STATE OF INDIANA **DEPARTMENT OF FINANCIAL INSTITUTIONS**

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September 21, 2012

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

RE: Request for Appropriations for FY 2014 & FY 2015

Dear Director Horst:

This request is for appropriations of $7,451,491 for fiscal year 2013-2014 ("FY 2014") and $7,451,491 for fiscal year 2014-2015 ("FY 2015") for the Department of Financial Institutions. These requests, as well as the Current Year Estimate ("CYE") of $7,451,491, reflect a decrease in the agency's fiscal year 2012-2013 ("FY 2013") approved appropriation of $7,681,949.

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. On an annual basis, pursuant to Ind. Code 28-11-3-5, the Members set the fees the Department assesses its regulated entities after a review 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 has been charged has been broadened to include the supervision of industrial loan and investment companies, pawnbrokers, money transmitters, check cashers, debt management companies, rental purchase companies, licensees and registrants under the Uniform Consumer Credit Code, and licensees under the Indiana Small Loan Act. In 2009, the regulatory responsibilities of the Department were broadened to include first lien mortgage lending companies and broadened again in 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 and consumers are protected by compliance examinations of lending institutions chartered and/or supervised by the Department.

As of December 31, 2011, the Department supervised the following entities: 93 commercial banks, savings banks and active industrial authorities; one savings association, eight corporate fiduciaries; 44 credit unions; 253 first lien mortgage lenders; 83 subordinate lien mortgage lenders; 32 licensed lenders; 36 payday lenders; 2,293 other creditors, credit sellers, and financial institutions; 38 debt management companies; 63 pawnbrokers; 32 money transmitters; 48 rental purchase businesses; 45 GAP administrators; 56 licensed check cashers; five debt cancellation administrators, five exempt company registrants; and 2,794 mortgage loan originators.

ACCOMPLISHMENTS AND CHALLENGES FOR 2010-2012

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 financial institution oversight departments that serve the citizens of their State by operating a capable and professional regulatory program.

   The Department was first accredited by CSBS in March 1988, and was re-accredited in August 1994, January 2001, August 2005, and August 2010. NASCUS first accredited the Department in May 1990, and re-accredited it in May 1995, May 2000, June 2005, and August 2010. Maintaining the Department's accredited status by both of these organizations is a goal in the Department's strategic plan.

2. Bank Division continued to fulfill its regulatory responsibilities regarding examination commitments made via the interagency alternating examination agreements 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. Consumer Credit Division completed over 1,600 examinations of all types of non-depository lenders which resulted in refunds totaling $3,720,782 to Indiana consumers and identified 659 non-dollar violations during the past two years.

4. Consumer Credit Division developed new examination procedures for verification of the licensing of mortgage loan originators employed by mortgage lenders. As of December 31, 2011, there were 2,794 licensed mortgage loan originators. The Consumer Credit Division also implemented new examination procedures on state chartered depository institutions. Consumer credit staff worked with their federal counterparts to expand compliance examinations to ensure consistency among federal and state exams in applicable compliance areas.

5. The Department met the reserve requirements placed on its FYs 2011 and 2012 approved budgets.

6. With the assistance of the Indiana Department of Administration, re-negotiated leases at the Columbus district office and the Fortune Park district office at reduced rates. We are currently in negotiations with the landlord at the main office for a reduction in rate as well.

7. Completed and implemented the new 2009 DFI Depository System. This system maintains vital current and historical information on all of the regulated entities in the Depository Division. The new system incorporates, among other efficiencies, the procedures necessary to efficiently report the Department's established Key Performance Indicator ("KPI") to the Governor. For its KPI, the Bank Division achieved an overall 95% resolution rate for the material supervisory issues reported from January 1, 2010 through June 30, 2012.

8. Restructured job responsibilities and realized other efficiencies to eliminate three positions of retiring support staff.

GOALS AND OBJECTIVES FOR 2013-2015

1. Continue to maintain national accredited status for 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.

2. Achieve compliance with the established goals in Department's Program Measures and Key Performance Indicator.

3. 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.

4. Maintain certifications achieved through the Education Foundation of State Bank Supervisors ("EFSBS"), NASCUS, or the Department's internal certification.

5. Work with CSBS to coordinate information sharing with the recently created Consumer Financial Protection Bureau ("CFPB"). Develop and implement cooperative supervision and regulation procedures with the CFPB.

6. Recruit and retain individuals who can view the Department as a long-term career option through the utilization of the Department's established career path. At least five employees with tenures ranging from 18 years to 37 years have indicated their intentions to retire within the next two years. Replacing these employees will be critical.

7. Complete the development and implementation of the new SharePoint 2010 site to fully utilize efficiencies and processes being developed. In April of 2012, the Department contracted with a third-party to provide expertise in the transition from the old SharePoint site and development of the new site. The project is approximately 75% completed.

8. Continue the development and maintenance of a well-trained and experienced staff capable of conducting professional safety and soundness and consumer credit examinations. This will

require continuing to provide the necessary training opportunities to ensure the staff is knowledgeable to identify current risks and potential consequences regulated entities encounter in the current or changing economic environment.

9. Continue efforts to scope examination procedures to maximize efficiency and prioritize examinations. This includes the successful integration of the new federal examination programs EST/ALERT and SAGE to continue to enhance the efficiency of the examination staff through a risk-oriented examination process.

10. Continue to review the benefits and implications of having more license types apply and renew their licenses via the Nationwide Mortgage Licensing System (NMLS). NMLS is an automated system that collects payments and records data for state regulatory agencies on a nationwide basis. This would require legislative changes be made on renewal dates as well as authorization for the Department to require the use of NMLS by the licensees.

11. Adopt and maintain a total electronic work paper and document storage system that reduces overall cost and effectively and securely stores information.

12. Review and, as necessary, update all Indiana statutes under the jurisdiction of the agency. Repeal outdated or unnecessary statutes.

MAJOR CHALLENGES

Increased merger or acquisition activity in the next few years could result in fewer banks and lower revenues. This is a particular concern if one or more large banks is acquired or converts from a state to a national charter. Beginning in FY 2013, the effect on revenue of the loss of two banks that were acquired in 2012 will be realized.

An increase in the number of banks and credit unions converting from federal to state charter could stress examiner resources but increase income. In FY 2012, four federally chartered institutions converted to a state charter. This, coupled with both anticipated retirements and possible unanticipated departures, could create a challenge for our limited examination resources.

Revenues are also likely to go down due to the improving condition of our financial institutions as the 25% surcharge is eliminated. While some of this may be offset by conversions or as certain banks expand their asset size though growth and acquisitions, the net effect is likely to be negative to the Department's revenue stream during FYs 2014 and 2015.

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. These services must be reviewed annually to ensure that they adequately address the risk factors present in today's ever-changing financial services industry. In order to achieve these goals, the Department must have sufficient staff that is well-trained and can adequately address the increasing supervisory responsibilities being placed upon the Department. The priorities built into the projected 2014-2015 biennium budget support these goals.

The Department believes it can fund its major funding priorities without an appropriation increase due to cost cutting measures initiated in previous fiscal years.

The Department's major funding priorities for FYE 2014 and FY 2015 are as follows:

1. Maintaining adequate staffing levels has always been 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 responding to the additional regulatory responsibilities being placed upon the Department. The Department is requesting funding for 61 full-time staffing positions.

   The previous biennium budget approved a staffing level of 66 full-time positions for the Department. The positions of several support staff who retired were not replaced . Future vacancies due to retirements and resignations must be replaced as soon as the retirement or resignation becomes known. Approximately 25% of the professional staff is currently eligible to retire. It takes a minimum of five years to fully train a financial institutions examiner, with a significant portion of that consisting of on-the-job training. The Department must begin that training process immediately to ensure sufficient time for the transfer of knowledge necessary to provide the required regulatory services in an effective and timely manner.

   The current year estimate and requested appropriations for FYs 2014 and 2015 do not include increases in Point 1 for promotions, certifications, and pay for performance, or increases in health care costs.

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 is a major priority. The Department is proposing a training budget, including travel and employee tuition reimbursement, of $99,000 for the current year and $108,000 in FYs 2014 and 2015.

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.

KEY PERFORMANCE INDICATOR AND PROGRAM MEASURES

The Department has one Key Performance Indicator ("KPI") and three Program Measures. The Department has one program identified and one fund/center associated with these four performance metrics. On August 16, 2012, Director David H. Mills and Deputy Director Gina Williams met with GEFP Analyst Gloria Downham to discuss these 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." This KPI encompasses the highest priority concerns and includes matters that have the potential to pose significant risk to the regulated entity's safety and soundness, or represent significant instances of noncompliance with laws and regulations. Approval for the KPI was received in an e-mail dated September 12, 2012 from Ms. Downham.

The satisfactory resolution to these material issues assures residents adequate and proper financial services; protects the interest of depositors, borrowers, shareholders, and consumers; promotes safety and soundness in Indiana financial institutions; and advocates and enforces compliance with applicable state and federal laws. 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%. As indicated previously in this document, an overall resolution rate 95% of material issues was achieved for the period of January 1, 2010 to June 30, 2012.

The three Program Measures reported quarterly are the following:

1) Program Objective: Provide timely examination feedback.

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

2) Program Objective: Ensure proper financial services.

   Target: Process applications submitted within statutory or internal timeframes.

3) Program Objective: Address customer concerns.

   Target: Resolve written complaints within 60 days of receipt.

The results of these Program Measures have been reported quarterly since the fourth quarter of 2006.

<u>ORGANIZATION INFORMATION</u>

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, 2011, these entities had combined total assets in excess of $48.5 billion. A 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, payroll, accounting, 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 bi-partisan 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 IC 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 attached.

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