

MINUTES OF THE SENATE FINANCIAL INSTITUTIONS AND INSURANCE

The meeting was called to order by Chairman Ruth Teichman at 9:30 A.M. on January 12, 2005 in Room 234-N of the Capitol.

Committee members absent: James Barnett- excused

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

Conferees appearing before the committee: Clancy Norris, Office of the State Bank Commissioner
Jerel Wright, Kansas Department of Credit Unions

Others attending: See attached list.

The Chair opened the meeting with introductions of the committee members and staff. The Chair than announced her proposed meeting days which will be Tuesdays, Wednesdays and Thursdays. Madam Chair set out some of the ground rules for the procedures to follow when introducing a bill to the committee.

The Chair announced that Sandy Praeger, Insurance Commissioner, Kansas Legislative Research Department and a representative from SRS will be here next Tuesday, January 18.

The Chair announced there would be no meeting on Wednesday, January 20, but instead the Kansas Health Institute and Kansas Legislative Research Department have put together a joint committee to discuss health care issues starting at 11:00 a.m. and ending at 3:00 p.m. Everyone from the legislature is welcome to attend.

The Chair announced there will be no meeting on Thursday, January 21.

Bill introductions on Tuesday, January 18.

Clancy Norris, Bank Commissioner, testified on the condition of the Office of the State Bank Commissioner pointing out some of the challenges and changes. The Commissioner introduced a few of his key staff including Judi Stork, Kevin Glendening, Louise Monell and Sonya Allen.

The Commissioner highlighted the number of state banks and the number of agency staff.

The Commissioner discussed the BSA (Bank Secrecy Act).

He than touched on the CML (Consumer Mortgage Lending) - staffing and changes to accommodate this.

Senator Wysong inquired as to the number of staffing total.

Madam Chair introduced Jerel Wright, Kansas Department of Credit Unions. Mr. Wright explained the Department of Credit Unions financial regulatory agency authorized by legislature to provide for management, control, regulation and general supervision of state chartered Kansas credit unions.

Jerel Wright, Credit Union Administrator, offered a written testimony. (Attachment 1)

Chair, Senator Teichman asked if in the banking area, have credit unions increased to CAMELS with the addition of sensitivity of rates.

Seeing no other business before the committee the meeting was adjourned at 10:22 a.m.

FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST

DATE: January 12, 2005

NAME	REPRESENTING
John Federico	KCUA
Clancy Norris	OSAC
Travis Monell	OSBC
Frank	KID
Michael Steina	KID
Jeral Wright	Ks Dept of Credit Unions
Jack Halverson	Ks Dept of Credit Unions
Bud Burke	A.C. Financial
David Roby	Intern for Senator Barone
Lee Wright	Farmers Ins.
Doug Wareham	KBA
Kaelly Olsen	KBA
Renée Murray	CBA
Matt Goddard	HCBA
Natalie Haag	Security Benefit Corp.
Karin Ann Rower	Loan Max, KATP
Whitney Damsa	KS Payday Loan Assn.

Before the

Senate Financial Institutions and
Insurance Committee

January 12, 2005

Jerel Wright
Credit Union Administrator

Attachment 1
1/12/05
FII

Kansas Department of Credit Unions

History

The Kansas Department of Credit Unions (KDCU) is the state credit union financial regulatory agency authorized by the 1968 Kansas Legislature to provide for management, control, regulation and general supervision of state-chartered, Kansas credit unions.

Regulation of credit unions was performed under the supervision of the Kansas Bank Commissioner beginning in 1929 when Kansas law authorized the organization of credit unions and continued until 1968, when the authority to regulate credit unions was transferred to the Kansas Credit Union Administrator.

KDCU is fully funded as a fee fund agency operating solely on the revenue produced through fees collected from state-chartered credit unions examined and regulated by the agency.

All fees received by the agency are remitted to the state treasurer with 20% credited to the state general fund and the balance credited to the credit union fee fund.

Today, the Department has 13 employees consisting of an Administrator, a Financial Examiner Administrator, four Financial Examiner Principals, three Financial Examiner Seniors, two Financial Examiners, and two Administrative Specialists. (Attachment A offers an organization chart for the Department)

Kansas Department of Credit Unions

KDCU supervises and examines 95 natural person credit unions with assets in excess of \$2.6 billion and two corporate credit unions with assets in excess of \$30 billion.

Kansas also has 26 federal-chartered credit unions with assets in excess of \$335 million.

State-chartered credit union share deposits are federally insured through the National Credit Union Share Insurance Fund, an arm of the National Credit Union Administration (NCUA).

Agency Function

KDCU is charged by law to examine every Kansas state-chartered credit union to ensure financial stability and compliance with state and federal laws and regulations.

The National Association of State Credit Union Supervisors (NASCUS) accredits the Department, recognizing the Department's examination standards as equivalent to the standards established by the NCUA, the federal credit union regulator/insurer.

The Department was accredited by NASCUS for the first time in 1995, re-accredited in the year 2000 and will stand for our third accreditation review in March 2005, when the NASCUS accreditation team will conduct our on-site review.

The Department grants new charters and mergers, provides for liquidation procedures when necessary and handles consumer complaints.

Kansas Department of Credit Unions

The Department is required to examine each credit union at least once every 18 months. Currently, the average period between examinations is just under a 13-month cycle, a standard the department has maintained throughout the years 2002, 2003 and 2004.

The Department uses a CAMEL rating scale to evaluation the financial condition of a credit union.

A CAMEL evaluation consists of a review of Capital or Net Worth, Asset Quality, Management, Earnings and Liquidity.

A credit union with a 3 or 4 CAMEL rating receive an examination no less than 12 months from their last exam.

The Department continues a major initiative regarding risk focused examinations which focus examination time on areas of highest risk.

The risk focused exam concentrates on seven areas: Credit Risk, Interest Rate Risk, Liquidity Risk, Transaction Risk, Compliance Risk, Strategic Risk and Reputation Risk (Attachment B offers a brief description of each risk area).

Administrator Responsibilities

The Administrator is bound with the responsibilities of management, control, regulation and general supervision of credit unions. This includes requiring every credit union to submit to an examination by the Department, consistent with the authority of the NCUA as insurer.

Kansas Department of Credit Unions

The Administrator may:

- Require an independent audit to be performed under standards established by the agency.
- Approve the merger, the sale or purchase of assets or the voluntary and involuntary dissolution of a credit union.
- Issue orders for corrective action for violations of law.
- Become the conservator for any credit union deemed insolvent and may appoint a liquidation agent.
- Suspend from office and prohibit from further participation in any manner in the conduct of the affairs of a credit union any director, officer, committee member or employee who has committed any violation of a law, rules and regulations or of a cease and desist order or who has engaged in or participated in any unsafe or unsound practice in connection with a credit union or who has committed or engaged in any act, omission or practice in connection with the credit union which constitutes a breach of that person's fiduciary duty as such director, officer, committee member or employee, when the administrator has determined that such action or actions have resulted or will result in substantial financial loss or other damage that seriously prejudices the interest of the members.
- Recommend the removal of directors, supervisory or credit committees or submit findings of dishonest, reckless or incompetent performance of duties to the board of directors, supervisory or credit committee or to the credit union members at a general meeting of the shareholders.

Kansas Department of Credit Unions

- Suspend the charter, merge, liquidate, or take possession of any credit union which fails to federally insure share deposits, which loses coverage or allows such coverage to lapse.
- Authorize any credit union to engage in any activity in which such credit union could engage were they operating as a federal credit union.
- Require a credit union to establish net worth accounts as set by law.
- Establish rules and regulations governing the powers of corporate credit unions.
- Establish rules and regulations governing loans to credit union members, directors and members of the supervisory or credit committees.
- Approve the purchase, lease or rental of real estate and improvements by credit unions.
- Disclose or approve the disclosure of any confidential information secured or produced by the administrator in making an investigation or examination of a credit union.
- Approve a credit union's place of business or change in place of business.
- Approve a conversion of a state-chartered credit union to a federal charter.
- Authorize a credit union organized in another state or under the federal Credit union act to do business in Kansas.

Kansas Department of Credit Unions

In addition, the Administrator has:

- General charge of the work of the Credit Union Council and shall keep a permanent record of all meetings and proceedings of the council at the office of the administrator.
- Administrative supervision of all agency employees.

Examination Process

Each Kansas credit union is examined at least once every 18 months.

The needs and condition of a particular credit union determine the length of time between examinations.

Our on-site examination format is based on a system called AIRE (Automated Integrated Regulatory Examination System), which is used by both the state and federal credit union regulators and provides for continuity between the state and federal examinations.

KDCU financial examiners are recognized as having requisite examination skills qualifying the Department for Accreditation by the National Association of State Credit Union Supervisors.

NCUA defers the examination of Kansas's state-chartered credit unions entirely to KDCU because the Department staff demonstrates the ability to conduct examinations equal in scope to any examination by the federal insurer.

Kansas Department of Credit Unions

Federal insurance examiners participate in joint examinations when KDCU and federal insurance fund representatives determine the need for a joint examination.

The examination format consists of a review of the credit union's core financial condition along with a regulatory compliance audit.

As mentioned earlier, KDCU issues a CAMEL rating which encompasses the review of Capital, Asset Quality, Management, Earnings, and Asset-Liability Management.

Each review includes a comparison of the credit union's financial ratios to standards desired by regulators, in addition to peer group statistics.

The examination report incorporates an examiner's findings into a Document of Resolution, which identifies the areas to be addressed by the credit union's board of directors.

All resolution items are tracked by KDCU for completion with follow-up contacts scheduled to review the credit union's progress.

As part of the regulatory process, KDCU requires every credit union to remit a quarterly financial report (call report) to update the Department and the federal insurer.

Legislative Post Audit Study

On December 13, 2004, the Kansas Legislative Post Audit Committee ordered a review of the Department.

The Post Audit Scope Statement is offered on Attachment C.

Kansas Department of Credit Unions

Credit Union Council

The Council serves as an advisory group to the Administrator on issues and needs of credit unions.

The Council reviews proposed legislation and regulations under consideration by the agency as well as the Department's biennial budget.

Each of the seven members of the Council is appointed by the Governor for a term of three years and each may serve for two consecutive three-year terms.

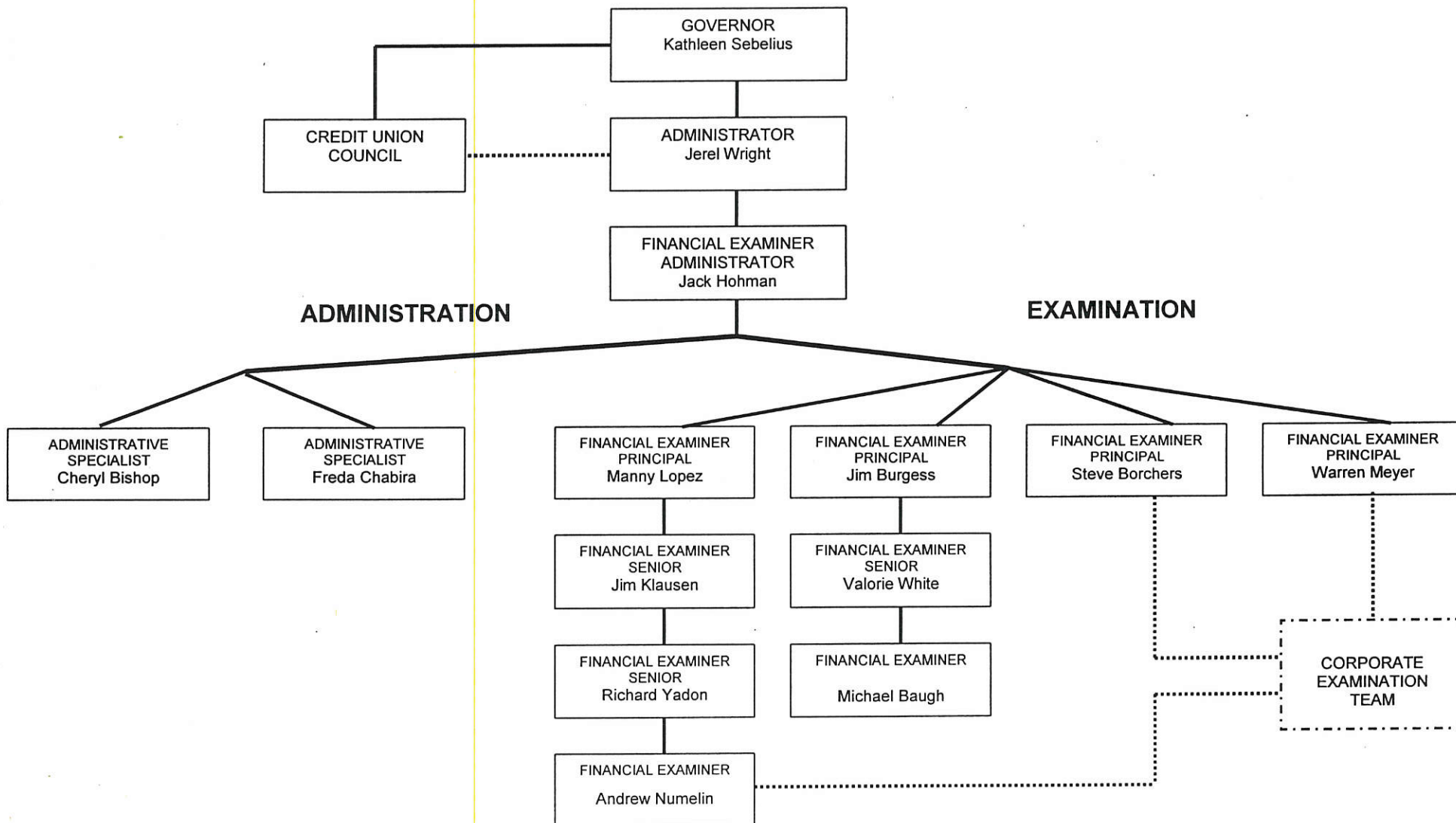
Five of the seven members shall be officers of state-chartered credit unions and four of these five Council members must be from different congressional districts and two are public members.

No more than four of the Council members may be from the same political party.

The Council holds one regular council meeting during each quarter of the year and may hold other meetings, as the Council considers necessary.

1-10

KANSAS DEPARTMENT OF CREDIT UNIONS ORGANIZATIONAL CHART



The Seven Supervisory Risks

Credit Risk - risk of default on expected repayments of loans or investments.

Interest Rate Risk - risk that changes in market rates impact the income statement and balance sheet.

Liquidity Risk – risk of an inability to fund obligations as they come due.

Transaction Risk – risk of fraud or operational problems in transaction processing that result in an inability to deliver products, remain competitive, and manage information.

Compliance Risk - risk of violations and noncompliance with laws, rules, regulations, or ethical standards resulting in fines, penalties, payment or damages.

Strategic Risk – risk of adverse business decisions (actions or inactions), improper implementation, or lack of responsiveness to industry changes.

Reputation Risk – risk of being the target of negative public opinion or perception leading to a loss of confidence and/or severance of relationships.

**POST AUDIT COMMITTEE
SCOPE STATEMENT**

**Regulation of Credit Unions: Reviewing the Department of Credit Unions'
Procedures for Ensuring Institutions' Safety, Soundness, and Compliance with the Law**

State law says that "any seven persons, residents of the state of Kansas, may apply to the administrator of the credit union department for permission to organize a credit union." And that "credit union organizations shall be limited to groups...having a common bond of occupation or association or to groups residing within a well-defined neighborhood, community or rural district." The Department of Credit Unions examines all state-chartered credit unions to ensure that they are financially stable and in compliance with state and federal laws and regulations. The Department also grants new charters and mergers, handles consumer complaints, and provides liquidation procedures when necessary. The credit union administrator is appointed by the Governor, with Senate confirmation, and serves a four-year term. A separate, seven-member Credit Union Council, appointed by the Governor, serves as an advisor to the credit union administrator. The Department is funded by fees from each State-chartered credit union.

In recent years, credit unions reportedly have expanded their range of services, spurred in part by regulatory changes and the advent of online services. Legislators have expressed an interest in knowing whether the Department of Credit Unions is providing adequate oversight of credit unions' expanded services consistent with the Department's current statutory authority, whether Kansas consumers are adequately protected, and whether the Department has adequate procedures for regulating expansions or mergers of credit unions.

Other legislative concerns have been raised about whether the Department has allowed out-of-state credit unions to operate branches in Kansas without reciprocity agreements allowing Kansas credit unions to operate in those states: the number of these out-of-state branches, the extent to which they have acquired Kansas credit unions, the impact these acquisitions may have on the Department's ability to carry out its mission; and whether State laws or regulations or Department actions may put Kansas-based credit unions at a competitive disadvantage or encourage those acquisitions. A performance audit in this area would address the following questions:

- 1. How have Kansas credit union services changed in recent years, and to what extent have credit unions grown in comparison with other segments of the financial-services industry?** To answer this question, we would review relevant literature and interview industry and regulatory officials to determine how and why credit unions have broadened their service offerings in recent years, and how those changes have affected credit unions' share of the financial-services business. We would attempt to describe this growth in terms of the number of institutions or facilities, the percentage increase of total deposits over the past few years, how those increases compare to other financial institutions, or other available measures.

- 2. Does the Department of Credit Unions have adequate procedures for ensuring the safety and soundness of credit unions, and how do they compare to oversight procedures for other financial institutions?** To answer this question, we would review the Department's written procedures and interview officials and staff to determine what the Department does to oversee and regulate the various services offered by Kansas credit

unions. We would compare those procedures to those employed by the Banking Department and Securities Commissioner, and conclude whether the credit union procedures are similar to or more or less stringent than those governing other financial institutions. We would examine how the Department governs the merger of credit unions, or deals with requests for new charters or branches, including any provisions for public input. We also would examine what the department does to ensure that credit unions' memberships comply with the "common bond" provision of Kansas law. We would review the Department's recent regulatory activities for a sample of credit unions to determine whether the Department follows its procedures. We also would review any recent enforcement actions to determine whether they appeared to be appropriate, timely and effective. We would perform other test work as required.

- 3. Are the Department's actions in relation to credit unions' expanded services consistent with State law?** To answer this question, we would review Department records for a sample of recent actions, particularly those related to approvals of new or expanded credit union financial services. We would review applicable state law, and determine whether the Department's approvals or other actions were within the scope of its authority.
- 4. Is the Department effectively regulating the influence of out-of-state credit unions?** To answer this question we would review applicable laws and regulations, Department policies and procedures, and other relevant records, and interview or survey Department staff and credit union officials as needed. We would attempt to determine which states the Department has allowed to operate branch credit unions in Kansas, and why, whether those states have reciprocity agreements with Kansas, how many out-of-state credit unions are operating branches in Kansas, how many branches have been opened and where, and how many Kansas-based credit unions these out-of-state branches have acquired. If possible, we would try to determine the amount of Kansas membership assets these merged credit unions now control. We would determine the requirements authority, and restrictions placed on in-State and out-of-State credit unions, and whether those requirements seem to treat out-of-State credit unions more favorably or give them any advantage over Kansas-based credit unions. If we identify any significant inequities, we would try to determine whether they've resulted in a significant financial impact to the State, and to identify what changes may be needed to help level the playing field for Kansas credit unions. In addition, for a sample of acquisitions we would determine what actions the department took – either directly or indirectly – that could have affected the merger decision, and assess whether those actions appeared to be reasonable and appropriate. We would perform other analyses and testwork as needed.

Estimated completion time 12-14 weeks, depending on the availability of data.