

Kansas

Quarterly Interest

The Newsletter of the Office of the State Bank Commissioner

Commissioner's Corner

J. Thomas Thull, Bank Commissioner

Fall 2007

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Wow! I've been with the Department for six months; and what a six months it has been. I've had the opportunity to travel to Washington D.C. to not only meet our Congressional delegation, but also Chairman Bernanke at the Federal Reserve and Chairman Bair at the FDIC. I have attended functions across the country sponsored by the Federal Reserve Bank, Kansas Bankers Association, Community Bankers Association, and Conference of State Bank Supervisors (CSBS) and have found everyone to be courteous, knowledgeable, and professional.

During my time here, the staff, in addition to their normal duties, has dealt with several issues, including, but not limited to: the sub-prime mortgage crisis; national mortgage licensing database; purchase and installation of new database software at our agency; purchase and installation of a secure email system; the 2009 budget submission; testimony on a few issues at the Statehouse; and a booth at the state fair. I will touch on each of these areas briefly.

The Department just adopted the Guidance on Nontraditional Mortgage Product Risks issued by CSBS and the American Association of Residential Mortgage Regulators (AARMR); and the Statement on Subprime Mortgage Lending, issued by CSBS, AARMR, and the National Association of Consumer Credit Administrators. I will chair a study group to assess mortgage fraud and subprime lending in Kansas and its effects on Kansas consumers. I have signed a letter of intent to participate in a National Mortgage Licensing database being developed by CSBS and AARMR. The exact date of our participation is unknown as we currently have a licensing process that serves our agency well.

We are in the process of building a new database system for the entire agency. The new system will replace the four legacy licensing and data management

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Mitigating Risk of the Subprime Mortgage Market

Ken Torgler, Regional Manager-East Region

The recent stock market fluctuations have been magnified by the subprime lending market. Market fears within the United States have spread globally due to foreign investment in the mortgage-backed U.S. bond market. Subprime lenders are going out of business at warp speed, while surviving lenders are trying to weather the crisis with massive layoffs in hopes of avoiding bankruptcy.

Subprime lending is a targeted business line phenomenon of the 1990's. Subprime loans are also called B-paper, near-prime, or second chance lending. The terms refer to the credit characteristics of the borrower and are an indicator of higher risk.

Hybrid and adjustable rate loans have been pricing upwards causing a squeeze on homeowners. The rate increases have come at a time that corresponds with increases in energy, education, and other general household expenses. Combine all this with a cooling in the housing market and a low savings rate, and some consumers are losing ground.

Did your bank anticipate and plan for these economic conditions? Is your management team appropriately protecting shareholder interests? The warning signs are not new, as regulatory agencies and the media have discussed these economic stressors at length for years. The issues did not simply come to light in 2007.

How could this economic downturn affect your bank? Banks could see a decrease in profitability due to charge offs, higher loan reserves, and/or a decrease in fee income. Adversely classified assets could increase. Other real estate balances and related costs could climb. Secondary lenders are drying up and banks could be forced to book long-term, lower-rate loans that otherwise would have sold; and capital could be at risk if problems persist.

An area of high risk in today's market is the 1-4 family construction portfolio. Due to the increased risk, management is advised to evaluate all homebuilders and consider doing the following:

- Revisit 1-4 family construction underwriting
- Review all appraised values for accuracy
- Re-evaluate the speculative inventory tolerance of the bank
- Conduct an updated creditworthiness review of all builders
- Evaluate the economic conditions of builder locations
- Tighten inspection practices; closely monitor percent completed to funding
- Ascertain advances are not funding projects elsewhere
- Enforce curtailment agreements on speculative inventory
- Focus aggressively on delinquent borrowers
- Monitor sales for lots and units

Once you become more comfortable with the bank's 1-4 family construction portfolio, realize other subprime risks still exist. To further mitigate risk and protect shareholder interests, bankers are asked to be more vigilant in the following areas:

- Make sure appropriate policies are in place and are followed
- Match the inherent risk of the subprime loan portfolio to the ALLL
- Re-verify subprime borrowers for employment, debt-to-income ratios, credit scores and credit reports

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Minihan Recognized for Years of State Service



JoAnne Minihan (left) pictured with Governor Kathleen Sebelius during the state employee service recognition ceremony.

Joanne Minihan was recently recognized for 40 years of service to the state of Kansas. JoAnne started working for the state of Kansas on July 1, 1966 with the Kansas Grain Inspection as a clerk-typist I. On January 1, 1967 she transferred to the Department of Revenue as a clerk-steno I. She again transferred to the Consumer Credit Commissioner's office as a clerk-steno II on September 1, 1969 and later became the secretary for that agency. In February 1982, Jo Anne was promoted to the position of financial examiner. She traveled the state of Kansas, with some out-of-state travel, examining finance companies for compliance with state and federal statutes. The Consumer Credit Commissioner's office was merged into the Office of the State Bank Commissioner on July 1, 1999. Jo Anne remains a review examiner for the Consumer and Mortgage Lending Division of the Bank Commissioner's office. In her spare time Jo Anne enjoys counted cross-stitching, reading and playing with her many great-nieces and great-nephews.

Mitigating Risk of the Subprime Mortgage Market (continued from previous page)

- Analyze agreements with secondary lenders
- Verify whether secondary lenders can back out of agreements
- Closely monitor brokered (purchased) loans
- Include high-risk loan types in formal loan reviews
- Timely recognize watch list loans and loan losses
- Consider a sales discount and realtor expenses when booking OREO
- Evaluate the need for access to construction crews to complete speculative OREO

While management teams can easily be influenced by the economy and other external forces, great management teams will plan ahead and have pertinent risks evaluated. When tough economic times are looking you straight in the face, the risk terminology "identify, measure, monitor and control" seems like good advice.

Torgler Appointed as Director of Exams

Bank Commissioner Tom Thull has appointed Kenneth F. Torgler to serve as the Director of Examinations for the Division of Banking. Ken is a 1989 graduate of Pittsburg State University with a degree in Finance. He also graduated with honors from the Colorado Graduate School of Banking. Ken began his career with the OSBC as a banking field examiner in 1989 in the Wichita office and transferred to the Overland Park office in 1990. Most recently, Ken served the OSBC as Regional Manager of the East Region, encompassing 77 banks in a 19 county area surrounding Kansas City and Topeka. In his new position as Director of Examinations, Ken will oversee all bank and trust examination staff of the agency as well as the oversight of the 254 state banks and ten trust companies regulated by the OSBC.

Ken replaces George E. Myers who retired.

2007 OSBC Annual Conference



The OSBC Staff stops for a group photo at the Liberty Memorial.

The twelfth OSBC Annual Conference was held on September 4 – 6 in Kansas City, Kansas. The conference is a once-a-year opportunity for all OSBC staff to come together and discuss current topics and issues. A committee of employees coordinates all the details for the Conference. Committee members include both field office and main office staff. This year's committee included Robin Wilson, Amy Meyer, Jayme Hosier, Jessica Kerr, Cindy Huddleston, Jim Payne, Amy Atkinson and Lea Tatum-Haskell – Facilitator.



Officer Duane Porterfield discussed personal security.



Staff members take a break between speakers.

Conference presentations are always varied and interesting and this year was no exception. Speakers Jere White, Executive Director of the Kansas Corn Growers Association spoke about the growth of Ethanol production in Kansas and highlighted the benefits of Ethanol as a automotive fuel source; Bill Greiner of UMB Financial Corporation provided an overview of economic trends and the state of the economy; Jeremy Deckard with the Kansas Human Rights Commission presented information regarding what constitutes sexual harassment and ways to prevent it; Officer Duane Porterfield of the Kansas City Police Department shared ways to maintain personal security; Ann Mah discussed why business etiquette is important in the workforce; and Candy Ruff, State Representative, discussed the legislative process and shared her experiences as a legislator.



The winning Walk Kansas team was presented with the traveling "trophy".

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OSBC Annual Conference

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Daryl Wetter, Commissioner Tom Thull, Ed Spielbusch and John Gibbons enjoyed a round of golf.

Conference activities included guided tours of the National Agriculture Center & Hall of Fame and The National WWI Museum. Several employees were honored at an awards and recognition lunch, including Timothy Kemp, who was named the OSBC Employee of the Year. Evening events included a golf tournament at Sunflower Hills Golf Course and a reception hosted by Commissioner Thull and Deputy Commissioner Stork at Great Wolf Lodge.



UMB Economist Bill Greiner shared his views.



Examiner Randy VanLeeuwen demonstrates his bull riding skills.



OSBC staff board the bus for the World War I Museum tour.

Commissioner's Corner

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systems that support agency functions. The vendor for our system is CAVU Corporation of North Carolina.

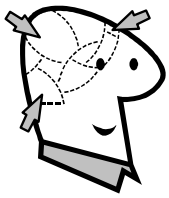
You will soon be receiving information on how to utilize our secure email system. We have developed a brochure to walk you through the registration and log-in procedures. We intend to utilize this system for confidential communication prior to and during our examinations as well as for other emails containing secure information.

Annually, the agency has a booth at the state fair where members of our Consumer and Mortgage Lending Division meet with Kansas consumers and provide helpful information. I attended the fair for one day and spent time visiting with folks that stopped by our booth. It is a productive outreach for our agency that we plan to continue in the future.

Our annual budget for fiscal year 2009 was submitted to the Governor. The agency's budget for this fiscal year is approximately \$8.5 million. More than half of that amount is for Banking and Trust Division expenditures. We feel we have adequate funding to support our examination goal and to adequately provide for suitable equipment and training for our staff.

Before I close this article, I do want to mention our continued association with CSBS. We are active members in this organization, and Judi Stork, our Deputy Bank Commissioner, serves as a board member representing District IV, the nine-state district of which we are a member. We are strong supporters of CSBS and the work they do for state chartered institutions. Prior to the end of this year, you will be receiving information from me regarding your bank's membership in CSBS. I hope you will give strong consideration to joining this association and review the benefits such membership would provide.

Barrister's Brain



As a regular feature in *Quarterly Interest*, our advice columnist, Barry Barrister, will answer a legal question the OSBC has received that we think would be of interest to bankers. Even though he's a fictional lawyer (arguably the best kind), Barry has insisted we include the caveat that the advice he dispenses is general in nature, and is not intended as a substitute for obtaining specific legal advice from counsel when necessary.

Dear Barry:

Is there a new state law or regulation that requires state-chartered banks and trust companies to use a secure e-mail product? We have heard that the Office of the State Bank Commissioner is going to start requiring all banks and trust companies to use secure e-mail. If that is the case, when does this requirement go into effect?

- Eager to Encrypt in Emporia

Dear Eager to Encrypt:

There is no new requirement that state banks or trust companies purchase a secure e-mail product. What you may have heard about is that the Office of the State Bank Commissioner has recently purchased an e-mail encryption product from ZixCorp. This product will give the OSBC the ability to encrypt e-mail messages it sends to banks, and also allow banks to send encrypted e-mail to the OSBC. There is no requirement that a bank or trust company purchase any software from ZixCorp or any other particular company in order to send or receive the encrypted e-mail. However, we would suggest that if you are sending sensitive information via e-mail outside of your internal system, you should consider the risks and have a plan in place to address them. The OSBC does not endorse ZixCorp or recommend any particular e-mail encryption service provider to banks. In the next few months, you (and all the entities the OSBC regulates) will be receiving detailed information from the OSBC regarding the procedures for using the OSBC's new encrypted e-mail service. In the meantime, if you have questions, I would suggest that they be directed to Glen Caspers, Director of Information Technology for the OSBC.

Regards,
Barry

Congratulations to Tim Kemp!



2007 OSBC Employee of the Year

Bank Application Summary

Dana S. Hampton, Director of Corporate Activities

Since June 30, we have received notice of the opening or relocation of several branch offices. Information about these offices follows.

Security Bank of Kansas City - opened a new branch at 5450 Roberts Street, Shawnee, on July 16, 2007.

SolutionsBank, Overland Park - opened branches at 214 South Main, Pratt, and 705 NE Woods Chapel Road, Lee's Summit, Missouri, on July 23, 2007.

Union State Bank, Arkansas City - relocated a branch office from 321 East 10th Winfield to 2100 Pike Road, Winfield on August 13, 2007.

We are happy to report the opening of a new state-chartered bank. On October 1, 2007 **CROSSPOINT Bank, Overland Park** opened for business at 11225 College Boulevard, Suite 150, Overland Park with total capital of \$15,125,000. Stock of the bank is widely held and Gregory Motley is bank president.

Monthly application logs are posted at www.osbckansas.org.



The BSA Laundry Room

Erik Berggren, Senior Review Examiner

Recently I was asked a question that had not been presented directly to me before. Apparently, it is a relatively common question and turned out to be a good learning experience for most everyone involved. The learning experience is why this topic has been chosen as the BSA feature.

The scenario is one where the bank's BSA Officer was out of the bank for an extended period. A State of Kansas law enforcement official came to the bank requesting that seized drug money be counted and converted to a Cashier's Check made payable to the U.S. Marshall. The bank refused to count the money and issue a Cashier's Check because the law enforcement official would not provide his own social security number (SSN), as requested by the bank. The law enforcement official conveyed that he/they had conducted like transactions at other banks in Kansas without having to provide personal information of this nature.

Once this situation came to our attention, we placed a call to the Financial Crimes Enforcement Network's (FinCEN's) Regulatory Helpline (1-800-949-2732) and also conferred with our counterparts at FDIC since the bank involved was a state nonmember bank. Both of these sources directed us to the frequently asked questions (FAQs) on FinCEN's website at: http://www.fincen.gov/reg_faqs.html. The applicable FAQ reads as follows:

Question 21: When a federal, state or local government official, as part of his or her official duties, engages in a transaction in currency over \$10,000, or purchases a monetary instrument for more than \$3,000 in currency, as a non-account holder, what kind of identifying information must a financial institution obtain?

Answer 21: Government officials sometimes need to conduct large currency transactions as part of their official duties. For example, a law enforcement official may wish to convert seized currency into monetary

instruments for security reasons. In such cases, when a transaction in currency over \$10,000 is conducted on behalf of a government agency, rather than on behalf of an individual, the financial institution involved in the transaction should file a one-time Designation of Exempt Person form (TD F 90-22.53), to exempt the government agency from the currency transaction reporting requirements and document the basis for its conclusion. Subsequent transactions on behalf of the same government agency would be similarly exempt from the currency reporting requirements. If a financial institution chooses to file a currency transaction report, it generally is required only to obtain, verify, and record identifying information pertaining to the agency for which the individual is working. Thus, any employee identification number, address, or other identifying information obtained should correspond to the government agency involved, and not the government official conducting the transaction.

Notwithstanding the above, a financial institution should still obtain and record the name of the government official conducting the transaction and take those steps that a reasonable and prudent bank would take to verify and document that the customer is a government official conducting business on behalf of a government agency. Regarding the purchase of a monetary instrument for more than \$3,000 in currency, a financial institution should record the date of birth of the government official, in addition to his or her name.

Considering this information, the bank could have opted to immediately exempt the law enforcement agency by filing a Phase I Designation of Exempt Person (DEP) and been free of any requirements to file a Currency Transaction Report (CTR). Phase I DEPs do not need to meet the test of eight transactions per year. Furthermore, the bank would not have had to require that the law enforcement officer provide his personal SSN, which is a required piece of information when a CTR is filed. In fact, FinCEN would prefer that banks

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The BSA Laundry Room
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file Phase I DEPs so CTRs are not unnecessarily submitted and entered into its database, cluttering the system and perhaps distorting monitoring reports generated by FinCEN.

It should be noted, however, that a bank may choose to have an internal policy that requires information such as SSNs from all persons conducting reportable transactions, even from those that have been exempted. If that is the case, that policy would have to be enforced on all persons proposing to conduct reportable transactions, and those persons would have to decide whether they wanted to provide the information requested and continue with the reportable transaction or go elsewhere.

The end to this particular story is that the above information was shared with the bank official involved, which resulted in a relatively easy fix to the matter; the bank plans to file a Phase I DEP.

This is also an opportunity to remind you of the resources available to you should you be uncertain of the answers to BSA related situations you encounter. FinCEN's Regulatory Helpline is one resource (1-800-949-2732). Other resources are your applicable Federal regulatory agency and your one and only Office of the State Bank Commissioner. Please know that all are dedicated to giving you the fastest and most accurate response possible.

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