

MINUTES OF THE SENATE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

The meeting was called to order by Chairman Ruth Teichman at 9:30 A.M. on January 24, 2007 in Room 234-N of the Capitol.

All members were present.

Committee staff present:

Melissa Calderwood, Kansas Legislative Research Department  
Terri Weber, Kansas Legislative Research Department  
Ken Wilke, Office of Revisor of Statutes  
Bev Beam, Committee Secretary

Conferees appearing before the committee:

Joe Lawhon, Legislative Post Audit  
John Smith, Kansas Dept. Of Credit Unions  
Jerel Wright, Kansas Credit Union Assn.  
Doug Wareham, Kansas Bankers' Assn.  
Stuart Little, Community Bankers' Assn.  
Matt Goddard, Heartland Community Bankers

Others attending:

See attached list.

The Chair welcomed everyone to the meeting.

Sonya Allen of the State Banking Commissioner's Office introduced a bill to add the office of the state bank commissioner, in addition to the State Banking Board, to the list of exempt entities.

Senator Steineger moved the bill be introduced. Senator Brungardt seconded. Motion carried.

The Chair asked for the Legislative Post Audit Credit Union Report. Joe Lawhon, Auditor, stated the following:

- The Department of Credit Unions was established in 1968 to oversee the safety and soundness of Kansas chartered credit unions.
- Since 1995, the number of financial institutions operating in Kansas dropped by 20%.
- Kansas-based credit unions' share of total assets, deposits, and loans have remained fairly constant over the years.
- State laws and regulations govern the basic services that Kansas-chartered credit unions can offer to their members.
- Credit unions have expanded the services they offer in a number of ways over the past 10 years.
- Credit unions also have expanded who they serve by increasing their "field of membership."
- The Department has adopted federal regulators' examination process and system for rating credit unions' financial conditions.
- The Department is examining credit unions on a timely basis, but needs to address issues related to examiner independence and follow-up actions.
- Staff's review of quarterly financial reports can be more complete.
- The Department lacks adequate guidance for when an enforcement action should be taken.

CONTINUATION SHEET

MINUTES OF THE Senate Financial Institutions and Insurance Committee at 9:30 A.M. on January 24, 2007 in Room 234-N of the Capitol.

- Managers of credit unions surveyed were satisfied with the Department's actions related to credit unions.
- The Department's oversight procedures are similar to those of the State Bank Commissioner's Office.
- Between 1998 and 2005, eight Kansas chartered credit unions merged with six out-of-state credit unions.
- The Department appears to have exercised reasonable oversight over mergers involving credit unions from other states.
- Currently, there doesn't seem to be a significant competitive advantage for out-of-state credit unions that operate in Kansas.

Based on our reviews, and given its limited statutory responsibility related to mergers, we didn't see anything to suggest that the Department wasn't effectively regulating the influence of out-of-state credit unions. The only issue we identified related to providing better documentation of the actions Department staff took when reviewing merger documents. Although out-of-state credit unions operating in Kansas have paid lower regulatory fees, the 2005 Legislature required them to pay partial fees to Kansas on top of the regulatory fees they pay to their home states.

To provide greater assurance that Department staff properly review merger agreements and supporting materials, the Department should require that the scope and nature of those reviews be documented. Depending on the materials reviewed, this could range from initialing documents to including in the file the results of any financial analyses performed.

The Chair next called on John Smith, Administrator, Kansas Department of Credit Unions. Mr. Smith said KDCU has 12 employees consisting of an Administrator, a Financial Examiner Administrator, two Financial Examiner Principals, four Financial Examiner Seniors, two Financial Examiners and two administrative specialists.

Kansas chartered credit unions are examined at least once every 18 months. The average examination cycle is 13 months. At the conclusion of the examination, credit unions are given a risk rating low, moderate or high. The risk focused examination concentrates on seven areas:

- Credit risk
- Interest Rate Risk
- Liquidity Risk
- Transaction Risk
- Compliance Risk
- Strategic Risk and
- Reputation Risk

Credit unions are also given a CAMEL rating from 1 (the lowest risk) to five, based on the CAMEL evaluation system (capital or Net worth, Asset Quality, Management, Earnings and Liquidity).

The examination format is based on a system called AIRES (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. Each review includes a comparison of the credit union's financial ratios to standards desired by regulators, in addition to peer group statistics.

The Administrator is bound with the responsibilities of management, control, regulation and general supervision of credit unions. Federal share insurance examiners participate in joint examinations with KDCU examiners.

## CONTINUATION SHEET

MINUTES OF THE Senate Financial Institutions and Insurance Committee at 9:30 A.M. on January 24, 2007 in Room 234-N of the Capitol.

The governor appointed seven-member Kansas Credit Union Council serves as an advisory group to the Administrator on issues and needs of credit unions. (Attachment 1)

Jerel Wright testified on behalf of the Kansas Credit Union Association. Mr. Wright's testimony focused on four questions contained in the Legislative Post Audit Performance Audit Report:

1. Credit union growth - the report indicates credit union growth has remained constant over the years, representing about five - six percent of the total held by Kansas based financial institutions.

2. Credit union services - the report indicates credit union services have expanded, not so much by the type of services, but through the delivery method of services and by the number of credit unions offering services. The report contends the Department's interpretation of the credit unions' membership requirements doesn't conform to state law.

3. Procedures for credit union safety and soundness and oversight - the report indicates that the Department has adequate procedures for ensuring the safety and soundness of credit unions and oversight procedures compare favorably to oversight procedures for other financial institutions.

4. Regulation of out-of-state credit unions - the report indicates that the department has effectively regulated the influence of out-of-state credit unions.

We find the Report provides considerable evidence that the Department is appropriately regulating Kansas credit unions and leaves mainly one issue with which we disagree. The Report seems to fall well short of providing supporting evidence for the critical comments regarding the Department's interpretation of credit union membership requirements. (Attachment 2)

The Chair asked Doug Wareham, Senior Vice President-Government Relations for his testimony on behalf of Kansas Bankers Association.

Mr. Wareham stated that the report sheds light on some very important and telling facts that warrant further consideration and action by the F I & I legislative committee:

1. State-chartered credit unions in Kansas are benefitting from loosely interpreted Kansas statutes regarding credit union common bonds/fields of membership.

2. Banks are subjected to a higher level of scrutiny and greater transparency requirements than credit unions when a merger/acquisition is proposed or when attempting to branch into a new market.

Mr. Wareham requested that the Senate Financial Institutions and Insurance Committee request approval for an interim legislative study that will afford the opportunity for the concerns highlighted in the Post Audit Report, as well as the related issues stated today, to be carefully and critically examined in an open and productive forum. (Attachment 3)

Next to testify was Stuart Little of Community Bankers Association of Kansas. Mr. Little said the members of CBA were pleased the audit report revealed that, for the most part, the department had followed adequate procedures to ensure the safety and soundness of credit unions, but that some improvements are needed. For that reason, CBA members request a more extensive review of non-compliance with state law regarding obvious field-of-membership expansions. He said CBA requests the committee propose and carry out a more extensive review that could occur during the interim as a study topic for the committee. (Attachment 4)

Matthew Goddard, on behalf of Heartland Community Bankers Association, testified that the audit report appears to be well done and very well researched; however, Heartland has a slight disagreement on what the report says are the two primary factors that distinguish credit unions from other financial institutions. He said the report casts serious doubt as to whether the Department of Credit Unions is applying Kansas law or instead choosing to ignore it. He said Heartland Community Bankers Association suggests that an interim study be

CONTINUATION SHEET

MINUTES OF THE Senate Financial Institutions and Insurance Committee at 9:30 A.M. on January 24, 2007 in Room 234-N of the Capitol.

requested to examine the Performance Audit Report and the issues it raises. (Attachment 5)

The Chair said there would be a continuation of the Legislative Post Audit Report on credit unions on Tuesday, January 30, 2007.

The meeting adjourned at 10:30 a.m.

FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST

DATE: 1-24-07

NAME	REPRESENTING
Haley Dalee	KCUA
Terel Wright	KCUA
Rob Idubee	Bwcu
Doug Wareham	KBA
Craig Messler	First National Bank
Kathy Olsen	KBA
Shari Weber	CBA
Bert Sued	Polsinelli
Stuart Little	CBA
GARY REGOLI	Bwcu
Don Murray	Federico Consulting
Paul Helman	His Dept C U's
John P. Amitt	KDCU
Marta March	KCUA
Larry Jensen	CESSNA CU
Sonya Allen	Office of State Bank Comm
Judi Stork	"

**Written testimony for the**  
**Senate Financial Institutions and Insurance**  
**Committee**

**January 24, 2007**

**John P. Smith**  
**Administrator**  
**Kansas Department of Credit Unions**

*FI&I*  
*1-24-07*  
*Attachment 1*

**General information about the Kansas Department of Credit Unions**

In 1929 Kansas law authorized the organization of credit unions; a 1968 amendment formed Kansas Department of Credit Unions (KDCU). KDCU is fully fee funded.

KDCU has 12 employees consisting of an Administrator, a Financial Examiner Administrator, two Financial Examiner Principals, four Financial Examiner Seniors, two Financial Examiners, and two Administrative Specialists.

KDCU is the safety and soundness regulator for 92 natural person credit unions with assets in excess of \$2.8 billion and a corporate credit unions with assets in excess of \$300 million. 494,305 individuals are members of Kansas state chartered credit unions. Shares or deposits are federally insured through the National Credit Union Share Insurance Fund. The 10 largest Kansas chartered credit unions, 11% in number, hold \$1,624,650,994 in assets, or 59% of the total assets.

Seven Kansas chartered credit unions qualify and are designated as low-income credit unions. To qualify for low-income designation, the credit union must serve a geographic area where a majority of residents fall at or below 80 percent of the median household income for the nation as established by the Census bureau. These credit unions can apply for special assistance programs.

71.5% of total assets or \$2,007,968,605 are in loans to credit union members. The types of loans are:

New and used automobile loans	\$1,119,487,906 = 55.8% of total loans
Real estate loans	\$ 635,126,469 = 31.6% of total loans
Credit card and unsecured loans	\$ 122,763,097 = 6.1% of total loans
Member business loans	\$ 59,536,111 = 3.0 % of total loans

KDCU is accredited by The National Association of State Credit Union Supervisors (NASCUS).

Kansas chartered credit unions are examined at least once every 18 months. The average examination cycle is at 13 months. At the conclusion of the examination credit unions are given a risk rating of Low, Moderate or High. The risk focused examination concentrates on seven areas:

- ✓ Credit Risk,
- ✓ Interest Rate Risk,
- ✓ Liquidity Risk,
- ✓ Transaction Risk,
- ✓ Compliance Risk,
- ✓ Strategic Risk and
- ✓ Reputation Risk

Credit unions are also given a CAMEL rating from 1 (the lowest risk) to 5 based on the CAMEL evaluation system (Capital or Net Worth, Asset Quality, Management, Earnings and Liquidity). 12 percent of the credit unions are rated as CAMEL 1, 60 percent CAMEL 2, 21 percent CAMEL 3 and 7 percent as CAMEL 4. There is no CAMEL 5 rated credit union.

The examination format is based on a system called AIREs (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. Each review includes a comparison of the credit union's financial ratios to standards desired by regulators, in addition to peer group statistics.

The Administrator is bound with the responsibilities of management, control, regulation and general supervision of credit unions. Federal share insurance examiners participate in joint examinations with KDCU examiners.

The governor appointed seven-member Kansas Credit Union Council serves as an advisory group to the Administrator on issues and needs of credit unions.



**Legislative Division of Post Audit**

The Legislative Division of Post Audit (LPA) in 2006 performed a performance audit of KDCU issuing a report in May 2006. KDCU has addressed the recommendations contained within the report through changes in policies and procedures as described in our response to each specific recommendation. LPA's recommendations and KDCU's responses to each follow.

**Recommendations 1a and b, Page 16 of the Report:**

1. To ensure that it is appropriately limiting credit unions' memberships, the Department of Credit Unions should do the following:
  - a. Enforce the current provisions of K.S.A. 17-2205 which limit such memberships to "groups...having a common bond of occupation or association or to groups residing within a well-defined neighborhood, community or rural district." The language of this statute wouldn't appear to allow a credit union's membership to include the entire State, nor to allow a credit union to serve a combination of groups with common occupational bonds and groups with geographic bonds. In addition, based on the U.S. Supreme Court's 1998 ruling, Kansas law as written also may not allow credit unions to have multiple common bonds within either an occupational group or a geographic group.
  - b. If the Department thinks it's important to the safety and security of credit unions to allow their "fields of membership" to be expanded in the ways it has allowed them to expand over the years, the Department should seek to amend State law accordingly. Such amendments should address the issue of allowing a Statewide common bond, multiple common bonds, or a combination of groups with common occupational bonds and groups with geographic bonds. Unless and until the law is changed, the Department should enforce the provisions of the law as written.

**KDCU Response:**

Since the establishment of the Department in 1968, various Department Administrators have interpreted K.S.A. 17-2205 differently as required to ensure credit union safety and soundness. Although KDCU cannot speak for former Administrators, we suggest their decisions were made in the best interest of credit union safety and soundness. Continuity of services to members, continued stability of credit unions during adverse economic times or when the financial services industry was undergoing dramatic changes probably influenced their decisions. The Department's Administrators consideration of common bond or field of membership probably included their reaction to a variety of situations including but not limited to a credit union's common bond or field of membership linked to a business or organization experiencing a decline in employment, ceasing business, relocating from Kansas, or merger.

These situations have been interpreted by state and federal regulators as allowing credit unions to expand their field of membership to include multiple common bonds.

While the Department is not opposed to seeking to amend state law, an option to the Department that will simultaneously allow parity of Kansas chartered credit unions with other federally insured credit unions would be for the Department to follow a more narrow construction of K.S.A. 17-2205 but comply with the provisions of K.S.A. 17-2244 through issuance of an order when achievement of parity is required.

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Recommendation 2, Page 16 of the Report:

2. To help ensure that credit unions and their service organizations provide only authorized services, the Department should adopt either new policies or Administrative Regulations which clearly define the "incidental powers and services: that Kansas-chartered credit unions have and can provide.

KDCU Response:

On December 15, 2006, the Administrator, Kansas Department of Credit Unions, adopted K.A.R. 121-7-1, Incidental Powers. This rule addresses recommendation 2.

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Recommendation 1 a, b, c, d, and e, Page 25 of the Report:

1. To help ensure that the Department of Credit Union's process for examining credit unions treats credit unions consistently and operates in an effective manner, the Department should do the following:
  - a. enforce its policy requiring examiners to complete conflict-of-interest forms annually.

KDCU Response:

KDCU is enforcing its policy requiring examiners to complete conflict-of-interest forms annually.

- b. revise its procedures to prohibit management staff from reviewing and approving examination reports of credit unions where family members are employed.

KDCU Response:

KDCU has revised its policies and procedure to prohibit management staff from reviewing and approving examination reports of credit unions where family members are employed.

- c. develop written guidance for examiners concerning when to make a formal recommendation to credit union management.

KDCU Response:

KDCU policies have been revised to provide guidance for examiners concerning when to make formal recommendations to credit union management.

- d. evaluate whether the current process of tracking only the progress of certain recommendations could be improved by tracking all recommendations.

KDCU Response:

KDCU has revised its process where all recommendations are now being tracked.

- e. develop procedures that outline the actions the department will take when credit unions don't submit required documentation of corrective action by the due date.

KDCU Response:

KDCU has developed policies and procedures that describe actions taken when credit unions don't submit required documentation of corrective action by the due date.

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Recommendation 2, Page 26 of the Report:

2. To help ensure that the Department process for monitoring credit unions between examinations provides staff with meaningful information about a credit union's financial condition, the Department should develop written procedures that describe the tasks examiners should perform when reviewing a credit union's quarterly report, and what information the examiners should report to Department management.

KDCU Response:

KDCU believes it is unnecessary to develop written procedures for examiners to follow when reviewing a credit union's quarterly report for the following reasons:

- Quarterly reports are electronic with a built-in algorithm to detect errors.
  - Review of quarterly reports is part of examiner training; written procedures cannot replace or be a substitute for training and experience.
  - A new 'risk report module' has been implemented since the issuance of the Report. The new module allows KDCU to retrieve and compare quarterly reports one day following electronic uploading. This change provides a rapid method of discovering errors.
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Recommendation 3, Page 26 of the Report:

3. To help ensure that the Department's process for taking enforcement actions treats credit unions consistently and operates in an effective manner, the Department should develop written guidance outlining the general parameters for when Letters of Understanding and Agreement or other enforcement actions will be taken.

KDCU Response:

Written policies containing guidance when Letters of Understanding and Agreement or other enforcement actions will be taken have been adopted.

Unnumbered recommendation, Page 34 of the Report:

To provide greater assurance that Department staff properly review merger agreements and supporting materials, The Department should require that the scope and nature of those reviews be documented. Depending on the materials reviewed, this could range from initialing documents to including in the file the results of any financial analyses performed.

KDCU Response:

Procedures are now in place to document review of merger agreements and any accompanying analysis.

*Jared Wright*

Testimony of the

Kansas Credit Union Association

Before the

Senate Financial Institutions &  
Insurance Committee

January 24, 2007

*FI & I  
1-24-07  
Attachment 2*

Madam Chairman & members of the committee:

Thank you for the opportunity to appear before you to speak to the Division of Legislative Post Audit Performance Audit Report (Report) on the Regulation of Credit Unions by the Kansas Department of Credit Unions (Department).

I am Jerel Wright, with the Kansas Credit Union Association, which serves 112 Kansas credit unions, 78 state-chartered credit unions and 24 federally-chartered credit unions.

My comments today will focus on four questions contained within the Report relating to:

- Credit union growth
- Credit union services
- Procedures for credit union safety and soundness & oversight
- Regulation of out-of-state credit unions

I have included our executive summary of these four questions in Attachment A, which includes information on recommendations for the Department. I would like to point out that the Report makes no legislative recommendations.

In brief, on question 1, the Report indicates credit union growth has remained constant over the years representing about 5-6% of the total held by Kansas-based financial institutions.

On question 2, the Report indicates credit union services have expanded, not so much by the type of services, but through the delivery method of services and by the number of credit unions offering services. The question also highlights a point of contention in the Report, regarding the field of membership of a credit union. The Report contends the Department's interpretation of the credit unions' membership requirements doesn't conform to the State law.

On question 3, the Report indicates that the Department has adequate procedures for ensuring the safety and soundness of credit unions and oversight procedures compare favorably to oversight procedures for other financial institutions.

Finally, on question 4, the Report indicates that the Department has effectively regulated the influence of out-of-state credit unions.

We find the Report provides considerable evidence that the Department is appropriately regulating Kansas credit unions and leaves mainly one issue with which we disagree. The Report seems to fall well short of providing supporting evidence for the critical comments regarding the Department's interpretation of credit union membership requirements. I would like to take a few minutes to show where the Report falls short.

First, the Report fails to acknowledge that the interpretations of the field of membership requirements identified by the Report have existed since the early 1980s. Next, the Report fails to acknowledge that all recent credit union administrators have sought and received consistent counsel from the Office of the Attorney General to maintain the established interpretation of field of membership requirements.

Further, the Report provides no evidence that post audit staff made contact with the Office of the Attorney General, which serves as the Department's counsel, to discuss the Department's reliance on their interpretation of the State law. We find this failure to be significant in light of the extreme criticism of the Department's interpretation.

It is important to note that Kansas consumers will be the ones who lose from a change in the interpretation of credit union field of membership law. We estimate that Kansas credit unions provided \$55,764,029 in direct financial benefits to our 543,996 members during the twelve month period ending June 2006. This equates to average credit union member realizing a financial benefit of \$103

by membership in a credit union. Changes in the interpretation of field of membership law could result in increased costs to over one-half million Kansas credit union members. National studies, including the American Banker annual satisfaction survey, rank credit unions at the top of the list for consumer-friendly rates, fees and services. The only persons who would benefit from a change in the interpretation of field of membership are those who compete with and criticize credit unions.

We should take a moment to discuss why we have field of membership restrictions within the State law. Kansas adopted our first credit union act in 1929 and like most states, sought to limit credit union field of membership as one of the ways to ensure safety and soundness. A credit union's board of directors would self-impose limitations on membership in order to help the credit union manage losses or potential for loss. The evolution of financial regulation has eliminated the need for self-imposed field of membership restrictions and regulators have assumed the role of ensuring safety and soundness. No one can disagree that the primary role of the regulator is to ensure safety and soundness.

However, we can argue that the Report fails to recognize that the Department has the important role of safety and soundness regulator when reviewing and approving field of membership changes. While the Report fails to address this role, I have included a copy of our attorney's opinion of the Report as Attachment (B). The opinion specifically addresses the Department's role as safety and soundness regulator as well as other distinct issues within the Report.

Finally, as a point of clarification, I would like to discuss member business loans by Kansas credit unions. Member business loans are loans to members for a business purpose and are regulated under member business loan regulations. Credit unions are being asked by their members to provide the loans and credit unions continually strive to serve all of their members needs. Kansas has two credit unions, which were originally chartered for the purpose of making agricultural business loans to members and as such, are recognized with



increased member business loan approval standards. Kansas credit unions are not commercial lenders. The Report cited confusion over the exact numbers of member business loans by Kansas credit unions, but all credit unions report member business loan data through a quarterly financial report to the regulators, so there should be no confusion as to the credit union activity in this area.

Again, I thank you for the opportunity to testify today and will stand for questions at your direction.

# Kansas Legislative Division of Post Audit Performance Audit Report Executive Summary

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

- The report makes no recommendations for action by the Kansas Legislature.
- The report indicates the Department is effectively regulating credit unions and the report makes individual recommendations for action by the Department.

### *Overview of the Department of Credit Unions*

The Department of Credit Unions was established in 1968 to oversee the safety and soundness of Kansas-chartered credit unions. Unlike banks and savings and loans, credit unions are not-for-profit entities with limited membership. As of June 2005, 96 Kansas-chartered and 26 Federally-chartered credit unions were operating in Kansas. The main difference between a federal charter and a state charter is the regulating authority; the Department oversees all credit unions that have chosen to have a Kansas charter.

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### **Question 1: To What Extent Have Credit Unions Grown in Comparison with Other Segments of the Financial-Services Industry?**

The report indicates the growth of credit unions was not at the expense of other financial institutions.

- Since 1995, the number of financial institutions operating in Kansas dropped by 20%.
- Kansas-based credit unions' share of total assets, deposits, and loans have remained fairly constant over the years.
- In both 1995 and 2005, their assets, loans and deposits represented about 5-6% of the total held by all Kansas-based financial institutions.

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### **Question 2: How Have Kansas Credit Union Services Changed in Recent Years, and Are the Department's Actions Related to Expanded Services in Accordance with the Law?**

The report cites federal law and a federal court decision to support the report's recommendation to the Department to seek amendment of the State law. The report fails to recognize the Department's responsibility to interpret the state law governing credit union membership to

ensure the safety and soundness of state's credit unions. The report gives little significance to the state statute, which expressly contemplates that credit union membership will be both "large and small."

- **State laws and regulations govern the basic services that Kansas-chartered credit unions can offer to their members.**
- **Credit unions have expanded the services they offer in a number of ways over the past 10 years.**
- **Credit unions also have expanded who they serve by increasing their "field of membership."**

**Conclusion.** For a variety of reasons over the past 10 years, more Kansas-chartered credit unions have started offering their members more of the traditional financial services they've historically been authorized to provide—such as checking accounts, first mortgage loans, and credit cards. Because of the Department's liberal interpretation of State law, some of those credit unions also have significantly increased the number of members they serve. Based on our reading of Kansas law, and on the U.S. Supreme Court's interpretation that a federal law almost identical to Kansas' law didn't allow credit unions' membership to be expanded in the ways the Department has allowed, we think the Department's current practice isn't in conformance with State law.

**Recommendations.** We recommended that the Department either enforce the provisions of State law related to credit unions' field of membership, or if the Department thinks it's important to the safety and security of credit unions to allow their fields of membership to be expanded in the ways it has allowed them to expand over the years, it should seek to have State law amended accordingly. We also recommended that the Department adopt either new policies or administrative regulations, which clearly define the "incidental powers and services" that Kansas-chartered credit unions have and can provide.

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### **Question 3: 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?**

The report indicates that the Department has adequate procedures for ensuring the safety and soundness of credit unions and oversight procedures compares favorably to oversight procedures for other financial institutions.

- **The Department has adopted federal regulators' examination process and system for rating credit unions' financial condition.**
- **The Department is examining credit unions on a timely basis, but needs to address issues related to examiner independence and follow-up actions.**
- **Staff's review of quarterly financial reports can be more complete.**
- **The Department lacks adequate guidance for when an enforcement action should be taken.**

- **Managers of credit unions we surveyed were satisfied with the Department's actions related to credit unions.**
- **The Department's oversight procedures are similar to those of the State Bank Commissioner's Office.**

**Conclusion.** In general, we found that the Department of Credit Unions has reasonable procedures in place for ensuring the safety and soundness of credit unions. The vast majority of credit union managers we surveyed also were satisfied with the Department's actions. Still, the improvements we've identified should provide even greater assurance that the Department's regulatory efforts are consistent and effective.

**Recommendations.** We recommended that the Department take several steps to help ensure that its process for examining credit unions treats them consistently and operates in an effective manner. These include having examiners complete conflict-of-interest forms annually, and developing procedures outlining the steps the Department will take when credit unions don't submit required documentation of corrective action by the due date. We also recommended that the Department develop policies to address such issues as providing better guidance to examiners regarding their quarterly reviews of credit unions' reports, and when Letters of Understanding and Agreement or other enforcement actions will be taken.

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#### **Question 4: Is the Department Effectively Regulating the Influence of Out-of-State Credit Unions?**

The report indicates that the Department has effectively regulated the influence of out-of-state credit unions.

- **Between 1998 and 2005, eight Kansas-chartered credit unions merged with six out-of-State credit unions.**
- **The Department appears to have exercised reasonable oversight over mergers involving credit unions from other states.**
- **Currently, there doesn't seem to be a significant competitive advantage for out-of-State credit unions that operate in Kansas.**

**Conclusion.** Based on our reviews, and given its limited statutory responsibility related to mergers, we didn't see anything to suggest that the Department wasn't effectively regulating the influence of out-of-State credit unions. The only issue we identified related to providing better documentation of the actions Department staff took when reviewing merger documents. Although out-of-State credit unions operating in Kansas have paid lower regulatory fees, the 2005 Legislature required them to pay partial fees to Kansas on top of the regulatory fees they pay to their home states.

**Recommendation.** We recommended that Department staff document their review of merger documents.

**BLACKWELL SANDERS PEPPER MARTIN**  
LLP

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November 10, 2006

Ms. Marla S. Marsh  
President/CEO  
Kansas Credit Union Association  
610 S. Westdale Drive, Suite 100  
Wichita, Kansas 67209

**Re:** Legislative Post Audit Committee Report Titled *Regulation of Credit Unions: Reviewing the Department of Credit Unions' Procedures for Ensuring Institutions' Safety, Soundness, and Compliance with the Law*  
Our File No.: 58568-2

Dear Ms. Marsh:

You have asked us to give our opinion regarding the Legislative Post Audit Committee's (the "Committee") suggestion that the Kansas Department of Credit Unions has improperly interpreted the statutory limitation on credit union membership. The Committee's view is contained in the May 2006 Performance Audit Report entitled *Regulation of Credit Unions: Reviewing the Department of Credit Unions' Procedures for Ensuring Institutions' Safety, Soundness, and Compliance with the Law* (the "Report").

We believe that the Committee has relied far too heavily on an interpretation of federal—not Kansas—law that was immediately repudiated by the United States Congress. In addition, the Committee has ignored important language in the Kansas statute itself, in reaching its conclusion.

This may well be the result of the Committee relying solely on itself for its legal interpretations and not seeking the opinion of the Department's legal counsel. Of course, we should acknowledge that the Committee can draw its own conclusions with regard to what it views as sound policy. We would respectfully suggest, however, that such conclusions should not be premised upon faulty legal analysis regarding the state of the law in this area.

It is our opinion that the Kansas Department of Credit Unions has reasonably interpreted the state law governing credit union membership to ensure the safety and soundness of the state's credit unions. This interpretation has created strong credit unions with the resources necessary to protect the interests of consumers, who are their members. Further, its action recognizes the Department's obligation under the act to protect the interests of the members of the credit unions by ensuring the financial soundness of each institution.

KC-1430376-1

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BLACKWELL SANDERS PEPPER MARTIN  
LLP

Ms. Marla S. Marsh  
November 10, 2006  
Page 2

**FEDERAL LAW INFORMS, BUT DOES NOT CONTROL KANSAS LAW**

The federal case that the Committee focuses on to support its view is *National Credit Union Administration v. First National Bank & Trust Co. et al.*, 522 U.S. 479 (1998). That case found, in a five to four decision, that the then existing federal law required a *single* “common bond” between the members of a credit union based on their occupation or their residence in a well defined geographic area. *Id.* at 503.

The mere fact that four of the justices disagreed with the majority’s position makes it clear that the Committee’s argument—supported primarily by this decision—is not as strong as they suggest in their Report. More importantly, however, whatever the United States Supreme Court thought about the federal statute does not govern how the Kansas courts might interpret the Kansas statute nor does it help determine what the legislature intended when it enacted the statute in 1929.

In our federal system the United States Supreme Court is not the final arbitrator on the meaning of our state’s laws; the final arbitrator is the Kansas Supreme Court. *See Kansas Public Employees Retirement System v. Reimer & Koger Associates, Inc.*, 262 Kan. 635, 669 941 P.2d 1321, 1343 (1997) (holding that “[f]ederal court decisions on issues of state law are not binding on and have limited precedential effect in state courts”). This is a position long accepted by the United States Supreme Court. *See Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78 (1938).

Indeed, the Committee has turned Kansas common law on its head by arguing that *federal* court decisions govern the interpretation of *Kansas* law. The Kansas Supreme Court has repeatedly held the contrary: “The interpretation of the laws . . . of Kansas by the Supreme Court of Kansas *is controlling upon the federal . . . courts.*” *Reimer*, 262 Kan. at 670, 941 P.2d at 1343 (emphasis added) (citing *Quality Oil Co. v. DuPont & Co.*, 182 Kan. 488, 493, 322 P.2d 731 (1958)); *see also State ex rel. Stephan v. Finney*, 254 Kan. 632, 633, 867 P.2d 1034, 1036 (Kan. 1994). Since the *Erie* ruling, the federal courts have generally recognized that federal decisions cannot be “seriously suggested [as] an ‘informed prophecy’ as to the meaning of a state statute.” *Commerce Oil Refining Corporation v. Miner*, 303 F.2d 125, 128 (1st Cir. 1962).

Thus, the significance of the cited split decision in the federal courts is of limited importance to the issue raised by the Committee and certainly is not an “informed prophecy” as the Report appears to argue. Moreover, the Committee’s suggestion that the wording of the federal statute is “nearly identical” to the state statute ignores a significant difference.

The Kansas statute expressly contemplates that, even with the limitations it imposes, credit union membership will be both “large and small.” K.S.A. § 17-2205. The parenthetical including this language is assiduously left out of the Committee’s quotation of the state statute.

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*Id.* (reading, in part, “shall be limited to groups (of both large and small membership) . . .”). This parenthetical anticipates the large memberships of which the Report complains.

**THE DEPARTMENT’S INTERPRETATION PROTECTS CONSUMERS**

In addressing the issue of multiple common bonds, the Committee ignores the requirement that the Department of Credit Unions establish rules and regulations to ensure the safety and soundness of credit unions—although it acknowledges that the Department contends that permitting multiple common bonds has “minimized the risk a credit union would experience severe financial problems.” Report at 15.

In interpreting the intent of the legislature, the Kansas courts “are required to consider and construe together all parts” of a statute “and are not permitted to consider only a certain isolated part . . . of an act.” *Reimer*, 262 Kan. at 644, 941 P.2d at 1328 (citations omitted). The Committee should likewise look at the whole statute and determine the intent of the legislature in 1929 “from a general consideration of the entire act.” *Id.* at 643, 941 P.2d at 1328.

In the very first line of the Report, the Committee acknowledges that the “Department of Credit Unions was established in 1968 to oversee the safety and soundness of Kansas-Chartered Credit Unions.” Report at *i*. Generally the Report gives the Department high marks for completing that mission and the vast majority of the Report is focused on preserving the soundness of the state’s credit unions. Report at 17-20; 24-24; 29-34.

Curiously, however, there is no significant discussion of how the Section 17-2205 membership provision is impacted by the safety and soundness mandates contained in Sections 17-2201, 2204a, 2206(b), (c), and (h), 2207, 2209, 2210, 2214, 2215, 2217, and others. Most of these provisions are easier to comply with the greater the financial resources available to the credit union. Likewise, the services that credit unions are authorized to provide are less likely to impact the soundness of a particular credit union the greater the resources of the union.

As the Department has recognized, the greater the membership, the greater the resources available to an individual credit union and the more sound that union will be. Report at 15. Taking this reality into account and recognizing that the membership provision must be interpreted along with a general consideration of the entire act, it is our view that the Department has reasonably interpreted the act to permit multiple bonds of occupation and geographic areas that cross county lines. Indeed, the rural nature of our state demands some flexibility if our citizens are going to join their financial resources together to form credit unions that can effectively compete in the modern marketplace.

LAW FIRM

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It must be acknowledged that the Committee's view that Section 17-2205 limits membership to a single common bond is one possible interpretation of the statute. But there is nothing on the face of the statute that expressly limits membership to a single common bond or that expressly limits membership to only a common bond or common geography. Moreover, the statute was originally adopted in 1929 and there is no available legislative history to tell us what was intended.

**THE COMMITTEE'S FAULTY LEGAL ANALYSIS DOES NOT IMPEACH THE DEPARTMENT'S  
LONG-STANDING, CONSUMER ORIENTED, REASONABLE INTERPRETATION**

What is clear is that reasonable people can differ on whether the statute limits membership to a single common bond and whether membership can be based on both geographic limits and common occupations. Not only has the Department concluded that this is appropriate, its federal equivalent and four United States Supreme Court Justices concluded that this would be acceptable under the more narrow federal statute. Finally, it cannot be ignored that the United States Congress disagreed with the Supreme Court's majority opinion and promptly enacted legislation to reverse the result which the Committee relies upon.

Given the Department's mandate to ensure the safety and soundness of all credit unions, and the Department's reasonable conclusion that a larger membership has and will continue to ensure the soundness of the credit unions in Kansas, its decision to permit membership based on large geographic areas and on multiple common bonds is reasonable and in compliance with state law. Moreover, there is nothing in the state statute that expressly prohibits the Department's view and the Committee's reliance on the now repudiated Supreme Court opinion is misplaced.

Very Truly Yours,

*Blackwell Sanders Pepper Martin, LLP*





**Date:** January 24, 2007  
**To:** Senate Financial Institutions & Insurance Committee  
**From:** Doug Wareham, Senior Vice President-Government Relations  
**Re:** Request for Credit Union Industry Interim Study

Madam Chairman and members of the Committee, I am Doug Wareham appearing on behalf of the Kansas Bankers Association (KBA). KBA's membership includes 352 Kansas banks, which operate more than 1,300 banking facilities in 440 towns and cities across the state. KBA appreciates the opportunity to appear and comment on this performance audit concerning the Kansas Department of Credit Unions.

For the record, KBA actively sought this performance audit back in 2004 and we appreciate this committee dedicating time to review this important topic today. We believe this report sheds light on some very important and telling facts that warrant further consideration and action by this legislative committee. At this time, I would share some highlights of the report and will also offer some additional concerns that our organization has identified that we believe should also be considered.

- **State-chartered credit unions in Kansas are benefiting from loosely interpreted Kansas statutes regarding credit union common bonds/fields of membership.**

The most telling finding within this report is outlined on page 14 where Post Audit states "The Department's interpretation of credit unions' membership requirements doesn't appear to conform to State law". The report mentions that despite clear limits on credit unions' memberships, the Department has allowed Kansas-chartered credit unions to expand their memberships, even to the point of allowing the entire state of Kansas to be designated a geographic group. This loose interpretation has led to 5 state-chartered credit unions that anyone in the State can join today.

The Department has also allowed membership expansion by allowing multiple common bonds. On page 15, Post Audit states that while federal law allows federally-chartered credit unions to serve people from two or more occupational groups, federal law does not allow them to include geographic groups in multiple bonds. The example of Boeing Wichita Credit Unions' growth from 44,000 eligible members in 1995 to more than 2 million in 2005 is another very telling example of the impact of the Department's loosely applied interpretation. We believe this scenario also warrants further review and that a definitive policy regarding the expansion of credit union memberships through the use of multiple common bonds should be established by the Kansas legislature.

- **Banks are subjected to a higher level of scrutiny and greater transparency requirements than credit unions when a merger/acquisition is proposed or when attempting to branch into a new market.**

When comparing the regulatory oversight procedures of the Kansas Department of Credit Unions with those of the State Bank Commissioner's office, we believe Post Audit failed to highlight some key differences in the respective agency's policies regarding mergers/acquisitions and branching. We believe the facts highlighted below should also be taken into account when further reviewing the role of the Kansas Department of Credit Unions:

- The banking code (K.S.A. 9-1723) sets forth stated grounds for disapproval of a bank acquisition. The banking code (K.S.A. 9-1724) also sets forth information that must be filed with the Bank Commissioner prior to a merger, requires the Commissioner to conduct an investigation, and prohibits a merger without consent of the Commissioner. The credit union code does not include stated grounds for disapproval of an acquisition. Furthermore, the credit union code contains no requirement for the Credit Union Administrator to analyze the effect of a merger or acquisition on the resulting credit union's common bond.
- The banking code (K.S.A. 9111) sets forth the application process for approval of a bank branch. Such process includes filing an application, which shall include proof of a publication of notice in a newspaper followed by a public comment period; opportunity for a hearing; and prior approval by the Bank Commissioner. The banking code also sets forth the factors that the Bank Commissioner must analyze before an application can be approved. There is no application process for the establishment of new branches in the credit union code – only an annual reporting requirement found in the department's administrative regulations (K.A.R. 121-6-2).
- The banking code (K.S.A. 9-1809) provides that the Bank Commissioner with approval of the banking board may assess a civil money penalty from a bank or any officer, director or employee in limited circumstances. There are no provisions for assessing civil money penalties within the credit union code.

Finally, we would also simply mention that recently there have been examples where tax-exempt federally chartered credit unions have voluntarily chose to convert to a tax-paying federal savings bank charter. In the state of Massachusetts on December 22, 2006 a credit union conversion law was signed by outgoing Governor Mitt Romney. The new law authorizes a credit union to convert to a mutual savings bank and establishes the rules for filing with the state credit union commissioner and the National Credit Union Administrator. It is my understanding that Kansas law addresses the conversion of state banks, state credit unions and state savings & loans to their respective federal charters, but Kansas law does not outline a process for a state chartered credit union that wishes to become a bank. We believe future discussions on state-chartered credit unions in Kansas should include a review of recently adopted Massachusetts House Bill 5357.

In conclusion, we respectfully request that the Senate Financial Institutions and Insurance Committee request approval for an interim legislative study that will afford the opportunity for the concerns highlighted in this Post Audit Report, as well as the related issues we have shared with you today, to be thoroughly vetted in an open and productive forum. Once again, thank you for the opportunity to appear before this committee and I would be happy to stand for questions.

# CBA



Community Bankers  
Association of Kansas

*Directed By The Members We Serve*

Testimony for Senate Financial Institutions & Insurance Committee  
Senator Ruth Teichman, Chairman  
Wednesday, January 24, 2007

Madame Chairman and members of the committee,

Thank you for this opportunity to appear before you today to comment on the recent Legislative Division of Post Audit performance and audit report reviewing the regulation and review of Credit Unions and the Department of Credit Unions which is charged with oversight and monitoring of credit unions in Kansas.

The Community Bankers Association has long been an advocate for the financial well-being of citizens residing in the state of Kansas. Therefore, the members of this association were pleased the audit report revealed that, "for the most part, we found the Department has and follows adequate procedures to ensure the safety and soundness of credit unions, but some improvements are needed".

The audit report also cited several areas of concern, including the issue of examiner independence during examinations and the Department of Credit Unions' guidance to examiners regarding recommendations to credit union managers. Additionally, the follow-up procedures regarding compliance with examination recommendations that credit unions failed to implement, also needs additional review and attention.

Most visible in the audit conclusions and in our own anecdotal view is the issue of non-compliance regarding the expansion of credit unions' field of membership. The documentation in the post audit revealed that, "the Department's interpretation of credit unions' membership requirements doesn't appear to conform to State law" because the Department has interpreted the law to allow:

- the definition of "groups residing within a well-defined neighborhood, community, or rural district" to include residents of the entire State, and
- credit unions to combine groups with occupational bonds and groups with geographic bonds."

Therefore, our members request a more extensive review of this aspect of non-compliance with State law regarding the obvious field-of-membership expansions. Whether such a review would result in the Department of Credit Unions moving toward a change in the statute to make their current practice lawful or a return to compliance with current state statute regarding credit unions' field-of-membership practices – CBA respectfully requests that the committee propose and carry out a more extensive review. Such a review could occur during the interim as a study topic for the committee.

The members of the Community Bankers Association offer themselves as a resource to the members of the committee and thank you for your consideration of this topic.

Thank you.

FI&I  
1-24-07  
Attachment 4

# Community Bankers Association of Kansas

Alden State Bank, Alden • First National Bank, Alma • Stockgrowers State Bank, Alma • Alta Vista State Bank, Alta Vista • First National Bank of Southern KS, Andale • Andover State Bank, Andover • First National Bank, Anthony • Kanza Bank, Anthony • Farmers & Merchants State Bank, Argonia • Union State Bank, Arkansas City • Citizens National Bank, Arlington • First State Bank, Arma • Bank of Atchison, USB, Atchison • Citizens Bank of Kansas, N.A., Atlanta • Citizens National Bank, Attica • Farmers State Bank, Atwood • State Bank of Bern, Axtell • Baldwin State Bank, Baldwin City • Community National Bank, Basehor • Bendena State Bank, Bendena • The Halstead Bank, Bentley • Peabody State Bank, Benton • State Bank of Bern, Bern • Midwest Community Bank, Beverly • Bison State Bank, Bison • State Bank of Blue Rapids, Blue Rapids • Citizens State Bank & Trust Co., Bremen • Farmers National Bank, Buhler • Nekoma State Bank, Burdett • First State Bank, Burlingame • Farmers National Bank, Bushton • State Bank of Canton, Canton • State Bank of Carbondale, Carbondale • Cottonwood Valley Bank, Cedar Point • Citizens State Bank, Cheney • The Farmers State Bank, Circleville • Union State Bank, Clay Center • United Bank & Trust, Clay Center • First National Bank, Clifton • Community State Bank, Coffeyville • Peoples State Bank, Colby • Coldwater Native Bank, Coldwater • Legacy Bank, Colwich • United Bank & Trust, Concordia • State Bank of Conway Springs, Conway Springs • Montezuma State Bank, Copeland • Swedish-American State Bank, Courtland • State Bank of Delphos, Delphos • Downs National Bank, Downs • State Bank of Downs, Downs • First Community Bank, Emporia • Union State Bank, Everest • Farmers State Bank, Fairview • Cottonwood Valley Bank, Florence • Union State Bank, Fort Scott • Fowler State Bank, Fowler • First National Bank, Frankfort • First National Bank, Fredonia • Farmers State Bank, Galva • Garden Plain State Bank, Garden Plain • First National Bank of Southern KS, Goddard • Peoples State Bank, Goodland • Community Bank of the Midwest, Great Bend • Signature Bank KC, Haddam • The Halstead Bank, Halstead • First National Bank, Harper • Freeport State Bank, Harper • The First National Bank of Harveyville, Harveyville • BankHaven, Haven • The Trust Company of Kansas, Haven • The First State Bank of Healy, Healy • First National Bank & Trust Co., Herington • Citizens State Bank, Hill City • First State Bank, Hill City • Hillsboro State Bank, Hillsboro • Denison State Bank, Holton • The Farmers State Bank, Holton • First National Bank, Hope • Union State Bank, Horton • Peoples State Bank, Hoxie • Denison State Bank, Hoyt • Citizens State Bank, Hugoton • Farmers National Bank, Inman • Johnson State Bank, Johnson • First National Bank & Trust Co., Junction City • Citizens Bank of Kansas, N.A., Kingman • Kanza Bank, Kingman • First State Bank, Kiowa • Nekoma State Bank, La Crosse • First Option Bank, La Cygne • Plains State Bank, Lakin • The Trust Company of Kansas, Lawrence • First National Bank, Le Roy • The Trust Company of Kansas, Leavenworth • State Bank of Lebo, Lebo • The State Bank of Leon, Leon • Midwest Community Bank, Lincoln • Farmers State Bank, Lindsborg • The Lyons State Bank, Lindsborg • United Bank & Trust, Linn • The Lyons State Bank, Little River • First National Bank & Trust, Logan • First National Bank & Trust, Long Island • Farmers & Merchants State Bank, Longford • Lorraine State Bank, Lorraine • First Option Bank, Louisburg • Lyndon State Bank, Lyndon • The Lyons State Bank, Lyons • First Community Bank, Madison • First National Bank, Manhattan • United Bank & Trust, Manhattan • State Exchange Bank, Mankato • Stockgrowers State Bank, Maple Hill • Tampa State Bank, Marion • United Bank & Trust, Marysville • First National Bank, Mayfield • Peoples State Bank, Mc Donald • Citizens National Bank, McPherson • Farmers State Bank, McPherson • Home State Bank & Trust Co, McPherson • Fowler State Bank, Meade • Lyndon State Bank, Melvern • Denison State Bank, Meriden • Citizens State Bank, Miltonvale • State Bank of Delphos, Minneapolis • Montezuma State Bank, Montezuma • Citizens State Bank, Morland • First National Bank of Southern KS, Mount Hope • United National Bank, Natoma • Midland National Bank, Newton • Midland National Bank, North Newton • First State Bank, Norton • Farmers State Bank, Oakley • Union State Bank, Olsburg • First State Bank, Osage City • First Option Bank, Osawatomie • Community Bank of the Midwest, Otis • First Security Bank, Overbrook • Kansas State Bank, Overbrook • First National Bank of Johnson County, Overland Park • Midwest Community Bank, Palco • First Option Bank, Paola • Stockgrowers State Bank, Paxico • Peabody State Bank, Peabody • Farmers State Bank, Phillipsburg • First National Bank & Trust, Phillipsburg • Plains State Bank, Plains • First State Bank, Plainville • Midwest Community Bank, Plainville • Prescott State Bank, Prescott • Citizens Bank of Kansas, N.A., Pretty Prairie • The Bank of Protection, Protection • Union State Bank, Randolph • The Riley State Bank, Riley • St Marys State Bank, Rossville • United National Bank, Russell • United Bank & Trust, Sabetha • Scandia State Bank, Scandia • First National Bank, Scott City • Kansas State Bank, Scranton • First National Bank, Sedan • Alliant Bank, Sedgwick • Baileyville State Bank, Seneca • Community National Bank, Seneca • United Bank & Trust, Seneca • Bank of Commerce & Trust Co., South Haven • Signature Bank KC, Spring Hill • First National Bank, St. Marys • St. Marys State Bank, St. Marys • Farmers National Bank, Stafford • Alden State Bank, Sterling • Cottonwood Valley Bank, Strong City • Citizens Bank of Kansas, N.A., Sylvania • Tampa State Bank, Tampa • Community National Bank, Tonganoxie • Denison State Bank, Topeka • Lyndon State Bank, Topeka • Towanda State Bank, Towanda • 1st Bank of Troy, Troy • Troy State Bank, Troy • Citizens Bank of Kansas, N.A., Turon • Grant County Bank, Ulysses • Johnson State Bank, Ulysses • Union State Bank, Uniontown • The Halstead Bank, Valley Center • Vermillion State Bank, Vermillion • Citizens State Bank, Wakeeney • Trego-Wakeeney State Bank, Wakeeney • Farmers & Merchants State Bank, Wakefield • The Walton State Bank, Walton • First National Bank, Wamego • Kaw Valley State Bank & Trust Co., Wamego • United Bank & Trust, Washington • Farmers State Bank, Wathena • Citizens Bank, Weir; Bank of Commerce & Trust Co., Wellington • Wellsville Bank, Wellsville • Andover State Bank, Wichita • Bankers' Bank of Kansas, N.A., Wichita • BankHaven, Wichita • Citizens Bank of Kansas, N.A., Wichita • Community Bank of Wichita Inc., Wichita • Farmers & Merchants State Bank, Wichita • First National Bank, Wichita • Garden Plain State Bank, Wichita • Kanza Bank, Wichita • Legacy Bank, Wichita • The Trust Company of Kansas, Wichita • Citizens Bank of Kansas, N.A., Winfield • Citizens State Bank & Trust Co., Woodbine

To: Senate Financial Institutions and Insurance Committee

From: Matthew Goddard  
Heartland Community Bankers Association

Date: January 24, 2007

Re: Performance Audit Report on Credit Union Regulation

The Heartland Community Bankers Association appreciates the opportunity to appear before the Senate Committee on Financial Institutions and Insurance to share its thoughts on the Performance Audit Report on the Regulation of Credit Unions by the Legislative Division of Post Audit.

The Report appears to be very well done and very well researched. HCBA, however, has a slight disagreement on what the Report says are the "two primary factors (that) distinguish credit unions from other financial institutions." First, the Report says credit unions are not-for-profit, but they do in fact make a profit. If they didn't, they would be unable to build up capital. Tax-exempt credit unions should not be confused with tax exempt 501(c)(3) charities. They are completely different types of nonprofit organizations. Our other issue with the Report is its claim that credit union membership "is limited to a specific group of people." The so-called "common bond" has been stretched to the point of absurdity and in many credit unions is nonexistent.

It appears that HCBA is not alone in questioning the appropriateness of some of the common bonds approved by the Department of Credit Unions. HCBA is very concerned with the conclusion reached on page 14 of the Performance Audit Report:

*"The Department's interpretation of credit unions' membership requirements doesn't appear to conform to State Law."*

The Report casts serious doubt as to whether the Department of Credit Unions is applying Kansas law or instead choosing to ignore it. If current law is not practical or poses challenges to the safety and soundness of credit unions, the law should be changed. If that is not the case, the law should be enforced. Either way, there should not be a discrepancy between the way a law is written and the way it is enforced by a regulator.

In addition to field of membership, there are other issues raised by the Report that we believe merit your attention. We would especially encourage a further review of the recommendations made on pages 25 and 26 of the report to ensure the effectiveness of enforcement actions and better safeguard the public.

The Heartland Community Bankers Association respectfully suggests that an interim study be requested to examine the Performance Audit Report and the issues it raises. It is quite possible that credit union statutes simply need to be modernized, not just on field of membership but also on matters of disclosure and charter choice. It is also possible that the expansion of credit unions to serve broad geographic areas without Community Reinvestment Act-like requirements is not in the public interest. These are issues that cannot be answered without further investigation and an interim study would appear to be the most viable solution.

Thank you for your consideration of this matter.