



Missouri Division of Finance

UPDATE

A Report of Missouri State Chartered Financial Institutions

Issue 06-1

March 2006

From . . .
Commissioner
D. Eric McClure

It is my pleasure to once again report that our banks are safe and sound while they continue to serve and share in the success of our Missouri communities. Total assets in our state chartered banks reached another milestone at year-end 2005 and now exceed \$60 billion. New charter activity continues this year, even after a strong showing in 2005 when six newly chartered state banks opened.

It has been my honor to serve as Chairman of CSBS (Conference of State Bank Supervisors) for the past nine months. I have never been more confident at how important our state banks are and how important our strong community bank system is to both our national and local economies. Thanks to all of you who support CSBS and its mission.

The effect of recent hurricanes in the South demonstrates again how the best in people often comes out during times of great challenge. I am very proud and impressed with how the banks and the state bank regulators dealt with the immediate and long term affects of these disasters. We can all learn from these experiences as well as those from the terrorist event which occurred in 2001. Our Missouri banks have successfully met their own disasters ranging from fire, flood and tornados. FEMA has recently raised its awareness of the significance of a Missouri earthquake and examiners are being asked to focus on this risk at future examinations. Formal meetings with federal regulators and the banking industry will be held in the coming months in order to further strengthen our disaster preparation and planning.

GENERAL USURY

Section 408.030 provides that the Director of Finance shall declare the quarterly market rate of interest each quarter, post it in accordance with Section 361.110 and publish it in appropriate publications. Said quarterly market rate for the period April 1, 2006 through June 30, 2006 shall be 7.7%; as an alternative, 10% may be used.

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Commissioner Comments (continued)

Our banks are well capitalized and overall earnings remain good. Several banks have very rapid growth strategies and we will continue to closely monitor how they face the many challenges of successfully managing that growth. Other issues we continue to monitor include a large number of banks with only moderate earnings and return on asset ratios hovering around .5 percent. Overall, loan portfolios continue to exhibit strong growth but I am concerned that loan loss reserves are not growing proportionately. For the first time in recent memory, a significant decline in the ratio of the loan loss reserves to total loans is apparent. I have always been very proud of the proactive approach exhibited by our banks to fund strong reserves and I will become alarmed if this significant decline continues. Systemwide, liquidity is very tight as many banks struggle to find deposits in order to fund their strong loan demand.

We are planning Outreach Meetings for October and November of this year. I always enjoy these meetings and value the opportunity to see you and hear about your local issues. The tentative dates are listed below. I hope you will please mark your calendars now and make plans to attend. By the time we meet, the Division of Finance will likely be operating from within the newly titled Department of Insurance, Financial Institutions and Professional Registration per Governor Blunt's Executive Order 06-04.

Kansas City - October 4

Sikeston - October 11

Jefferson City - October 31

Springfield - November 2

St. Louis - October 12

CONSOLIDATION

Governor Matt Blunt issued executive order 06-04 on February 1, 2006, which will consolidate the state agencies that manage and regulate financial services and provide professional oversight. The Division of Finance, Division of Credit Unions, State Banking Board and Professional Registration will transfer into the Department of Insurance and create a newly titled Department of Insurance, Financial Institutions and Professional Registration.

Governor Blunt states "The financial products market is evolving and to regulate these industries effectively and efficiently we must also evolve."

The new department's primary function will be the regulation of industries and individuals. Dale Finke will serve as director of the Department and he will appoint a deputy director whose primary responsibility will be to assist with insurance industry regulation.

Barring any legislative opposition, the Division of Finance, Division Credit Unions and Division of Professional Registration will be transferred to the new department effective August 28, 2006. The State Banking Board and the Directors of the Division of Finance, Division of Credit Unions and Division of Professional Registration will continue to be appointed by the governor and retain all authority as currently provided by law.

SUPER WILDCARD PROVISIONS ISSUED IN 2005

In 2005 the Division of Finance issued two "super wildcard" letters pursuant to Section 362.106(4), RSMo. in order to provide Missouri state chartered banks parity with federally chartered banks and to provide regulatory relief. You may wish to review the full content of these letters on our website at www.missouri-finance.org.

Interpretative Letter No. 1-2005 increases the amount a Missouri bank is allowed to invest in a "banker's bank" from 5 percent to 10 percent of unimpaired capital, provided the investing bank performs proper due diligence. This relief measure provides an increased opportunity to enhance the correspondent services available to Missouri banks.

Interpretative Letter No. 2-2005 relieves Missouri banks from the publication requirement for the notice of shareholder's meetings, provided the bank complies with the model business code (Chapter 351) and provides the actual printed or written notice to the shareholder. This authorization matches that of federally chartered banks and alleviates the expense of publication while still ensuring that actual notice is provided to the shareholder.

PROPOSED INTERAGENCY GUIDELINES FOR COMMERCIAL REAL ESTATE (CRE) LENDING

These proposed guidelines, which are out for comment until April 14, 2006, will require banks with high concentrations of commercial real estate to bolster their underwriting and risk management policies and in some instances even raise capital. Banks with commercial real estate portfolios (including loans for multifamily and non-farm, nonresidential properties that are not owner-occupied) equal to 300 percent or more of capital would be considered highly concentrated, as well as those with construction loans (including construction, land development and other land) equal to 100 percent or more of capital. If enacted, the guidelines would impose numerous requirements in the area of CRE lending, including Board and management oversight, strategic planning, risk assessment and monitoring of CRE loans, internal rating systems and a two dimensional loan classification system.

At present 91 of Missouri's state chartered institutions will come under this guidance if the proposal is enacted. Bank management should become familiar with this proposal and the effect it will have on individual institutions as redrafting of loan policies will be likely and additional segregation and identification of all real estate loans by type and possible establishment of reserves for CRE concentrations may be required. To review this proposal, go to: <http://www.fdic.gov/regulations/laws/federal/2006/06guide113.html>.

EARTHQUAKE INSURANCE --- ARE MISSOURI BANKS COVERED?

Recent studies by various groups report that along the Mississippi River corridor and for many miles to the west, severe to total devastation could result from a large earthquake. Commissioner Eric McClure has recently spoken to several banks and trade groups in Missouri as well as around the nation, about the need for banks to obtain earthquake coverage to mitigate their loan risk, and the concern that this coverage is absent on a majority of the banks' existing credits.

The Division of Finance strongly urges your Board of Directors and daily management to consider this potential risk and to obtain appropriate insurance coverage where possible. In addition, the topic of earthquake disaster should be addressed in your Disaster/Recovery and Emergency/Contingency Plan in order to provide guidance should a catastrophic event occur. The recent destruction in the Gulf Coast area provides us with a reality check of how critical adequate planning is in order to limit potential loss and prevent unnecessary interruption of service.

THE TRUST INDUSTRY IN MISSOURI

The Division of Finance regulates 45 institutions (35 banks and 10 non-deposit trust companies) that provide fiduciary and investment management services with the largest providers geographically located in St. Louis, Kansas City, Springfield, and St. Joseph. Statewide, the trend in the dollar amount of assets under management is as follows:

2003	\$18,199,000,000
2004	\$13,577,000,000
2005	\$17,845,000,000

The decrease in assets under management which occurred in 2004 resulted from the merger of a Missouri non-deposit trust company into an out of state affiliate. Growth in assets of 31 percent during 2005 was the result of several favorable factors, not the least of which included strong equity and real estate markets, low interest rates and enactment of favorable trust laws. Concerted business development efforts and establishment of trust offices in Florida, California and Illinois by some of our larger institutions, have all contributed to strong healthy growth in this industry. During 2005, one non-deposit trust company with assets of \$12 million self-liquidated.

CHARTER ACTIVITY IN 2005 – A NEAR RECORD YEAR

Six de novo bank charters were issued in 2005 which was the second highest year of activity in the past seventeen years, surpassed only in 1997 when seven new charters were issued. The newest members to the state banking system and the amount of their initial cash capital are:

1st Advantage Bank	St. Peters, Missouri	\$10,695,000
St. Louis Bank	Town & Country, Missouri	20,300,000
American Trust Bank	Kirksville, Missouri	3,750,000
FortuneBank	Arnold, Missouri	9,300,000
Triad Bank	Frontenac, Missouri	13,246,000
WestBridge Bank & Trust Co.	Chesterfield, Missouri	12,500,000

In addition, the purchase and relocation of an existing charter which is majority owned by an out of state holding company, allowed for the start-up of Summit Bank of Kansas City, Lee's Summit, Missouri, with capitalization of \$8,300,000.

Strong expansion activity by our banks resulted in the establishment of 46 new branches in 2005. The most recent FDIC data indicates there are a total of 2,225 main bank and branch locations in the entire state of Missouri with 1,289 or 58 percent of these offices maintained by Missouri state charters.

LEGISLATIVE UPDATE 2005

HB 707 presents significant updates to sections of law affecting the Division of Finance (Chapter 361), banks (Chapter 362) and financial institutions in general. The Division was pleased to have the support of the administration, the legislature and the industry for this bill. HB 707 became effective August 28, 2005.

(1) Political Affiliation. The requirement that bank examiners must be hired on the basis of their political affiliation was removed from Section 361.060.

(2) Confidentiality. Sections 361.070 and 361.080 were updated to include all business entities under the Division's jurisdiction with confidentiality protection. The circumstances under which sensitive information could be obtained from the Division, subject to protective order, have been more closely defined.

(3) Subpoena power. The Commissioner's authority to compel the attendance of witnesses and the production of documents and electronic records in an examination or investigation is updated (361.070). The changes reflect modern administrative practice.

(4) Removal of officers. The Commissioner's authority to remove an officer or director from a financial institution (361.262) is enhanced so that the removal may also bar that individual from any other state bank, savings or trust institution.

(5) Bank liquidation. Under 361.365 the Commissioner may appoint the FDIC as the liquidating agent when an insured depository institution has been closed. The amendment to this statute removes a requirement to petition the circuit court for an order confirming the appointment of the FDIC. (361.365). A decision to take possession of or to close a bank continues to be subject to judicial review under 361.360.

(6) Amendment and restatement of articles. Section 362.042 is amended to allow the amendment and restatement of bank Articles of Agreement in one step. This is modeled after similar authority for general business corporations (351.107).

(7) Drop Boxes. Section 362.107 is amended to specify that a drop box for deposit purposes is not considered a branch bank.

(8) Loans to insiders. Section 362.170 is amended to remove the loan limitation and required board reports relating to insider loans and adopts Federal Reserve Regulation O as the state standard. The repealed provision broadly applied to all "salaried officers" whereas Regulation O applies to insiders and executive officers as defined.

(9) Reserves. Sections 362.210, .213, .215, and .217 are repealed and Section 362.225 amended to eliminate state reserve requirements that have been pre-empted by federal law for depository institutions.

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(10) Accounting. Sections 362.300 and 362.305 are amended to strike antiquated language regarding net income, surplus funds and undivided profits and edit sections 362.310 and 362.315 for clarity.

(11) Non-emergency temporary branch closings. Section 362.520 is amended to allow non-emergency temporary branch closings and procedures for notice. A notice must be posted in the lobby, on the entrances, and provided to the Division in order for a branch office of a bank to temporarily close for a reasonable period of time, for necessary repairs or for purposes decided by the bank's board of directors.

(12) Reciprocity Law for out-of-state trust companies. Section 362.600 is updated with the term "foreign corporation" changed to "out-of-state bank or trust company" and expanded to include any thrift institution under the jurisdiction of the Office of Thrift Supervision as well as national banks. Unless the out-of-state bank or trust company verifies to the Division that it satisfies certain capital requirements or maintains a bond for faithful performance of fiduciary duties, the Commissioner may require a bond of at least \$1 million.

Legislative Proposal for 2006

Clean Up and Regulatory Relief – Banks

Section 362.275 mandates certain bank reports and lists that must be reviewed by the Board of Directors. It is being proposed that the required content of these reports be revised to provide more useful information to the Board and to eliminate information that is no longer needed.

A proposed change to Section 362.445 regarding service of legal process on a bank will make this section consistent with Missouri rules of civil procedure and be expanded to cover all types of service for all banks. All banks will be authorized at their option to appoint a service agent and register the appointment with the Division for public reference.

Amendment of Money Order/ Money Transmitter Law

The "sale of checks law" at Sections 361.707, .711 and .715 applicable to money order and money transmitter businesses, including stored value cards, is proposed to be substantially amended.

The cost of doing business in the money transmitter industry is escalating due to more stringent federal Bank Secrecy Act and Anti-Money Laundering laws and there is a decline in the number of banks willing to take on the risks associated with serving this industry. Enhanced licensing requirements and state regulatory oversight is expected to mitigate some of these concerns and help reduce the banking costs associated with serving the money transmitter industry.

DEPOSITARIES REQUESTED TO ADHERE TO LEVY COMPLIANCE RULES

Article provided by and printed at the request of the IRS

In 2004, the number of levies issued by the Internal Revenue Service exceeded 2 million – triple the number in 2001. As IRS enforcement efforts continue to increase, the IRS is asking depositaries to review and understand their responsibilities with regard to processing levies.

Method of Delivery

Treas. Reg. § 301.6331-1(c) authorizes the IRS to provide depositaries notices of levy by mail. However, the regulation does not preclude in-person delivery of a levy to a local branch or office by a revenue officer. Additionally, depositaries may not designate a specific branch or location for service of hand-delivered levies.

No matter how a levy is received, by mail or hand delivered, depositaries are expected to adhere to IRS guidelines by immediately processing the levy and freezing all affected accounts for the 21-day period required by Internal Revenue Code (IRC) Section 6332(c). A levy becomes effective the date signed and noted by a representative acting on behalf of the depositary or the date it is hand-delivered in person by a revenue officer.

Requests for Account Balance

When the IRS has served a levy or is about to serve a levy, the IRS may make immediate demand for information about the balance in accounts maintained by the taxpayer. The 21-day waiting period does not apply to such requests and the information should be provided to the duly authorized and credentialed IRS employee as soon as possible. (IRC Section 6333)

Research

The IRS has observed that some depositaries have overlooked easily identifiable accounts. The instructions on Form 668-A, Notice of Levy, require the recipient to:

Make a reasonable effort to identify all property and rights to property belonging to this person. At a minimum, search your records using the taxpayer's name, address, and identifying number(s) shown on this form.

Processing Fees

All of the funds in a taxpayer's account up to the amount of the levy should be turned over to the IRS. The levy instructions state:

You may not subtract a processing fee from the amount you send us.

Any fees due to the depositary must be paid from funds remaining, if any, after the levy has been satisfied.

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Personal Liability

In cases where the IRS learns a depository overlooked or misreported information in response to a levy, the IRS may serve a summons to obtain the balance of the account at the time of the levy. The IRS will demand payment of that amount from the depository regardless of the current availability of funds in the account.

If payment is not received, the IRS may file suit to ask the court to determine whether the depository's failure to identify the account was reasonable and whether personal liability and a 50 percent penalty should be imposed for failure to honor the levy. There is no statute of limitations for bringing a levy enforcement suit against a third party depository. (IRC Section 6332(d))

Summary

The IRS wants to avoid wrongful levies just as much as depositories want to protect depositors and appreciates that depositories must carefully balance competing interests and legal duties when processing levies. However, if an error is made, the aggrieved depositor has recourse only against the IRS. In these rare cases, the IRS provides the complying depositories with explicit indemnification from liability.

Any depository in doubt about any aspect of processing a levy is encouraged to call the contact number on the levy for clarification.

CSBS TO CONDUCT BOOT CAMP FOR BSA PROFESSIONALS IN KANSAS CITY MAY 1 – 5

This is a high level, intensive five day course that has been used to train 180 bank examiners from 25 states along with 23 bankers to think like a BSA compliance officer. A team of highly experienced BSA experts from both the governmental and private sectors will lead each session and utilize hands-on exercises in order to have the student apply his/her knowledge to real-life situations. At the conclusion of this training, students will have the skills to evaluate the strengths and weaknesses of a BSA program and the knowledge to improve it. If you are interested in registering, or wish to obtain additional information, visit the CSBS website at www.csbs.org and click on the picture of Uncle Sam.

BANKING PERFORMANCE

Missouri state-chartered banks continue to produce strong overall results. As of December 31, 2005, 298 state-chartered banks held \$60.4 billion in assets and \$48.4 billion in deposits. These totals represent growth rates of 8.6 and 8.7 percent, respectively, since December 31, 2004 when 298 banks held assets and deposits of \$55.6 billion and \$44.6 billion. During the preceding twelve months, six banks left the state banking system through mergers. Six new banks were chartered.

Selected performance measurements of Missouri state-chartered banks include:

	Missouri State Banks		
	2005	2004	2003
Total Assets (\$millions)	60,383	55,584	52,196
Asset Growth (%)	8.63	6.49	12.12
Loan Growth (%)	11.70	7.99	14.81
Deposit Growth (%)	8.65	5.65	11.43
Loan Loss Reserve/Total Loans	1.30	1.44	1.41
Net Income/Average Assets	1.15	1.12	1.13
Net Interest Income/Earning Assets	3.78	3.71	3.82
Net Charge-offs/Loans	0.16	0.20	0.27
Non Performing Loans/Total Loans	1.52	1.54	1.76
Tangible Equity Capital/Assets	9.00	8.92	9.01
Loans/Assets	72.98	70.98	70.00
Earning Assets/Assets	92.31	92.82	91.94

Missouri state-chartered banks remain in good condition. Earnings performance remains generally strong; however, there are some negative earnings signs. There were fifteen banks that were unprofitable in 2005 (including nine de novo institutions) compared to only ten in 2004 (five de novo institutions). Additionally, the number of state-chartered banks with return on average assets ratios under 0.50 percent increased from 37 in 2004 to 47 in 2005. Overall earnings performance remains stable. The number of problem banks remains low. Currently eight Missouri state-chartered banks are considered “problem banks” due to their composite CAMELS ratings being a 3 or worse (two reports in process will likely increase the number of problem banks to ten).

INTEREST RATE RISK - JUST A REMINDER

Almost a decade ago, the Joint Agency Policy Statement on Interest Rate Risk was issued and universally applied to all federally insured banks. This Policy Statement requires certain things of all banks, regardless of their size or complexity. It assigns responsibility to the Board of Directors for establishing policy limits for interest rate risk and ensuring these parameters are being monitored and maintained. Limitations on the potential impact of changes in market interest rates on both earnings and the economic value of equity should be adopted.

On at least a quarterly basis, senior management and the Board should receive a report on the bank's interest rate risk profile and the content of this report should address the requirements specified in the Policy Statement. It is the responsibility of your senior management to manage interest rate risk on both a long range and day-to-day basis consistent with the directives provided by the Board.

Periodically, an independent review should be conducted to ensure the bank's interest rate risk management process is accurate and the findings of this review should be reported to the Board annually. The review should include back-testing of the risk measurement calculations by comparing actual to forecasted results.