

Kansas

Quarterly Interest

The Newsletter of the Office of the State Bank Commissioner

Commissioner's Corner

*Judi Stork,
Acting Bank Commissioner*



I recently read an article written by the Texas Bank Commissioner wherein he asked "have you checked your spare tire lately?" The gist of his comments was that we often drive around thinking our spare is fully inflated and ready to use in case of an emergency. When, in fact, we open the trunk to find the spare has lost air and really doesn't serve its purpose in the time of need. He correlated the spare tire to a bank's business continuity plan and

questioned whether such plan would be adequate in an emergency. It's an important question I'd like you to consider.

Have you checked your disaster recovery and business continuity plans to make sure they cover all the areas necessary and are ready to go in time of need? Recent natural disasters such as Hurricanes Rita and Katrina, as well as the events of September 11th, forced many banks to implement these plans. Some parts of the plans worked well; other parts failed. While Kansas may not be subject to a hurricane anytime soon, we do have other natural disasters that could occur along with technological failures, human error, and terrorism that would require your bank to implement your plan.

The evaluation of your risk management processes is key to ensuring adequate continuity plans. Review the structure of your organization and ensure you provide a central point of coordination and responsibility for recovery efforts. Confirm that everyone knows their responsibility and understands how the chain of authority will work. If you are not doing periodic disaster drills, you may want to start. Review your IT function to make sure you have the right technological resources available following the disaster. Provide for adequate backup facilities, for both the relocation of daily operations and for data storage, that are located a safe distance away from the main bank. In the case of the recent hurricanes, many banks found their backup facilities suffering from the same effects as their primary location. Finally, and most importantly, protect the people portion of your plan. The safety and welfare of your employees, customers and their families should be of foremost importance. Your plan should be as specific as possible in this area, because it will be your staff that helps rebuild the bank.

CSBS and the FFIEC have put together a booklet called Lessons Learned from Hurricane Katrina that may be a useful reference when reviewing your existing plans. The booklet is available online at: www.fdic.gov/regulations/resources/lessons/index.html. I would urge you to "kick your spare tire" and check your contingency plans. Banks play such a crucial role in our economy and necessary precautions should be taken to minimize the effects of any disruption.

Summer 2006

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Team OSBC Participates in Relay for Life



Team OSBC (back row from left): Julie Tipton, Mari Tucker, Mike Tucker, Dana Hampton, Eileen Caspers, Amy Atkinson and son, Caleb, Glen Caspers, Sheila Rice, Alan Rice. (Seated): JoAnne Minihan and Judi Stork.

On June 2nd and 3rd, 2006, eight OSBC employees, their family, and friends walked in the 15th Annual Shawnee County Relay for Life held at Hayden High School. The Relay for Life is the American Cancer Society's signature activity. It unites millions of people in thousands of communities nationwide each year to raise money to help prevent cancer, save lives, and diminish suffering from the disease. It is the largest nonprofit fund-raising event in the world. The event is held outside and participants walk around the stadium track.

For the third year in a row, Team OSBC (Office Staff Beating Cancer) raised more than \$1,500 for the cause. Team members from the OSBC were Dana Hampton (Co-Captain), Mari Tucker (Co-Captain), JoAnne Minihan, Judi Stork, Julie Tipton, Amy Atkinson, Alan Rice, and Glen Caspers. During the Relay, team members chose time slots and walked in shifts throughout the 12 hour period from 7 p.m. on the 2nd to 7 a.m. on the 3rd. As part of their fund-raising activities, the group hosted an office

"picnic" which featured hot dogs and all the trimmings, created a basket (with a gardening theme) for the Relay silent auction, and sold purple "Hope" wristbands and purple magnetic ribbon signs. Additionally, the team collected donations and sold 50 luminaries. Luminaries are white paper bags which are decorated in honor of cancer survivors or in memory of cancer victims. During the Relay, the bags were displayed around the football field and a special luminary ceremony displayed the luminary names on a large screen. Over \$147,000 was raised by the 63 teams participating in this year's Relay in Topeka. Team OSBC was one of 24 teams that received special recognition for their level of donations. Each team member was awarded a Bronze pin signifying their team raised more than \$1,500. There were 13 teams reaching the Bronze level, six reaching Silver (\$3,000), three reaching Gold (\$5,000), one reaching Platinum (\$10,000) and, for the first time at the Topeka Relay, one team reached the Diamond level of \$25,000. Corporate sponsorship also plays a vital role in the Relay's activities and fund raising. Topeka banks, Heritage Bank and Commerce Bank, were among the 34 corporate sponsors of this year's event.

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Technology Matters

IT Examination Procedures Get An Overhaul

In late 2005, a new program for conducting IT examinations was implemented called Information Technology Risk Management Program (IT-RMP). Unless you have been locked up in the server room for several months, you've probably heard of IT-RMP by now. There have been numerous seminars, conference calls, webinars and Internet publications on this subject. The new procedures apply to all banks, regardless of their size, complexity or prior examination rating. The focus of the new procedures is on the financial institution's information security program and risk-management practices. These risk-management practices include the following:

- Risk assessment;
- Operations security and risk management;
- Audit and independent review;
- Disaster recovery and business continuity; and
- Compliance with federal regulations that make GLBA guidelines applicable to banks.

Key features of the new procedures are:

IT Examination Officer's Questionnaire

The new IT Examination Officer's Questionnaire is an important aspect of the IT-RMP examination program. This document covers the five risk-management practice areas listed above and will be used by the examiner in both pre-examination and on-site examination procedures. The questionnaire must be completed by an officer of the financial institution and returned to the examiner-in-charge prior to the on-site portion of the examination. IT officers are encouraged to review the questionnaire well in advance of their next examination.

Flexible Use of Work Programs

Use of the IT-RMP risk-management work program, which is aligned with the categories in the Questionnaire, is the standard work program used by examiners. Examiners are allowed the flexibility

to customize on-site activities with the use of a variety of topic-based work programs. These extra work programs are available for identified problem areas or more complex IT environments.

Pre-examination Request List

The IT Examination Officer's Questionnaire is the only mandatory pre-examination documentation requirement. Depending on the IT environment, examiners may request additional information to facilitate the on-site examination.

IT Rating Guidelines

A single composite IT rating will be assigned to the institution. Ratings will no longer be assigned to the individual component areas.

The growth of and reliance on information technology (IT) requires a thorough assessment of the risks inherent in such activities. The new examination procedures demonstrate regulatory expectations that management recognize and address the risks and challenges posed by using technology. Examiner focus has now been shifted from detailed technical and control reviews, to an assessment of whether management has established effective risk management and audit practices. This new top-down approach places considerable emphasis on the management of risk and assurances through audit or independent review. What does this mean for you? If your institution has not developed an internal or external IT audit program, risk assessment, and information security program, you could be facing a problem rating at your next examination. It's not too late to get started. You are selling security to your customers - security is a cost of doing business today.

If you have any questions about the new IT Examination Process or how state examiners will be utilizing the procedures, please contact Glenn Caspers at (785) 296-2266.



Allowance for Loan and Lease Losses Adequacy: Revisiting FASB Statements 5 & 114

Ken Torgler, Regional Manager-East

The thought process behind calculating the adequacy of the allowance for loan and lease losses (ALLL) has undergone multiple changes over time. In the past, it was a fairly simple calculation, requiring very little time to prepare and analyze. However, beginning with the Tax Reform Act of 1986, which stripped away real estate investment tax shelters and devalued real estate, legislative and regulatory actions significantly altered the process. Also in 1986, the Securities Exchange Commission (SEC) issued an update for "Procedural Discipline in Determining the Allowance and Provision for Loan Losses". Then, in 1991, Congress passed the FDIC Improvement Act which required regulators to verify Call Report consistency with Generally Accepted Accounting Procedures (GAAP). While Financial Accounting Standards (FAS) 5 was originally issued in 1975, the creation of FAS 114 in 1993 changed GAAP. Once the lingering effects of the Tax Reform Act subsided, banks overall became highly profitable and loan losses decreased, but the ALLL continued to grow. In 1998, SEC analysts questioned whether financial entities were managing earnings through provision expenses (i.e., were current earnings deferred to future periods in anticipation of losses?). If so, the current period earnings were being understated, the true market value of the entity was not reflected, and there was a need to protect shareholder interests. While the SEC was focused on larger national entities, the changes soon trickled down to community banks. The result is the application of today's standards.

FAS 5 and FAS 114 are documentation-based accounting standards and GAAP does not permit the establishment of allowances that are not supported

by appropriate analyses. Therefore, the approach to determine the ALLL adequacy should be well-documented and applied consistently from period to period. Since bankers typically assume a conservative view when funding the ALLL, regulatory agencies have adopted an educational approach in discussing the ALLL funding methodology. Some bankers are using FAS 5 and FAS 114 as a justification for a lower ALLL, while others are implementing higher-risk environmental factors into the methodology to justify increased ALLL balances. Either method is acceptable as long as a systematic methodology is employed, the rationale supporting the determination is adequate, relevant matters for loan collectibility are consistently applied, and a disciplined manner and prudent judgment are utilized in all periods. Again, the key is documentation, documentation, documentation.

The majority of bankers have adopted some form of methodology in the spirit of FAS 5 and FAS 114. However, some may need to revisit their adequacy calculation and update their methodology to better reflect the intent of the accounting standards. While the actual accounting standards are not always exciting reading material, other documents can offer insight. As you conduct your review, the following information should prove helpful: SEC Staff Accounting Bulletin 102 (SAB 102) (www.sec.gov/interps/account.shtml); FFEIC Interagency Policy Statement July 2001 (www.fdic.gov/news/news/financial/2001/fil0163a.pdf); Emerging Issues Task Force Topic D-80 (www.osbckansas.org/topicD-80.pdf) and FAS 5 and 114 (Review Statements, Status, and Summary links) (www.fasb.org/).



Employee Spotlight

Main Office Administrative Staff

Do you ever wonder about the friendly voice who answers your phone call to the OSBC? This quarter's Employee Spotlight will not focus on one employee, but rather the four individuals who support the many administrative office duties at the OSBC.

Linda Bundy is the Senior Administrative Specialist who serves as the personal secretary to the Commissioner. She also supports senior management and is responsible for recordation and arrangement of the State Banking Board monthly meetings. Linda, a Topeka native, has a combined thirty-five years of office management experience and was a manager of a retail business before coming to the OSBC on May 1st, 2000. When asked what aspect of her job she enjoyed most, Linda replied, "the ability and freedom to work independently and the cohesive, positive atmosphere of the OSBC". Linda has been married for twenty-two years to Steve; they have three sons, Jared, Dustin and Aaron and one grandson, Justin. Linda is actively involved in her local church, having taught grade school and high school Sunday school classes for thirty years. She and her husband train yearling Quarter horses and she also enjoys playing the piano.



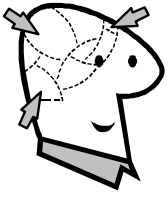
Standing (from left): Pierre Sutphin, Courtney Bevan, Linda Bundy
Seated: Barbara Worford

Pierre Sutphin, an Administrative Specialist, is originally from southern California. Pierre, who has been with the OSBC since December 17th, 2001, provides administrative support for the agency's Review Examiners and General Counsel. Pierre, a Vietnam veteran, retired from the U.S. Coast Guard in 1995 after also serving in Hawaii, the Philippines, Japan, Bangkok and Hong Kong. He has one daughter who lives in the San Francisco Bay area with his two year old grandson, Nathan. Pierre enjoys collecting Fred Harvey post cards, exploring railroad trestles, visiting antique shops and cafes. He remarked "this department's people, ethics and work environment make it a great place to be".

Barbara Worford, a Topeka native, is a Senior Administrative Assistant for the OSBC. Prior to her employment with the State of Kansas, Barbara worked for Jostens Printing and Publishing. Her first job with the state was with the Department of Social and Rehabilitative Services (SRS), where she worked in the Foster Care and Reintegration Division. She has been at the OSBC since April of 2003 and is the receptionist at the front desk. Her duties are varied, including answering the telephone switchboard, recording the timesheet and payroll information for all OSBC employees and updating annual information to bank fidelity bonds. When reflecting on her job at the OSBC, Barbara commented "Working with such wonderful people is a great privilege". Barbara has one son and is grandmother to seven year old Marquito and three year old Amari. In her free time, Barbara enjoys spending time with her grandchildren and other family members and also frequents the local coffee shops.

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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:

Our bank filed a Suspicious Activity Report (SAR) on an individual back in December of 2005. We also filed one in January and May on this same individual because the suspicious activity continued. We have been in contact with our local Federal Bureau of Investigation office, and were told the FBI is declining to further investigate the matter. Do we have to keep filing supplemental SARs if the suspicious activity is still going on? Seems like a lost cause and a waste of time if it is not going to be investigated.

- Fastidious Filer Freda

Dear Freda:

I think you may know deep down what the likely answer to this question is, but you just don't want to hear it! You are obligated to continue filing SARs if the suspicious activity continues. Guidance has been previously given on this subject by the Financial Crimes Enforcement Network (FinCEN). The guidance indicates that if conduct continues for which a SAR has been filed, the financial institution should report the ongoing suspicious activity at least every 90 days, "even if a law enforcement agency has declined to investigate or there is knowledge that an investigation has begun". FinCEN notes, "Although a series of filings may not generate immediate contact from law enforcement, the filings could still prove vital during the investigative process at a later time", and they also state, "...the information contained in a SAR that one law enforcement agency has declined to investigate may be of interest to other law enforcement agencies, as well as supervisory agencies." (*The SAR Activity Review, Trends Tips & Issues*, Issue 10, May 2006 and "Answers to Frequently Asked Bank Secrecy Act Questions" #4 and #8, at www.fincen.gov.)

There are a few clarifications to this position worth noting:

-If the bank believes the activity surrounding a SAR warrants prompt attention, the bank should contact appropriate law enforcement directly.

-If the bank believes the suspicious activity may relate to terrorism, the bank should promptly contact FinCEN's Financial Institutions Hotline, at 1-866-556-3974. It is operational seven days a week, 24 hours a day.

-And finally, an exception to the continued filing rule has been made for those types of suspicious activities referred to as "4-1-9" schemes, "advance fee fraud" schemes or "Nigerian scams". These are the ones where a person receives an unsolicited communication from someone in a foreign country, often an African nation, who purports to be a current or former official of the foreign government, and is soliciting help in transferring a large sum of money (with the promise that the recipient of the communication, of course, will benefit financially from providing assistance in the transaction). Detailed information about these schemes is available from the United State Secret Service website, at www.secretservice.gov/alert419.shtml. FinCEN has indicated they no longer want to receive SARs on these scams *if there is no monetary loss involved*. If a monetary loss has occurred, or there are indicators of other illegal activity in connection with the scam, FinCEN indicates the financial institution "should consider filing a Suspicious Activity Report based on the requirements of 31 C.F.R. Part 103 and the Suspicious Activity Report filing instructions. In addition, the financial institution should contact the local United States Secret Service field office, local police department or other appropriate law enforcement agency." (*The SAR Activity Review, Trends Tips & Issues*, Issue 7, August 2004.)

Lawfully yours,
Barry

Branch Application Summary

Dana S. Hampton, Director of Corporate Activities

We are happy to report the opening of two new state-chartered banks. Space restrictions in the winter edition of this newsletter did not allow us to give details of RelianzBank, which opened for business December 12, 2005, at 2327 North Ridge Road, Wichita. The bank opened with total capital of \$3,900,000 and is owned by Relianz Bancshares, Inc. David Harris is bank president.

On June 19, 2006, Freedom Bank opened for business at 6640 West 143rd Street, Overland Park, with total capital of \$8,325,000. The bank is owned by Freedom Bancshares, Inc. and Kurt Knutson is bank president.

On December 31, 2005, 261 state chartered banks were operating in Kansas. Since that time, four banks have merged out of existence and one new bank has opened, bringing the total number of state-chartered banks to 258. Since year end 2005, no changes in trust companies have occurred; ten state-chartered trust companies are operating in Kansas. An overview of application activity for the first half of 2006 is provided below.

Farmers State Bank, Hazelton, merged into Meno Guaranty Bank, Meno, Oklahoma, on January 1, 2006. On March 3, the former Farmers State Bank, Corning, was involved in a transaction that took place in several steps. As the end result, the Corning office became a branch of First National Bank, Centralia.

On April 1, 2006, Gold Bank, Lenexa, merged into M&I Marshall & Ilsely Bank, Milwaukee, Wisconsin; and Commercial State Bank, Bonner Springs, merged into Union Bank and Trust Company, Lincoln, Nebraska.

While these mergers resulted in a substantial decline in total assets of Kansas state-chartered banks, a number of banks expanded operations by opening the following branches:

Heartland Bank, Leawood, at 5000 West 95th Street, Suite 120 (inside the Grapeview Building), Overland Park, on January 17, 2006;

Bank of Parsons, Parsons, at 3201 North 16th Street (inside Wal-Mart), Parsons, on March 22, 2006;

First State Bank, Norton, at 801 Main, Hoxie, on April 1, through the merger with First National Bank, Hoxie;

Patriots Bank, Garnett, at 1008 Poplar, Wellsville, on April 1, through the purchase and assumption of the Gardner National Bank branch;

United Bank of Kansas, Whiting, at 734 Commercial, Atchison, on April 22, through the purchase and assumption of the Bank Midwest, N.A. branch;

The Mission Bank, Mission, at 13501 Aberdeen Parkway, Leawood, on May 9, 2006;

First Community Bank, Emporia, at 715 Merchant, Emporia, on May 20, 2006, through the purchase and assumption of the State Bank of Kansas branch; and

The Columbian Bank and Trust Company, Topeka, at 529 SW 2nd Street, Suite A., Lee's Summit, Missouri, on May 22, 2006.

In addition, on May 1, 2006, the main office of KansasLand Bank (formerly known as Americus State Bank) was moved to 314 Main Street, Quinter; the Americus office will operate as a branch.

As always, if you have questions concerning specific banks, applications, or procedures, feel free to review the application summary logs maintained on our Web page or call the main office.

Employee Spotlight

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Courtney Bevan is an Administrative Specialist for the Consumer and Mortgage Lending (CML) division of the OSBC. Originally from Oskaloosa, Kansas, she moved to Topeka in January, 2005. Courtney previously worked for Key Staffing and came to the OSBC as a part-time temporary employee in November, 2005. In May of this year, she accepted a full-time position with the OSBC. As an Administrative Specialist, she assists in planning, organizing, and implementing the CML division's nationwide licensing enforcement programs. Courtney's two children, Caden who is three years old and McKenna who is 23 months, keep her very busy! She is an avid reader and enjoys spending time at the library. When asked about her job at the OSBC, Courtney remarked "I like the teamwork atmosphere in the office and everyone here is really nice."



What's New?

Look for two new feature articles in this edition of the Kansas Quarterly Newsletter. "Technology Matters" will highlight areas of interest in the Information Technology world and will be written by Glenn Caspers, the OSBC's Regional Manager of the Technology division. Each quarter, one of the four Banking Division Regional Managers will contribute to the "Regional Review" column, which will detail current events in the various regions of our state. We hope our readers will find these new additions relevant, interesting and informative.

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