account of the original letter of credit issuer. Absent a direct agreement between the applicant and a confirmor, normally the obligations of a confirmor are to the issuer not the applicant, but the applicant might have a right to injunctive against a confirmor under Section 5-109 or warranty claim under Section 5-110, and either might have claims against the other under Section 5-117.

2. No one has a duty to advise until that person agrees to be an adviser or undertakes to act in accordance with the instructions of the issuer. Except where there is a prior agreement to serve or where the silence of the adviser would be an acceptance of an offer to contract, a person's failure to respond to a request to advise a letter of credit does not in and of itself create any liability, nor does it establish a relationship of issuer and adviser between the two. Since there is no duty to advise a letter of credit in the absence of a prior agreement, there can be no duty to advise it timely or at any particular time. When the adviser manifests its agreement to advise by actually doing so (as is normally the case), the adviser cannot have violated any duty to advise in a timely way. This analysis is consistent with the result of Sound of Market Street v. Continental Bank International, 819 F.2d 384 (3d Cir. 1987) which held that there is no such duty. This section takes no position on the reasoning of that case, but does not overrule the result. By advising or agreeing to advise a letter of credit, the adviser assumes a duty to the issuer and to the beneficiary accurately to report what it has received from the issuer, but, beyond determining the apparent authenticity of the letter, an adviser has no duty to investigate the accuracy of the message it has received from the issuer. "Checking" the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate the message (e.g., by "testing" the telex that comes from the purported issuer, and if it is unable to authenticate the message must report that fact to the issuer and, if it chooses to advise the message, to the beneficiary. By proper agreement, an adviser may disclaim its obligation under this section.

3. An issuer may issue a letter of credit which the adviser may advise with different terms. The issuer may then believe that it has undertaken a certain engagement, yet the text in the hands of the beneficiary will contain different terms, and the beneficiary would not be entitled to honor if the documents it submitted did not comply with the terms of the letter of credit as originally issued. On the other hand, if the adviser also confirmed the letter of credit, then as a confirmor it will be independently liable on the letter of credit as advised and confirmed. If in that situation the beneficiary's ultimate presentation entitled it to honor under the terms of the confirmation but not under those in the original letter of credit, the confirmor would have to honor but might not be entitled to reimbursement from the issuer.

4. When the issuer nominates another person to "pay," "negotiate," or otherwise to take up the documents and give value, there can be confusion about the legal status of the nominated person. In rare cases the person might actually be an agent of the issuer and its act might be the act of the issuer itself. In most cases the nominated person is not an agent of the issuer and has no authority to act on the issuer's behalf. Its "nomination" allows the beneficiary to present to it and earn it certain rights to payment under Section 5-109 that others do not enjoy. For example, when an issuer issues a "freely negotiable credit," it contemplates that banks or others might take up documents under that credit and advance value against them, and it is agreeing to pay those persons but only if the presentation to the issuer made by the nominated person complies with the credit. Usually there will be no agreement to pay, negotiate, or to serve in any other capacity by the nominated person, therefore the nominated person will have the right to decline to take the documents. It may return them or agree merely to act as a forwarding agent for the documents but without giving value against them or taking any responsibility for their conformity to the letter of credit.

SECTION 5-108. ISSUER'S RIGHTS AND OBLIGATIONS.

(a) Except as otherwise provided in Section 5-109, an issuer shall honor a presentation...
that, as determined by the standard practice referred to in subsection (e), appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in Section 5-113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(1) to honor,
(2) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incum a deferred obligation, or
(3) to give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in subsection (d), an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in subsection (b) or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonest fraud or forgery as described in Section 5-109(a) or expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) the performance or nonperformance of the underlying contract, arrangement, or transaction,
(2) an act or omission of others, or
(3) observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (e).

(g) If an undertaking constituting a letter of credit under Section 5-102(a)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to, that effect to, the presenter.

(i) An issuer that has honored a presentation as permitted or required by this article:

(1) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;
(2) takes the documents free of claims of the beneficiary or presenter;
(3) is precluded from asserting a right of recourse on a draft under Sections 3-414 and 3-415;
(4) except as otherwise provided in Sections 5-110 and 5-117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and
(5) is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

Official Comment

1. This section combines some of the duties previously included in Sections 5-114 and 5-109. Because a confirmer has the rights and duties of an issuer, this section applies equally to a confirmer and an issuer. See Section 5-107(a).

The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those having to do with time and place of presentation are strictly complied with. Typically, a letter of credit will provide that presentation is timely if made to the issuer, confirmer, or any other nominated person prior to expiration of the letter of credit. Accordingly, a nominated person that has honored a demand or otherwise given value before expiration will have a right to reimbursement from the issuer even though presentation to the issuer is made after the expiration of the letter of credit. Conversely, where the beneficiary negotiates documents to one who is not a nominated person, the beneficiary or that person acting on behalf of the beneficiary must make presentation to a nominated person, confirmer, or issuer prior to the expiration date.

This section does not impose a bifurcated standard under which an issuer's right to reimbursement might be broader than a beneficiary's right to honor. However, the explicit reference to standard practice in Section 5-109(a) and elsewhere expands issuers' rights of reimbursement where that practice so provides. Also, issuers can and often do contract with their applicants for expanded rights of reimbursement. Where that is done, the beneficiary will have to meet a more stringent standard of compliance as to the issuer than the issuer will have to meet as to the applicant. Similarly, a nominated person may have reimbursement and other rights against the issuer based on this article, the UCP, bank-to-bank reimbursement rules, or other agreement or undertaking of the issuer. These rights may allow the nominated person to recover from the issuer even when the nominated person would have no right to obtain honor under the letter of credit.

The section adopts strict compliance, rather than the standard that commentators have called "substantial compliance," the standard arguably applied in Banco Español de Credito v. State Street Bank and Trust Company, 385 F.2d 230 (1st Cir. 1967) and Flagship Cruises Ltd. v. New England Merchants Nat. Bank, 569 F.2d 699 (1st Cir. 1978). Strict compliance does not mean slavish conformity to the terms of the letter of credit. For example, standard practice (what issuers do) may recognize certain presentations as complying that an unschooled layman would regard as discrepant. By adopting standard practice as a way of measuring strict compliance, this article indorses the conclusion of the court in New Braunfels Nat. Bank v. Odiorne, 780 S.W.2d 313 (Tex.Ct.App. 1989) (beneficiary could collect when draft requested payment on 'Letter of Credit No. 86-122-5') holding strict compliance does not demand oppress-
sive perfectionism). The section also imposes the result in *Tosco Corp. v. Federal Deposit Insurance Corp.*, 723 F.2d 1242 (6th Cir. 1983). The letter of credit in that case called for "drafts Drawn under Bank of Clarksville Letter of Credit Number 105." The draft presented was stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105." The court correctly found that despite the change of upper case "L" to a lower case "l" and the use of the word "No."

Instead of "Number," and despite the addition of the words "Clarksville, Tennessee," the presentation conformed. Similarly a document addressed by a foreign person to General Motors as "General Motors" would strictly conform in the absence of other defects.

Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make these decisions will also encourage the salutary practice of courts' granting summary judgment in cases where there are no significant factual disputes. The statute encourages outcomes such as *American Coleman Co. v. Intrawest Bank*, 887 F.2d 1382 (10th Cir. 1989), where summary judgment was granted.

In some circumstances standards may be established between the issuer and the applicant by agreement or by custom that would free the issuer from liability that it might otherwise have. For example, an applicant might agree that the issuer would have no duty whatsoever to examine documents on certain presentations (e.g., those below a certain dollar amount). Where the transaction depended upon the issuer’s payment in a very short time period (e.g., on the same day or within a few hours of presentation), the issuer and the applicant might agree to reduce the issuer’s responsibility for failure to discover discrepancies. By the same token, an agreement between the applicant and the issuer might permit the issuer to examine documents exclusively by electronic or electro-optical means. Neither those agreements nor others like them explicitly made by issuers and applicants violate the terms of Section 5-108(a) or (b) or Section 5-109(c).

2. Section 5-108(a) balances the need of the issuer for time to examine the documents against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. What is a "reasonable time" is not extended to accommodate an issuer’s procure a waiving from the applicant. See Article 14c of the UCP.

Under both the UCC and the UCP the issuer has a reasonable time to honor or give notice. The outside limit of time is measured in business days under the UCC and in banking days under the UCP, a difference that will rarely be significant. Neither business nor banking days are defined in Article 5, but a court may find useful analogies in Regulation CC, 12 CFR 229.2, in state law outside of the Uniform Commercial Code, and in Article 4.

Examiners must note that the seven-day period is not a safe harbor. The time within which the issuer must give notice is lesser of a reasonable time or seven business days. Where there are few documents (as, for example, with the mine run standby letter of credit), the reasonable time would be less than seven days. More than a reasonable time is consumed in examination, no timely notice is possible. What is a "reasonable time" is to be determined by examining the behavior of those in the business of examining documents, mostly banks. Absent prior agreement of the issuer, one could not expect a bank issuer to examine documents while the beneficiary waited in the lobby if the normal practice was to give the documents to a person who had the opportunity to examine those together with many others in an orderly process. That the applicant has not yet paid the issuer or that the applicant’s account with the issuer is insufficient to cover the amount of the draft is not a basis for extension of the time period.

This section does not preclude the issuer from contacting the applicant during its examination; however, the decision to honor rests with the issuer, and it has no duty to seek a waiver from the applicant or to notify the applicant of receipt of the documents. If the issuer dishonors a conforming presentation, the beneficiary will be entitled to the remedies under Section 5-111, irrespective of the applicant’s views.

Even though the person to whom presentations is made cannot conduct a reasonable examination of documents within the time after presentation and before the expiration date, presentation establishes the parties’ rights. The beneficiary’s right to honor or the issuer’s right to dishonor arises upon presentation at the place provided in the letter of credit even though it might take the person to whom presentation has been made several days to determine whether honor or dishonor is the proper course. The issuer’s time for honor or giving notice of dishonor may be extended or shortened by a term in the letter of credit. The time for the issuer’s performance may be otherwise modified or waived in accordance with Section 5-106.

The issuer’s time to inspect runs from the time of its "receipt of documents." Documents are considered to be received only when they are received at the place specified for presentation by the issuer or other party to whom presentation is made.

Failure of the issuer to act within the time permitted by subsection (b) constitutes dishonor. Because of the preclusion in subsection (c) and the liability that the issuer may incur under Section 5-111 for wrongful dishonor, the effect of such a silent dishonor may ultimately be the same as though the issuer had honored, i.e., it may owe damages in the amount drawn but unpaid under the letter of credit.

3. The requirement that the issuer send notice of the discrepancies be precluded from asserting discrepancies is new to Article 5. It is taken from the similar provision in the UCP and is intended to promote certainty and finality.

The section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in *Flagship Cruises Ltd. v. New England Merchants' Nat. Bank*, 569 F.2d 699 (1st Cir. 1978) and *Wing On Bank Ltd. v. American Nat. Bank & Trust Co.*, 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer’s failure to give notice.

Assume, for example, that the beneficiary presented documents to the issuer shortly before the letter of credit expired, in circumstances in which the beneficiary could not have cured any discrepancy before expiration. Under the reasoning of *Flagship* and *Wing On*, the beneficiary’s inability to cure, even if it had received notice, would absolve the issuer of its failure to give notice. The virtue of the preclusion obligation adopted in this section is that it forecloses litigation about reliance and detriment.

Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits them to raise late presentation as a defect despite their failure to give that notice.

4. To act within a reasonable time, the issuer must normally give notice without delay after the examining party makes its decision. If the examiner decides to dishonor on the first day, it would be obliged to notify the beneficiary shortly thereafter, perhaps on the same business day. This rule accepts the reasoning in cases such as *Datapoint Corp. v. M & I Bank*, 665 F. Supp. 722 (W.D. Wis. 1987) and *Esso Petroleum Canada, Div. of Imperial Oil, Ltd. v. Security Pacific Bank*, 710 F. Supp. 275 (D. Ore. 1989).

The section departs the examining party of the right simply to sit on a presentation that is made within seven days of expiration. The
section requires the examiner to examine the documents and make a decision and, having made a decision to dishonor, to communicate promptly with the presenter. Nevertheless, a beneficiary who presents documents shortly before the expiration of a letter of credit runs the risk that it will never have the opportunity to cure any discrepancies.

5. Confirmers, other nominated persons, and collecting banks acting for beneficiaries can be presenters and, when so, are entitled to the notice provided in subsection (b). Even nominated persons who have honored or given value against an earlier presentation of the beneficiary and are themselves seeking reimbursement or honor need notice of discrepancies in the hope that they may be able to procure complying documents. The issuer has the obligations imposed by this section whether the issuer’s performance is characterized as “reimbursement” of a nominated person or as “honor.”

6. In many cases a letter of credit authorizes presentation by the beneficiary to someone other than the issuer. Sometimes that person is identified as a “payor” or “paying bank,” or as an “acceptor” or “accepting bank,” in other cases as a “negotiating bank,” and in other cases there will be no specific designation. The section does not impose any duties on a person other than the issuer or confirmor, however a nominated person or other person may have liability under this article or at common law if it fails to perform an express or implied agreement with the beneficiary.

7. The issuer’s obligation to honor runs not only to the beneficiary but also to the applicant. It is possible that an applicant who has made a favorable contract with the beneficiary will be injured by the issuer’s wrongful dishonor. Except to the extent that the contract between the issuer and the applicant limits liability, the issuer will have liability to the applicant for wrongful dishonor under Section 5-111 as a matter of contract law. A good faith extension of the time in Section 5-108(h) by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension.

The issuer’s obligation to dishonor when there is no apparent compliance with the letter of credit runs only to the applicant. No other party to the transaction can complain if the applicant waives compliance with terms or conditions of the letter of credit or agrees to a less stringent standard for compliance than that supplied by this article. Except as otherwise agreed with the applicant, an issuer may dishonor a noncomplying presentation despite an applicant’s waiver.

Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely on honor over past waivers as a basis for concluding that a future defective presentation will justify honor. The reasoning of Corts v. North America Inc. v. North Carolina Nat. Bank, 528 F.2d 802 (4th Cir. 1975) is accepted and that expressed in Schwaditz v. Pontchartrain State Bank, 389 So.2d 731 (La.App. 1980) and Titanium Metals Corp. v. Space Metals, Inc., 529 P.2d 431 (Utah 1974) is rejected.

8. The standard practice referred to in subsection (e) includes (i) international practice set forth in or referenced by the Uniform Customs and Practice, (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice. It is possible that standard practice will vary from one place to another. Where there are conflicting practices, the parties should indicate which practice governs their rights. A practice may be overridden by agreement or course of dealing. See Section 1-204(4).

9. The responsibility of the issuer under a letter of credit is examined documents and to make a prompt decision to honor or dishonor based upon that examination. Nondocumentary conditions have no place in this regime and are better accommodated under contract or suretyship law and practice. In requiring that nondocumentary conditions in letters of credit be ignored as surpluses, Article 5 remains aligned with the UCP (see UCP 500 Article 13c), approves cases like Pringle-Associated Mortgage Corp. v. Southern National Bank, 571 F.2d 871, 874 (5th Cir. 1978), and rejects the reasoning in cases such as Sherwood & Roberts, Inc. v. First Security Bank, 682 P.2d 149 (Mont. 1984).

Subsection (g) recognizes that letters of credit sometimes contain nondocumentary terms or conditions. Conditions such as a term prohibiting “shipment on vessels more than 15 years old,” are to be disregarded and treated as surpluses. Similarly, a requirement that there be an award by a “duly appointed arbitrator” would not require the issuer to determine whether the arbitrator had been “duly appointed.” Likewise a term in a standby letter of credit that provided for differing forms of certification depending upon the particular type of default does not obligate the issuer independently to determine which kind of default has occurred. These conditions must be disregarded by the issuer. Where the nondocumentary conditions are central and fundamental to the issuer’s obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely. See Section 5-102(a)(10) and Comment 6 to Section 5-102.

Subsection (g) would not permit the beneficiary or the issuer to disregard terms in the letter of credit such as place, time, and mode of presentation. The rule in subsection (g) is intended to prevent an issuer from deciding or even investigating extrinsic facts, but not from consulting the clock, the calendar, the relevant law and practice, or its own general knowledge of documentation or transactions of the type underlying a particular letter of credit.

Even though nondocumentary conditions must be disregarded in determining compliance of a presentation (and thus in determining the issuer’s duty to the beneficiary), an issuer that has promised its applicant that it will honor only on the occurrence of those nondocumentary conditions may have liability to its applicant for disregarding the conditions.

10. Subsection (f) condones an issuer’s ignorance of “any usage of a particular trade”; that trade is the trade of the applicant, beneficiary, or others who may be involved in the underlying transaction. The issuer is expected to know usage that is commonly encountered in the course of document examination. For example, an issuer should know the common usage with respect to documents in the maritime shipping trade but would not be expected to understand synonyms used in a particular trade for product descriptions appearing in a letter of credit or an invoice.

11. Where the issuer’s performance is the delivery of an item of value other than money, the applicant’s reimbursement obligation would be to make the “item of value” available to the issuer.

12. An issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under Section 5-109(a).

13. The last clause of Section 5-108(i)(5) deals with a special case in which the fraud is not committed by the beneficiary, but is committed by a stranger to the transaction who forges the beneficiary’s signature. If the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary.

SECTION 5-109. FRAUD AND FORGERY.

(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or
applicant:

(1) the issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmor who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer’s or nominated person’s deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and

(2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) all of the conditions to entitle a person to the relief under the law of this State have been met; and

(4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (a)(1).

Official Comment

1. This recodification makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant. See Cromwell v Commerce & Energy Bank, 464 So.2d 721 (La. 1985).

Secondly, it makes clear that fraud must be "material." Necessarily courts must decide the breadth and width of "materiality." The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction. Assume, for example, that the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice showing 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. The courts must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material.

Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor. The section indorses articulations such as those stated in Intraworld Indus. v. Girard Trust Bank, 336 A.2d 316 (Pa. 1975), Roman Ceramics Corp. v. People's Nat. Bank, 714 F.2d 1207 (3d Cir. 1983), and similar decisions and embraces certain decisions under Section 5-114 that relied upon the phrase "fraud in the transaction." Some of these decisions have been summarized as follows in Ground Air Transfer v. Westane's Airlines, 899 F.2d 1269, 1272-73 (1st Cir. 1990):

We have said throughout that courts may not "normally" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in In re 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "plainly" show that the underlying contract forbids the beneficiary to call a letter of credit, In re 730 F.2d at 24; where they show that the contract deprives the beneficiary of even a "colorable" right to do so, id., at 25; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," id.; see Dynamics Corp. of America, 356 F. Supp. at 999; where the beneficiary's conduct has "so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served," In re 730 F.2d at 25 (quoting Roman Ceramics Corp. v. Peoples National Bank, 714 F.2d 1207, 1212 n.12, 1215 (3d Cir. 1983) (quoting Intraworld Indus., 336 A.2d at 324-25)); then a court may enjoin payment.

2. Subsection (e)(2) makes clear that the issuer may honor in the face of the applicant's claim of fraud. The subsection also makes clear what was not stated in former Section 5-114, that the issuer may dishonor and defend that dishonor by showing fraud or forgery of the kind stated in subsection (e). Because issuers may be liable for wrongful dishonor if they are unable to prove forgery or material fraud, presumably most issuers will choose to honor despite applicant's claims of fraud or forgery unless the applicant procures an injunction. Merely because the issuer has a right to dishonor and to defend that dishonor by showing forgery or material fraud does not mean it has a duty to the applicant to dishonor. The applicant's normal recourse is to procure an injunction, if the applicant is unable to procure an injunction, it will have a claim against the issuer only in the rare case in which it can show that the issuer did not honor in good faith.

3. Whether a beneficiary can commit fraud by presenting a draft under a clean letter of credit (one calling only for a draft and no other documents) has been much debated. Under the current formulation it would be possible but difficult for there to be fraud in such a presentation. If the applicant were able to show that the beneficiary were committing material fraud on the applicant in the underlying transaction, then payment would facilitate a material fraud by the beneficiary on the applicant and honor could be enjoined. The courts should be skeptical of claims of fraud by one who has signed a "suicide" or clean credit and thus granted a beneficiary the right to draw by mere presentation of a draft.

4. The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted. Some courts have enjoined payments on letters of credit in insufficient showing by the applicant. For example, in Griffin Cos. v. First Nat. Bank, 374 N.W.2d 768 (Minn.App. 1985), the court enjoined payment under a standby letter of credit,
SECTION 5-110. WARRANTIES.

(a) If its presentation is honored, the beneficiary warrants:

(1) to the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in Section 5-109(a); and

(2) to the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(b) The warranties in subsection (a) are in addition to warranties arising under Article 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those articles.

Official Comment

1. Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer. Any defense must be based on Section 5-108 or 5-109 and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) cannot excuse the applicant’s duty to reimburse.

2. The warranty in Section 5-110(a)(2) assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108(a). It is a warranty that the beneficiary has performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon “due performance” and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party’s determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of the draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary’s drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 and 4.

Unlike wrongful dishonor cases — where the damages usually equal the amount of the draw — the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant’s damages for breach of warranty in subsection (a)(2) are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the “amount in default.” Assume a default of $200,000 and a draw of $500,000. The damages for breach of warranty would be no more than $300,000.

SECTION 5-111. REMEDIES.

(a) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer’s obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant’s election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant’s recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(b) If an issuer wrongfully dishonors a draft or demand presented under a letter of
credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmor breaches an obligation under this article or an issuer breaches an obligation not covered in subsection (a) or (b), a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmor has the liability of an issuer specified in this subsection and subsections (a) and (b).

(d) An issuer, nominated person, or adviser who is found liable under subsection (a), (b), or (c) shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(e) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

**Official Comment**

1. The right to specific performance is new. The express limitation on the duty of the beneficiary to mitigate damages adopts the position of certain courts and commentators. Because the letter of credit depends upon speed and certainty of payment, it is important that the issuer not be given an incentive to dishonor. The issuer might have an incentive to dishonor if it could rely on the burden of mitigation falling on the beneficiary, (to sell goods and sue only for the difference between the price of the goods sold and the amount due under the letter of credit). Under the scheme contemplated by Section 5-111(a), the beneficiary would present the documents to the issuer. If the issuer wrongfully dishonored, the beneficiary would have no further duty to the issuer with respect to the goods covered by documents that the issuer dishonored and returned. The issuer thus takes the risk that the beneficiary will let the goods rot or be destroyed. Of course the beneficiary may have a duty of mitigation to the applicant arising from the underlying agreement, but the issuer would not have the right to assert that duty by way of defense or setoff. See Section 5-117(d). If the beneficiary sells the goods covered by dishonored documents or if the beneficiary sells a draft after acceptance but before dishonor by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages — at least where the damage claim against the issuer equals or exceeds the damage suffered by the beneficiary. If, on the other hand, the beneficiary suffers damages in an underlying transaction in an amount that exceeds the amount of the wrongfully dishonored demand (e.g., where the letter of credit does not cover 100 percent of the underlying obligation), the damages avoided should not necessarily be deducted from the beneficiary's claim against the issuer. In such a case, the damages would be the lesser of (i) the amount recoverable in the absence of mitigation (that is, the amount that is subject to the dishonor or repudiation plus any incidental damages) and (ii) the damages remaining after deduction for the amount of damages actually avoided.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if the beneficiary could never have obtained documents necessary for a presentation conforming to the letter of credit, the beneficiary cannot recover for anticipatory repudiation of the letter of credit. Doeliger v. Battery Park Bank, 201 A.D. 515, 194 N.Y.S. 582 (1922) and Decoby NiiKolot Int'l, Inc. v. Federal Republic of Nigeria, 497 F.Supp. 893 (S.D.N.Y. 1980), aff'd, 647 F.2d 300 (2d Cir. 1981), cert. denied, 454 U.S. 1143 (1982). The last sentence of subsection (c) does not expand the liability of a confirmor to persons to whom the confirmor would not otherwise be liable under Section 5-107.

Almost all letters of credit, including those that call for an acceptance, are "obligations to pay money" as that term is used in Section 5-111(a).

2. What damages "result" from improper honoring is for the courts to decide. Even though an issuer pays a beneficiary in violation of Section 5-108(a) or of its contract with the applicant, it may have no liability to an applicant. If the underlying contract has been fully performed, the applicant may not have been damaged by the issuer's breach. Such a case would occur when A contracts for goods at $100 per ton, but, upon delivery, the market value of the conforming goods has decreased to $25 per ton. If the issuer pays over discrepancies, there should be no recovery by A for the price differential if the issuer's breach did not alter the applicant's obligation under the underlying contract, i.e., to pay $100 per ton for goods now worth $25 per ton. On the other hand, if the applicant intends to resell the goods and must itself satisfy the strict compliance requirements under a second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment despite discrepancies because the applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary, and may be unable to mitigate its damages by enforcing its rights against others in the underlying transaction. Note that an issuer found liable to its applicant may have recourse under Section 5-117 by subrogation to the applicant's claim against the beneficiary or other persons.

One who inaccurately advises a letter of credit breaches its obligation to the beneficiary, but may cause no damage. If the beneficiary knows the terms of the letter of credit and understands the advice to be inaccurate, the beneficiary will have suffered no damage as a result of the adviser's breach.

3. Since the confirmor has the rights and duties of an issuer, in general it has an issuer's liability, see subsection (c). The confirmor is usually a confirming bank. A confirming bank often also plays the role of an adviser. If it breaks its obligation to the beneficiary, the confirming bank may have liability as an issuer or, depending upon the obligation that was broken, as an adviser. For example, a wrongfully dishonored would give ii liability as an issuer under Section 5-111(a). On the other hand a confirming bank that breaks its obligation to advise the credit but did not commit wrongful dishonor would be treated under Section 5-111(c).

4. Consequential damages for breach of obligations under this article are excluded in the belief that these damages can best be avoided by the beneficiary or the applicant and out of the fear that imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic. A fortiori punitive and exemplary damages are excluded, however, that section does not bar recovery of consequential or even punitive damages for breach of statutory or common law duties arising outside of this article.

5. The section does not specify a rate of interest. It leaves the setting of the rate to the court. It would be appropriate for a court to use the rate that would normally apply in that court in other situations where interest is imposed by law.

6. The court must award attorney's fees to
the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or an adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer to recover those fees from a losing beneficiary may also protect the applicant against undisputed losses. The party entitled to attorneys’ fees has been described as the “prevailing party.” Sometimes it will be unclear which party “prevailed,” for example, where there are multiple issues and one party wins on some and the other party wins on others. Determining which is the prevailing party is in the discretion of the court. Subsection (e) authorizes an attorney’s fees in all actions where a remedy is sought “under this article.” It applies even when the remedy might be an injunction under Section 5-109 or when the claimed remedy is otherwise outside of Section 5-111. Neither an issuer nor a confirmor should be treated as a “losing” party when an injunction is granted to the applicant over the objection of the issuer or confirmor; accordingly neither should be liable for fees and expenses in that case.

“Expenses of litigation” is intended to be broader than “costs.” For example, expense of litigation would include travel expenses of witnesses, fees for expert witnesses, and expenses associated with taking depositions.

7. For the purposes of Section 5-111(f) “harm anticipated” must be anticipated at the time when the agreement that includes the liquidated damage clause is executed or at the time when the undertaking that includes the clause is issued. See Section 2A-504.

SECTION 5-112. TRANSFER OF LETTER OF CREDIT.

(a) Except as otherwise provided in Section 5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) the transfer would violate applicable law; or
(2) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within the standard practice referred to in Section 5-108(e) or is otherwise reasonable under the circumstances.

Official Comment

1. In order to protect the applicant’s reliance on the designated beneficiary, letter of credit law traditionally has forbidden the beneficiary to convey to third parties its right to draw or demand payment under the letter of credit. Subsection (a) codifies that rule. The term “transfer” refers to the beneficiary’s conveyance of that right. Absent incorporation of the UCP (which make elaborate provision for partial transfer of a commercial letter of credit) or similar trade practice and absent other express indication in the letter of credit that the term is used to mean something else, a term in the letter of credit indicating that the beneficiary has the right to transfer should be taken to mean that the beneficiary may convey to a third party its right to draw or demand payment. Even in that case, the issuer or other person controlling the transfer may make the beneficiary’s right to transfer subject to conditions, such as timely notification, payment of a fee, delivery of the letter of credit to the issuer or other person controlling the transfer, or execution of appropriate forms to document the transfer. A nominated person who is not a confirmor has no obligation to recognize a transfer.

The power to establish “requirements” does not include the right absolutely to refuse to recognize transfers under a transferable letter of credit. An issuer who wishes to retain the right to deny all transfers should not issue transferable letters of credit or should incorporate the UCP. By stating its requirements in the letter of credit an issuer may impose any requirement without regard to its conformity to practice or reasonableness. Transfer requirements of issuers and nominated persons must be made known to potential transferors and transferees to enable those parties to comply with the requirements. A common method of making requirements known is to use a form that indicates the information that must be provided and the instructions that must be given to enable the issuer or nominated person to comply with a request to transfer.

2. The issuance of a transferable letter of credit with the concurrence of the applicant is ipso facto an agreement by the issuer and applicant to permit a beneficiary to transfer its drawing right and permit a nominated person to recognize and carry out that transfer without further notice to them. In international commerce, transferable letters of credit are often issued under circumstances in which a nominated person or adviser is expected to facilitate the transfer from the original beneficiary to a transferee and to deal with that transferee. In those circumstances it is the responsibility of the nominated person or adviser to establish procedures satisfactory to protect itself against double presentation or dispute about the right to draw under the letter of credit. Commonly such a person will control the transfer by requiring that the original letter of credit be given to it or by causing a paper copy marked as an original to be issued where the original letter of credit was electronic. By keeping possession of the original letter of credit the nominated person or adviser can minimize or entirely exclude the possibility that the original beneficiary could properly procure payment from another bank. If the letter of credit requires presentation of the original letter of credit itself, no other payment could be procured. In addition to imposing whatever requirements it considers appropriate to protect itself against double payment the person that is facilitating the transfer has a right to charge an appropriate fee for its activity.

“Transfer” of a letter of credit should be distinguished from “assignment of proceeds.” The former is analogous to a novation or a substitution of beneficiaries. It contemplates not merely payment to but also performance by the transferee. For example, under the typical terms of transfer for a commercial letter of credit, a transferee could comply with a letter of credit transferred to it by signing and presenting its own draft and invoice. An assignee of proceeds, on the other hand, is wholly dependent on the presentation of a draft and invoice signed by the beneficiary.

By agreeing to the issuance of a transferable letter of credit, which is not qualified or limited, the applicant may lose control over the identity of the person whose performance will earn payment under the letter of credit.

SECTION 5-113. TRANSFER BY OPERATION OF LAW.

(a) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.
letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary’s assignment of the proceeds of a letter of credit and are superior to the assignee’s right to the proceeds.

(f) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer’s or nominated person’s payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary’s rights to proceeds is governed by Article 9 or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary’s right to proceeds and its perfection are governed by Article 9 or other law.

**Official Comment**

1. Subsection (b) expressly validates the beneficiary’s present assignment of letter of credit proceeds if made after the credit is established but before the proceeds are realized. This section adopts the prevailing usage — "assignment of proceeds" — to an assignee. That terminology carries with it no implication, however, that an assignee acquires no interest until the proceeds are paid by the issuer. For example, an "assignment of the right to proceeds" of a letter of credit for purposes of security that meets the requirements of Section 9-201(1) would constitute the present creation of a security interest in that right. This security interest can be perfected by possession (Section 9-305) if the letter of credit is in written form. Although subsection (a) explains the meaning of "proceeds of a letter of credit," it should be emphasized that those proceeds also may be Article 9 proceeds of other collateral. For example, if a seller of inventory receives a letter of credit to support the account that arises upon the sale, payments made under the letter of credit are Article 9 proceeds of the inventory, account, and any document of title covering the inventory. Thus, the secured party who had a perfected security interest in that inventory, account, or document has a perfected security interest in the proceeds collected under the letter of credit, so long as they are identifiable cash proceeds (Section 9-306(2), (3)). This perfection is continuous, regardless of whether the secured party perfected a security interest in the right to letter of credit proceeds.

2. An assignee’s rights to enforce an assignment of proceeds against an issuer and the priority of the assignee’s rights against a nominated person or transferee beneficiary are governed by Article 5. Those rights and that priority are stated in subsections (c), (d), and (e). Note also that Section 4-210 gives first priority to a collecting bank that has given value for a documentary draft.

3. By requiring that an issuer or nominated person consent to the assignment of proceeds...
of a letter of credit, subsections (c) and (d) follow more closely recognized national and international letter of credit practices than did prior law. In most circumstances, it has always been advisable for the assignee to obtain the consent of the issuer in order better to safeguard its right to the proceeds. When notice of an assignment has been received, issuers normally have required signatures on a consent form. This practice is reflected in the revision. By unconditionally consenting to such an assignment, the issuer or nominated person becomes bound, subject to the rights of the superior parties specified in subsection (e), to pay to the assignee the assigned letter of credit proceeds that the issuer or nominated person would otherwise pay to the beneficiary or another assignee.

Where the letter of credit must be presented as a condition to honor and the assignee holds and exhibits the letter of credit to the issuer or nominated person, the risk to the issuer or nominated person of having to pay twice is minimized. In such a situation, subsection (d) provides that the issuer or nominated person may not unreasonably withhold its consent to the assignment.

**SECTION 5-115. STATUTE OF LIMITATIONS.** An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

**Official Comment**

1. This section is based upon Sections 4-111 and 2-725(2).
2. This section applies to all claims for which there are remedies under Section 5-111 and to other claims made under this article, such as claims for breach of warranty under Section 5-110. Because it covers all claims under Section 5-111, the statute of limitations applies not only to wrongful dishonor claims against the issuer but also to claims between the issuer and the applicant arising from the reimbursement agreement. These might be for reimbursement (issuer v. applicant) or for breach of the reimbursement contract by wrongful honor (applicant v. issuer).
3. The statute of limitations, like the rest of the statute, applies only to a letter of credit issued on or after the effective date and only to transactions, events, obligations, or duties arising out of or associated with such a letter. If a letter of credit was issued before the effective date and an obligation on that letter of credit was breached after the effective date, the complaining party could bring its suit within the time that would have been permitted prior to the adoption of Section 5-115 and would not be limited by the terms of Section 5-115.

**SECTION 5-116. CHOICE OF LAW AND FORUM.**

(a) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in Section 5-104 or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. The person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(c) Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in Section 5-103(c).

(d) If there is conflict between this article and Article 3, 4, 4A, or 9, this article governs.

(e) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a).

**Official Comment**

1. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection (a) and that provided in the absence of agreement under subsection (b) is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law — in the absence of agreement — even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another State. Subsection (b) states the relevant choice of law principles and it should not be subordinate to some other choice of law rule. Within the States of the United States removal will not be a problem once every jurisdiction has enacted Section 5-116 because every jurisdiction will then have the same choice of law rule and in a particular case all choice of law rules will point to the same substantive law.

Subsection (b) does not state a choice of law rule for the "liability of an applicant." However, subsection (b) does state a choice of law rule for the liability of an issuer, nominated person, or adviser, and since some of the issues in suits by applicants against those
persons involve the “liability of an issuer, nominated person, or adviser,” subsection (b) states the choice of law rule for those issues. Because an issuer may have liability to a consumer both as an issuer (Section 5-108(a), Comment 5 to Section 5-108) and as an applicant (Section 5-107(a), Comment 1 to Section 5-107, Section 5-108(i)), subsection (b) may state the choice of law rule for some but not all of the issue’s liability in a suit by a consumer.

2. Because the consumer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a consumer or nominated person may be obligated to pay (under their law) but will not be entitled to payment from the issuer (under its law). Similarly, the rights of an unreimbursed issuer, consumer, or nominated person against a beneficiary under Section 5-109, 5-110, or 5-117, will not necessarily be governed by the same law that applies to the consumer’s or consumer’s obligation upon presentation. Because the UCP and other practice are incorporated in most international letters of credit, disputes arising from different legal obligations to honor have not been frequent. Since Section 5-108 incorporates standard practice, these problems should be further minimized—at least to the extent that the same practice is and continues to be widely followed.

3. This section does not permit what is now authorized by the uniform Section 5-102(a) in New York. Under the current law in New York a letter of credit that incorporates the UCP is not governed in any respect by Article 5. Under revised Section 5-116 letters of credit that incorporate the UCP or similar practice will still be subject to Article 5 in certain respects. First, incorporation of the UCP or other practice does not override the nonvariable terms of Article 5. Second, where there is no conflict between Article 5 and the relevant provision of the UCP or other practice, both apply. Third, practice provisions incorporated in a letter of credit will not be effective if they fail to comply with Section 5-103(c). Assume, for example, that a practice provision purport to free a party from any liability unless it were “grossly negligent” or that the practice generally limited the remedies that one party might have against another. Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective because of Section 5-103(c).

Even though Article 5 is generally consistent with UCP 500, it is not necessarily consistent with other rules or with versions of the UCP that may be adopted after Article 5’s revision, or with other practices that may develop. Rules of practice incorporated in the letter of credit or other undertakings are those in effect when the letter of credit or other undertaking is issued. Except in the unusual cases discussed in the immediately preceding paragraph, practice adopted in a letter of credit will override the rules of Article 5 and the parties to letter of credit transactions must be familiar with practice (such as future versions of the UCP) that is explicitly adopted in letters of credit.

4. In several ways Article 5 conflicts with and overrides similar matters governed by Articles 3 and 4. For example, “draft” is more broadly defined in letter of credit practice than under Section 3-104. The time allowed for honor and the required notification of reasons for dishonor are different in letter of credit practice than in the handling of documentary and other drafts under Articles 3 and 4.

5. Subsection (e) must be read in conjunction with existing law governing subject matter jurisdiction. If the local law restricts a court to certain subject matter jurisdiction not including letter of credit disputes, subsection (e) does not authorize parties to choose that forum. For example, the parties’ agreement under Section 3-116(e) would not confer jurisdiction on a probate court to decide a letter of credit case.

If the parties choose a forum under subsection (e) and if the court to which the forum will not take jurisdiction, the parties’ agreement or undertaking should then be construed (for the purpose of forum selection) as though it did not contain a clause choosing a particular forum. That result is necessary to avoid sentencing the parties to eternal purgatory where neither the chosen State nor the State which would have jurisdiction but for the clause will take jurisdiction—the former in disregard of the clause and the latter in honor of the clause.

**SECTION 5-117. SUBROGATION OF ISSUER, APPLICANT, AND NOMINATED PERSON.**

(a) An issuer that honors a beneficiary’s presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (a).

(c) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

1. the issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

2. the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

3. the applicant to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (a) and (b) do not arise until the issuer honors the letter of credit or otherwise pays and the rights in subsection (c) do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

**Official Comment**

1. By itself this section does not grant any right of subrogation. It grants only the right that would exist if the person seeking subrogation were a secondary obligor. (The term “secondary obligor” refers to a surety, guarantor, or other person against whom or whose property an obligee has recourse with respect to the obligation of a third party. See Restatement of the Law Third, Suretyship § 1 (1995)). If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section. In effect, the section does no more than to remove an impediment that some courts have found to subrogation because they conclude that the issuer’s or other claimant’s rights are “independent” of the underlying obligation. If, for example, a sec-
ondary obligor would not have a subrogation right because its payment did not fully satisfy the underlying obligation, none would be available under this section. The section indorses the position of Judge Becker in Tudor Development Group, Inc. v. United States Fidelity and Guaranty, 968 F.2d 357 (3rd Cir. 1991).

2. To preserve the independence of the letter of credit obligation and to insure that subrogation not be used as an offensive weapon by an issuer or others, the admonition in subsection (d) must be carefully observed. Only one who has completed its performance in a letter of credit transaction can have a right to subrogation. For example, an issuer may not dishonor and then defend its dishonor or assert a setoff on the ground that it is subrogated to another person’s rights. Nor may the issuer complain after honor that its subrogation rights have been impaired by any good faith dealings between the beneficiary and the applicant or any other person. Assume, for example, that the beneficiary under a standby letter of credit is a mortgagee. If the mortgagee were obliged to issue a release of the mortgage upon payment of the underlying debt (by the issuer under the letter of credit), that release might impair the issuer’s rights of subrogation, but the beneficiary would have no liability to the issuer for having granted that release.
CONFORMING AND MISCELLANEOUS AMENDMENTS TO ARTICLE 1

SECTION 1-105. TERRITORIAL APPLICATION OF THE ACT; PARTIES' POWER TO CHOOSE APPLICABLE LAW.

... (2) Where one of the following provisions of this [Act] specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

... Governing law in the Article on Funds Transfers. Section 4A-507.
Letters of Credit. Section 5-116.
Bulk sales subject to the Article on Bulk Sales. Section 6-103.
...

CONFORMING AND MISCELLANEOUS AMENDMENTS TO ARTICLE 2

SECTION 2-512. PAYMENT BY BUYER BEFORE INSPECTION.

... (b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of this Act (Section 4-414 2-109(b)).
...

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48
SECTION 9-103. PERFECTION OF SECURITY INTEREST IN MULTIPLE STATE TRANSACTIONS.

(1) Documents, instruments, letters of credit, and ordinary goods.

(a) This subsection applies to documents, and instruments, rights to proceeds of written letters of credit, and to goods other than those covered by a certificate of title described in subsection (2), mobile goods described in subsection (3), and minerals described in subsection (5).

...}

SECTION 9-104. TRANSACTIONS EXCLUDED FROM ARTICLE. This Article does not apply

...}

(1) to a transfer of an interest in any deposit account (subsection (1) of Section 9-105), except as provided with respect to proceeds (Section 9-306) and priorities in proceeds (Section 9-312); or

(2) to a transfer of an interest in a letter of credit other than the rights to proceeds of a written letter of credit.

Official Comment

...


[ ]

SECTION 9-105. DEFINITIONS AND INDEX OF DEFINITIONS.

...

(3) The following definitions in other Articles apply to this Article:

...}

"Letter of credit" Section 5-102.

...}

"Proceeds of a letter of credit" Section 5-114(a).

SECTION 9-106. DEFINITIONS: "ACCOUNT"; "GENERAL INTANGIBLES." "Account" means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance. "General intangibles" means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, investment property, rights to proceeds of written letters of credit, and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts.

SECTION 9-304. PERFECTION OF SECURITY INTEREST IN INSTRUMENTS, DOCUMENTS, PROCEEDS OF A WRITTEN LETTER OF CREDIT, AND GOODS COVERED BY DOCUMENTS; PERFECTION BY PERMISSIVE FILING; TEMPORARY PERFECTION WITHOUT FILING OR TRANSFER OF POSSESSION.

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in the rights to proceeds of a written letter of credit can be perfected only by the secured party’s taking possession of the letter of credit. A security interest in money or instruments (other than instruments which constitute part of chattel paper) can be perfected only by the secured party’s taking possession, except as provided in subsections (4) and (5) of this section and subsections (2) and (3) of Section 9-306 on proceeds.

...}

Special Legislative Note. As Sections 9-304 and 9-305 appear in the Official Text of the Conforming Amendments to Revised Article 8 (1995), they incorporate the amendments made to these sections in 1994, when Revised Article 8 was promulgated. If Revised Article 3 with Conforming Amendments, as promulgated in 1995, is adopted by any State before Revised Article 8 with Conforming Amendments of 1994 is adopted, the 1990 text for Sections 9-304 and 9-305 should be used as a basis for amendment, as follows:

SECTION 9-304. PERFECTION OF SECURITY INTEREST IN INSTRUMENTS, DOCUMENTS, PROCEEDS OF A WRITTEN LETTER OF CREDIT, AND GOODS COVERED BY DOCUMENTS; PERFECTION BY PERMISSIVE FILING; TEMPORARY PERFECTION WITHOUT FILING OR TRANSFER OF POSSESSION.

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in the rights to proceeds of a written letter of credit can be perfected only by the secured party’s taking possession of the letter of credit. A security interest in money or instruments (other than certificated securities) can be perfected only by the secured party’s taking possession, except as provided in subsections (4) and (5) of this section and subsections (2) and (3) of Section 9-306 on proceeds.

...}
taking possession of the letter of credit. If such collateral other than goods covered by
a negotiable document is held by a bailee, the secured party is deemed to have pos­
session from the time the bailee receives notification of the secured party's interest. A
security interest is perfected by possession from the time possession is taken without a
relation back and continues only so long as possession is retained, unless otherwise
specified in this Article. The security interest may be otherwise perfected as provided
in this Article before or after the period of possession by the secured party.

Official Comment

SECTION 9-305. WHEN POSSESSION BY SECURED PARTY PERFECTS SECU­
RITY INTEREST WITHOUT FILING. A security interest in letters of credit and advice of
credit (see Section 5-116), goods, instruments, money, negotiable documents, or
chattel paper may be perfected by the secured party's taking possession of the collateral.
A security interest in the right to proceeds of a written letter of credit may be perfected by the
secured party's taking possession of the letter of credit. If such collateral other than goods
covered by a negotiable document is held by a bailee, the secured party is deemed to have
possession from the time the bailee receives notification of the secured party's interest. A secu­
riority interest is perfected by possession from the time possession is taken without a relation back
and continues only so long as possession is retained, unless otherwise specified in this Article.
The security interest may be otherwise perfected as provided in this Article before or after the
period of possession by the secured party.

Special Legislative Note: See Special Legislative Note, Section 9-304.

Official Comment

1. As under the common law of pledge, no filing is required by this Article to perfect a
security interest where the secured party has possession of the collateral. Compare Section
9-302(1)(e). This section permits a security interest to be perfected by transfer of possession
only when the collateral is goods, rights to proceeds of letters of credit (if written), instru­
ments (other than certificated securities, which are governed by Section 8-322)*, documents or
chattel paper; that is to say, accounts and general intangibles are excluded. As to
perfection of security interests in certificated securities by possession, see the general rules
on perfection of security interests in investment property in Section 9-115(4) and the
special rule in Section 9-115(6) dealing with cases where a secured party takes possession
of a security certificate in registered form without obtaining an indorsement. * See Sec­
tion 5-116 for the special case of assignments of letters and advice of credit. A security in­
terest in accounts and general intangibles—property not ordinarily represented by any
writing whose delivery operates to transfer the claim—may under this Article be perfected
only by filing, and this rule would not be affected by the fact that a security agreement or

other writing described the assignment of such collateral as a "pledge". Section 9-302(1)(e)
exempts from filing certain assignments of accounts which are out of the ordinary course
of financing: such exempted assignments are

perfected when they attach under Section 9­
303(1); they do not fall within this section.

*Amendments in italics approved by the Per­
manent Editorial Board for Uniform Com­
GENERAL ASSEMBLY
COMMONWEALTH OF KENTUCKY
2000 REGULAR SESSION

SENATE BILL 11
Sections Pertaining to UCC Article 5
AN ACT providing for the adoption of revised articles of the Uniform Commercial Code and making changes incidental thereto.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SEGMENT A

REVISED ARTICLE 5

(LETTERS OF CREDIT)

SECTION 1. KRS 355.5-101 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

This article may be cited as Uniform Commercial Code – Letters of Credit.

SECTION 2. KRS 355.5-102 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) In this article:

(a) "Adviser" means a person who, at the request of the issuer, a confirmer, or another adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(b) "Applicant" means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(c) "Beneficiary" means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(d) "Conformer" means a nominated person who undertakes, at the request of or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(e) "Dishonor" of a letter of credit means failure timely to honor or to take an interim action, such as acceptance of a draft, that may be required by the letter of credit.

(f) "Document" means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion:

1. Which is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in subsection (5) of Section 8 of this Act; and

2. Which is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(g) "Good faith" means honesty in fact in the conduct or transaction concerned.

(h) "Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs:

1. Upon payment;

2. If the letter of credit provides for acceptance, upon acceptance of a draft and, at maturity, its payment; or

3. If the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(i) "Issuer" means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

(j) "Letter of credit" means a definite undertaking that satisfies the requirements of Section 4 of this Act by an issuer to a beneficiary at the request of or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

(k) "Nominated person" means a person whom the issuer:

1. Designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit; and

2. Undertakes by agreement or custom and practice to reimburse.

(l) "Presentation" means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(m) "Presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person.

(n) "Record" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.
Definitions in other articles in this chapter applying to this article and the sections in which they appear are:

"Accept" or "Acceptance" KRS 355.3-409;
"Value" KRS 355.3-303 and 355.4-211.

Article 1 of this chapter contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

SECTION 3. KRS 355.5-103 IS REPEALED AND REENACTED TO READ AS FOLLOWS:
(1) This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.
(2) The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.
(3) With the exception of this subsection, subsections (1) and (4) of this section, subsection (1)(i) and (i) of Section 2 of this Act, subsection (4) of Section 6 of this Act, and subsection (4) of Section 14 of this Act, and to the extent prohibited in KRS 355.1-102(5) and subsection (4) of Section 17 of this Act, the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.
(4) Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

SECTION 4. KRS 355.5-104 IS REPEALED AND REENACTED TO READ AS FOLLOWS:
A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated:
(1) By a signature;
(2) In accordance with the agreement of the parties or the standard practice referred to in subsection (5) of Section 8 of this Act.

SECTION 5. KRS 355.5-105 IS REPEALED AND REENACTED TO READ AS FOLLOWS:
Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

SECTION 6. KRS 355.5-106 IS REPEALED AND REENACTED TO READ AS FOLLOWS:
(1) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.
(2) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.
(3) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one (1) year after its stated date of issuance, or if none is stated, after the date on which it is issued.
(4) A letter of credit that states that it is perpetual expires five (5) years after its stated date of issuance, or if none is stated, after the date on which it is issued.

SECTION 7. KRS 355.5-107 IS REPEALED AND REENACTED TO READ AS FOLLOWS:
(1) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer.
(2) A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.
(3) A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.
(4) A person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (3) of this section. The terms in the notice to the transferee beneficiary:
may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

SECTION 8. KRS 355.5-108 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) Except as otherwise provided in Section 9 of this Act, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (5) of this section, appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in Section 13 of this Act and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(2) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:
   (a) To honor;
   (b) If the letter of credit provides for honor to be completed more than seven (7) business days after presentation, to accept a draft or incur a deferred obligation; or
   (c) To give notice to the presenter of discrepancies in the presentation.

(3) Except as otherwise provided in subsection (4) of this section, an issuer is precluded from asserting any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(4) Failure to give the notice specified in subsection (2) of this section or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor fraud or forgery as described in subsection (1) of Section 9 of this Act or expiration of the letter of credit before presentation.

(5) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer’s observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(6) An issuer is not responsible for:
   (a) The performance or nonperformance of the underlying contract, arrangement, or transaction;
   (b) An act or omission of others;
   (c) Observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (5) of this section.

(7) If an undertaking constituting a letter of credit under subsection (1) of Section 2 of this Act contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(8) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(9) An issuer that has honored a presentation as permitted or required by this article:
   (a) Is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;
   (b) Takes the documents free of claims of the beneficiary or presenter;
   (c) Is precluded from asserting a right of recourse on a draft under KRS 355.3-414 and 355.3-415;
   (d) Except as otherwise provided in Sections 10 and 17 of this Act, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and
   (e) Is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

SECTION 9. KRS 355.5-109 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:
   (a) The issuer shall honor the presentation, if honor is demanded by:
      1. A nominated person who has given value in good faith and without notice of forgery or material fraud;
      2. A confirmer who has honored its confirmation in good faith;
      3. A holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the
issuer or nominated person; or
4. An assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and
(b) The issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(2) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:
(a) The relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;
(b) A beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;
(c) All of the conditions to entitle a person to the relief under the law of this Commonwealth have been met; and
(d) On the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (1)(a) of this section.

SECTION 10. KRS 355.5-110 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) If its presentation is honored, the beneficiary warrants:
(a) To the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in subsection (1) of Section 9 of this Act; and
(b) To the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit.

(2) The warranties in subsection (1) of this section are in addition to warranties arising under Articles 3, 4, 7, and 8 of this chapter because of the presentation or transfer of documents covered by any of those articles.

SECTION 11. KRS 355.5-111 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit is not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(2) If an issuer wrongfully dishonors a draft or demand presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(3) If an adviser or nominated person other than a confirmer breaches an obligation under this article or an issuer breaches an obligation not covered in subsection (1) or (2) of this section, a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (1) and (2) of this section.

(4) An issuer, nominated person, or adviser who is found liable under subsection (1), (2), or (3) of this section shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(5) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

(6) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

SECTION 12. KRS 355.5-112 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

If a letter of credit is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) The transfer would violate applicable law; or

(2) The transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement.
relating to transfer imposed by the issuer which is within the standard practice referred to in subsection (5) of Section 8 of this Act or is otherwise reasonable under the circumstances.

SECTION 13. KRS 355.5-113 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(2) A successor of a beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (5) of this section, an issuer shall recognize a disclosed successor of a beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in subsection (5) of Section 8 of this Act or, in the absence of such a practice, compliance with other reasonable procedures sufficient to protect the issuer.

(3) An issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of a purported successor is genuine or authorized.

(4) Honor of a purported successor's apparently complying presentation under subsection (1) or (2) of this section has the consequences specified in subsection (9) of Section 8 of this Act even if the purported successor is not the successor of a beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of Section 9 of this Act.

(5) An issuer whose rights of reimbursement are not covered by subsection (4) of this section or substantially similar law and any confirmor or nominated person may decline to recognize a presentation under subsection (2) of this section.

(6) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

SECTION 14. KRS 355.5-114 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) In this section, "proceeds of a letter of credit" means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(2) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(3) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(4) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(5) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

(6) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 of this chapter or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 of this chapter or other law.

SECTION 15. KRS 355.5-115 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

An action to enforce a right or obligation arising under this article must be commenced within one (1) year after the expiration date of the relevant letter of credit or one (1) year after the claim for relief accrues, whichever occurs later. A claim for relief accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

SECTION 16. KRS 355.5-116 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in Section 4 of this Act or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(2) Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit
confirmation, or other undertaking is expressly made subject. If:

(a) ___ This article would govern the liability of an issuer, nominated person, or adviser under subsection (1) of this section;

(b) ___ The relevant undertaking incorporates rules of custom or practice; and

(c) ___ There is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in subsection (3) of Section 3 of this Act.

(3) If there is conflict between this article and Article 3.4.4A, or 9 of this chapter, this article governs.

(4) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (1) of this section.

SECTION 17. KRS 355.5-117 IS REPEALED AND REENACTED TO READ AS FOLLOWS:

(1) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(2) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (1) of this section.

(3) A nominated person who pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(a) ___ The issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(b) ___ The beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(c) ___ The applicant to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the applicant.

(4) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (1) and (2) of this section do not arise until the issuer honors the letter of credit or otherwise pays the rights in subsection (3) of this section do not arise until the nominated person pays or otherwise gives value. Until then, the issuer, nominated person, and the applicant do not derive under this section present or prospective rights forming the basis of a claim, defense, or excuse.

SECTION 18. A NEW SECTION OF ARTICLE 5 OF KRS CHAPTER 355 IS CREATED TO READ AS FOLLOWS AND TO BE NUMBERED AS KRS 355.5-118:

(1) An issuer or nominated person has a security interest in a document presented under a letter of credit to the extent that the issuer or nominated person honors or gives value for the presentation.

(2) So long as and to the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document under subsection (1) of this section, the security interest continues and is subject to Article 9 of this chapter, but:

(a) ___ A security agreement is not necessary to make the security interest enforceable under subsection (2)(c) of Section 33 of this Act;

(b) ___ If the document is presented in a medium other than a written or other tangible medium, the security interest is perfected; and

(c) ___ If the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, the security interest is perfected and has priority over a conflicting security interest in the document so long as the debtor does not have possession of the document.

SEGMENT B
CONFORMING AMENDMENTS
FOR REVISED ARTICLE 5

Section 19. KRS 355.1-105 is amended to read as follows:

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this Commonwealth[state] and also to another state or nation the parties may agree that the law either of this Commonwealth[state] or of such other state or nation shall govern their rights and duties. Failing such agreement this chapter applies to transactions bearing an appropriate relation to this Commonwealth[state].

(2) Where one (1) of the following provisions of this chapter specifies the applicable law, that provision governs and a contrary
agreement is effective only to the extent permitted by the law (including the conflict of the laws rules) so specified:

Rights of creditors against sold goods. KRS 355.2-402.

Applicability of the article on leases. KRS 355.2A-105 and 355.2A-106.

Applicability of the article on bank deposits and collections. KRS 355.4-102.

Applicability of the article on investment securities. KRS 355.8-110.

Law governing perfection, the effect of perfection or nonperfection, and the priority of security interests and agricultural liens. Sections 41 to 47 of this Act (Perfection provisions of the article on secured transactions. KRS 355.9-103).

Governing law in the article on funds transfers. KRS 355.4A-507.

Letters of credit. Section 16 of this Act.

Section 20. KRS 355.2-512 is amended to read as follows:

(1) Where the contract requires payment before inspection nonconformity of the goods does not excuse the buyer from so making payment unless
(a) the nonconformity appears without inspection; or
(b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of this chapter (subsection (2) of Section 9 of this Act [KRS 355.5-114]).

(2) Payment pursuant to subsection (1) does not constitute an acceptance of goods or impair the buyer's right to inspect or any of his remedies.
CURRENT ISSUES BEFORE THE KENTUCKY DEPARTMENT OF FINANCIAL INSTITUTIONS

J. Rick Jones
Kentucky Department of Financial Institutions
Frankfort, Kentucky

SECTION N
NOTICE OF INTENT
TO
PROMULGATE ADMINISTRATIVE REGULATION

April 13, 2000

Public Protection and Regulation Cabinet
Department of Financial Institutions

(1) 808 KAR 1:150 Establishment and Relocation of Bank Branches or Offices.
(2) The Department of Financial Institutions intends to promulgate an administrative regulation governing the subject matter listed above.

(3) A public hearing to receive oral and written comments on this administrative regulation has been scheduled for Monday, May 22, 2000 at 9:00 a.m., at the offices of the Department of Financial Institutions, 1025 Capital Center Drive, Suite 200, Frankfort, Kentucky 40601.

This hearing is open to the public. Any person who attends will be given an opportunity to comment on this administrative regulation. Any disabled person desiring to attend or participate in the public hearing will be provided reasonable accommodation if requested at the time of notification of intent to attend. A transcript of the public hearing will not be made unless a written request for a transcript is made, with cost to be borne by the requesting party.

(4)(a) The public hearing will be held if it is requested, in writing, by at least 5 persons, or an administrative body, or an association having at least 5 members; and a minimum of 5 persons, or the administrative body or association, agree, in writing, to be present at the public hearing.

(b) If 5 persons or an administrative body or association, request this public hearing, and agree in writing to be present at this public hearing, it will be held as scheduled.

(c) If a request for a public hearing is not received from the required number of people at least 10 calendar days prior to May 22, 2000, the public hearing will be canceled.

(5)(a) Persons wishing to request a public hearing should mail their written request(s) to the following person and address:  J. Rick Jones, General Counsel, Department of Financial Institutions, Public Protection and Regulation Cabinet, 1025 Capital Center Drive, Suite 200, Frankfort, Kentucky 40601, (502) 573-3390, fax (502) 573-8787.

(b) On a request for public hearing, a person shall state:

1. "I agree to attend the public hearing"; or
2. "I will not attend the public hearing."

(6)(a) KRS Chapter 13A provides that persons who desire to be informed of the intent of an administrative body to promulgate an administrative regulation governing a specific subject matter may file a request to be informed by the administrative body.
(b) Persons who wish to file this request may obtain a request form from the Department of Financial Institutions at the address listed above.

(7) Information relating to this administrative regulation.

(a) The statutory authority for the promulgation of this administrative regulation is Senate Bill 169, which, when effective, will amend KRS 287.180 and KRS 287.185.

(b) This administrative regulation will be a new regulation section to designate those banks that will not have to apply for approval of the commissioner for permission to establish a branch or to relocate its principal office or branch.

(c) The Necessity and Function of this administrative regulation is as follows:

The Department of Financial Institutions is authorized pursuant to Senate Bill 169, which, when effective, will amend KRS 287.180 and KRS 287.185, to designate those banks that do not have to apply for approval of the commissioner for permission to establish a branch or to relocate its principal office or branch. This administrative regulation will set forth the criteria that such banks will have to meet in order to be designated as not having to obtain commissioner approval to establish a branch or relocate a principal office or branch.

(d) The benefits expected from this administrative regulation are:

Designating banks that will not require commissioner approval to establish branches or relocate principal offices or branches will reduce administrative costs associated with such activities, from both an industry and governmental standpoint, and eliminate administrative delays in completing such activities. At the same time, by designating only banks that have met defined compliance criteria, the Department can continue to exercise appropriate levels of oversight over the activities of those institutions that have not exhibited the same level of compliance.

(e) The administrative regulation will be implemented as follows:

Appropriate staff and banks will be notified of this administrative regulation, and the Department's examination branch will be largely responsible for its enforcement and implementation.
AN ACT relating to banks.

Be it enacted by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. A NEW SECTION OF KRS CHAPTER 287 IS CREATED TO READ AS FOLLOWS:

(1) As used in this section, a CAMEL rating means a system of rating used by examiners of financial institutions to rate the institutions in five (5) categories: capital adequacy, asset quality, management effectiveness, quantity and quality of earnings, and liquidity.

(2) In addition to all other banking activities permitted by this chapter, a state bank receiving a CAMEL rating of 1 or 2 at its most recent state or federal bank regulatory examination may engage in any banking activity in which the bank could engage if:

(a) It was operating as a national bank in any state;
(b) It was operating as a state bank, state thrift, or state savings bank in any state; or
(c) It meets the qualified thrift lender test as determined by the Office of Thrift Supervision or its successor, or was operating as a federally chartered thrift or federal savings bank in any state.

(3) Before a state bank may engage in any of the banking activities permitted by subsection (1) of this section, the state bank shall obtain a legal opinion specifying the statutory or regulatory provisions that permit the activity in which the state bank intends to engage. This legal opinion shall be maintained by the bank and provided to the department upon request.
Section 2. KRS 287.011 is amended to read as follows:

(1) There is created a Department of Financial Institutions, which constitutes a department of the state government within the meaning of KRS Chapter 12. The department shall be headed by a commissioner of financial institutions, who shall be the executive head of the department and shall be charged with the administration of the department.

(2) The Department of Financial Institutions shall exercise all administrative functions of the state in relation to the regulation, supervision, chartering and licensing of banks, trust companies, savings and loan associations, consumer loan companies, investment and industrial loan companies, and credit unions, and in relation to the regulation of securities.

(3) There is established within the Department of Financial Institutions the following divisions and offices:
   (a) The Division of Financial Institutions, which shall be headed by a director appointed by the commissioner, subject to prior written approval of the Governor in accordance with KRS 12.050. The division shall consist of entities deemed appropriate by the commissioner;
   (b) The Division of Securities, which shall be headed by a director appointed by the commissioner in accordance with KRS 12.050. The division shall consist of entities deemed appropriate by the commissioner;
   (c) The Division of Administrative Services, which shall be headed by a director appointed by the commissioner in accordance with KRS 12.050. The division shall be composed of organizational entities deemed appropriate by the commissioner;
   (d) The Office of the Commissioner, which shall be composed of organizational entities deemed appropriate by the commissioner; and
   (e) The Office of General Counsel, which shall be headed by a general counsel appointed by the commissioner in accordance with KRS 12.050. The office shall be composed of organizational entities as deemed appropriate by the commissioner.

(4) The department may accept any application or other document required to be filed with the department in electronic format or in any other technology acceptable to the department.
Section 3. KRS 287.100 is amended to read as follows:

A bank may:

(1) Hold personal property that has been transferred to it as collateral for the payment of any debt;

(2) Acquire and hold title to real estate, provided:
   (a) The real estate is necessary or appropriate for the transaction of legitimate business and the acquisition has been approved by the commissioner as required by KRS 287.103; and
   (b) The cost of the real estate, including furniture and fixtures, shall not exceed forty percent (40%) of the total paid-in capital, unimpaired surplus and undivided profits (determined on accrual basis). The investment may exceed the bank's forty percent (40%) limit with prior written approval of the commissioner;

(3) Acquire and hold for not longer than ten (10) years, any real estate conveyed to it in satisfaction of debts previously contracted in the course of its business, or that it may purchase under a judgment in its favor. A bank acquiring real estate in satisfaction of debts previously contracted in the course of business shall write down the acquisition at ten percent (10%) per year;

(4) Invest in the bonds of any federal home loan bank;

(5) Invest in obligations issued separately or collectively by or for federal land banks, federal intermediate credit banks and banks for cooperatives under the Act of Congress known as the Farm Credit Act of 1971, 85 Stat. 583, 12 U.S.C. sec. 2001 and amendments thereto;

(6) Invest, subject to the approval of the commissioner, in the capital stock or bonds or both of any domestic realty corporation organized or existing for the sole purpose of acquiring and holding title to real property used by the bank, through lease or otherwise, for the transaction of the bank's legitimate business;

(7) Purchase, hold, and convey the shares of any open end registered investment company registered under the Investment Company Act of 1940, or a series of such company, whose shares are registered under the Securities Act of 1933 and whose investments are limited to:
   (a) Bonds or other interest-bearing obligations of the United States, or those for the payment of the principal and interest on which the faith and credit of the United States is pledged;
   (b) Stocks, bonds, or other interest-bearing or dividend-yielding obligations issued or guaranteed as to the payment of principal and interest or dividend by any instrumentality presently or hereafter incorporated by authority of an Act of Congress;
   (c) General obligation bonds or revenue bonds issued and guaranteed as to payment of principal and interest by any state, county, or municipal governments legally authorized to issue such instruments of indebtedness;
   (d) Any other obligations in which national banking associations organized under the laws of the United States are permitted to invest in directly;

(8) Purchase and hold shares of a bank service corporation as that term is used in the Bank Service Corporation Act (12 U.S.C. sec. 1861) and any amendments thereto;

(9) Invest in:
   (a) Bonds or other interest-bearing obligations of the United States, or those for the payment of the principal and interest on which the faith and credit of the United States is pledged;
   (b) Stocks, bonds, or other interest-bearing or dividend-yielding obligations issued or guaranteed as to the payment of principal and interest or dividend by any instrumentality presently or hereafter incorporated by authority of an Act of Congress;
   (c) General obligation bonds or revenue bonds issued and guaranteed as to payment of principal and interest by any state, county, or municipal governments legally authorized to issue such instruments of indebtedness;
Investments in accordance with subsections (7) and (9) of this section are subject to KRS 287.280 and 287.290. For purposes of computing the maximum investment of a bank in bonds, notes, and other investments, book value shall be used. For deep discount bonds or zero coupon bonds, accreted book value shall be used.

Section 4. KRS 287.180 is amended to read as follows:

(I) Banks authorized under the laws of this state may, except as provided in subsections (2) or (3) of this section, exercise, only at their principal office, powers necessary to carry on the business of banking by discounting and negotiating notes, drafts, bills of exchange and other evidences of debt, and by purchasing bonds, receiving deposits and allowing interest on these items, buying and selling exchange, coin, and bullion, and lending money on personal or real security.

(2) A bank may establish a branch in a county in which its principal office or an existing branch is located and may exercise all of the powers conferred in subsection (1) of this section at the branch. A bank, except for a bank that the commissioner may designate by the promulgation of administrative regulations, shall apply to the commissioner for permission to establish a branch. Any corporation presently or after July 13, 1990, engaged in the business of banking, and meeting the requirements of this subsection, may apply to the commissioner for permission to establish, within any county in which its principal office or an existing branch is located, a branch at which all of the powers conferred in subsection (1) of this section may be exercised. Before the commissioner shall approve or disapprove any application made under this subsection the commissioner shall ascertain and determine that the public convenience and advantage will be served and promoted and that there is reasonable probability of the successful operation of the branch based upon the financial and managerial impact of the branch on the bank establishing the branch. The following conditions shall apply to applications for branches:

(a) The permission to open a branch shall lapse one (1) year after the commissioner has rendered a final order as defined in KRS 13B.010, unless it shall have been opened and business actually begun in good faith. If, for reasons beyond the control of the applicant, the branch is not opened within this time period, permission to open the branch may, with the approval of the commissioner, be extended for any period of time the commissioner deems to be necessary; and
(b) An application to establish a branch office shall be approved or disapproved by the commissioner based upon the facts existing at the date of filing of the application, except for the financial condition of the bank proposing to establish a branch office, which condition shall be subject to review until an order ruling on the application is made.

(3) Any corporation which on January 1, 1966, was engaged in operating an agency or branch bank may continue to retain and operate the agency or branch bank under the general banking laws, and the requirements set forth in this section in respect to capital shall not apply to any existing agency or branch bank but only as to those agencies or branch banks which may be established in the future in accordance with terms of this section.

(4) The provisions of this section shall not be construed to prohibit the merger of banks in the same county and the operation by the merged corporation of the banks, nor to prohibit the sale of any bank to, and the purchase by, any other bank in the same county and the operation of the bank by the purchasing bank as a branch, provided the commissioner shall determine that the public convenience and necessity will be served by the operation, and provided further that, at the time of the merger or purchase, each of the banks involved shall have been in operation for a period of five (5) years or more. The bank which does not survive the merger shall surrender its charter.

(5) Any national banking association or any state bank member of the Federal Reserve system whose principal office is located in this state may do all things and perform all acts which state banks are permitted to do or perform under this section, subject to the conditions and restrictions provided for banks as to exercise of these powers.

(6) When a branch or agency bank has once been established any operation of the branch or agency bank shall not be discontinued, and the branch or agency bank shall not be closed until after ninety (90) days' notice in writing to the commissioner. In the discretion of the commissioner the branch or agency bank proposing to discontinue operation may be required to give notice of the date when its operation will cease.

Section 5. KRS 287.185 is amended to read as follows:

A bank may move its principal office or a branch from one location to another. A bank, except for a bank that the commissioner may designate through the promulgation of administrative regulations, shall apply to the commissioner for approval to relocate its principal office or a branch. No branch or principal office of any bank shall be moved from one location to another without the approval of the commissioner. Before the commissioner shall approve or disapprove any change of location he shall ascertain and determine that the public convenience and advantage will be served and promoted and that there is a reasonable probability of the successful operation of the branch or principal office at the new location.

Section 6. KRS 287.900 is amended to read as follows:

For purposes of this section and KRS 287.905:

(a) "Bank" means any institution organized under this chapter, the banking laws of another state, or the National Bank Act, as amended, to do a banking business. However, it shall not include an "interim bank" chartered solely for the purpose of facilitating the acquisition of an existing bank unless the existing bank has been in existence for less than five (5) years;

(b) "Bank holding company," "company," and "control" have the meanings accorded them in the Federal Bank Holding Company Act of 1956, as amended (12 U.S.C. secs. 1841 et seq.). "Control" may be acquired by acquisition of voting securities, by purchase of assets, by merger or consolidation, by contract, or otherwise;
(c) "Individual" means a natural person, partnership, association, business trust, voting trust, or similar organization. Individual does not include a corporation; and

(d) "Deposit" has the meaning accorded it in the Federal Deposit Insurance Act, as amended, and regulations promulgated thereunder; excluded, however, from deposits are all interbank deposits and all deposits in foreign branches and international banking facilities, as shown in the reports made by all federally-insured depository institutions to their respective supervisory authorities.

(2) Any individual, or any bank holding company having its principal place of business in this state, may acquire control of one (1) or more banks or bank holding companies wherever located, except that no individual, who on July 13, 1984, controls a bank or bank holding company wherever located, and no bank holding company wherever located, may acquire, directly or indirectly, control of greater than fifty percent (50%) of the voting securities of a bank having its principal place of business in this state if the bank was chartered after July 13, 1984, and if, at the time of the acquisition, the bank has been in existence less than five (5) years. The provisions of this subsection shall not prohibit the organization of a one (1) bank holding company for the purpose of acquiring control of a bank even if the bank was chartered after July 13, 1984, and has been in existence less than five (5) years at the time of the acquisition.

(3) No individual or bank holding company wherever located may acquire control of any bank or bank holding company if, upon the acquisition, the individual or bank holding company would control banks in this state holding more than fifteen percent (15%) of the total deposits and member accounts in the offices of all federally-insured depository institutions in this state as reported in the most recent June 30 quarterly report(s) made by the institutions to their respective supervisory authorities which are available at the time of the acquisition.

(4) The limitations set forth in this section or any other provision of this chapter or any administrative regulation promulgated thereunder, as now in effect or amended after July 13, 1984, shall not apply to the acquisition of a bank if, in his or her discretion, the commissioner, if the bank is organized under the laws of this state, or the comptroller of the currency, if the bank is a national bank, determines that an emergency exists and the acquisition is appropriate in order to prevent the probable failure of the bank which is closed or is in danger of closing.

(5) The provisions of this section shall not be construed to prohibit or restrict the merger or consolidation of banks or bank holding companies having their principal places of business in the same county and the operation by the merged or consolidated corporation of the banks, nor to prohibit the sale of any bank or bank holding company to, and the purchase thereof by, any other bank or bank holding company with its principal place of business in the same county and the operation of the bank as a branch so long as the provisions of KRS 287.180(4) have been satisfied.

Section 7. KRS 287.920 is amended to read as follows:

(1) As used in this section, unless the context requires otherwise:

(a) "Interstate merger transaction" means the merger or consolidation of banks with different home states, and the conversion of branches of any bank involved in the merger or consolidation into branches of the resulting bank; and

(b) "Resulting bank" means a bank that has resulted from an interstate merger transaction under this section.

(2) A Kentucky state bank may establish, maintain, and operate one (1) or more branches in a state other than Kentucky in accordance with an interstate merger transaction in which the Kentucky state bank is the resulting bank, or if the other state permits, by acquisition of a branch or branches in the other state. Not later than the date on which the required application for the interstate merger transaction or branch acquisition is filed with the responsible federal bank supervisory agency, the applicant shall file an application on a form prescribed by the commissioner and pay the fee prescribed by KRS 287.480. The applicant shall also comply with the applicable provisions of KRS
287.180(2) and the commissioner shall base his or her approval or disapproval in the same manner as prescribed in KRS 287.180(2).

(3) An out-of-state state bank may establish, maintain, and operate one (1) or more branches in Kentucky in accordance with an interstate merger transaction in which the out-of-state state bank is the resulting bank. Not later than the date on which the required application for the interstate merger transaction is filed with the responsible federal bank supervisory agency, the applicant shall file an application on a form prescribed by the commissioner, pay the fee prescribed by KRS 287.480, and agree in writing to comply with the laws of this state applicable to its operation of branches in Kentucky. The applicant shall also comply with the applicable provisions of KRS 287.180(2) and the commissioner shall base his or her approval or disapproval in the same manner as prescribed in KRS 287.180(2).

(4) The bank to be acquired in an interstate merger transaction under the provisions of subsection (3) of this section shall have been involved in operation for a period of five (5) years or more. No interstate merger transaction under subsections (2) or (3) of this section shall be approved if the transaction would result in a bank holding company having control of banks or branches in this state holding more than fifteen percent (15%) of the total deposits and member accounts in the offices of all federally-insured depository institutions in this state as reported in the most recent June 30 quarterly report made by the institutions to their respective supervisory authorities which are available at the time of the transaction.

(5) An individual or bank holding company that controls two (2) or more banks may, from time to time, combine any or all of the commonly controlled banks in this Commonwealth into and with any one (1) of the banks, and thereafter the surviving bank shall continue to operate its principal office and may operate the other authorized offices of the banks so combined as branches of the surviving bank.

(6) A branch of an out-of-state state bank may conduct any activities that are authorized under the laws of this state for state banks. Additionally, the branch of an out-of-state state bank is authorized to conduct any activities relating to the administration of trusts that are authorized under the laws of its home state, if the activities are conducted in conformity with the laws of its home state.

(7) A branch of a Kentucky state bank located in a host state may conduct any activities that are:
   (a) Authorized under the laws of the host state for banks chartered by the host state; or
   (b) Authorized for branches of national banks located in the host state, but whose principal location is in a state other than the host state.