

MINUTES OF THE SENATE FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE

The meeting was called to order by Chairman Ruth Teichman at 9:30 am. on January 18, 2011, in Room 152-S of the Capitol.

All members were present.

Committee staff present:

Ken Wilke, Office of the Revisor of Statutes
Melissa Calderwood, Kansas Legislative Research Department
Heather O'Hara, Kansas Legislative Research Department
Beverly Beam, Committee Assistant

Conferees appearing before the Committee:

Ed Splichal, Acting State Bank Commissioner
Kevin Glendening, Deputy Bank Commissioner
Chuck Stones, President and CEO Kansas Bankers Association

Others attending:

See attached list.

Chairman Teichman welcomed everyone to the meeting.

Ed Splichal, Acting State Bank Commissioner, gave an overview of the Office of the State Bank Commissioner along with an explanation about the agency and current statistical information about the condition of the entities the commission regulates. Mr. Splichal stated that frequently, national and state-chartered banks will participate in the same loans which are secured by real estate. He said if the borrower defaults on the loan, then the collateral may be foreclosed upon with title to the real estate held in the names of all the participating banks. Continuing, he stated that subject to certain conditions, national banks are allowed to exchange their participation interest in the real estate for an interest in a limited liability company which then holds, manages, markets, and disposes of the real property. He said titling the real estate in the sole name of a limited liability company, as opposed to several banks, may allow for an easier disposition of the collateral and improve the banks' ability to limit their loss.

Mr. Splichal said that since the Kansas Banking Code does not specifically grant such authority to state-chartered banks, it was determined the Special Order should be issued. Special Order 2010-1 grants state-chartered banks with similar authority to exchange their participation interests in real estate owned and acquired through debts previously contracted for an interest in a corporate entity which will manage, market and dispose of the real property. The Special Order is required to preserve the welfare of state-chartered banks and to ensure they are able to compete equally with national banks. (Attachment 1)

Following Q & A, the Chair asked Kevin Glendening for his testimony. It is attached as Page 1-4 of Acting Commissioner Splichal's testimony under CML Division.

Judy Stork, Deputy Commissioner, Banking Division, introduced a bill to amend the statutes within the banking code and allow the commissioner to require fingerprinting of any proposed officer, director, shareholder, or any other person deemed necessary. She said such fingerprints may be submitted to the Kansas Bureau of Investigation, Federal Bureau of Investigation, or other law enforcement agency for the purposes of verifying the identity of such persons and obtaining the records of their criminal arrests and convictions. Senator Taddiken moved to introduce the bill. Senator Masterson seconded. Motion passed.

Chuck Stones, President and CEO, Kansas Bankers Association, gave an overview of the Dodd-Frank Bill and summarized the main issues affecting banks of all sizes, but especially traditional community banks. Mr. Stones also gave a summary of the issues affecting state governments the most and issues that have the potential to be helpful to the banking community. (Attachment 2)

The next meeting is scheduled for January 19, 2011.

The meeting was adjourned at 10:31 am.

SENATE FINANCIAL INSTITUTIONS & INS. COMMITTEE GUEST LIST

DATE: 1-18-11

[illegible]



Ed Splichal, Acting Commissioner

Office of the State Bank Commissioner

Sam Brownback, Governor

SENATE FINANCIAL INSTITUTIONS AND INSURANCE COMMITTEE

January 18, 2011

Madame Chair and Members of the Committee:

My name is Ed Splichal, and I am the acting bank commissioner for the State of Kansas. I am pleased to have the opportunity to appear before you today and provide an overview of the Office of the State Bank Commissioner. I thought I would go into a brief explanation about the agency, who we are and what we do, and then share some current statistical information about the condition of the entities we regulate.

Our agency is totally fee funded and is primarily comprised of two divisions with oversight of financial entities. We have the banking division which charters and supervises state chartered banks, trust companies and trust departments, and money transmitter companies. This division has 56 employees. The majority of these employees are field examiners who go into the banks and trust companies, do a review of the condition of the entities, and provide feedback to our office. As a result of these on-site examinations, we provide a written examination report that is sent back to the entity, which summarizes our assessment of their bank or trust company. Additionally, our staff in Topeka provides follow-up with the entities when weaknesses are noted, and if warranted, we may issue some form of enforcement action to assist the entity in improving their condition. Our goal is to ensure safe and sound banking in Kansas. We rate our banks and trust companies on a scale of one to five, with one being the best and five being the worst. In a moment, I will share more with you on these ratings. We also have a nine member banking board that consists of six bankers, and three public members, that approve various applications, including new charters, and provides advice to the agency.

In addition, the banking division oversees money transmitter companies. We currently oversee 53 entities. These companies provide services for individuals to transmit money whether it is through wire services, money orders, or stored-value cards. We have regulated these entities for a number of years but have increased our supervision within just the last year, and are ready to begin on-site examinations of these entities.

Our second division is the Consumer and Mortgage Lending Division. They license and supervise mortgage companies and brokers, supervised lenders, loan originators, payday loan companies, notifiers, and credit service organizations. This division has a staff of 32. Much like banking, they do onsite examinations, and provide a report back to the main office for follow-up. The CML division does enforcement actions on a regular basis and fines companies and individuals for illegal activities. Additionally, unlicensed groups performing activities falling under the supervision of this division are issued cease and desist actions for being unlicensed and are fined for their inappropriate actions.

Finally, we have staff members that support the primary functions of our agency. We have a legal division with three attorneys, a consumer relations person, and a legal assistant. Additionally, we have an IT staff of four individuals, and a Finance and Administration area to oversee our budgeting, accounting, payroll, and HR functions.

Now, to share a little bit of information about the condition of the entities we regulate.

*FI: I Committee
1-18-11
Attachment 1*

BANKING DIVISION

1. **Condition of banks.** Ratings show that we currently have 52 out of 240 banks rated 3, 4, or 5. If you remember I mentioned the scale of one to five, with one being the best. Any bank rated 3 or worse is considered a problem bank. Right now we have 22% of our banks on the problem bank list. Also, we have six of those banks rated a five, which is extremely concerning. Just to contrast this, at year end 2006, we had 7 banks on the problem bank list out of 255, which is less than 3%. Additionally, we had no 5 rated banks and only one 4 rated bank.

| Week Period | Not Rated | 1 | 2 | 3 | 4 | 5 | Total / 3-4-5 |
|---|-----------|----|-----|----|----|---|---------------|
| 1/1/11 | 2 | 72 | 114 | 34 | 12 | 6 | 240 / 52 |
| Condon National Bank, Coffeyville, converted to a state bank effective 1/1/2011 | | | | | | | |

| Year Ending | Not Rated | 1 | 2 | 3 | 4 | 5 | Total / 3-4-5 |
|-------------|-----------|-----|-----|-----|----|----|---------------|
| 12-86 | 0 | 65 | 213 | 95 | 59 | 12 | 444 / 166 |
| 12-87 | 0 | 69 | 202 | 92 | 56 | 16 | 435 / 164 |
| 12-88 | 0 | 76 | 194 | 106 | 40 | 8 | 424 / 154 |
| 12-89 | 0 | 71 | 214 | 87 | 30 | 5 | 407 / 122 |
| 12-90 | 0 | 72 | 199 | 81 | 40 | 2 | 394 / 123 |
| 12-91 | 0 | 62 | 219 | 69 | 25 | 4 | 379 / 98 |
| 12-92 | 0 | 68 | 214 | 64 | 18 | 1 | 365 / 83 |
| 12-93 | 0 | 97 | 197 | 47 | 5 | 4 | 350 / 56 |
| 12-94 | 0 | 121 | 181 | 24 | 9 | 1 | 336 / 34 |
| 12-95 | 0 | 138 | 158 | 17 | 2 | 0 | 316 / 19 |
| 12-96 | 0 | 144 | 134 | 14 | 1 | 0 | 293 / 15 |
| 12-97 | 0 | 171 | 111 | 5 | 1 | 0 | 288 / 6 |
| 12-98 | 2 | 167 | 108 | 3 | 1 | 0 | 281 / 4 |
| 12-99 | 2 | 154 | 117 | 4 | 2 | 0 | 279 / 6 |
| 12-00 | 2 | 145 | 111 | 7 | 4 | 0 | 269 / 11 |
| 12-01 | 3 | 142 | 110 | 12 | 2 | 0 | 269 / 14 |
| 12-02 | 3 | 137 | 106 | 11 | 5 | 0 | 262 / 16 |
| 12-03 | 2 | 121 | 109 | 26 | 5 | 0 | 263 / 31 |
| 12-04 | 0 | 126 | 119 | 15 | 1 | 0 | 261 / 16 |
| 12-05 | 2 | 138 | 113 | 7 | 1 | 0 | 261 / 8 |
| 12-06 | 1 | 137 | 110 | 6 | 1 | 0 | 255 / 7 |
| 12-07 | 2 | 118 | 122 | 8 | 2 | 1 | 253 / 11 |
| 12-08 | 0 | 104 | 112 | 20 | 10 | 1 | 247 / 31 |
| 12/25/09 | 3 | 85 | 111 | 30 | 15 | 2 | 246 / 47 |
| 12/31/10 | 1 | 72 | 114 | 34 | 12 | 6 | 239 / 52 |

2. **Banking Enforcement Actions.** Currently we have 63 active and pending actions against banks. This includes:

3 Board Resolutions
 32 Memorandums of Understanding
 18 Cease and Desist Orders
 7 Written Agreements
 1 IT Board Resolution
 1 IT Memorandum of Understanding
 1 BSA Memorandum of Understanding

3. **Bank Closings**

Closed Sylvan Grove State Bank, Sylvan Grove on 7-23-10 Total assets at closing approx. \$28,569,714
 Closed Hillcrest Bank, Overland Park on 10-22-10 Total assets at closing approx. \$1,561,056,814

4. **Bank Conversions in 2010**

Community National Bank, Topeka, converts to a state bank effective 1/1/2010

5. **Banking Industry Financial Data – STATE Chartered Banks in KS**

| | 12-31-09 | 9-30-10 |
|---------------------------------|------------|------------|
| Total assets | 30,238,914 | 30,261,753 |
| Total deposits | 24,500,163 | 24,564,250 |
| Loan loss allowance | 371,111 | 384,499 |
| Total equity capital | 3,018,181 | 3,119,931 |
| Noncurrent loans and leases | 573,540 | 667,291 |
| Earning assets | 27,729,959 | 27,768,133 |
| Restructured loans and leases | 103,255 | 173,838 |
| Net income attributable to bank | 51,613 | 63,748 |
| Net charge-offs | 262,323 | 177,262 |
| % of unprofitable institutions | 17.07% | 14.88% |
| Net interest margin | 3.67% | 3.61% |
| Return on assets (ROA) | 0.17% | 0.28% |
| Net charge-offs to loans | 1.36% | 1.26% |
| Noncurrent loans to loans | 3.01% | 3.60% |
| Core capital (leverage) ratio | 9.21% | 9.23% |
| Tier 1 risk-based capital ratio | 13.08% | 13.68% |

6. Industry Issues

Asset Quality
Earnings
Reg Burden – new Dodd Frank law

CML DIVISION

Approved Regulated Entities as of year-end FY 10:

| | | |
|-------------------------------|-------|-------|
| Mortgage Company Licensees | | |
| Supervised Loan Licensees | | |
| Loan Originators | | |
| Notification Registrants | | |
| Credit Services Organizations | Total | 7,023 |

Total assets of licensees \$269 Billion

Fiscal Year 2010

Exams 201

Enforcement Actions completed 94

Total Cash Refunds to Consumers through Exams and Actions \$1,161,551.00

Consumer Savings through reduction in contractual obligations \$326,517.00

Fines, Settlements, and Investigative Fees Collected \$323,649.00

Telephone Contacts 11,799

CML Website Hits 1,554,932

Currently Open

Enforcement Actions 96

Complaints 121

Recent Changes

Passage of SAFE Act (July, 2008)

Implementation of NMLS for licensing all of our entities

Require testing and continuing education for loan originators

NMLS Mortgage Call Reports:

To provide state regulators with information concerning mortgage origination activity

Passage of Dodd-Frank Wall Street Reform & Consumer Protection Act which created the Bureau of Consumer Financial Protection Bureau (CFPB) (July, 2010)

Reg Z

Prohibitions against Loan Originators steering consumer to lender with less favorable terms in order to increase own compensation (YSP)

Disclosures for private education loans

Many credit card regulation and disclosure changes – limits on fees and rate increases

Higher priced mortgage loan disclosures

New Mortgage Transfer Disclosure which tells consumer who now owns their loan

g X (RESPA)

Changes to Good Faith Estimate and HUD-1 Settlement Statement

Meant to simplify ability of consumer to understand their cost of a loan product and facilitate ability of consumer to shop around for best mortgage product.

Upcoming Changes

July 21, 2011 - Transfer Date - Bureau of Consumer Financial Protection (CFPB)

Implement and enforce at least 17 Federal consumer financial laws including:

AMTPA – Alternative Mortgage Transaction Parity Act

ECOA – Equal Credit Opportunity Act

FCRA – Fair Credit Reporting Act

HOPA – Home Owners Protection Act

FDCPA – Fair Debt Collection Practices Act

GLBA - Gramm-Leach Bliley Act

HMDA – Home Mortgage Disclosure Act

RESPA – Real Estate Settlement Procedures Act

SAFE Mortgage Licensing Act

TILA – Truth – in – Lending Act

CLA – Consumer Leasing Act

Multi-State Mortgage Committee (MMC), and Multi-State Mortgage Exams

History:

- EXAMINATION PROTOCOL and AGREEMENT was created, outlining the basic framework for the coordination and supervision of multistate mortgage entities
- 49 states (including Kansas) have signed to AGREEMENT (by early 2009)
- Multistate Mortgage Committee (MMC) was established as the oversight body charged with implementing and directing processes under the AGREEMENT
- MMC comprised 10 state regulatory officials appointed by the Conference of State Bank Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR)

Kansas' involvement:

- Kevin Glendening with Kansas was an original committee member of the MMC for a 2-year term from December 2008 to December 2010
- Kansas has had involvement with MMC in drafting and implementing Exam Procedures and Multistate Exam Report Templates for use in exams
- Kansas has been involved with three multi-state exams so far
- Kansas took lead role as state in charge on the latest exam (Examiner-In-Charge state)

Special Order

Pursuant to K.S.A. 9-1715, I am notifying this committee of the one special order issued June 7, 2010 by the bank commissioner's office during 2010.

Frequently, national and state-chartered banks will buy participations in the same loans which are secured by real estate. If the borrower defaults on the loan, then the collateral may be foreclosed upon with title to the real estate held in the names of all the participating banks. Subject to certain conditions, national banks are allowed to exchange their participation interest in the real estate for an interest in a limited liability company which then holds, manages, markets, and disposes of the real property. Titling the real estate in the sole name of a limited liability company, as opposed to several banks, may allow for an easier disposition of the collateral and improve the banks' ability to limit their loss.

Since the Kansas Banking Code does not specifically grant such authority to state-chartered banks, former Commissioner Thull determined that Special Order 2010-1 should be issued. This Special Order gives state-chartered banks similar authority to that which national banks enjoy and which allows the banks to exchange their participation interests in real estate owned and acquired through debts previously contracted, for an interest in a corporate entity which will manage, market and dispose of the real property. The Special Order was required to preserve the welfare of state-chartered banks and to ensure they are able to compete equally with national banks.

STATE OF KANSAS
STATE BANK COMMISSIONER
SPECIAL ORDER 2010-1

This Special Order issued this 7th day of June 2010, by the State Bank Commissioner (Commissioner).

WHEREAS, the Comptroller of Currency (OCC) has stated that a national bank is authorized, pursuant to 12 U.S.C. § 24(Seventh) and 29, 12 C.F.R. 5.36, and OCC Interpretive Letters #1118 and #1123, to exchange real property or a participation interest in real property permissibly acquired through debts previously contracted (DPC) for other types of real and personal property as long as it is done in good faith by the bank to improve its ability to recover, or otherwise limit its loss on the DPC property, and as shall be approved by the OCC; and

WHEREAS, no provision of Kansas law presently allows a Kansas state-chartered bank to exchange its participation interest in other real estate owned (OREO) acquired through DPC for an interest in a corporate entity which would manage, market and dispose of the real property; and

WHEREAS, K.S.A. 9-1715, as amended, grants the Commissioner the power to authorize Kansas state-chartered banks to engage in any activity in which such banks could engage were they operating as a national bank; and

WHEREAS, the Commissioner deems the issuance of this Special Order to be reasonably required to preserve the welfare of state banks and to promote the competitive equality of state banks and other insured depository institutions.

IT IS THEREFORE ORDERED, that subject to the limitations and conditions set forth in this Special Order, a Kansas state-chartered bank is hereby authorized to exchange its participation interest in OREO acquired through DPC for an interest in a corporate entity which will manage, market and dispose of the real property.

IT IS FURTHER ORDERED, prior to making the exchange, the bank's directors must determine that the exchange is in the best interest of the bank and would improve the ability of the bank to recover, or otherwise limit, its loss on the DPC property. The basis for such determination must be documented.

IT IS FURTHER ORDERED, prior to making the exchange, the bank must notify the Commissioner in writing of the proposed exchange, detailing the structure of the investment and the activity or activities to be conducted by the corporate entity. Also, prior to making the exchange, the bank must receive written notification of the Commissioner's approval. The approval will be based on an evaluation of the bank's risk management and measurement systems and controls to enable the bank to exchange for, hold, and dispose of the interest in the corporate entity in a safe and sound manner, and an evaluation of any other supervisory considerations relevant to the exchange; and

IT IS FURTHER ORDERED, the bank must certify that the bank's loss exposure is limited, as a legal and accounting matter, and the bank does not have open ended liability for the obligations of the corporate entity; and

IT IS FURTHER ORDERED, that the bank must certify that the enterprise in which the bank is investing agrees to be subject to supervision and examination by the Office of the State Bank Commissioner; and

IT IS FURTHER ORDERED, the bank may not further exchange its interest in the corporate entity for an interest in any other real or personal property. Such property would be too far removed from the bank's original DPC interest in the real estate to be considered DPC property; and

IT IS FURTHER ORDERED, the bank must ensure that the corporate entity complies with K.S.A. 9-1102 and K.A.R. 17-11-17, including obtaining a current appraisal of the real estate; and

IT IS FURTHER ORDERED, consistent with the limitations in 12 U.S.C. § 29 and 12 C.F.R. Part 34, the bank must dispose of its interest in the corporate entity no later than five years from the date it initially acquired title to the OREO, unless an extension up to an additional five years is granted by the Commissioner; and

IT IS FURTHER ORDERED pursuant to K.S.A. 9-1715(b), as amended, the terms of this Special Order shall take effect on June 7, 2010, and shall remain in full force and effect until amended or revoked by the Commissioner.
IT IS SO ORDERED.

STATE BANK COMMISSIONER

J. Thomas Thull



1-19-2011

TO: Senate Financial Institutions and Insurance Committee
FROM: Chuck Stones, President

Chairwoman Teichman and Members of the Committee,

I appreciate the opportunity to appear before you today to briefly explain the Dodd-Frank Act that was passed last year in Congress.

The DFA is the largest, potentially most onerous piece of federal legislation related to the banking industry ever passed by Congress.

Included in my written testimony is:

- a summary of the main issues affecting banks of all sizes, but especially traditional community banks;
- a summary of the issues that I believe will affect State governments the most;
- a summary of issues that have the potentially helpful for the banking community.

Also, as a part of my written testimony, I have attached:

- summaries of the DFA that have been prepared by the ABA and by the legal staff of the KBA;
- some of the industry's efforts to help banks deal and comply with the DFA legislation;
- articles from the *American Banker* newspaper regarding the implications of the DFA; (the American Banker is the leading industry news source and is not affiliated with the ABA)
- a copy of my testimony prepared for a Congressional Sub-Committee this summer related to the effects of regulations on the banking industry;
- a copy of a letter from all State Bankers Associations in the country to Congress requesting hearings to examine the current regulatory and examination environment affecting banks and the future of community banks in particular;
- a copy of a very recent letter from the Chairman of the US House Committee on Financial Services relating to the prospect of those hearings.

While we realize that the majority of these issues do not affect the Kansas State Legislature, they do affect the banking industry in the state, which in turn affects the economy of the State and the Nation.

Thank you for allowing me to appear before the Committee,

A handwritten signature in black ink, appearing to read "Chuck Stones", with a stylized flourish at the end.

Chuck Stones
President & CEO

610 SW Corporate View, Box 4407 ♦ Topeka, KS ♦ 66604-0407 ♦ 785-232-3444 fax- 785-232-3484
e-mail - cstones@ksbankers.com

FI&I Committee
1-18-11
Attachment 2

The Dodd-Frank Bill Has Enormous Consequences for Community Banks

The Dodd-Frank Act will dramatically and negatively affect **all** banks – **large and small**. Some provisions will have a direct negative impact, such as the sheer volume of new regulations and new reporting burdens, many of which will flow from the new rules set by the Consumer Financial Protection Bureau (CFPB). There are other provisions which ostensibly provide some relief for community banks, but market competition and other unintended consequences are expected to quickly reverse any “static” or “initial” savings. These include the loss of interchange income (despite an exemption from mandated, below market pricing for debit transactions) and the increased competition for deposits resulting from the rise in cost of funding using **non**-deposit liabilities which will now be subject to FDIC assessments. Here are some things to consider:

5,000 Pages Of New Regulations

Congress consistently underestimates the complexity and volume of the regulations resulting from new laws. Based on the number of pages of regulations resulting from previous laws, the Dodd-Frank Act will result in more than 5,000 pages of new regulation for traditional banks. This is in addition to the 50 new or expanded regulations affecting banks over the last two years.

Consumer Financial Protection Bureau Rules Apply to All Banks

All banks – **large and small** – will be required to comply with rules and regulations set by the CFPB, including rules that identify what the bureau considers to be “unfair, deceptive, or abusive.” The CFPB can require community banks to submit whatever information it decides it needs and the **CFPB can examine community banks** at its discretion on a “sampling basis.” Thus, the new legislation will result in enormous new compliance burdens for community banks and a new regulator looking over their shoulders.

New, Undefined term in “consumer protection” laws

UDAAP – Unfair and Deceptive Acts and Practices, is well defined, accepted law. Dodd-Frank adds the term “abusive” to this law, yet did not define the term. This leaves it open for the interpretation to anyone and everyone’s interpretation. The Bureau will have broad authority to curb practices it finds to be unfair, deceptive and abusive. What constitutes “abusive” behavior may be very broadly defined and is very likely to create an environment conducive to increased litigation. This is likely to be exacerbated by the fact that State Attorneys General are authorized to enforce Federal consumer laws transferred to the Bureau and any rules issued by the Bureau as well.

Significant New Disclosures and Reporting Requirements

All banks, regardless of size, will have to comply with extensive new disclosure and reporting requirements created by the bill. For instance, the CFPB is given sweeping authority to require whatever disclosures it thinks are necessary to permit consumers to understand “the costs, benefits, and risks associated with the product or service, in light of the facts and circumstances.” All banks will have to ask a business customer whether it is a women-owned, minority-owned, or small business, maintain records of the responses, and submit the information to the CFPB each year. The Dodd-Frank Act also requires 20 new HMDA reporting obligations. These and other reporting requirements will add considerable compliance costs to every bank’s bottom line.

Loss of Interchange Income on Debit Transactions

Small banks have an exemption from the rules the Fed will set for large banks, but market share will always flow to the lowest priced product, even if those lower prices are mandated. We expect that retailers in the market will seek to reduce their costs which will compress rates overall. It also means a loss of revenue that supports free transactions and other valuable services, or both.

New Capital Standards

All banks with over \$500 million in assets will be prohibited from using trust preferred securities to raise Tier 1 capital at their holding companies going forward. This will eliminate a popular source of capital that often is down streamed to a bank. In addition, the agencies will be imposing more onerous capital rules on banks, large and small, and will force all banks to maintain higher levels of capital than expected in the past.

No Limit on Size of FDIC Insurance Fund

The Dodd-Frank Act **eliminates dividends** whenever the deposit insurance fund (DIF) exceeds 1.35 percent of insured deposits and **eliminates the hard cap** (of 1.50 percent) on the size of the fund. It also gives the FDIC **unrestricted authority** to set a new "designated reserve ratio" or long-term target ratio **above** 1.50 percent. The bill **raises the minimum** level for DIF to 1.35 percent, and does benefit banks under \$10 billion by requiring larger banks to make up the gap from the old minimum of 1.15 percent to the new minimum of 1.35 percent. Smaller banks would continue to pay premiums, however, and how this provision will be implemented is unknown. All banks would be required to keep the fund above the minimum and at the new designated reserve ratio wherever that is set.

Heightened Regulation of Mortgages

The Act significantly increases the regulation of mortgage lending and servicing by banks and nonbanks. In particular, the Act:

- Mandates comprehensive additional residential mortgage loan related disclosures.
- Requires mortgage loan securitizers to retain a certain amount of risk (as established by the regulatory agencies). However, mortgages that conform to the new regulatory standards as "qualified residential mortgages" will not be subject to risk retention requirements. DFA was passed in part to correct systemic problems in the securitization market which contributed to the crisis. Congress determined that some form of risk retention was desirable to ensure that participants in a mortgage securitization transaction had so-called "skin in the game." The goal was to prevent (or at least discourage) the origination of loans both without regard for a borrower's ability to repay, and without regard to default risk or the ultimate losses posed if originators or others in the securitization process had no risk beyond the origination stage. However, risk retention requirements cannot be considered in isolation from the other many other new mandated changes in the mortgage loan process. There have been dramatic changes to the mortgage lending process with changes to the Real Estate Settlement Procedures Act (RESPA), the Truth in Lending Act (TILA) and the Secure and Fair Enforcement for Mortgage Licensing Act. (SAFE)

These changes, in and of themselves, would be onerous. But when added all together they are driving many banks out of the mortgage lending business.

ISSUES MOST AFFECTING STATE LEGISLATURES

OCC Federal Preemption

The standard for preemption is modified for national banks. Blanket preemption will be limited and will be on a more case-by-case basis.

Interstate Branching

DFA overrides state law regarding interstate branching and provides that national and state banks can establish de novo branches in new host states under the same conditions that a bank chartered within the host state could branch on an intrastate basis.

POTENTIALLY POSITIVE ISSUES RESULTING FROM DFA

Ends the practice of "too big to fail"

- Designates "systemically significant" banks and creates a Financial Stability Oversight Council
- See included article referring to Tom Hoenig

Deposit Insurance

- Permanently increased FDIC insurance to \$250,000, but adds costs because of reserve ratio
- Changed the FDIC assessment base from deposits to assets

Non-banks subject to BCFP

Collateral Damage

Latest round of financial reforms has community banks feeling like they're catching fire meant for someone else.

by Dennis Boone

AS PRESIDENT OF THE KANSAS BANKERS ASSOCIATION, Chuck Stones has four attorneys on his staff. They deal with roughly 5,000 legal inquiries raised each year by the KBA's 320 member banks. And they're about to get a lot busier.

Although many business owners may still feel otherwise, the worst economic contraction in a generation is now, by official measures, history. But even if the country is able to dodge a recessionary Round II—which appears more unlikely as negative indicators continue to pile up—folks in Stones' line of work are becoming increasingly worried. The most recent cause for concern is a mammoth package of legislation moving through Congress and being sold as financial reforms.

At more than 2,000 pages, the complete bill has essentially been vetted by no single member of Congress, let alone by the banking industry. Hence the now-infamous quote by Sen. Chris Dodd of Connecticut, the bill's co-author, that "no one will know until this is actually in place how it works."



"Banks just don't know what to expect yet, and this is going to cause them to pull back even further."

— Chuck Stones, president, Kansas Bankers Association

So, much like the insurance industry executives awaiting the regulatory shoe to drop after health-care reform earlier this year, bankers anticipate that thousands of pages enabling regulation are headed their way. And because we still have no true understanding how the reforms will affect financial institutions' operations, Stones and other banking figures say a certain measure of paralysis is bound to set in soon.

For how long? That's anybody's guess.

"The uncertainty created by this, at least psychologically, will affect the lending markets," Stones

said. "Banks just don't know what to expect yet, and this is going to cause them to pull back even further."

"It's not exactly a whole new ball game, it's just an uncertain ball game."

If one thing is for certain as the reforms move forward, he said, it's that community banks in particular will suffer. They simply don't have the existing staff, Stones said, to deal with the huge volumes of additional regulations that are coming.

"It's not entirely clear yet, but we're estimating something like 5,000 pages of regulations that will apply to traditional banks coming from this," he said. "We're really worried about that. We've always felt like we're one of the most highly regulated industries out there, and if you add 5,000 new pages of regulations, that's an extra burden, especially on community banks."

Dealing with that, he said, will not be a simple matter of consulting his staff attorneys or devoting more bank resources needed to interpret the new laws. As with changes last year in requirements for mortgage-lending processes, the costs of compliance, and the added costs of documenting it, could prove to be too much for some banks.

"Hiring cuts into the bottom line, and some banks just aren't going to be able to do that," Stones said. "Most experts are looking at another round of consolidation like we saw in late '80s and early '90s; I have no idea what that number might be, but there will definitely be fewer banks in Kansas and in the U.S.—and that's never good for the consumer."

Max Cook, Stones' counterpart with the Missouri Bankers Association, views development with as much trepidation. The measure that could clear Congress this month, he said, "is a piece of legislation that negatively impact community banks and is going, in turn, to have a big impact on Main Street in this