



Dora
Department of Regulatory Agencies

Office of Policy, Research and Regulatory Reform

2012 Sunset Review: Division of Financial Services

October 15, 2012





Executive Director's Office

Barbara J. Kelley
Executive Director

John W. Hickenlooper
Governor

October 15, 2012

Members of the Colorado General Assembly
c/o the Office of Legislative Legal Services
State Capitol Building
Denver, Colorado 80203

Dear Members of the General Assembly:

The mission of the Department of Regulatory Agencies (DORA) is consumer protection. As a part of the Executive Director's Office within DORA, the Office of Policy, Research and Regulatory Reform seeks to fulfill its statutorily mandated responsibility to conduct sunset reviews with a focus on protecting the health, safety and welfare of all Coloradans.

DORA has completed the evaluation of the Colorado Division of Financial Services. I am pleased to submit this written report, which will be the basis for my office's oral testimony before the 2013 legislative committee of reference. The report is submitted pursuant to section 24-34-104(8)(a), of the Colorado Revised Statutes (C.R.S.), which states in part:

The department of regulatory agencies shall conduct an analysis of the performance of each division, board or agency or each function scheduled for termination under this section...

The department of regulatory agencies shall submit a report and supporting materials to the office of legislative legal services no later than October 15 of the year preceding the date established for termination....

The report discusses the question of whether there is a need for the regulation provided under Article 44 of Title 11, C.R.S. The report also discusses the effectiveness of the Division of Financial Services and staff in carrying out the intent of the statutes and makes recommendations for statutory changes in the event this regulatory program is continued by the General Assembly.

Sincerely,

Barbara J. Kelley
Executive Director





John W. Hickenlooper.
Governor

Barbara J. Kelley
Executive Director

2012 Sunset Review: Colorado Division of Financial Services

Summary

What Is Regulated?

The Financial Services statute provides regulatory oversight for state chartered credit unions, state chartered savings and loan associations and life care institutions (collectively referred to as "institutions") as well as the Colorado Public Deposit Protection Act.

Why Is It Regulated?

The purpose of the regulatory oversight is to provide protection to consumers by ensuring, among other things, financial stability of state chartered credit unions and state chartered savings and loan associations, as well as to ensure that life care institutions are in compliance with applicable laws and regulations.

Who Is Regulated?

In fiscal year 10-11, there were 50 state chartered credit unions, 4 savings and loan associations and 8 life care institutions.

How Is It Regulated?

The Financial Services statute is enforced by the Financial Services Board (Board) and the Commissioner of Financial Services. The Board is a Type 1, policy autonomous board with the authority to, among other things, impose discipline and promulgate rules.

What Does It Cost?

In fiscal year 10-11, the total expenditures for the oversight of institutions were \$1,672,110. There were 14 full-time equivalent employees associated with this regulatory oversight.

What Enforcement Activity Is There?

In fiscal year 10-11, there were two enforcement actions imposed on state chartered credit unions, and both enforcement actions were fines for credit unions that failed to submit their financial statements on time.

Key Recommendations

Continue the Division of Financial Services for 11 years, until 2024.

One of the most important regulatory requirements, to ensure consumer protection, for institutions is the examination and audit process, which is generally conducted by both the Division of Financial Services and the Federal Deposit Insurance Corporation. Additionally, the Board is authorized to impose discipline (enforcement actions) on institutions. All of the enforcement actions in fiscal years 06-07 through 10-11 were on credit unions. There were various types of enforcement actions, including the revocation of a state charter. The absence of regulatory oversight, particularly the examination and audit requirements, of institutions in Colorado would likely compromise consumer protection as well as Colorado's short-term and long-term economic stability. As such, the General Assembly should continue the Division of Financial Services for 11 years, until 2024.

Major Contacts Made During This Review

Colorado Division of Financial Services
Erickson Retirement Communities
Federal Deposit Insurance Corporation
Financial Services Board Members
Mountain West Credit Union Association
National Association of State Credit Union Supervisors

What is a Sunset Review?

A sunset review is a periodic assessment of state boards, programs, and functions to determine whether or not they should be continued by the legislature. Sunset reviews focus on creating the least restrictive form of regulation consistent with protecting the public. In formulating recommendations, sunset reviews consider the public's right to consistent, high quality professional or occupational services and the ability of businesses to exist and thrive in a competitive market, free from unnecessary regulation.

Sunset Reviews are Prepared by:
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Background

Introduction

Enacted in 1976, Colorado's sunset law was the first of its kind in the United States. A sunset provision repeals all or part of a law after a specific date, unless the legislature affirmatively acts to extend it. During the sunset review process, the Department of Regulatory Agencies (DORA) conducts a thorough evaluation of such programs based upon specific statutory criteria¹ and solicits diverse input from a broad spectrum of stakeholders including consumers, government agencies, public advocacy groups, and professional associations.

Sunset reviews are based on the following statutory criteria:

- Whether regulation by the agency is necessary to protect the public health, safety and welfare; whether the conditions which led to the initial regulation have changed; and whether other conditions have arisen which would warrant more, less or the same degree of regulation;
- If regulation is necessary, whether the existing statutes and regulations establish the least restrictive form of regulation consistent with the public interest, considering other available regulatory mechanisms and whether agency rules enhance the public interest and are within the scope of legislative intent;
- Whether the agency operates in the public interest and whether its operation is impeded or enhanced by existing statutes, rules, procedures and practices and any other circumstances, including budgetary, resource and personnel matters;
- Whether an analysis of agency operations indicates that the agency performs its statutory duties efficiently and effectively;
- Whether the composition of the agency's board or commission adequately represents the public interest and whether the agency encourages public participation in its decisions rather than participation only by the people it regulates;
- The economic impact of regulation and, if national economic information is not available, whether the agency stimulates or restricts competition;
- Whether complaint, investigation and disciplinary procedures adequately protect the public and whether final dispositions of complaints are in the public interest or self-serving to the profession;
- Whether the scope of practice of the regulated occupation contributes to the optimum utilization of personnel and whether entry requirements encourage affirmative action;
- Whether administrative and statutory changes are necessary to improve agency operations to enhance the public interest.

¹ Criteria may be found at § 24-34-104, C.R.S.

Types of Regulation

Consistent, flexible, and fair regulatory oversight assures consumers, professionals and businesses an equitable playing field. All Coloradans share a long-term, common interest in a fair marketplace where consumers are protected. Regulation, if done appropriately, should protect consumers. If consumers are not better protected and competition is hindered, then regulation may not be the answer.

As regulatory programs relate to individual professionals, such programs typically entail the establishment of minimum standards for initial entry and continued participation in a given profession or occupation. This serves to protect the public from incompetent practitioners. Similarly, such programs provide a vehicle for limiting or removing from practice those practitioners deemed to have harmed the public.

From a practitioner perspective, regulation can lead to increased prestige and higher income. Accordingly, regulatory programs are often championed by those who will be the subject of regulation.

On the other hand, by erecting barriers to entry into a given profession or occupation, even when justified, regulation can serve to restrict the supply of practitioners. This not only limits consumer choice, but can also lead to an increase in the cost of services.

There are also several levels of regulation.

Licensure

Licensure is the most restrictive form of regulation, yet it provides the greatest level of public protection. Licensing programs typically involve the completion of a prescribed educational program (usually college level or higher) and the passage of an examination that is designed to measure a minimal level of competency. These types of programs usually entail title protection – only those individuals who are properly licensed may use a particular title(s) – and practice exclusivity – only those individuals who are properly licensed may engage in the particular practice. While these requirements can be viewed as barriers to entry, they also afford the highest level of consumer protection in that they ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Certification

Certification programs offer a level of consumer protection similar to licensing programs, but the barriers to entry are generally lower. The required educational program may be more vocational in nature, but the required examination should still measure a minimal level of competency. Additionally, certification programs typically involve a non-governmental entity that establishes the training requirements and owns and administers the examination. State certification is made conditional upon the individual practitioner obtaining and maintaining the relevant private credential. These types of programs also usually entail title protection and practice exclusivity.

While the aforementioned requirements can still be viewed as barriers to entry, they afford a level of consumer protection that is lower than a licensing program. They ensure that only those who are deemed competent may practice and the public is alerted to those who may practice by the title(s) used.

Registration

Registration programs can serve to protect the public with minimal barriers to entry. A typical registration program involves an individual satisfying certain prescribed requirements – typically non-practice related items, such as insurance or the use of a disclosure form – and the state, in turn, placing that individual on the pertinent registry. These types of programs can entail title protection and practice exclusivity. Since the barriers to entry in registration programs are relatively low, registration programs are generally best suited to those professions and occupations where the risk of public harm is relatively low, but nevertheless present. In short, registration programs serve to notify the state of which individuals are engaging in the relevant practice and to notify the public of those who may practice by the title(s) used.

Title Protection

Finally, title protection programs represent one of the lowest levels of regulation. Only those who satisfy certain prescribed requirements may use the relevant prescribed title(s). Practitioners need not register or otherwise notify the state that they are engaging in the relevant practice, and practice exclusivity does not attach. In other words, anyone may engage in the particular practice, but only those who satisfy the prescribed requirements may use the enumerated title(s). This serves to indirectly ensure a minimal level of competency – depending upon the prescribed preconditions for use of the protected title(s) – and the public is alerted to the qualifications of those who may use the particular title(s).

Licensing, certification and registration programs also typically involve some kind of mechanism for removing individuals from practice when such individuals engage in enumerated proscribed activities. This is generally not the case with title protection programs.

Regulation of Businesses

Regulatory programs involving businesses are typically in place to enhance public safety, as with a salon or pharmacy. These programs also help to ensure financial solvency and reliability of continued service for consumers, such as with a public utility, a bank or an insurance company.

Activities can involve auditing of certain capital, bookkeeping and other recordkeeping requirements, such as filing quarterly financial statements with the regulator. Other programs may require onsite examinations of financial records, safety features or service records.

Although these programs are intended to enhance public protection and reliability of service for consumers, costs of compliance are a factor. These administrative costs, if too burdensome, may be passed on to consumers.

Sunset Process

Regulatory programs scheduled for sunset review receive a comprehensive analysis. The review includes a thorough dialogue with agency officials, representatives of the regulated profession and other stakeholders. Anyone can submit input on any upcoming sunrise or sunset review via DORA's website at: www.askdora.colorado.gov.

The regulatory functions of the Division of Financial Services (Division), as enumerated in Article 44 of Title 11, Colorado Revised Statutes (C.R.S.), shall terminate on July 1, 2013, unless continued by the General Assembly. During the year prior to this date, it is the duty of DORA to conduct an analysis and evaluation of the administration of the Division pursuant to section 24-34-104, C.R.S.

The purpose of this review is to determine whether the currently prescribed regulation of state chartered credit unions, state chartered savings and loans and life care institutions should be continued for the protection of the public and to evaluate the performance of the Division staff. During this review, the Division must demonstrate that the regulation serves to protect the public health, safety or welfare, and that the regulation is the least restrictive regulation consistent with protecting the public. DORA's findings and recommendations are submitted via this report to the Office of Legislative Legal Services.

Methodology

As part of this review, DORA staff attended Financial Services Board (Board) meetings; interviewed Division staff; reviewed Board records and minutes including complaint and disciplinary actions; interviewed officials with state and national professional associations; interviewed state chartered credit union, state chartered savings and loans and life care institution representatives; reviewed Colorado statutes and Board rules; and reviewed the laws of other states.

Profile of the Industry

The Board and Division provide regulatory oversight for state chartered credit unions, state chartered savings and loan associations and life care institutions as well as administers the Colorado Public Deposit Protection Act.

There are two types of charters available for credit unions and savings and loan associations: federal and state. This sunset review focuses on the regulation of state chartered credit unions and state chartered savings and loan associations. Hence, this sunset review will refer to state chartered credit unions and state chartered savings and loan associations as credit unions and savings and loan associations, respectively.

Further, life care institutions do not receive a state charter from the Board, so they are referred to as life care institutions throughout this sunset review.

The Board approves state charters for credit unions and savings and loan associations. A state charter is essentially an agreement that governs the manner in which a credit union or savings and loan is regulated and operates.

Credit Unions

Credit unions are similar to traditional banks in terms of the products and services they offer to their members. For instance, credit unions may offer deposit accounts and investment services, and they may issue checks and automated teller machine (ATM) cards.²

Credit unions are also authorized to provide business loans as long as the loans do not exceed 12.25 percent of a credit union's total assets. For example, a credit union with total assets of \$10 million is authorized to provide not more than \$1,225,000 in business loans.

Some of the most recognizable differences between credit unions and banks include:

- Credit unions are cooperative financial institutions;
- Credit unions are exempt from federal taxes; and
- Credit unions require a common field of membership for customers.

Credit unions are non-profit institutions that are mutually owned by their account holders, also known as members.³ Profits earned by credit unions are either invested back into the organization or paid out to members as dividends.⁴

Credit unions are exempt from federal taxes, which could be one element that enables credit unions to offer competitive and sometimes lower rates on loans (e.g., auto and personal).

² How Stuff Works. *How Credit Unions Work*. Retrieved October 24, 2011, from <http://money.howstuffworks.com/personal-finance/banking/credit-union.htm>

³ How Stuff Works. *How Credit Unions Work*. Retrieved October 24, 2011, from <http://money.howstuffworks.com/personal-finance/banking/credit-union.htm>

⁴ How Stuff Works. *How Credit Unions Work*. Retrieved October 24, 2011, from <http://money.howstuffworks.com/personal-finance/banking/credit-union.htm>

Originally, credit unions were designed to be cooperative financial institutions for people who share a common bond. Common bond includes members who work for the same company or organization; attend the same college; serve in the Armed Forces; belong to the same church; or live in the same neighborhood.

All of the credit union members' deposits are insured up to \$250,000 per individual depositor by the National Credit Union Share Insurance Fund (NCUSIF). The NCUSIF is administered by the National Credit Union Administration (NCUA).

NCUA insurance covers all type of deposits, including deposits in shared draft accounts, savings accounts or time deposit (certificate of deposit) accounts.⁵

NCUA insurance does not insure money invested in stocks, bonds, mutual funds, life insurance policies, annuities or municipal securities.⁶

Savings and Loan Associations

Savings and loan associations were originally established to provide financing of long-term residential mortgages.⁷ In addition to financing long-term residential mortgages, over the years, savings and loan associations expanded the types of services offered to their customers such as accepting deposits in savings accounts.

Additionally, savings and loan deposits are insured by the Federal Deposit Insurance Corporation (FDIC). The FDIC is an independent agency of the federal government, and its mission is to protect consumers (depositors) against the loss of their deposits if an insured savings and loan association fails.⁸ FDIC insurance covers all types of deposits received at an insured savings and loan association, including deposits in a checking account, negotiable order of withdrawal account, savings account, money market deposit account or time deposit such as a certificate of deposit.⁹

FDIC insurance covers consumers' accounts dollar-for-dollar, including principal and any accrued interest through the date of the insured bank's closing, up to the insurance limit (\$250,000).¹⁰ The standard deposit insurance amount (\$250,000) is per consumer, per insured savings and loan association for each ownership category.¹¹

⁵ NCUA. *Is My Money Safe in a Credit Union?* Retrieved August 8, 2012, from <http://www.mycreditunion.gov/protect/Pages/Is-My-Money-Safe-in-a-Credit-Union.aspx>

⁶ NCUA. *Is My Money Safe in a Credit Union?* Retrieved August 8, 2012, from <http://www.mycreditunion.gov/protect/Pages/Is-My-Money-Safe-in-a-Credit-Union.aspx>

⁷ Enotes. *Banks, Savings and Loans, Credit Unions.* Received August 8, 2012, from <http://www.enotes.com/banks-banking-reference/banks-savings-and-loans-credit-unions>

⁸ Federal Deposit Insurance Corporation. *Your Insured Deposits.* Retrieved July 10, 2012, from <http://www.fdic.gov/deposit/deposits/insured/basics.html>

⁹ Federal Deposit Insurance Corporation. *Your Insured Deposits.* Retrieved July 10, 2012, from <http://www.fdic.gov/deposit/deposits/insured/basics.html>

¹⁰ Federal Deposit Insurance Corporation. *Your Insured Deposits.* Retrieved July 10, 2012, from <http://www.fdic.gov/deposit/deposits/insured/basics.html>

¹¹ Federal Deposit Insurance Corporation. *Your Insured Deposits.* Retrieved July 10, 2012, from <http://www.fdic.gov/deposit/deposits/insured/basics.html>

The FDIC, however, does not insure money invested in stocks, bonds, mutual funds, life insurance policies, annuities or municipal securities.¹²

Life Care Institutions

Life care institutions, also known as continuing care retirement communities, offer a variety of living options and services for older adults. Oftentimes, healthy adults can choose to live in single-family homes, apartments or condominiums.¹³ When assistance with everyday activities becomes necessary, residents can move into assisted living or nursing care facilities.¹⁴

The cost of living at a life care institution varies, with most facilities requiring an entrance fee, which is paid up-front, ranging from \$100,000 to \$1 million.¹⁵ Residents may also be required to pay a monthly fee.

The Colorado Department of Public Health and Environment issues licenses to life care institutions. The regulatory function of the Division with respect to life care institutions is the financial review and evaluation of the facilities to ensure compliance with laws and regulations. The Board, in turn, is authorized to issue implementing regulations for the examinations.

Prior to 1992, the Colorado Division of Insurance (DOI) within the Department of Regulatory Agencies was responsible for reviewing financial statements to ensure safety and soundness of life care institutions. The General Assembly, in 1992, shifted this responsibility from the DOI to the Division. Essentially, the rationale for the shift was that the regulation of life care institutions was more analogous to financial products rather than to insurance. As such, the Division now reviews the financial statements of life care institutions to monitor compliance with laws and regulations.

¹² Federal Deposit Insurance Corporation. Your Insured Deposits. Retrieved July 10, 2012, from <http://www.fdic.gov/deposit/deposits/insured/basics.html>

¹³ AARP. *Continuing Care Retirement Communities: What They Are and How They Work*. Retrieved August 8, 2012, from http://www.aarp.org/relationships/caregiving-resource-center/info-09-2010/ho_continuing_care_retirement_communities.html

¹⁴ AARP. *Continuing Care Retirement Communities: What They Are and How They Work*. Retrieved August 8, 2012, from http://www.aarp.org/relationships/caregiving-resource-center/info-09-2010/ho_continuing_care_retirement_communities.html

¹⁵ AARP. *Continuing Care Retirement Communities: What They Are and How They Work*. Retrieved August 8, 2012, from http://www.aarp.org/relationships/caregiving-resource-center/info-09-2010/ho_continuing_care_retirement_communities.html

Legal Framework

History of Regulation

The General Assembly originally enacted Colorado's Credit Union Act (Act) in 1931, presently set forth in Article 30, Title 11, Colorado Revised Statutes (C.R.S.). The law required the regulation of, among other financial businesses, credit unions and savings and loan associations.

Additionally, in 1992 the regulatory oversight of life care institutions shifted from the Division of Insurance to the Division of Financial Services (Division).

Since enactment of the Act and the shift in regulatory oversight of life care institutions in 1992, the industry has continually evolved. The Department of Regulatory Agencies completed sunset reviews of the Division in 1993 and 2003.

One notable recommendation in the 1993 sunset review was to repeal the regulation of small business development credit corporations. The 1993 sunset review states that there were no licenses issued by the Division and no applications for a license. Therefore, the license was unnecessary and should be repealed. The General Assembly subsequently passed the recommendation in the 1994 legislative session.

The 2003 sunset review recommended amending the Act to require credit unions to provide notification to the Division that a credit union is opening or closing a branch office. The General Assembly passed the recommendation in the 2004 legislative session.

Federal Laws

There are several federal laws that influence the regulation of credit unions and savings and loan associations, including but not limited to:

- Credit Union Act (CUA);
- Truth in Lending (TILA);
- Bank Secrecy Act (BSA);
- National Credit Union Share Insurance Fund (NCUSIF); and
- Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The CUA, which was enacted by Congress in 1934, among other things, created the National Credit Union Administration (NCUA), which is an independent federal government agency. The purpose of the NCUA, among other things, is to conduct examinations of both federally and state chartered credit unions to ensure safety and soundness of each financial institution.

Additionally, the TILA was enacted by Congress in 1968. One of the most important components of the TILA was the requirement that a lender disclose information to a borrower prior to extending credit, such as the annual percentage rate, term of the loan and total costs to the borrower.¹⁶

The BSA was originally enacted by Congress in 1970. The purpose of the BSA is to fight money laundering and other financial crimes.¹⁷ Money laundering is the process of making illegally-gained proceeds (i.e., “dirty money”) appear legal (i.e., “clean”).¹⁸ Typically, money laundering involves three steps: placement, layering and integration.¹⁹ Placement of funds occurs when the illegitimate funds are furtively introduced into the legitimate financial system.²⁰

Layering occurs when the money is moved around to create confusion, sometimes by wiring or transferring the funds through numerous accounts.²¹

Integration occurs when the funds are integrated into the financial system through additional transactions until the “dirty” money appears “clean.”²²

The NCUSIF, which is the federal share (also known as “deposit”) insurance fund administered by NCUA, was created by Congress in 1970, and its purpose is to provide insurance to credit union members’ deposits. The NCUSIF offers insurance of up to \$250,000 per individual account holder.²³ NCUSIF does not insure money invested in stocks, bonds, mutual funds, life insurance policies, annuities or municipal securities.²⁴

The Dodd-Frank Act, which was enacted by Congress in 2010, included a provision that permanently established NCUA’s standard share insurance amount at \$250,000.²⁵

¹⁶ Investopedia. *Definition of Truth in Lending Act – TILA*. Retrieved July 29, 2012, from <http://www.investopedia.com/terms/t/tila.asp#axzz222RUESy9>

¹⁷ Financial Crimes Enforcement Network U.S. Department of the Treasury, Washington D.C. *Bank Secrecy Act Requirements*. Retrieved May 3, 2012, from http://www.fincen.gov/financial_institutions/msb/materials/en/bank_reference.html

¹⁸ U.S. Department of the Treasury – Financial Crimes Enforcement Network. *History of Anti-Money Laundering Laws*. Retrieved May 7, 2012, from http://www.fincen.gov/news_room/aml_history.html

¹⁹ U.S. Department of the Treasury – Financial Crimes Enforcement Network. *History of Anti-Money Laundering Laws*. Retrieved May 7, 2012, from http://www.fincen.gov/news_room/aml_history.html

²⁰ U.S. Department of the Treasury – Financial Crimes Enforcement Network. *History of Anti-Money Laundering Laws*. Retrieved May 7, 2012, from http://www.fincen.gov/news_room/aml_history.html

²¹ U.S. Department of the Treasury – Financial Crimes Enforcement Network. *History of Anti-Money Laundering Laws*. Retrieved May 7, 2012, from http://www.fincen.gov/news_room/aml_history.html

²² U.S. Department of the Treasury – Financial Crimes Enforcement Network. *History of Anti-Money Laundering Laws*. Retrieved May 7, 2012, from http://www.fincen.gov/news_room/aml_history.html

²³ National Credit Union Administration. *NCUA Share Insurance Fund Information, Reports, and Statements. Frequently Asked Questions*. Retrieved August 9, 2012, from <http://www.ncua.gov/DataApps/Pages/FAQs.aspx>

²⁴ NCUA. *Is My Money Safe in a Credit Union?* Retrieved August 8, 2012, from <http://www.mycreditunion.gov/protect/Pages/Is-My-Money-Safe-in-a-Credit-Union.aspx>

²⁵ National Credit Union Administration. *NCUA Share Insurance Fund Information, Reports and Statements. Share Insurance Overview*.

State Law

The applicable statutes that provide regulatory oversight for credit unions, savings and loan associations and life care institutions include: powers and duties of the Division, the Financial Services Board (Board) and Commissioner of Financial Services (Commissioner) (section 11-44-101, *et seq.*, Colorado Revised Statutes, (C.R.S.)); credit unions (section 11-30-101, *et seq.*, C.R.S.); savings and loan associations (Title 11, Articles 40 through 48, C.R.S.); and life care institutions (section 12-13-101, *et seq.*, C.R.S.).

The Commissioner has the authority to issue cease and desist orders if he or she determines that a credit union or savings and loan association is engaged in, has engaged in or is about to engage in unsafe or unsound practices.²⁶ The Commissioner may also issue cease and desist orders if he or she determines that a credit union or savings and loan association has violated or is about to violate applicable laws or rules or any written condition or agreement made with the Commissioner.²⁷

Further, the Commissioner has the authority to suspend or remove any director, officer or employee of a credit union or a savings and loan association if he or she determines that such a person has, among other things.²⁸

- Engaged in or participated in any unsafe or unsound practice in the conduct of a credit union or savings and loan association;
- Committed or engaged in any act, omission or practice that constitutes a breach of fiduciary duty to the credit union or savings and loan association, and the credit union or savings and loan association has suffered or will suffer financial loss or other damage or the interests of members or account holders may be seriously prejudiced; or
- Received financial gain by reason of a violation, practice or breach of fiduciary duty that involved personal dishonesty or demonstrated a willful or continuing disregard for the safety and soundness of the credit union or chartered savings and loan association.

If the Commissioner revokes the state charter of a credit union or savings and loan association, he or she is required to appoint a liquidating agent to liquidate its assets.²⁹

The Commissioner may also assess civil penalties for violations of cease and desist, suspension or removal orders,³⁰ and civil penalties cannot exceed \$1,000 per day.³¹

²⁶ §11-30-106(7), C.R.S.

²⁷ §11-30-106(7), C.R.S.

²⁸ §§11-30-106(8)(a)(I) and 11-44-106.5(1)(a)(I-III), C.R.S.

²⁹ §11-30-120(1)(c), C.R.S.

³⁰ §11-30-106.5(1)(a), C.R.S.

³¹ §11-30-106.5(3), C.R.S.

Additionally, members of the Board are appointed by the Governor with the consent of the majority of the members of the Senate.³² The Board is comprised of five members, and the composition is as follows:³³

- Three members who are executive officers of credit unions and who possess a minimum of five years practical experience as such;
- One member who is an executive officer at a savings and loan association and possesses a minimum of five years practical experience as such; and
- One member who serves as a public member and possesses expertise in finance.

The Board acts as the policymaking and rulemaking authority for the Division, and it has the following powers, including but not limited to:³⁴

- Making, modifying, reversing and vacating rules for the proper enforcement and administration of the regulation of credit unions, savings and loan associations and life care institutions;
- Making all final decisions regarding the organization, conversion or merger of credit unions, savings and loan associations and administration of life care institutions; and
- Making all final decisions regarding the suspension or liquidation of credit unions and savings and loan associations.

Credit Unions

Membership in a credit union is limited to groups of people who share a common bond, which include:³⁵

- Employment;
- Association or groups which reside within a well-defined neighborhood or community; or
- Well defined rural district having a population of less than 25,000 residents.

Small groups of people that have a common bond of employment or association but lack the potential membership to organize their own credit union may be eligible for membership in an existing credit union.³⁶ Small groups consist of 1 to 1,000 persons having a common bond of employment or association.³⁷

³² § 11-44-101.6(3), C.R.S.

³³ §§11-44-101.6(2)(a-c), C.R.S.

³⁴ §§11-44-101.7(1)(b) and (2), C.R.S.

³⁵ §11-30-103(2), C.R.S.

³⁶ §11-30-103(2), C.R.S.

³⁷ Colorado Division of Financial Services. Rules and Regulations 3.2 Small Groups.

Credit unions are authorized to engage in a variety of financial services, including, but not limited to:³⁸

- Receiving savings deposits from members;
- Making loans to members; and
- Making loans to other credit unions.

Credit unions are required to be examined for safety and soundness by the Commissioner at least once during any 18-month period.³⁹ However, the Commissioner is authorized to examine credit unions more frequently if he or she chooses.

Credit unions are also required to submit a financial report to the Commissioner on an annual basis.⁴⁰

Credit unions are authorized to merge, with approval of the Board.

The Commissioner is authorized to assess fees to credit unions to cover the expenses of the Division for regulatory oversight.⁴¹

Savings and Loan Associations

In order to form a savings and loan association, five or more persons are required to submit articles of incorporation to the Commissioner.⁴² Articles of incorporation must include, among other things:⁴³

- The name of the savings and loan association;
- The name of the city, town and county where the principal office is located;
- The names of the incorporators, their respective occupations and residence addresses; and a statement of the number of shares or amount of stock subscribed by each and the amount of cash paid upon the shares or stock of each; and
- The number of directors and the names and residences of the directors.

All savings and loan associations are subject to periodic safety and soundness examinations by the Commissioner.

Additionally, on or before February 1 each year, savings and loan associations are required to submit a financial report of their affairs and operations to the Commissioner.⁴⁴

³⁸ §§11-30-104(1)(a),(b), and (c), C.R.S.

³⁹ §11-30-106(1)(a), C.R.S.

⁴⁰ §11-30-106(2), C.R.S.

⁴¹ §11-30-106(1)(a), C.R.S.

⁴² §11-41-104(1), C.R.S.

⁴³ §§11-41-104(1)(a),(c),(e) and (j), C.R.S.

⁴⁴ §11-40-105(1), C.R.S.

Savings and loan associations are eligible to hold public funds, which are funds from various types of government entities such as state and local governments. When holding public funds, savings and loan associations must comply with the minimum eligible collateral, as highlighted in the Division of Financial Services Rules and Regulations. Specifically, Rule 4-13(a) states the market value of the pledged eligible collateral of an eligible public depository is required to be at least \$250,000.

Life Care Institutions

Life care institutions, also known as continuing care retirement communities, offer a variety of living options and services for older adults. Life care institutions are required to establish escrow accounts for entrance fees prior to the date that a resident is permitted to occupy his or her living unit in a facility.⁴⁵ The escrow accounts are required to be deposited with banks, trust companies or other licensed corporate escrow agents in Colorado.⁴⁶

New residents of life care institutions must enter into a contract with the institution. Each life care contract includes:⁴⁷

- The value of all property transferred from a new resident;
- The services that the life care institution will provide and all items the resident will receive such as room, board, clothing, incidentals, medical care, transportation, and burial;
- A financial statement showing the financial condition of the life care institution, including a statement of earnings for the previous 24-month period;
- The monthly service fee and whether the fee is subject to adjustment; and
- The rights, if any, a resident has to participate in management of financial decisions affecting the life care institution.

The Commissioner is required to record with the county clerk and recorder in the county where the life care institution is located, a notice of lien on behalf of all residents who enter into life care contracts.⁴⁸

Additionally, life care institutions are required to file an annual report with the Commissioner within 90-days of the end of the fiscal year. Annual reports must contain certified financial statements for each facility.⁴⁹

Life care institutions are also required to submit to compliance examinations by the Commissioner.⁵⁰

⁴⁵ §12-13-104(1), C.R.S.

⁴⁶ §12-13-104(1), C.R.S.

⁴⁷ §12-13-114(1), C.R.S.

⁴⁸ §12-13-106(1), C.R.S.

⁴⁹ §12-13-108(1), C.R.S.

⁵⁰ §12-13-110, C.R.S.

Program Description and Administration

The statutes that provide regulatory oversight for credit unions, savings and loan associations and life care institutions include: powers and duties of the Division of Financial Services (Division), the Financial Services Board (Board) and Commissioner of Financial Services (Commissioner) (section 11-44-101, *et seq.*, Colorado Revised Statutes (C.R.S.)); credit unions (section 11-30-101, *et seq.*, C.R.S.); saving and loan associations (Title 11, Articles 40 through 48, C.R.S.); and life care institutions (section 12-13-101, *et seq.*, C.R.S.).

The regulation of credit unions, savings and loan associations and life care institutions (collectively referred to as “institutions”) is vested in the Board. The Board is a Type 1, policy autonomous board that is responsible for approving state charters, imposing discipline on credit unions, savings loan associations and life care institutions, rulemaking and policymaking.

The Commissioner, as well as the Division of Financial Services (Division) staff, is responsible for completing safety and soundness examinations and audits, reviewing financial statements and completing duties delegated to the Commissioner by the Board (including the Commissioner imposing discipline).

In fiscal year 10-11, the Division devoted 14 full-time equivalent (FTE) employees to conduct examinations and provide administrative support. The FTE are as follows:

- Administrative Support Staff – 2.0 FTE;
- Commissioner – 1.0 FTE;
- Financial Credit Examiner IV– 1.0 FTE;
- Financial Credit Examiner III – 5.0 FTE;
- Financial Credit Examiner II – 1.0 FTE;
- Financial Credit Examiner I – 1.0 FTE;
- Intern – 1.0 FTE; and
- Supervisory Examiner – 2.0 FTE.

Table 1 highlights the total expenditures for the Division in fiscal years 06-07 through 10-11.

Table 1
Total Program Expenditures in Fiscal Years 06-07 through 10-11

Fiscal Year	Total Expenditures
06-07	\$1,087,013
07-08	\$1,322,100
08-09	\$1,384,692
09-10	\$1,680,646
10-11	\$1,672,110

Table 1 shows that the total expenditures increased approximately 54 percent from fiscal year 06-07 to 10-11. The increase is attributable to the Division adding additional financial examiner staff.

In order to fund the Division, the institutions are required to pay a semi-annual assessment. Specifically, the assessments fund the regulatory oversight of the institutions by the Division. The assessments are sent to the institutions on June 15 and November 15 each year.

Credit Unions, Savings and Loan Associations and Life Care Institutions

Table 2 highlights the number of institutions in fiscal years 06-07 through 10-11.

**Table 2
Total Number of Institutions in Fiscal Years 06-07 through 10-11**

	FY 06-07	FY 07-08	FY 08-09	FY 09-10	FY 10-11
Credit Unions	67	62	56	53	50
Savings and Loan Associations	4	4	4	4	4
Life Care Institutions	8	8	8	8	8
Total	79	74	68	65	62

As highlighted in Table 2, the number of credit unions declined from 67 in fiscal year 06-07 to 50 in fiscal year 10-11. The decrease is attributable to the tumultuous economic climate in Colorado. Credit unions are only able to grow through retained earnings such as interest gained from auto loans. With poor economic conditions, some credit unions were unable to withstand the downturn in the economy. As such, there were 23 credit union mergers in fiscal years 06-07 through 10-11.

Also, during the past five fiscal years, two federally chartered credit unions converted to state charters, and one state chartered credit union converted to a federal charter.

The number of savings and loan associations and life care institutions has remained constant in fiscal years 06-07 through 10-11.

In order to obtain a new credit union state charter, an applicant is required to submit the following information to the Division:⁵¹

- Letter of application;
- Draft Articles of Incorporation;
- Draft bylaws;
- Biographical reports for proposed members of the board of directors, managers and any other person who signs the Articles of Incorporation; and
- Business plan.

There is no fee associated with the establishment of a new state chartered credit union.

In order to convert from a federally chartered credit union to a state charter, an applicant is required to submit the following to the Division:⁵²

- A letter of application explaining the reason for the conversion request and a general description of the credit union (i.e., services offered, field of membership);
- Articles of Incorporation;
- Bylaws;
- Biographical reports for members for the credit union's board of directors, manager and any other person signing the Articles of Incorporation;
- A complete copy of the most recent NCUA examination report; and
- The most recent audit report.

There is no fee associated with the application for a state charter.

Additionally, to obtain a new savings and loan state charter, an applicant is required to provide the following, including but not limited to:⁵³

- Application;
- Articles of Incorporation; and
- Bylaws.

There is no fee associated with obtaining a new state charter for a savings and loan association.

In order to convert from a federally chartered savings and loan association to a state chartered savings and loan association, an application must be approved by a majority of all members present or by proxy at an annual or special meeting.⁵⁴ Also, members of the savings and loan association must vote on a board of directors.⁵⁵

⁵¹ Division of Financial Services. Applications for New Credit Union Charters. Policy 400-20.

⁵² Division of Financial Services. Conversions of Federal Credit Unions to State Charter. Policy 400-14.

⁵³ §11-41-107(1), C.R.S.

⁵⁴ §11-45-103(1), C.R.S.

⁵⁵ §11-45-103(2), C.R.S.

The board of directors must provide to the Division a certificate of incorporation and bylaws.⁵⁶

There is no fee associated with the conversion from a federal savings and loan charter to a state charter.

Life care institutions do not secure a state charter from the Division. Instead, they are licensed by the Colorado Department of Public Health and Environment (CDPHE).

Examinations and Audits

The Division utilizes Financial Examiners to conduct various types of examinations and audits for institutions.

Credit Unions

Credit unions undergo two types of examinations: full scope and, if necessary, supervisory contacts. Full scope examinations are comprehensive examinations of a credit union to ensure safety and soundness as well as compliance with existing laws and regulations. They are conducted by the Division's Financial Examiners, but the National Credit Union Association (NCUA) staff, which is the federal agency that administers the National Credit Union Share Insurance Fund, may also be present.

Supervisory contacts are follow-up examinations to previously completed full scope examinations. Generally, supervisory contacts are conducted solely by Division staff.

When conducting full scope examinations on credit unions, the Division utilizes a CAMEL composite rating system of "1" to "5," where "1" is the best and "5" is the worst.

The CAMEL rating system utilizes five components, which are:

- Capital adequacy;
- Asset quality;
- Management capability;
- Earnings quantity and quality; and
- Liquidity.

⁵⁶ §11-45-103(2), C.R.S.

A CAMEL composite rating of “1” indicates that the credit union is sound in every respect. Any weaknesses are minor and can be handled in a routine manner by the board of directors and management. These credit unions are capable of withstanding unpredictable business conditions and are resistant to outside influences such as economic instability.

Credit unions that achieve a CAMEL composite rating of “2” are stable and capable of withstanding business fluctuations. Also, these credit unions are in substantial compliance with laws and regulations.

Credit unions with a CAMEL composite rating of “3” are generally less capable of withstanding business fluctuations and may be in significant non-compliance with laws and regulations.

Credit unions with a CAMEL composite rating of “4” have demonstrated unsafe or unsound practices or conditions. These institutions are generally not capable of withstanding business fluctuations, and there may be significant non-compliance with laws and regulations. Also, these institutions require close regulatory supervision, which means, in most cases, formal enforcement action is necessary to address the problem(s).

Credit unions with a CAMEL composite rating of “5” (the lowest rating) exhibit extremely unsafe and unsound practices or conditions; exhibit a critically deficient performance; and often contain inadequate risk management practices. These institutions require ongoing supervisory attention.

The frequency of full scope examinations of credit unions, in large part, is dependent on the CAMEL composite rating from the previous examination.

Generally, credit unions that receive a CAMEL composite rating of “1” or “2” undergo a full scope examination every 18 months.

Credit unions that receive a CAMEL composite rating of “3” will undergo a full scope examination every 12 to 18 months.⁵⁷ These institutions are also required to undergo supervisory contacts every six to nine months between full scope examinations.⁵⁸

Credit unions with a CAMEL composite rating of “4” or “5” will undergo a full scope examination every 12 months.⁵⁹ These institutions are also required to undergo supervisory contacts every three to four months between full scope examinations.⁶⁰

⁵⁷ Division of Financial Services. Risk-Based Examination Policy.

⁵⁸ Division of Financial Services. Risk-Based Examination Policy.

⁵⁹ Division of Financial Services. Risk-Based Examination Policy.

⁶⁰ Division of Financial Services. Risk-Based Examination Policy.

Table 3 highlights the total number of full scope examinations and supervisory contacts concerning credit unions in fiscal years 06-07 through 10-11.

Table 3
Total Number of Credit Union Full Scope Examinations and Supervisory Contacts in Fiscal Years 06-07 through 10-11

Fiscal Year	Number of Credit Union Full Scope Examinations	Number of Credit Union Supervisory Contacts
06-07	44	18
07-08	40	12
08-09	33	29
09-10	38	16
10-11	39	9
Total	194	84

The total number of full scope examinations for credit unions has remained fairly constant in the past five fiscal years even though the total number of credit unions has declined. This is attributable, at least in part, to the NCUA mandating an increase in the frequency of full scope examinations (every 12 months) for credit unions with assets of more than \$250 million.

Also, the increase in the frequency of full scope examinations for credit unions with assets of more than \$250 million has reduced the need for supervisory contacts. This explains the decrease in the number of supervisory contacts in fiscal year 10-11.

Savings and Loan Associations

Savings and loan associations undergo full scope examinations, and when applicable, desk and on-site audits.

Full scope examinations are conducted by the Federal Deposit Insurance Corporation (FDIC) staff with the Division's Financial Examiners present.

Also, state and federally chartered savings and loan associations that are public depositories (e.g., hold public funds) are subject to both desk and on-site audits. Division staff completes desk audits of state and federally chartered savings and loan associations.

Generally, desk audits are completed by reviewing financial reports required by the Division for accuracy and content.

On-site audits are more in-depth than desk audits, where Division staff reviews the records and supporting documentation of state and federally chartered savings and loan associations that are public depositories. The Division has the authority to approve federally chartered savings and loan associations to be public depositories of Colorado governmental entities. As such, they are required to undergo on-site audits conducted by Division staff.

The composite rating system (“1” to “5”) for full scope examinations of savings and loan associations is similar to credit unions. The only difference is that the FDIC uses the CAMELS rating system, which utilizes six components:

- Capital adequacy;
- Asset quality;
- Management capability;
- Earnings quantity and quality;
- Liquidity; and
- Sensitivity to market risk.

Generally, the FDIC, with Division staff attending, conducts full scope examinations of savings and loan associations every 18 months.

The frequency of desk and on-site audits depends, in large part, on the financial stability of a state and federally chartered savings and loan association, which could range from 9 to 24 months.

Table 4 illustrates the total number of state and federally chartered savings and loan associations’ full scope, desk and on-site audits.

Table 4
Total Number of State and Federally Chartered Savings and Loan Associations Full Scope, Desk and On-Site Audits in Fiscal Years 06-07 through 10-11

Fiscal Year	Number of Savings and Loan Associations Full Scope Examinations	Number of State and Federally Chartered Savings and Loan Associations Public Depositories Desk Audits	Number of State and Federally Chartered Savings and Loan Association Public Depositories On-Site Audits
06-07	2	52	Not Tracked
07-08	2	52	Not Tracked
08-09	2	49	7
09-10	1	45	12
10-11	2	43	6
Total	9	241	25

As highlighted in Table 4, the number of savings and loan associations’ full scope and desk audits has remained fairly constant in fiscal years 06-07 through 10-11.

However, the Division did not track on-site audits in fiscal years 06-07 and 07-08, so it is impossible to discern whether there was a pattern of increasing or decreasing on-site audits in the past five fiscal years.

Life Care Institutions

Division staff conducts on-site audits of life care institutions on an annual basis. The purpose of the on-site audit is to ensure life care institutions have the necessary reserves as required by law.

Table 4 highlights the total number of life care institutions on-site audits in fiscal years 06-07 through 10-11.

Table 5
Total Number of Life Care Institutions On-Site Audits in Fiscal Years 06-07 through 10-11

Fiscal Year	Number of Life Care Institutions On-Site Audits
06-07	6
07-08	8
08-09	8
09-10	8
10-11	8
Total	38

The data in Table 5 reveal that six on-site audits were completed by Division staff in fiscal year 06-07, while eight on-site audits were completed in each of fiscal years 07-08 through 10-11. It is unclear why the number of on-site desk audits was lower in fiscal year 06-07.

Complaints/Enforcement Actions

There have been a number of complaints to the Board in fiscal years 06-07 through 10-11. All of the complaints concerned credit unions. Table 13 highlights the total number of complaints to the Board in fiscal years 06-07 through 10-11.

Table 6
Total Number of Complaints to the Board Concerning Credit Unions in Fiscal Years 06-07 through 10-11

Fiscal Year	Number of Complaints
06-07	81
07-08	79
08-09	62
09-10	77
10-11	66
Total	365

The Division did not track the nature of complaints for the past five fiscal years, so it is difficult to accurately report the nature of each complaint the Division received. However, the Division has recently implemented procedures to accurately record the nature of each complaint.

The Division, however, provided the five most common complaints received by staff, which are:

- Courtesy pay (overdraft) fees charged by credit unions;
- Victims of fraud;
- Repossessions of automobiles;
- Withdrawal of funds from jointly held accounts without the knowledge of all joint account holders; and
- Changes in interest rates on various credit products.

Additionally, Table 7 highlights the total number of enforcement actions imposed on credit unions in fiscal years 06-07 through 10-11. In fiscal years 06-07 through 10-11, there were no enforcement actions imposed on savings and loan associations or life care institutions.

Table 7
Total Number of Enforcement Actions Imposed on Credit Unions in Fiscal Years 06-07 through 10-11

Type of Enforcement Action	FY 06-07	FY 07-08	FY 08-09	FY 09-10	FY 10-11
Cease and Desist Orders	2	0	1	1	0
Charter Revocations/Closures	0	0	0	1	0
Conservatorships	1	3	0	0	0
Fines for Late Call Reports (Financial Statements)	1	0	2	2	2
Letters of Understanding	0	0	0	1	0
Net Worth Restoration Plans	0	0	0	1	0
Other Orders	0	0	0	1	0

As highlighted in Table 7, the most common enforcement action imposed on credit unions was “fines for late call reports,” which as the phrase implies, certain credit unions failed to submit their financial statements on time to the Division.

The second highest category of enforcement action concerning credit unions was the issuance of cease and desist orders. Generally, the cease and desist orders were issued to restrict credit unions from engaging in certain lending practices.

Table 7 shows that in fiscal years 06-07 through 10-11, there were four conservatorships of credit unions. Typically, the Commissioner conserves (takes control of or takes over) a credit union when it experiences extreme financial difficulties.

One credit union had its charter revoked and the federal regulator, NCUA, merged it with another credit union.

Analysis and Recommendations

Recommendation 1 – Continue the Division of Financial Services for 11 years, until 2024.

The first sunset criterion asks whether regulation is necessary to protect the health, safety and welfare of the public. The Financial Services Board (Board) as well as the Commissioner of Financial Services (Commissioner) provide regulatory oversight for credit unions, savings and loan associations and life care institutions (collectively referred to as “institutions”).

One of the most important regulatory requirements for institutions is the examination and audit process.

Specifically, credit unions are required to undergo full scope examinations, which are comprehensive examinations to ensure, among other things, compliance with existing laws and regulation. Full scope examinations of credit unions are conducted by the Division of Financial Services (Division) staff, but the National Credit Union Association staff is also present. Full scope examinations utilize the CAMEL composite rating system from “1” to “5,” where “1” is the worst and “5” is the best. The CAMEL rating system utilizes five components, which are:

- Capital adequacy;
- Asset quality;
- Management capability;
- Earnings quantity and quality; and
- Liquidity.

If necessary, credit unions also undergo supervisory contacts, which are follow-up examinations to previously completed full scope examinations. For the most part, these examinations are completed solely by Division staff.

Additionally, savings and loan associations are also required to undergo full scope examinations. Full scope examinations of savings and loan associations are conducted by the Federal Deposit Insurance Corporation (FDIC) staff with Division staff present.

The composite rating system (“1” to “5”) for full scope examinations for savings and loan associations are similar to credit union full scope examinations. The only difference is that the FDIC uses the CAMELS rating system, which includes six components:

- Capital adequacy;
- Asset quality;
- Management capability;
- Earnings quantity and quality;
- Liquidity; and
- Sensitivity to market risk.

State and federal chartered savings and loan associations that are public depositories (e.g., hold public funds) are subject to both desk and on-site audits, which are completed by Division staff.

Division staff conducts on-site audits of life care institutions on an annual basis. The purpose of the on-site audit is to ensure life care institutions have the necessary reserves as required by law.

Periodic examinations and audits of institutions served to lessen the negative impact of the poor economy for consumers. As such, examinations and audits are an effective mechanism to ensure regulatory compliance with the laws for financial institutions and applicable rules, as well as assessing the financial stability for institutions.

Further, Colorado, as well as virtually every other state, has experienced a tumultuous economic climate in the recent past, and as the data show in the Program Description Section of this sunset review, there has been a noticeable decrease in the number of credit unions.

Generally, the decrease is attributable to credit unions that were unable to withstand the poor economic conditions and either merged with other credit unions or, in some instances, failed (closed).

Additionally, in order to ensure consumer protection, the Board is authorized to impose discipline (enforcement action) on institutions. All of the enforcement actions imposed by the Board in fiscal years 06-07 through 10-11 were on credit unions. There were various types of enforcement actions, including the revocation of a state charter. The revocation of a state charter ensures the closure of the institution.

The Board’s ability to utilize enforcement actions is an important mechanism to provide protection to consumers.

The absence of regulatory oversight (e.g., examinations, audits and enforcement actions) of institutions in Colorado would likely compromise consumer protection as well as Colorado's short-term and long-term economic stability.

In order to continue to ensure that institutions are viable and solid businesses that are important elements to Colorado's economy, which, in turn, provide protection to consumers, the General Assembly should continue the Division for 11 years, until 2024.