

Office of the
Legislative Fiscal Analyst

FY 2002 Budget Recommendations

Joint Appropriations Subcommittee for
Commerce and Revenue

Department of Financial Institutions

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1.0 Department of Financial Institutions

Summary

The Department of Financial Institutions regulates the deposit taking state-chartered institutions in the State of Utah. This includes banks and credit unions. The assets of these regulated businesses have grown in recent years. The Year 2000 challenge will have a significant impact on this industry.

Funding for the Department is from a General Fund Restricted Account for Financial Institutions. Fees are collected on assets and some examinations (UCA 7-1-401,402, 403). These funds are used solely for the regulation of financial institutions. Funds remaining at the end of the year lapse back to the restricted account.

Department Mission Statement

The mission of the Department of Financial Institutions is to promote the availability of sound financial services in the State of Utah through chartering, regulating, and supervising financial institutions under the Department's jurisdiction.

In the case of depository institutions, the statutory charge is to charter, regulate, supervise and safeguard the interest of shareholders, members, depositors, and borrowers, through on site examinations and remedial action orders. The primary activity of the department is the examination of supervised depository institutions to determine their financial strength and solvency.

In the case of persons or entities that provide financial services to the public, the statutory requirement is that credit terms extended to consumers in the State of Utah be lawful and easily understood.

Utah Tomorrow

The Department of Financial Institutions has been involved with Utah Tomorrow since its inception. Benchmarks have been established in the areas of Free Enterprise and Regulatory Systems and Economic Development. The Department of Financial Institutions contributes to the State business climate and to the growth and expansion of free enterprise within the State.

Financial Summary

	Analyst FY 2002 Base	Analyst FY 2002 Changes	Analyst FY 2002 Total
Financing			
GFR - Financial Institutions	\$2,850,300	\$856,600	\$3,706,900
Total	<u>\$2,850,300</u>	<u>\$856,600</u>	<u>\$3,706,900</u>
Programs			
Administration	\$2,759,500	\$832,600	\$3,592,100
Bldg Operations & Maintenance	90,800	24,000	114,800
Total	<u>\$2,850,300</u>	<u>\$856,600</u>	<u>\$3,706,900</u>
FTE/Other			
Total FTE	40	10	50

2.0 Budget Highlights: Financial Institutions

2.1 Significant Increase in Revenue

Because of the growth in the Industrial Loan Corporation (ILC) industry, revenues to the Department's Restricted Fund are projected to exceed \$5.0 million in FY 2002. The Department's expenditure request is \$3.8 million, leaving over \$1.2 million in surplus revenues. The Department's Restricted Fund already has a surplus sufficient to allow for budgetary adjustments during any potential economic downturn in the industries they regulate.

Financial institutions annual fees are set by statute, requiring legislative action for any change. In the operation of the Department, revenues should equal expenditures as closely as possible. Surplus in the Department's Restricted Fund account should be kept to a minimum, while allowing for fluctuations in the growth or decline in the industries they regulate. Legislation has been proposed that will reduce the revenue. Senate Bill 44, "Fees Payable to the Commissioner of Financial Institutions" will reduce the revenue and still provide enough funding for the building block recommendations.

2.2 Ten Financial Examiners

The financial services industry in Utah has more than tripled in the last five years. As financial institutions grow in size and complexity, the Department's examination abilities also need to increase. Growth in the industry must mean growth in regulator oversight. Besides the growth of assets, the complexity of financial products has also increased. As financial institutions introduce new and complex products for citizens to invest in, the Department's examiners need to be well trained to adequately assess the safety and soundness of these products. With an increase in FTEs, examiners would be available to participate on each examination and more experienced examiners would receive training in complex and specialized areas. The Analyst recommends full funding for 10 FTE. This is \$729,600 from the General Fund Restricted – Financial Institutions Account.

General Fund Restricted – Financial Institutions Account ...\$729,600

2.3 Infrastructure

The Analyst recommends an additional \$89,000 one-time funding from the General Fund Restricted – Financial Institutions Account for space preparation and equipment for the additional ten FTE recommended above.

General Fund Restricted – Financial Institutions Account ...\$89,000

2.4 Rent Increase

The Analyst recommends an additional \$24,000 ongoing funding from the General Fund Restricted – Financial Institutions Account for rent for the additional space for the new financial examiners.

General Fund Restricted – Financial Institutions Account ...\$24,000

2.5 Copy Machine

The Analyst recommends \$14,000 one-time funding from GFR – Financial Institutions Account to replace a seven year old copy machine.

General Fund Restricted – Financial Institutions Account ...\$14,000

3.1 Programs: Financial Institutions-Administration

Recommendation The Analyst recommends funding of \$3,592,100 General Fund Restricted - Financial Institutions. This funding is for all Department personnel and operations. The recommendation includes 1) the retirement fund reduction; 2) the ongoing building block recommendation of \$729,600; and 3) a one-time funding recommendation of \$89,000. If the Committee does not approve these building blocks, the base budget would be \$2,773,500.

Financial Summary

	2000	2001	2002	Est/Analyst
Financing	Actual	Estimated	Analyst	Difference
GFR - Financial Institutions	\$2,743,000	\$2,817,000	\$3,592,100	\$775,100
Lapsing Balance	(232,700)			
Total	<u>\$2,510,300</u>	<u>\$2,817,000</u>	<u>\$3,592,100</u>	<u>\$775,100</u>
Expenditures				
Personal Services	\$2,224,300	\$2,446,600	\$3,055,900	\$609,300
In-State Travel	56,600	55,000	66,100	11,100
Out of State Travel	45,000	75,900	101,000	25,100
Current Expense	137,400	159,100	236,200	77,100
DP Current Expense	47,000	80,400	118,900	38,500
Total	<u>\$2,510,300</u>	<u>\$2,817,000</u>	<u>\$3,592,100</u>	<u>\$775,100</u>
FTE/Other				
Total FTE	40	40	50	10

Summary The Department of Financial Institutions regulates 23 banks, 97 credit unions, 19 industrial loan companies and one savings and loan. This totals 140 institutions. The Department employs 40 personnel.

Two primary Department goals are: 1) to do the number of examinations required to maintain the health of the State-chartered banking and credit union systems in Utah; and 2) to be accredited by the financial institution peers in the new interstate banking environment.

Department Revenue The Department of Financial Institutions has a dedicated source of revenue from fees approved by the Legislature. These funds are deposited into a General Fund restricted account identified for the Department. All allocations of funds to the Department must be appropriated by the Legislature. Unexpended funds at the end of the year automatically lapse back to the Restricted General Fund Account for the Department of Financial Institutions.

Because a large fund balance was building, a fee reduction enacted by the Legislature went into effect during FY 1998. It is estimated that revenue will continue to grow as both assets and the number of financial institutions are expected to increase. Projections indicate continued growth in assets and institutions that should increase the fund for future budgets.

Financial Institutions General Fund Restricted Revenue Collections	
FY 1995 Actual	\$1,951,479
FY 1996 Actual	2,156,990
FY 1997 Actual	2,444,899
FY 1998 Actual	2,321,554
FY 1999 Actual	2,539,205
FY 2000 Actual	2,765,266
FY 2001 Estimated	3,279,400
FY 2002 Projected	5,397,600

Largest Utah Chartered Institutions

The following is a partial list of the largest Utah-Chartered Financial Institutions:

❖ Merrill Lynch Bank USA	(ILC)	\$ 14.8 Billion
❖ American Express Centurion Bank	(ILC)	\$ 14.9
❖ G E Capital Financial	(ILC)	\$ 3.1
❖ Providian Bank	(ILC)	\$ 2.8
❖ American First Credit Union		\$ 1.7
❖ Conseco Bank		\$ 1.6
❖ Advanta Bank	(ILC)	\$ 1.0

Industrial Loan Corporations (ILC)

The FY 2002 revenues to the Department’s Restricted Fund are projected to exceed \$5.0 million in FY 2002 primarily because of Industrial Loan Corporation assets. An Industrial Loan Corporation is a depository charter that:

- ❖ Can be owned by a non-bank.
- ❖ Is eligible for Federal Depository Insurance Corporation (FDIC) insurance.
- ❖ Is excepted from the definition of a “bank” set forth in the Bank Holding Company Act of 1956 (BHCA).

Ten Financial Examiners

The financial services industry in Utah has more than tripled in the last five years. As financial institutions grow in size and complexity, the Department’s examination abilities also need to increase. Growth in the industry must mean growth in regulator oversight. Historically, the Department has averaged approximately 1.9 examiners per billion dollars in assets under supervision. This is slightly higher than the national average. As the level of total assets has increased, the number of examiners has not kept pace with the Department’s supervisory responsibility. As of June 30, 1999, the Department had 24 examiners supervising \$25.6 billion in total assets. (.94 examiners per billion in total assets.) As of June 30, 2000, the Department had 23 examiners supervising \$49.4 billion in total assets. (.47 examiners per billion in total assets.)

Besides the growth of assets, the complexity of financial products has also increased. As financial institutions introduce new and complex products for citizens to invest in, the Department’s examiners need to be well trained to adequately assess the safety and soundness of these products. With an increase in FTEs, examiners would be available to participate on each examination and more experienced examiners would receive training in complex and specialized areas.

The Analyst recommends full funding for 10 additional FTE. This is \$729,600 from the General Fund Restricted – Financial Institutions Account.

General Fund Restricted – Financial Institutions Account ...\$729,600

Infrastructure

The Analyst recommends an additional \$89,000 one-time funding from the General Fund Restricted – Financial Institutions Account for space preparation and equipment for the additional ten FTE recommended above.

General Fund Restricted – Financial Institutions Account ...\$89,000

Copy Machine

The Department’s current photocopy machine will be seven years old by FY 2002. Given the number of breakdowns it is now experiencing and the changes in technology, it is time for a change. The Analyst recommends \$14,000 one-time funding from GFR – Financial Institutions Account to replace a seven year old copy machine.

General Fund Restricted – Financial Institutions Account ...\$14,000

Performance Measures

The Department of Financial Institutions has established a series of performance measures and tracking items. The following items are a partial listing to indicate Department activity.

The additional types of examinations that must be done are listed above. Increased revenue is expected due to the growth in the number of institutions and their assets.

Examinations	FY 1996	FY 1997	FY 1998	FY 1999	FY 2000
Safety and Soundness					
Banks/ILC/S&Ls	25	32	28	26	29
Credit Unions	94	85	91	81	88
Specialty					
All Types	7	3	6	2	5
Year 2000	0	0	80	119	121
Compliance	0	0	1		
Assets in Financial Institutions					
Under Department Jurisdiction	\$22.2B	\$22.2B	\$24.9B	\$37.2B	\$49.4B

3.2 Programs: Financial Institutions-Office Lease

Recommendation The Analyst recommends funding of \$114,800. This continues the lease at the same rate as FY 2001 with additional funding of \$24,000 for added space for ten new financial examiners. Funding is from the General Fund Restricted Account for Financial Institutions.

Financial Summary

	2000	2001	2002	Est/Analyst
	Actual	Estimated	Analyst	Difference
Financing				
GFR - Financial Institutions	\$82,400	\$90,800	\$114,800	\$24,000
Total	<u>\$82,400</u>	<u>\$90,800</u>	<u>\$114,800</u>	<u>\$24,000</u>
Expenditures				
Current Expense	\$82,400	\$90,800	\$114,800	\$24,000
Total	<u>\$82,400</u>	<u>\$90,800</u>	<u>\$114,800</u>	<u>\$24,000</u>
FTE/Other				

Summary The Department of Financial Institutions is located at 324 South State Street on the second floor. This prime Salt Lake City office space is located in an area of escalating lease expenses. The parking garage is being rebuilt. The project has been in process over one year. Parking is provided from third party vendors.

The current lease was negotiated four years ago and expires in 2005. The rate is \$11.75 per square foot with no escalation clause. Other agencies that have had to renew their leases are considering moving. The Department’s lease is well within the acceptable range established by the Division of Facilities and Construction Management (DFCM). The new space will cost more, currently estimated at approximately \$18 per square foot.

Rent Increase The Analyst recommends an additional \$24,000 ongoing funding from the General Fund Restricted – Financial Institutions Account to rent the additional space needed for the new financial examiners.

General Fund Restricted – Financial Institutions Account ...\$24,000

Performance Measures No performance measures for this area.

4.0 Tables: Department of Financial Institutions

	1998	1999	2000	2001	2002
Financing	Actual	Actual	Actual	Estimated	Analyst
GFR - Financial Institutions	\$2,503,300	\$2,832,800	\$2,825,400	\$2,907,800	\$3,706,900
Beginning Nonlapsing		37,700			
Closing Nonlapsing	(37,700)				
Lapsing Balance	(10,200)	(251,800)	(232,700)		
Total	\$2,455,400	\$2,618,700	\$2,592,700	\$2,907,800	\$3,706,900
Programs					
Administration	\$2,374,800	\$2,533,800	\$2,510,300	\$2,817,000	\$3,592,100
Bldg Operations & Maintenance	80,600	84,900	82,400	90,800	114,800
Total	\$2,455,400	\$2,618,700	\$2,592,700	\$2,907,800	\$3,706,900
Expenditures					
Personal Services	\$2,046,100	\$2,078,000	\$2,224,300	\$2,446,600	\$3,055,900
In-State Travel	56,400	53,200	56,600	55,000	66,100
Out of State Travel	52,300	75,000	45,000	75,900	101,000
Current Expense	229,300	210,600	219,800	249,900	351,000
DP Current Expense	32,800	70,400	47,000	80,400	118,900
DP Capital Outlay	16,300	131,500			
Capital Outlay					14,000
Other Charges/Pass Thru	22,200				
Total	\$2,455,400	\$2,618,700	\$2,592,700	\$2,907,800	\$3,706,900
FTE/Other					
Total FTE	39	39	40	40	50