Approved: <u>February 13, 2007</u>
Date

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.

<u>Senator Steineger moved the bill be introduced. Senator Brungardt seconded. Motion carried.</u>

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.

- 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 ever 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.

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.

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.

Next to testify was Jerel Wright of Community Bankers Association of Kansas. Mr. Wright 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.

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 requested to examine the Performance Audit Report and the issues it raises.

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

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 meeting adjourned at 10:30 a.m.