

Kansas

Quarterly Interest

The Newsletter of the Office of the State Bank Commissioner

Commissioner's Corner

*Judi Stork,
Acting Bank Commissioner*



As we begin the year of 2007, best wishes to all of you from the OSBC staff for a prosperous New Year. May all of your ratings be "1"!

2006 marked another good year for the OSBC and it brought both new additions to and departures from our staff. Long time employees Stacy Morris and George Myers, who served the agency for 23 and 27 years respectively, retired during the year, as did Commissioner Clancy Norris. We added a new Network Administrator position in our IT department this last year and filled seven vacant field examiner positions.

With regard to legislative issues, we eliminated the mandatory requirement for trust departments to file fiduciary asset reports; we will begin using the data obtained from the FDIC call reports instead. Hopefully, the elimination of this additional report will provide some small amount of regulatory relief.

The condition of the Kansas state banks as of December 31, 2006 showed 97.3% of the 255 banks with a CAMELS composite rating of 1 or 2. We currently have seven problem banks, which is the lowest number the agency has noted since 1998, when there were only four problem institutions.

Looking forward to 2007, the Governor has announced the appointment of Thomas Thull, Newton, as the new commissioner. By the time this newsletter arrives in your office, we hope Mr. Thull will have joined us here in Topeka. The new commissioner has both legislative and banking experience, which is a plus for the agency.

It has once again been my pleasure to serve as the Acting Commissioner. The cooperation, knowledge and skills of Kansas bankers are an immeasurable benefit and help to me, and our agency's staff, in carrying out our regulatory duties. I sincerely appreciate the relationships we have established.

Winter 2007

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Technology



Matters

Glenn Caspers, Regional Manager -- Technology Division

Common Deficiencies Noted in IT Examinations

Federal and State regulations target the security of information assets; therefore, regulatory Information Technology (IT) examinations and audits are focused on the confidentiality, integrity, and availability of those assets. While every examination is different and procedures may vary slightly depending on the agency, examiner, and institution, a common group of recommendations is usually being discussed in IT Reports of Examination. The intent of this article is to identify the most common deficiencies uncovered during a typical IT regulatory examination.

This information resulted from a random sample of state and federal IT Examination Reports for state banks in Kansas in 2006. The results represent a very unscientific survey, however, they do a good job of highlighting the most common IT issues. The ranking is based on the number of instances the recommendation and/or criticism appeared in the sample. Has your auditor and management team also identified and addressed these deficiencies at your institution?

1. The most common Report topic is IT audit. Exceptions ranged from very minor to extreme. On the extreme side, several banks did not have any IT audit procedures in place. Some of the less extreme recommendations involved (a) scope -- several key areas were not being included in the audit's scope; (b) frequency -- audits should generally be done on an annual basis; (c) independence -- the person conducting the review also had some control in that area; and (d) follow up -- audit exceptions were not being addressed or the Board was not being kept up-to-date on correction efforts.

2. The next most common topic relates to the risk assessment. Recommendations regarding the risk assessment process included: no ranking system of the identified risks; the need to expand the assessment to cover more areas and functions; and the lack of a

regular review (the risk assessment is a living document and must change as the bank changes).

3. IT policies are another common issue. A variety of operating policies needed expanded detail to address key technology topics and procedures. Many times, actual procedures were adequate, however, the procedures needed to be formalized and added to bank policy. A common example of this is the need to document how vendor vulnerability patches and updates are applied (i.e., patch management).

4. Board reporting and involvement is addressed regularly in IT Reports. At least annually, the Board of Directors needs to be informed of the status of the bank's information security program. Also, the Board needs to be involved in technology issues and audit results, and approve IT policies. Sufficient detail to demonstrate this involvement is sometimes lacking in the Board meeting minutes.

5. Another common topic relates to Disaster Recovery/Business Continuity. Some common deficiencies in this area include the lack of a detailed plan; the failure to test various recovery and continuity plan elements; the addition of new bank services or functions without expanding the plan; and issues with remote storage of data tapes and supplies.

6. Lastly, Report comments regularly address the Incident Response Plan. This is basically a plan for outlining what actions should be taken in case a security breach occurs or is suspected. In numerous banks, the plan was either lacking or in need of expansion.

While there are many other IT recommendations and issues that appear in Reports on a periodic basis, these topics appear to be the hot buttons at the current time. I hope this information will give you a starting place as you prepare for your next IT examination.



Where are They Now?

Then: Sharon Lessard graduated from Kansas State University with a Bachelor of Science Degree in Agriculture Economics, and served as a Financial Examiner in the Hays Field Office from June 1985 to June 1999.

Now: Sharon is currently the Chief Financial Officer & Senior Vice President with the First State Bank & Trust Company of Larned, Larned, Kansas. Besides her CFO responsibilities, Sharon handles technology and personnel responsibilities for the bank.

When asked about her experience at the OSBC, Sharon remarked, "The most challenging change from examiner to banker was the multitasking required in banking. I have so much respect for the bankers I examined. The western Kansas economy was very difficult when I began my bank examination career. During those times, you had the opportunity to learn quickly and I hope none of us forget the lessons we learned in the 1980's."

Sharon is currently serving as the President of the Fort Larned School Board and is actively involved in various other community activities, including the Larned Chamber Ambassadors Club, Fort Larned Foundation for Education, 4-H Project Leader, and Sunday School Superintendent. Her service helps her to live her motto: "Make the community where you live a better place to be".

Sharon and her husband, Mark, have two children, Alexandra, a sixth grader, and Amanda, a second grader.



Sharon Lessard

Corporate Application Overview for 2006

Dana S. Hampton, Director of Corporate Activities

Currently, 255 state-chartered banks are operating in Kansas. As of December 31, 2005, the total was 261. During 2006, one new bank opened for business and seven banks merged out of existence. No changes in state-chartered trust companies were reported during the year; ten companies remain in operation.

For the year 2006, 64 applications were filed by banks and trust companies. Applications processed include one new charter; twenty-five new branches; nine main/branch office relocations; two name changes; twelve mergers; ten changes of control; one request for fiduciary power; and four contracting trustees requests. Also processed were thirty-eight new or renewal applications authorizing companies to conduct money transmitter business in Kansas. A summary of some of the applications and transactions completed during 2006 is provided on pages six and seven of this newsletter.

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Liquidity: A Balancing Act in a Changing Landscape

Ed Spielbusch, Regional Manager -- Southeast Region

Liquidity is basically defined as the ability to fund assets and meet obligations as they come due. Financial institutions must have the ability to meet expected and unexpected cash demands from their customers, and potential customers, to function profitably, and maintain confidence in the banking system. However, cost is the part of the liquidity equation that is sometimes not fully factored in when discussions of pure liquidity arise. Banks must not only have access to funding sources, but need access to reasonably priced funding sources that lead to reasonable profits. In the simplest of times, almost all bank liquidity was provided by local customers who loaned their funds to the bank in the form of deposit accounts for a return. The bank would in turn employ these funds by purchasing investments or making loans. As a result, liquidity was easily measurable and was entirely contained within the "balance sheet" of the bank. Banks would maintain liquid balance sheet assets such as cash, due from banks, Federal funds sold, and a laddered investment portfolio. The first three categories provided immediate cash, with the laddered investment portfolio spinning off ongoing additional funding. Oh, what simple times; easily understood, easily managed, easily measured, and generally cost effective.

Now, banks are finding themselves with a myriad of non-core choices to meet their funding needs. Most prevalent of these contingent sources of liquidity is the ability to extract cash from their loan portfolio through borrowing from the Federal Home Loan Bank (FHLB). The bank pledges loans to a borrowing line from the FHLB, which depending on type, receive varying loan values. Of course, the bank must own stock in the FHLB and are bound by other limitations such as collateral. FHLB advances are available in varying products from lines-of-credit to various types of short-term, intermediate, and long-term advances under

different pricing and repayment structures. Other sources of liquidity include extracting funds from the securities portfolio, such as substituting deposit insurance for pledged securities on public funds and selling repurchase agreements. A bank can also sell participations in loans, borrow from correspondent banks, utilize a Treasury Tax and Loan (TT&L) note option, or utilize the Federal Reserve discount window. In addition, advances in technology allow for the acquisition of funds through the internet, allowing a bank to theoretically acquire funds from the world. In addition, bank's can also acquire funds through brokers in the form of brokered deposits. However, in utilizing these funding sources, management must keep in

mind part two of the liquidity equation, which is the acquisition of funding sources at a reasonable cost. More and more in today's economic environment, small banks in rural settings are finding themselves with dwindling core deposit bases which must be replaced in some manner. Couple this with the desire for some of these entities to attain growth and a higher reliance on non-traditional, non-core funding has developed. However, as a time tested saying of sage advice I recall states, "All things in moderation."

Managing liquidity in the simplest of times essentially required limited management. Banks seemed to fall within a certain balance and were bound by the restraints of their local economies, before the advent of branch banking, the internet, the FHLB, deposit insurance, and other vehicles for creating funds. Now, banking is more competitive than ever with numerous competitors chipping away at the core that individual banks enjoyed for so long. As a result, liquidity management, and the understanding of sources and uses of funds, coupled with the cost/return equation, requires constant management. Boards should develop strong investment and funds management policies along with tools to measure ongoing liquidity. Stagnant liquidity measurement



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Employee Spotlight

Jayme Hosier, Financial Examiner

Jayme is a Financial Examiner Senior in the Erie field office of the Southeast Region. She joined the agency in July 2003. Jayme says she is fortunate to work with a seasoned examination crew as well as many experienced bankers in her territory, and remains committed to learning from these tenured and capable people. In addition to her examination duties, Jayme has served on the Bank Secrecy Act (BSA) Manual Committee.



Jayme holds a Bachelor Degree in Accounting from Pittsburg State University. She began her banking career early at the age of 16, working as a teller at Peoples State Bank, Cherryvale, Kansas, for four years and returning there as an operations administrator in January 2003. She also worked as a teller for CitizensBank, N.A., Pittsburg, Kansas, while attending college. Jayme feels that in addition to her business degree, her previous bank employment provided a solid banking education that included general ledger components, basic loan documentation, customer service, and working in a professional environment; all skills that have proven invaluable in her examining career.

Jayme resides in her hometown of Cherryvale, Kansas, with her husband Danny and daughter Halle, who is two-and-a-half years old. She takes great pleasure in being a mother, and enjoys the comedic antics of her daughter. Jayme's other interests include photography, cooking, and reading.

Liquidity

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tools are probably a thing of the past and should be replaced with cash flow and profit analysis under varying funding sources. Care should be taken to not make the institution so reliant on non-traditional funding sources that they are backed into a corner where the funds have to be obtained at any cost, eroding spreads and profitability. In addition, a sufficient number of contingent sources should always be maintained as an "emergency" fund, so to speak. Lastly, it becomes very easy for balance sheet mismatches to develop, leading to interest rate risk, with short-term borrowings funding long-term assets. Liquidity is just one more aspect of banking that must be managed and monitored closer in an increasingly complicated world.

Liquidity is obviously one of the six components rated at examinations, being the "L" in the CAMELS rating system. Examiners, as always, will be scrutinizing the level and sources of your liquidity at your next examination. Examiners will measure the level of your balance sheet liquidity, look at the timing of that liquidity, look at your contingent sources of liquidity, your dependence on non-traditional funding sources, the funding commitments you have, and their likelihood of coming to fruition. In addition, the degree of mismatches such as the use of volatile liabilities and non-traditional funding sources to support long term assets (i.e. Dependency Ratio) will also be measured. Managerial oversight, measurement, and policy parameters for funds management will also be assessed.

Corporate Application Overview for 2006

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New Bank Charter	Location	Date Opened
Freedom Bank	6640 West 143 rd Street, Overland Park	6-19-06
New Branch	Branch Office Location	Date Opened
The Columbian Bank and Trust Company, Topeka	Bank-Owned Courier	1-1-06
Heartland Bank, Leawood	5000 West 95 th Street, Suite 120, Overland Park	1-17-06
Bank of Parsons, Parsons	3201 North 16 th Street, (inside WalMart), Parsons	3-22-06
The Mission Bank, Mission	13501 Aberdeen Parkway, Leawood	5-9-06
The Columbian Bank and Trust Company, Topeka	529 SW 2 nd Street, Suite A, Lee's Summit, Missouri (1)(see page 8)	5-22-06
State Bank of Delphos, Delphos	201 East Main, Glasco	7-18-06
Emporia State Bank (now known as ESB Financial), Emporia	224 East Poyntz, Manhattan	7-19-06
Hillcrest Bank, Overland Park	2911 Turtle Creek Boulevard, Dallas, Texas	7-25-06
Peoples Bank and Trust Company, McPherson	215 South Main Street (temporary office), Inman	10-10-06
Alliance Bank, Topeka	2620 SW 6 th , Topeka	10-13-06
Community Bank of Wichita	371 North Main, Haysville	10-19-06
1 st Financial Bank, Overland Park	19310 Midland Drive, Shawnee	11-1-06
First Bank of Newton	1216 North Main (inside Dillons), Newton	11-13-06
Hillcrest Bank, Overland Park	1901 Ptarmigan Trail (inside Estes Park Retirement Center), Estes Park, Colorado (2)(see page 8)	11-28-06
Solutions Bank, Overland Park	Bank-Owned Courier	12-1-06
Metcalfe Bank, Overland Park	Bank-Owned Courier	12-15-06
The Citizens State Bank, Moundridge	2315 South Kansas Avenue, Newton	12-15-06
Mulvane State Bank, Mulvane	4641 East Douglas, Wichita	12-21-06
The Valley State Bank, Belle Plaine	330 East Madison, Suite 100, Derby	12-21-06
Heartland Bank, Overland Park	8600 Ward Parkway, Suite 2015 (temporary office), Kansas City, Missouri (3)(see page 8)	12-29-06
New Branch (through bank merger or P&A of a branch office)	Branch Office Location	Date Opened
Patriots Bank, Garnett, acquired one branch office of Gardner National Bank	1008 Poplar, Wellsville	4-1-06
First State Bank, Norton, acquired First National Bank, Hoxie	801 Main, Hoxie	4-1-06
United Bank of Kansas, Whiting, acquired one branch office of Bank Midwest, N.A., Kansas City, Missouri	734 Commercial, Atchison	4-22-06
First Community Bank, Emporia, acquired one branch of State Bank of Kansas, Fredonia	715 Merchant, Emporia	5-20-06

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Corporate Application Overview for 2006

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The Union State Bank, Arkansas City acquired four branch offices of The Bank of Beaver City, Beaver, Oklahoma	119 West First Street, Udall 321 East Tenth Street, Winfield 823 Main Street, Winfield 121 West Ninth Street, Winfield (branches were formerly offices of The State Bank, Winfield)	7-1-06
Security Bank of Kansas City, Kansas City, acquired one branch office of Bank Midwest, N.A., Kansas City, Missouri	444 Minnesota Avenue, Kansas City (effective 9-29-06 the office was consolidated into the main bank)	7-15-06
Garnett State Savings Bank, Garnett acquired one branch office of Bank of Kansas City, N.A., Overland Park	207 East Broad Street, Colony (the branch was the former main office of the State Bank of Colony)	11-6-06
Hillcrest Bank, Overland Park acquired Colonial Bank, Loveland, Colorado	2102 South Garfield Avenue, Loveland, Colorado	11-6-06
Emprise Bank, Wichita, acquired Prairie State Bank, Augusta (all branch offices of Prairie State Bank were included in the merger)	512 State Street, Augusta	11-10-06
The First State Bank, Norton, acquired one branch office of Stockton National Bank, Stockton	200 South Jefferson, Plainville	12-16-06
Name Change	New Name	Effective Date
Americus State Bank, Americus (now located in Quinter)	KansasLand Bank	4-15-06
Emporia State Bank and Trust Company, Emporia	ESB Financial	9-7-06
Main Office Relocations	New Location	Date Opened
Americus State Bank (now known as KansasLand Bank), Americus	314 Main Street, Quinter (the Americus office remains a branch)	5-1-06
First Trust company of Onaga, Onaga	214 West 9 th , Onaga	11-13-06
First Community Bank, Emporia	715 Merchant, Emporia (the 2160 West Highway 50, Emporia office remains a branch)	12-8-06
Branch Office Relocations	Old and New Location	Date Opened
Haviland State Bank, Haviland	219 South Main, Mullinville 100 North Main, Mullinville	6-26-06
Ellis State Bank, Ellis	2700 Oak Street, Hays 2428 Vine Street, Hays	7-24-06
Peoples Bank, Lawrence	7810 West 151 st Street, Overland Park 7579 West 151 st Street, Overland Park	11-6-06
Fiduciary Powers		Effective Date
Silver Lake Bank, Topeka		8-23-06
Contracting Trustee	Service and Location	Effective Date
Advantage Trust Company, Salina	Trust Service Desk at First Bank Kansas, Salina, Abilene Branch	2-6-06

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Corporate Application Overview for 2006

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(1) In order to establish the branch office, Columbian Bank and Trust Company first acquired Keystone Bank, Northwoods, Missouri. After opening the branch office, assets and liabilities of the former Keystone Bank were sold to Truman Bank, Clayton, Missouri.

(2) In order to establish the branch office, Hillcrest Bank first acquired Colonial Bank, Loveland, Colorado.

(3) In order to establish the branch office, Heartland Bank first acquired Bank of Freeburg, Freeburg, Missouri. After opening the branch office, assets and liabilities of the former Bank of Freeburg were sold to Bank of St. Elizabeth, St. Elizabeth, Missouri.

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