



STATE OF INDIANA

DEPARTMENT OF FINANCIAL INSTITUTIONS



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September 17, 2010

Mr. Adam Horst
State Budget Director
212 State House
Indianapolis, Indiana 46204

RE: Request for Appropriations for FY 2012 & FY 2013

Dear Director Horst:

Requests for appropriations of \$7,641,949 for fiscal year 2011-2012 ("FY 2012") and \$7,681,949 for fiscal year 2012-2013 ("FY 2013") for the Department of Financial Institutions are enclosed. These requests, as well as the Current Year Estimate ("CYE") of \$7,641,949, reflect a decrease in the agency's approved fiscal year 2010-2011 ("FY 2011") appropriation of \$8,491,054.

The Department is funded exclusively by examination, supervisory, and license fees paid to it by the entities subject to its jurisdiction. No general fund monies are received by the Department. The Department is overseen by a Board of seven Members, each of whom is appointed by the Governor. Five of the seven Members represent the industries regulated by the Department, one Member represents the general public and the Director of the Department serves as the seventh Member. Pursuant to Ind. Code 28-11-3-5, the Board annually sets the fees the Department will assess its regulated entities after an analysis of projected revenue and expenditures for the upcoming fiscal year.

The Department was created by the Indiana Financial Institutions Act of 1933. This act commissioned the Department with the responsibility for supervising commercial banks, trust companies, private banks, savings banks, building and loan associations, credit unions, and finance companies incorporated under the laws of the State of Indiana. Since that time the scope of regulatory responsibility with which the Department is charged has been broadened to include the supervision of pawnbrokers, licensees under the Uniform Consumer Credit Code, licensees under the Indiana Small Loan Act, industrial loan and investment companies, money transmitters, check cashers, debt management companies, debt collection companies, and rental-purchase agreement companies. On January 1, 2009, the regulatory responsibilities of the Department were broadened to include mortgage lending companies and broadened again on July 1, 2010, to include loan originators employed by licensed mortgage lenders. The deposits of the public are protected by safety and soundness examinations and supervision of depository institutions. Borrowers are protected by compliance examinations of lending institutions chartered and/or supervised by the Department.

As of December 31, 2009, the Department supervised the following entities: 95 commercial banks, savings banks and active industrial authorities; one savings association, nine corporate fiduciaries; 47 credit unions; 230 first lien mortgage lenders; 88 subordinate lien mortgage lenders; 35 licensed lenders;

EQUAL OPPORTUNITY EMPLOYER

41 payday lenders; 2,428 other creditors, credit sellers, and financial institutions; 29 debt management companies; 61 pawnbrokers; 27 money transmitters; 48 rental/purchase businesses; 48 GAP administrators; and 60 licensed check cashers.

ACCOMPLISHMENTS AND CHALLENGES FOR 2008-2010

1. Maintained accredited status in the agency's Bank and Credit Union Divisions through the Conference of State Bank Supervisors ("CSBS") and the National Association of State Credit Union Supervisors ("NASCUS"), respectively. The accreditation programs recognize banking departments that serve the citizens of their State by operating a capable and professional regulatory program.

In 2010, CSBS and NASCUS each performed separate three-day on-site evaluations of the Department. The primary purpose of these evaluations was to determine whether the Department continues to fulfill its statutory responsibility to charter, examine, supervise and regulate all state-chartered commercial banks, trust companies, and credit unions in Indiana.

CSBS and NASCUS sent in review teams of highly experienced former regulators to perform the on-site reviews at the Indianapolis office of the Department during the three-day visits. The review teams conducted a thorough review of the Department's recently completed Self-Evaluation Questionnaires, interviewed key personnel and a cross-section of examiners, and reviewed the products of supervision.

The Department was first accredited by CSBS in March 1988, and was re-accredited in August 1994, January 2001 and August 2005. NASCUS first accredited the Department in May 1990, and re-accredited in May 1995, May 2000, and June 2005. Maintaining the Department's accredited status by both of these organizations is a goal in the Department's strategic plan.

2. Bank Division fulfilled regulatory responsibilities regarding examination commitments made via the interagency alternating examination agreement with their federal counterparts. Additionally, numerous visitations and target examinations were performed jointly with federal counterparts between examinations on various institutions due to their less than satisfactory condition.
3. The Consumer Credit Division successfully initiated and completed the licensing of over 200 First Lien Mortgage Licensees in conjunction with the Nationwide Mortgage Licensing System ("NMLS"). Additionally, approximately 100 active consumer loan licenses were transitioned to Subordinate Lien Mortgage Licenses using NMLS.
4. The Consumer Credit Division processed roughly 2,500 license applications for Mortgage Loan Originators as required by the S.A.F.E. Act, again in conjunction with NMLS. Processing the applications required a review of the applicant's credit history, a criminal background check, confirming educational requirements had been met, and corresponding with other agencies.
5. Consumer Credit Division examinations resulted in refunds in excess of \$2 million to Indiana consumers during the past two years.

6. The Department was able to meet the reserve requirements placed on its FYs 08, 09, and 10 approved budgets. Much of the cost savings were realized from a reduction in both in-state and out-of-state travel expenses. The Department has continued to expand the use of its work at home policy. In-state travel expenses were reduced in excess of \$83,000 in FY 10 from FY 09. Out-of-state travel expenses were reduced by \$34,500 in FY 10 from FY 09 as a result of a reduction in out-of-state training.
7. Evaluated and reorganized offices at the Columbus district office and were able to reduce the amount of square feet leased by 840 square feet and saved approximately \$10,000 in annual lease payments.

GOALS AND OBJECTIVES FOR 2011-2013

1. Continue to maintain national accredited status for the agency's Bank and Credit Union Divisions through CSBS and NASCUS, respectively.
2. Evaluate the merits of accreditation by CSBS of the Consumer Credit Division's mortgage regulation function and seek accreditation if deemed appropriate.
3. Achieve compliance with the established goals in Department's Program Measures and Key Performance Indicator.
4. Continue to meet the obligations of the alternating examination agreements with the Department's federal counterparts and to maintain effective cooperative working relationships with these agencies.
5. Maintain certifications achieved through the Education Foundation of State Bank Supervisors ("ESSBS") or the Department's internal certification standards that were developed in cooperation with the Governor's Office, the State Budget Agency, and State Personnel Department in 1999.
6. Complete and fully implement the new DFI Depository System. This system maintains vital current and historical information on all of the regulated entities in the Depository Division. The new system will incorporate, among other efficiencies, the procedures necessary to efficiently report the Department's established Key Performance Indicator to the Governor. The current system was developed in 2004.
7. Ind. Code 24-4.4 placed regulation of first lien mortgage lenders under the Department's jurisdiction beginning January 1, 2009. New examination procedures have been developed and approximately 100 examinations of these licensed entities have been conducted. Future examination of lenders will include new examination procedures for verification of licensing of mortgage loan originators employed by mortgage lenders who were required to become individually licensed by the Department as of July 1, 2010.
8. The Consumer Credit Division began working with their federal counterparts two years ago to conduct expanded compliance examinations of selected depository institutions. Examiners' knowledge of the examination issues has expanded and has provided the Department with timely

information regarding the compliance issues of these institutions. Consumer credit staff has reviewed compliance exam procedures used by federal compliance examiners to ensure consistency among federal and state exams in applicable areas and will implement these new examination procedures on state chartered depository institutions.

9. Continue the development and maintenance of a well-trained and experienced staff capable of conducting professional safety and soundness and consumer credit examinations. Provide necessary training opportunities to ensure the staff is knowledgeable to identify current risks and potential consequences regulated entities encounter in the current economic environment.
10. Continue efforts to scope examination procedures to maximize efficiency and prioritize examinations. Enhance the efficiency of the examination staff through a risk-oriented examination process based on the current economic environment.
11. Review and update all Indiana statutes under the jurisdiction of the agency. Repeal outdated or unnecessary statutes.

MAJOR CHALLENGES

The ongoing local and global economic crisis has had a direct impact on the Department and the entities regulated by it. Legislation passed in the 2008 general assembly to combat the real estate mortgage crisis broadened the regulatory responsibilities of the Department to include licensing and regulating mortgage lending companies on January 1, 2009. The Federal law known as the S.A.F.E. Mortgage Licensing Act of 2008 required the Department to license loan originators employed by licensed mortgage lenders by July 1, 2010. This entailed a review of over 2,500 applicant's credit history, criminal background check, and verification of educational training. Renewal of these licenses is required by December 31, 2010.

The impact of the economic crisis has also had a negative impact on the condition of Indiana Banks and Credit Unions and therefore significantly increased the Department's workload in the supervision/regulation of these entities. As of June 30, 2010 approximately 28% percent of depository institutions were adversely rated and require additional examinations or visitations to comply with examination mandates.

The Department's primary operational goal is to ensure all regulatory examinations are performed within the mandated or established time frames and to further improve on the services provided to the entities which fall under the Department's regulatory jurisdiction. In order to achieve these goals, the Department must have sufficient staff that is well-trained to identify the ever-changing risks in the financial services industry and can adequately address the increasing supervisory responsibilities being placed upon the Department. The priorities built into the projected 2012-2013 biennium budget support these goals.

On July 21, 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Act"). This sweeping legislation will require the Department to make amendments to its statutes as well as its supervisory standards and processes. Agency management is working with CSBS, NASCUS, and its federal regulatory counterparts to more clearly define the implications of this Act and to prepare for its implementation.

Please note the Department is not requesting a budget increase from our CYE (FY 2011 Spending Plan which includes agreed upon reserves) except to fund new computers pursuant to the Indiana Office of Technology's ("IOT") computer refresh cycle in FY 13, which is discussed below. The Department believes it can fund its major funding priorities without an appropriation increase from cost cutting measures initiated in the previous fiscal year.

The Department's major funding priorities for FYE 2012 and FY 2013 are as follows:

1. Maintaining adequate staffing levels is critical to the Department's ability to meet the contractual requirements of the interagency examination agreements currently in place with our federal counterparts and effectively respond to the additional regulatory responsibilities being placed upon the Department. The Department is requesting funding for 66 full-time staffing positions. This includes three vacant positions for financial institutions examiners which DFI management anticipates submitting hiring requests to fill in January 2011 and one senior level IT staff position. These three positions carry an annual cost of \$294,610 but will be partly offset by the retirement of several support staff positions that will not be filled.
2. In addition to maintaining an adequate staffing level, employees must be provided with the necessary training to ensure they achieve and retain a satisfactory level of technical competence and expertise. Department examiners must have a great deal of technical knowledge and a thorough understanding of the ever-changing risk profiles of the financial industry.

Training must be a major priority. The Department is proposing a training budget, including travel and employee tuition reimbursement, of \$158,839 for the current year and FYs 12 and 13.

3. Continue to fully fund information technology ("IT") needs to ensure that the Department can continue to provide effective and efficient regulation. The agency's cooperative examination agreements with the federal regulators require the Department to maintain a high level of sophistication in the IT area. Many of the programs used by the examining staff are developed by the federal agencies and shared with the Department for consistency purposes. In addition, the Department has its own internal programs. The standard computers provided by the Indiana Office of Technology ("IOT") do not meet the specialized needs of the software utilized by the Department.

The Department is scheduled to have its computers replaced pursuant to IOT's four-year computer refresh cycle in October 2012. The additional cost for the upgraded computers in FY 09 was \$44,000. The Department is requesting an additional \$40,000 over the CYE in FY 13 to upgrade to computers which are capable of running all of the programs necessary for the Department to provide effective and efficient regulation.

KEY PERFORMANCE INDICATOR AND PROGRAM MEASURES

The Department has one Key Performance Indicator (“KPI”) and three Program Measures approved by the Government Efficiency and Financial Planning (“GEFP”) division within the Office of Management and Budget. The Department has one program identified and one fund/center associated with these four performance metrics.

The KPI is “Satisfactory resolution to all material supervisory issues noted in Reports of Examinations and all material weaknesses identified in audit reports.” The objective of the KPI is to achieve sound financial institutions by requiring regulated entities to resolve all material supervisory issues identified by the Department or the Federal Regulators and to resolve all material audit weaknesses identified in the course of the entities’ required annual audit. The target is to have 95% of these issues resolved to the satisfaction of the Department by the next regulatory examination. The minimum acceptable percentage resolution to these issues is 85%.

Since reporting this metric beginning in the first quarter of 2009, the Department has achieved resolutions of 95% or higher three out of six quarters, resolutions of 94% to 85% two of the quarters, and fell below the minimum target of 85% one quarter.

As indicated earlier in this document, 28% of regulated financial institutions are under some type of enforcement action as a result of the current economic environment. All of these institutions as well as many of the institutions that are not under some type of regulatory enforcement action have identified supervisory material weaknesses. The success of meeting the desired target of 95% is dependent upon the ability of the financial institution management and board of directors to satisfactorily resolve those issues given the major challenges faced in the current economic environment.

The three Program Measures reported quarterly are the following:

- 1) Program Measure Objective: Provide timely examination feedback.

Target: Process 90% of independent examination reports for return to the regulated entity within 30 days from the date that the examiners leave the entity.

- 2) Program Measure Objective: Ensure proper financial services.

Target: Process 95% of applications submitted within statutory or internal timeframes.

- 3) Program Measure Objective: Address customer concerns.

Target: Resolve 95% of written complaints within 60 days of receipt.

The results of these Program Measures have been reported quarterly since the fourth quarter of 2006. There has only been three quarters in which the 95% target for Program Measure #2 was not achieved and it never fell below 90%.

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ORGANIZATION INFORMATION

The Depository Division is responsible for the safety and soundness of all State chartered banks, credit unions, corporate fiduciaries, industrial authorities and savings and loan associations. As of December 31, 2009, these entities had combined total assets in excess of \$45.1 billion. The position of Deputy Director is responsible for the daily operations of the division.

The Consumer Credit Division is responsible for consumer credit companies, pawnbrokers, payday lenders, check cashers, rental purchase companies, debt management companies, money transmitters, first lien mortgage lenders, subordinate lien mortgage lenders, mortgage loan originators, guaranteed auto protection providers and compliance with the Uniform Consumer Credit Code. The Deputy Director who is responsible for the daily operations of the Consumer Credit Division also serves as the agency's chief legal counsel. He and the associate legal counsel provide legal expertise to all divisions of the Department to ensure compliance with both state and federal laws.

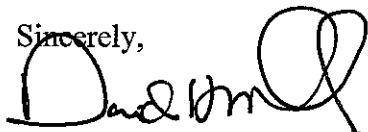
The Administration Division is managed by a Deputy Director whose responsibilities include office management, fiscal operations/budgeting, planning, training, human resources, and information technology.

The three Deputy Directors report directly to the Director of the Department. The Director, who is appointed by and serves a four-year term at the pleasure of the Governor, is the chief executive and administrative officer. The policy-making power of the Department is vested in a bipartisan board of seven Members who are appointed by the Governor. The Director is one of the seven members. Three of the Members must have practical experience at the executive level of a state chartered bank, state chartered savings association, or a state chartered savings bank. Of the remaining three Members, one must have practical experience at the executive level as a lender licensed under Ind. Code 24-4.5, one must have practical experience at the executive level of a state chartered credit union, and one must be appointed with due regard for the consumer, agricultural, industrial, and commercial interests of Indiana.

A copy of the Department's organizational chart is enclosed.

If you have any questions please do not hesitate to contact me at 317-233-9460 or Gina Williams, Deputy Director of Administration, at 317-232-5841.

Sincerely,



David H. Mills, Director
Department of Financial Institutions

cc: James Cooper
John Schroeder
Troy Pogue
Gina Williams