DIVISION OF FINANCIAL SERVICES

Submitted by
Department of Regulatory Agencies
Office of Policy and Research
June 30, 1993

TABLE OF CONTENTS

EXECUTIVE SUMMARY i

I. THE SUNSET PROCESS 1

II. INTRODUCTION AND OVERVIEW 2

1. The Credit Union Industry 2
2. The Savings and Loan Industry 6
3. Life Care Institutions 9
4. Small Business Development Credit Corporation 11

III. THE DIVISION OF FINANCIAL SERVICES 12

1. Overview 12
2. Examination and Enforcement 13

IV. CREATION OF THE FINANCIAL SERVICES BOARD 23

V. THE NEED FOR REGULATION 26

VI. STATUTORY RECOMMENDATIONS 32

VII. ANALYSIS OF STATUTES 39

APPENDIX

SUNSET STATUTORY EVALUATION CRITERIA 46

EXECUTIVE SUMMARY

The Department of Regulatory Agencies has concluded its sunset review of the Division of Financial Services (Division). The primary recommendation of this report is that regulation continue and that The Division of Financial Services be continued to administer that regulation.

The Division of Financial Services administers regulatory oversight of several industries: credit unions, savings and loan associations, life care institutions, and small business credit corporations. A significant part of the regulation of savings and loan associations is the conduct of the Public Deposit Protection Act. This report discusses at length the need to continue this area of regulation.

Indeed, two of the critical functions of the Division are the examination and enforcement activities that the Division undertakes regarding credit unions and savings and loan associations. Colorado's regulatory structure provides safeguards for hundreds of thousands of members of state chartered credit unions. Savings and loan associations, while perhaps serving fewer depositors than other institutions, hold over $400 million in assets. The potential for catastrophic harm is always present in these industries and there are very few consumers who are capable of determining the safety and soundness of a financial institution in which they are considering depositing money or becoming members.

This sunset review also recommends that regulation of life care institutions continue. These institutions hold large deposits of money from residents in return for services and housing. Often, residents may invest their life savings in such an institution. If the life care institution fails, the residents may become homeless and penniless. The Division examines these institutions to determine compliance with Colorado law.

This report does recommend the termination of the Small Business Development Credit Corporation Act. This licensing program was enacted in 1988, but there has not been a single application for a license since that time.

In addition to recommendations to continue or discontinue specific programs, this review discusses elements of regulatory theory of financial institutions that are critical to a complete understanding of Colorado's regulatory scheme. For instance, the value of the state charter opposed to the federal charter is explored. Some opponents of the state charter believe that Colorado should allow the federal government to regulate credit unions and savings and loan associations. This sunset report discusses the advantages and disadvantages of that choice and recommends against elimination of the state charter.

Similarly, any examination of regulatory alternatives, particularly from a cost saving approach, must consider consolidation of regulation. In the instant case, the consolidation would involve consolidating the duties of the Division of Financial Services with those of the Division of Banking. This report discusses the advantages and disadvantages of this action and recommends against consolidation at this time.

A Financial Services Board was created in the 1993 legislative session. Colorado has relied upon ultimate regulatory enforcement responsibility resting with the Commissioner of Financial Services prior to the creation of this Board. A recommendation to create such a board would have likely been a significant part of this sunset review. This report will instead discuss the events and decisions leading up to the creation of the Board and explain the Board's authority and duties as created by House Bill 1275.

This report also makes recommendations for statutory changes designed to improve and enhance Colorado's regulation of financial institutions.

I. THE SUNSET PROCESS

The Division of Financial Services, formerly The Division of Savings and Loan (now cited as the Division of Financial Services), created by article 44 of title 11, C.R.S., is scheduled to terminate on July 1, 1994, unless continued by the General Assembly. During the year prior to that date, it is the responsibility of the Department of Regulatory Agencies to conduct a sunset review and evaluation of the Division of Financial Services. During this review, the Division must demonstrate that there is a need for its continued existence and that the regulation it provides is the least restrictive consistent with the public interest. The Department's findings and recommendations are submitted via this report to the Joint Legislative Sunrise/Sunset Review Committee of the Colorado General Assembly. (Statutory criteria used in this sunset review is found in the Appendix of this report.)

This sunset review was comprehensive in nature. It included discussions with staff of the Division of Financial Services, officials of the Colorado credit union and savings and loan industries, federal regulatory officials, regulatory officials of other states, and the National Association of State Credit Union Supervisors. In addition, the Department conducted a survey of consumers surrounding a variety of issues related to financial institutions.

This sunset report is the second to be performed on this Division. The previous sunset evaluated the Division of Savings and Loan.

II. INTRODUCTION AND OVERVIEW

This section of the sunset review will provide information about the credit union and savings and loan industries. Regulation of state chartered savings and loan and credit union institutions is among the most important functions of the Division of Financial Services (Division). The Division regulates 83 state chartered credit unions. Colorado is also home to well over 100 credit unions that are federally chartered and are regulated by the National Credit Union Administration.

1. The Credit Union Industry

History. The original purpose of credit unions was to provide the persons who were unable to obtain credit with a place to deposit savings and borrow money at reasonable rates. Few commercial banks made such loans at the time of the genesis of credit unions.

The original savings cooperatives were owned by groups of individuals who worked for the same employer, lived in the same community, had the same religious or club affiliation, or shared some other "common bond." To this day, the common bond usually lowers the cost of collecting and investigating credit information which generally results in a reduction of loan losses.

Credit Union spokespersons stress that credit unions are democratically controlled, not-for-profit cooperatives that exist to serve the financial needs of their members. Since credit union earnings are returned to members through better rates on savings and loans, or through increasing services to members, consumer services are the most important functions of a credit union as opposed to commercial activities designed and pursued to create profit.

Colorado's credit union industry is large in some ways and small in others, reflective of the average national picture of the credit union industry in many ways. For instance, membership in credit unions is large. Over one million Colorado citizens belong to credit unions, mainly through their employment. Nearly every major corporation in Colorado has or offers access to a credit union as a service to employees. Although some members receive all of their financial services from credit unions, many members "shop around" and receive services from a variety of sources. However, in terms of total assets, credit unions account for a small amount of deposits relative to other financial institutions in Colorado and across the nation.

Regardless of any statistical analysis, most agree that today's credit union industry bares little resemblance to the community cooperatives that arose some 75 years ago. As the credit union industry grows, it adapts to changing social and demographic trends. For instance, some suggest that credit unions might consider marketing their own national credit card to compete with Visa and MasterCard. (Gart:86) Certainly, credit unions would require a sizeable market base to consider offering such a service. Also, the market base would need to be nationwide in scope and not concentrated in only a few geographic areas.

Colorado Credit Union Statistics

When credit union size is compared to other depository institutions, the industry can appear somewhat small. The Credit Union National Association (CUNA) reports the following assets for Colorado depository institutions (1989). Although this is a "snapshot" comparison from a few years ago, it provides a reasonable basis for comparison. Table A shows that Colorado credit unions, in total assets comprise a smaller industry than other financial industries.

Table A

INSTITUTION	ASSETS (Billions)	NUMBER	AVERAGE ASSET SIZE (Millions)	PERCENTAGE SHARE OF TOTAL ASSETS
Commercial Banks	$26.5	451	$58.27	61.2%
Savings Banks				0.0%
Savings & Loans	$13.3	35	$380.0 3	31.0%
Credit Unions	$3.4	212	$15.99	7.9%

However, if these figures are compared to national figures, it can be seen that the Colorado credit union industry is a little larger than the national average for credit unions. Colorado credit unions have a higher percentage of total assets and a slightly larger average asset size than the national average. CUNA reports the following 1989 national data:

Table B

INSTITUTION	ASSETS (Billions)	NUMBER	AVERAGE ASSET SIZE (Millions)	PERCENTAGE SHARE OF TOTAL ASSETS
Commercial Banks	$3,287.6	12,707	$258.72	65.5%
Savings Banks	$240.6	468	$514.07	4.8%
Savings & Loans	$1,283.9	2,884	$445.18	25.6%
Credit Unions	$205.8	15,131	$13.60	4.1%

The small average asset size can be misleading. There is a wide distribution of total assets in credit unions. Some credit unions are very small while others are large. Some credit unions, in fact, are as large as many banks. In Table C, The Colorado Credit Union League reports the following data regarding asset distribution in Colorado's federally chartered and state chartered credit unions.

Table C

All Colorado Credit Unions		
ASSET CATEGORY	NUMBER OF CREDIT UNIONS	PERCENT OF CREDIT UNIONS
Over $100 Million	9	4.6
$50 to $100 Million	9	4.6
$25 to $50 Million	23	11.6
$10 to $25 Million	26	13.1
$5 to $10 Million	27	13.6
$2 to $5 Million	47	23.7
Less than $2 Million	57	28.8

Table C shows that over 66% of credit unions have assets under $10 million. Of that group, many have assets of under $2 million. On the other hand, several credit unions have assets over $50 million and another group have assets over $100 million. While these smaller groups of credit unions account for a small percentage of total credit unions, they likewise account for a large percentage of total assets.

The figures in Table C include credit unions that hold federal charters as well as state chartered credit unions. The assets of the 83 credit unions under the responsibility of the Division of Financial Services reflect a similar distribution. Table D shows that a similar distribution of number of credit unions and their total assets is reflected by state chartered credit unions.

Table D

STATE CHARTERED CREDIT UNIONS	
ASSET CATEGORY	NUMBER OF CREDIT UNIONS
Over $100 Million	5
$50 to $100 Million	3
$25 to $50 Million	11
$10 to $25 Million	9
$5 to $10 Million	9
$2 to $5 Million	17
Less than $2 Million	29

Credit unions and membership figures are dropping slightly. At the end of 1992, there were 13,379 credit unions in the United States with a membership of 64.7 million. Over 8,000 were chartered federally while the remaining 6,000 (approximate) were chartered under state laws. Total credit union assets were $271.4 billion.

The Credit Union National Association reports the continuance of a slight downward trend in the number of credit unions. For instance, in 1991 there were 13,989 credit unions. Therefore, the industry experienced a loss of 610 credit unions during 1992. This has been a rather steady trend since the late 1960's and early 1970's when credit union numbers were their highest at about 28,000 institutions.

This is mostly due to credit union mergers as smaller credit unions merge with larger institutions in order to continue offering reasonably priced services to their members. Also, the flurry of corporate mergers, buy outs, and casualties experienced during the eighties contributed to a decrease in total number of credit unions because most credit unions are affiliated with a particular employer.

2. The Savings and Loan Industry

The savings and loan industry, in Colorado and elsewhere, has undergone enormous change since the early 1980's. Most analysts, like Crawford and Sihler in their book, The Troubled Money Business, agree that to grasp the problems and pitfalls of the thrift industry requires an understanding of the history of the industry.

Thrift industries date back to sixteenth century England. The first savings and loan in the United States was founded in 1831. Like most financial institutions, the savings and loan industry prospered and grew.

Prior and up to the onset of the Great Depression, most home financing involved short-term rollover mortgages which were refinanced every five years. A significant contributing factor to the Great Depression was the homeowner's inability to refinance a home mortgage.

Crawford and Sihler stress that runs on financial institutions at the beginning of the Depression led to a general consensus that deposit insurance was needed for all institutions that took public deposits. The New Deal created the Federal Savings and Loan Insurance Corporation (FSLIC) to insure the deposits of thrifts. Partly through insurance of deposits, the Federal Housing Administration (FHA) intended to lengthen mortgage maturities and solve the problems created by short-term rollover mortgages.

This resulted in the thrift's practice of borrowing short-term deposits and lending them for mortgages (long-term instruments). Problems were being identified in the 1970's. Congressional hearings were held but no action was taken.

However, facing the inflation of the 1970's, the federal government did begin to respond. The Division of Financial Services reported, in 1990, that in order to dampen inflation, the Federal Reserve Board began tightening control of the money supply in 1979. Interest rates were left to rise and fall as the market dictated. In 1981, the prime rate peaked at 20.5%. Of course, money flowed from savings and loan associations to money market mutual funds. These money funds were free to pay the higher interest rates of the market. Therefore, consumers had little incentive to leave their deposits in low interest saving and loan accounts.

Federal authorities attempted to stem the flow of funds from S&Ls so that money would be available for financing home mortgages. The federal effort was to remove interest rate caps on savings in 1980 so that S&Ls could attract funds. This worked to some degree and money began to return to S&Ls.

However, the cost of paying record high interest rates on deposits exceeded the return on long-term, fixed-rate mortgage loans. What Crawford and Sihler call a complete mismatch between deposits and loans was occurring. Savings and loans now began to experience serious trouble.

The Federal government voluntarily increased the liability of the taxpayer by increasing federal deposit insurance from $40,000 to $100,000 in 1980. This situation was made even more risky by the Federal Home Loan Bank Board, which repeatedly lowered savings and loan capital requirements.

In 1982, Congress passed the Garn-St Germain Act. This deregulating stroke allowed unsecured commercial lending up to 10% of assets-including junk bonds or unsecured loans to corporations. It increased commercial real estate lending authority from 20% to 40% of assets and permitted savings and loans to finance real estate projects at 100% or with no borrower equity.

All of these actions stand in sharp contrast to the conservative savings and loan industry that had survived the Great Depression. The results were catastrophic. Between 1980 and early 1991, the number of savings and loans was chopped in half.

Crawford and Sihler called it the biggest financial debacle in the history of the country. They estimated the cost of the bailout is equal to fifty years of annual federal aid to education.

Congress responds. In yet another response, Congress passed the Financial Institutions Reform Recovery and Enforcement Act (FIRREA) in 1989. A brief summary of the federal legislation follows:

1. Separation of federal regulation from federal insurers.

2. Higher capital standards.

3. A ban against "brokered deposits" unless approved by the Federal Deposit Insurance Corporation.

4. Conservative limits on loans and investments.

5. Application of certain capital standards to state-chartered S&Ls regarding the exercise of powers not authorized for federal S&Ls.

6. Tightening of loan limitations to one borrower.

7. Prohibitions against investing in junk bonds.

8. The imposition of a "lender test" designed to point S&Ls toward more traditional thrift investments, such as residential mortgage loans, and away from commercial real estate lending.

9. Tightened requirements for real estate appraisals performed in connection with federally-related transactions.

10. Increases federal enforcement powers such as civil and criminal penalties.

Legislative Responses in Colorado

Legislation was passed in 1989 in Colorado to strengthen savings and loan association oversight. HB 1052 expanded the grounds for removal of officers and directors of savings and loans and authorized civil money penalties for savings and loans. HB 1052 also strengthened regulatory oversight of public deposits under the savings and loan Public Deposit Protection Act.

Some experts argue that while these responses, particularly at the federal level, may aid depositors, they may not be able to save the thrift industry. As previously stated, the national savings and loan industry shrank dramatically during the 1980's. In Colorado, from the mid-1980's through 1989, twenty savings and loans failed (five state-chartered and fifteen federally-chartered). Today, there are twenty-one savings and loans operating in Colorado, seven of which are state-chartered. Crawford and Sihler argue that the federal government will have to continue to take over thrifts and liquidate them as demand for housing finance drops and more efficient forms of financing emerge. They believe by the turn of the century, thrifts will be non-existent.

The Colorado Thrift Industry

A recent article appearing in Governing magazine includes Colorado in a group of states with 100% profitable savings and loans. Many factors play a part in the fate of financial institutions, of course. The thrift industry has undergone massive changes. Insolvent thrifts have been liquidated, smaller, vulnerable thrifts have been merged with stronger institutions which survived the thrift crisis. The good news is that Colorado's thrift industry appears to have weathered the crisis.

At the end of 1992, there were seven state chartered savings and loan associations in Colorado. These institution have combined assets of over $406 million. The remaining state charters tend to be smaller savings and loans and generally are rural institutions.

As part of this sunset review, the Department of Regulatory Agencies surveyed savings and loan associations in Colorado. Responses to general topics and regulatory areas follow.

* Overall Performance of the Division of Financial Services

  Most respondents rated the Division's performance as "Excellent" or "Very Good."

  The Division received responses of "good," and "average" from two institutions.

* **Need For A Dual Regulatory System (state and federal)**

Responses to this question produced the most division of opinion. A small majority of respondents favor the dual system. Some stated that state regulation should continue because of confidence in the state's examination and oversight. Most supporters of the dual system, though, cited enforcement of the Public Deposit Protection Act as the main justification for continuance of dual regulation.

3. Life Care Institutions

In 1992, regulatory authority over life care institutions was transferred to the Division of Financial Services from the Division of Insurance. Life Care Institutions are facilities that provide living facilities and other services to persons who are generally aged or retired. In some cases, care provided may be similar to that provided by a nursing home. In fact, the Department of Health has some jurisdiction over these facilities pertaining to quality of care. The Division of Financial Services monitors and examines these institutions to determine that they comply with statutory fiscal responsibility requirements.

This financial regulation is important because these institutions contractually agree to provide certain facilities and services to the consumer upon payment of an entrance fee and additional costs as required throughout the person's life. Residents often sell their homes and liquidate all or most of their assets to enter such an institution. If the institution fails, the residents are likely to find themselves penniless and homeless.

Statutory requirements that institutions receive state approval through a certificate of authority were repealed as part of the 1991 Sunset review of the Division of Insurance. What remains are the statutory nuts and bolts needed to make certain that residents moneys are safe.

The statute requires that life care institutions demonstrate fiscal responsibility in several areas, including: reserve requirements; production of annual reports; examinations by the Division of Financial Services; and, the recordings of liens by the Commissioner of Financial Services. A summary of each regulatory component follows.

1. Reserves. Each life care institution must initially reserve for 65% of entrance fees paid by residents. This amount is amortized over five years to an amount no less than 19.5% of the original fee. These reserves must be "covered" by various assets including bank deposits, allowable securities, and the value of the life care institution's physical plant.

2. Escrows. All deposits paid by a resident prior to occupancy are to be placed in escrow at an independent bank or trust company.

3. Liens. The Commissioner of Financial Services has a lien on the buildings used by life care institutions, for the benefit of the residents to help assure performance of the life care contracts.

4. Examination. The Division of Financial Services is statutorily authorized to examine life care institutions as often as deemed necessary, for compliance with applicable

statutes and regulations. The Commissioner of Financial Services may designate an independent auditor to conduct the examination.

5. **Contracts.** All life care contracts must be clearly written and state specifically services to be provided and fees to be paid.

6. **Register.** Life care institutions are required to maintain a register setting forth certain facts concerning all residents. Required information includes name, age, and name of the person responsible for the resident's care and maintenance.

7. **Advertising.** Advertisements are required to accurately and adequately disclose the financial responsibility of any person entering into a life care contract.

Presently, there are four companies operating life care institutions in Colorado. In terms of efforts to reduce the risk of residents losing money deposited with a life care institution, reserve requirements and the state's lien on buildings are two very important components.

The level of reserves for the four operating life care entities in Colorado follows.

Table E

	# of Residents	Required Reserves	Actual Reserves
Institution A	7	$42,889	$823,202
Institution B	401	$5,821,375	$27,455,570
Institution C	196	$1,433,136	$13,996,694
Institution D	46	$295,952	$1,274,846
TOTALS	650	$7,593,352	$43,550,312

It can be seen that each institution is exceeding Colorado's reserve requirement by a substantial percentage. The Division of Financial Services has not detected any trends or "red flags" that have led to the need for an examination of any institution. However, the Division is in the process of developing procedures to require examinations by the institutions' independent auditors.

4. Small Business Development Credit Corporation

The Division of Financial Services is responsible for the licensing and examination of Small Business Development Credit Corporations (SBDCC). The purpose of this program is to improve the financial environment for small businesses by making capital available to them.

These are corporations that exist to provide financing and business assistance to firms. Essentially, a SBDCC raises capital by borrowing, issuing corporate bonds or notes, or in other ways. However, it cannot accept deposits from the public like a bank or S&L. The SBDCC, in turn, loans this money to small businesses for initial capitalization or for acquiring and equipping facilities.

The federal Small Business Development Credit Corporation Act (Act) was created in 1988. The Small Business Administration, a federal agency, offers loan guaranties to lenders who provide small business loans. In order to qualify for the loan guarantee, the lender must be a regulated financial institution. By regulating SBDCC firms, the state allows these lenders to be eligible for the loan guarantee.

Although this configuration would appear to attract investors, Colorado has experienced no success with small business development credit corporations. There have been only a handful of requests for information and no applications have been filed. Therefore, there are no licensed SBDCCs in Colorado.

III. THE DIVISION OF FINANCIAL SERVICES

1. Overview

Mission

The Division of Financial Services identifies its goal as promotion of lawful, safe and sound operations of state chartered credit unions, savings and loan associations and small business credit corporations. The Division also is responsible for providing protection of public moneys on deposit in state and federal savings and loan associations above and beyond the protection provided by federal deposit insurance. Finally, the Division is responsible for providing monitoring and oversight of certain financial activities of life care institutions.

Staffing Overview

The Division is staffed by nine people. This includes a commissioner, a supervising examiner, five examiners, and two support staff. Examiners assigned to credit unions have been increasing: from four in FY 89-90 to 4.25 in FY 92-93. Conversely, savings and loan examiners have decreased from one examiner in FY 89-90 to .75 in FY 92-93.
The Division performs its regulatory mission primarily through administration of the following statutes: Credit Unions, 11-30-101 et. seq.; Savings and Loan Associations 11-40-101 et. seq.; Protection of Deposits of Public Money 11-47-101 et. seq.; Small Business Development Credit Corporations, 11-36-101 et. seq.; Electronic Fund Transfers 11-48-101 et. seq.; Life Care Institutions 12-13-101 et. seq.; and, the Uniform Consumer Credit Code, 5-1-101 et. seq.

The Divisions responsibilities are summarized below.

1. Credit Unions. The Division approves new state credit union charters, changes of locations and mergers, and examines state-chartered credit unions on a risk-based schedule to assure sound financial condition and compliance with laws and regulations.

2. Savings and Loans. The Division approves applications to incorporate new state chartered savings and loans associations, approve branch office applications and examine each state chartered association on a regular basis to assure sound financial condition and compliance with applicable laws and regulations.

3. Public Deposit Protection Act. The Division administers this act to safeguard uninsured deposits of any public institution in a savings and loan association.

4. Life Care Institutions.

5. Small Business Development Credit Corporations

2. Examination and Enforcement

Examination of financial institutions and enforcement and corrective actions taken by the state are at the heart of the regulatory efforts of the Division. The following section will explore the examination used by the Division of Financial Services.

The Examination System

The foundation of Colorado's state oversight of financial services is the examination. It is accepted that the examination of financial institutions is the most significant factor in the general public's perception of the effectiveness of regulation.

The Division conducts safety and soundness examinations of credit unions using the CAMEL rating system. Savings and Loan Associations are examined using the MACRO examination, which is similar to the examination used for credit unions. As this report will discuss later, the Division plays a fairly small role in the examination of savings and loan associations which are primarily regulated by federal agencies. For this reason, the following detailed discussion of the examination will focus on credit union examinations.

Although the CAMEL title is used by other federal and state bank and saving and loan regulators, the credit union CAMEL system is unique. The examination components are evaluated in a manner taking into account the unique characteristics of credit unions. All examination components consider quantitative and qualitative factors.

Credit Unions, under the CAMEL Rating System, are evaluated on these five components:

1. Capital Adequacy
2. Asset Quality
3. Management
4. Earnings
5. Liquidity

Capital Adequacy. The Division's examiner seeks to determine the strength of the credit union's capital position to withstand potential losses that could affect its capital reserves. To do this, an examiner looks at a variety of ratios. Two key ratios are the capital to assets and net capital to assets ratios. Other ratios employed include solvency evaluation and capital plus deposits to deposits, delinquent loans to capital and classified assets to capital.

Asset Quality. In conducting the quantitative asset quality review, the examiner looks at soundness of the assets and the effect of those classified assets on the financial condition of the credit union. There are three key ratios used in the asset quality examination:

1. Delinquent loans to total loans.
2. Net charge-offs to average loans.
3. Fixed assets and DRED to assets.

Qualitative examinations attempt to determine that the credit union policies and procedures, especially those related to lending and investments, are being followed by management. The examination may seek to determine that the credit union conducts periodic reviews of its policies and procedures to make certain that goals and objectives are being met.

Management. Examination of management is an important part of the CAMEL examination. This portion of the examination results in a management rating of "1" through "5". A rating of "1" is assigned to fully effective management that demonstrates an ability to cope successfully with existing and foreseeable problems. At the other end of the scale, a "5" rating is assigned when management weakness is so severe that action must be taken before safety and soundness can be realized.

Management effectiveness is rated in relation to the other financially driven components of CAMEL but additional factors are included in the review of management including:

1. Compliance with regulations and statutes.

2. Written policies and procedures.

3. Conduct of annual audits.

4. Record keeping that complies with accepted accounting practices.

Earnings. In the examination of earnings, all aspects of income and expenses are analyzed and then related to the overall condition of the credit union. A sound credit union has the ability to cover all expenses and still provide for capital growth, among other factors. CAMEL requires a minimum examination of seven ratios to evaluate the earnings of a credit union. The two key ratios are:

1. Net income to average assets (before reserve transfers).

2. Net operating expenses to average assets.

Qualitatively, the examiner must make three primary determinations: First, that the board of directors has in place a budget and the mechanisms that are needed to properly evaluate earnings on a continuing basis. Second, that management is adhering to sound practices in carrying out policies of the board. Third, that adjustments are made in a timely manner which are supported by cost/benefit analysis. When making the qualitative review of earnings, the examiner must also determine that management decisions concerning the accounting treatment of income/expense items which have a material effect on earnings are made in compliance with regulatory accounting standards and Generally Accepted Accounting Principles.

Liquidity. A credit union's liquidity must be evaluated on the basis of its capacity to promptly meet the demand for payment of its obligations and to readily fill the reasonable credit needs of its members. In appraising liquidity, attention should be directed to the credit union's average liquidity over a specific period of time, as well as its liquidity position on any particular date.

When evaluating liquidity, you must be concerned with the volatility of shares, the degree of reliance on interest-sensitive funds, the frequency and level of borrowing, and the availability of assets readily convertible to cash.

In conducting the quantitative analysis of liquidity, the examination considers the following key ratios.

1. Long term assets to assets.

2. Net long term assets to assets.

3. Regular share to total deposits.

4. Total loans to total shares.

The examination also considers whether or not the board has established asset-liability management policies based on the overall short and long-range goals and objectives of the credit union. The credit union's exposure and ability to adjust to interest rate fluctuations is considered, along with management's ability to actively control the liquidity position without unnecessary sacrifice of earnings potential.

The examination also analyzes the effect long-term assets could have on capital and the effect these assets could have on liquidity. Management's technical competence to manage liabilities and the existence of a plan to access lines of credit or other sources of cash, should the need arise, is also examined.

The Examination Ratings

Each credit union is accorded a composite rating that is predicated upon the evaluations of the five aforementioned components. The composite rating is also based upon a scale of 1 through 5, in ascending order of supervisory concern. In arriving at a composite rating, each financial component must be weighed and due consideration given to the interrelationships among the various aspects of credit union operations. The delineation of the specific components does not preclude consideration of other factors that, in the judgement of the examiner, are deemed relevant to accurately reflect the overall condition, safety and soundness of the credit union. However, assessment of the specific components represents the essential foundation upon which the composite rating is based.

The five composite ratings are:

Composite 1
Credit unions in this group are sound institutions in almost every respect; any critical findings are basically of a minor nature and can be handled as a routine matter. They are resistant to external economic and financial disturbances and are capable of withstanding the unexpected actions of business conditions more ably than those with a lower composite rating.

Composite 2
Credit unions in this group are also fundamentally sound institutions, but may reflect modest weaknesses correctable in the normal course of business. They are stable and well able to withstand business fluctuations quite well. However, areas of weakness can be seen which could develop into conditions of greater concern. To the extent that the minor adjustments are handled in the normal course of business, the supervisory response is limited.

Composite 3
Credit unions in this group exhibit a combination of weakness ranging from fair to unsatisfactory. They are only nominally resistant to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting certain identifiable areas of weakness. Consequently, such credit unions are vulnerable and require more than normal supervisory attention. Overall strength and financial capacity is present so as to make failure only a remote probability.

Composite 4
Credit unions in this group have more than a moderate volume of asset weaknesses, or a combination of other conditions that are unsatisfactory. Unless prompt action is taken to correct these conditions, they could reasonably develop into a situation that could impair future viability. A potential for failure is present. Credit unions in this category require close supervisory attention.

Composite 5
Credit unions in this group have a volume and character of weaknesses such as to require urgent aid from the shareholders or other sources. Such credit unions require immediate corrective action and constant supervisory attention. Their probability of failure is high.

Credit Union Insurance Provides Depositor Protection

Colorado state law requires that all state chartered credit unions be insured with the National Credit Union Share Insurance Fund (NCUSIF) unless the Commissioner approves other insurance as comparable in protection to federal insurance. The Division's policy has been to permit only NCUSIF insurance. Only a handful of states permit state chartered credit unions to secure private insurance. In at least one instance, the results have been quite negative for depositors. The Colorado requirement provides solid protection for depositors in state chartered credit unions.

The National Credit Union Administration (NCUA) and the NCUSIF supervise and insure approximately 8,600 federal credit unions and 4,400 state chartered credit unions. The NCUSIF was created in 1970. The credit union industry was in a mode of expansion. Credit unions, essentially by offering new services to members, realized strong growth: between 1977 and 1984, deposits grew from $37.4 billion to $84.2 billion and assets grew from $43.5 billion to $92.9 billion. Low insurance losses in this expansionary period coupled with minimal operating expenses allowed the insurance fund to place most revenues directly into reserves.

However, various economic factors contributed to liquidity and earnings problems. For instance, the statutory interest rate cap on credit union loans was set at 12 percent. Market conditions, though, were vastly different - the prime rate was 20 percent in the early 1980s. Between 1980 and 1984, over 1,200 credit unions failed. This financial problem paralleled the savings and loan crisis. Of course, a significant difference is that the credit union industry was not raided by unscrupulous "entrepreneurs." No doubt, the industry's solid membership requirements and not for profit status helped to protect it. Nevertheless, the fund was depleted below the safe level although it is important to remember that the fund did cover all losses. Congressional action to recapitalize the fund occurred in 1984. Today, the fund has over $2 billion in assets.

The worst year for the NCUSIF was 1982. The fund experienced total expenses of $1.52 for every $1.00 of insured deposits. It is estimated that, at current levels, the fund would have to experience losses at more than eight times the 1982 rate before experiencing any problems.

Although authorities point out that reliance on low historical loss rates can be misleading, most agree that the above scenario is remote. It appears to most in the industry that Colorado's federal insurance requirement for state chartered credit unions provides strong, reasonable, proactive oversight.

Enforcement Activities of the Division of Financial Services

The examination of credit unions and savings and loan associations requires that the division work closely with federal regulators. This cooperative process is quite different with regard to each industry.

As mentioned, state chartered credit unions are required to maintain federal insurance to protect members. Therefore, state chartered credit unions are subject to federal examinations since the insuring agency has a strong interest in the health of any credit union that might cause losses to the fund.

In Colorado, the National Credit Union Administration (NCUA) meets with the Commissioner of Financial Services to discuss credit unions that the NCUA is concerned about and may require federal participation in the examination. In some cases, the Commissioner may be able to provide additional information from Division records that shows federal participation in the examination is not required.

This is not always the case, however, and sometimes a joint examination is conducted. In these examinations, and in the Division's own required examinations which occur at least every 18 months, the NCUA accepts the results of the Division's examination.

This is strong support for the integrity and reliability of credit union examinations conducted by the Division. The NCUA has eleven credit union examiners in Colorado. It would be quite simple to schedule federal examiners into state chartered credit unions. However, the federal regulators only assist in approximately 30% of the examinations conducted in Colorado. In those instances, federal policy states that the state regulator is the "Examiner In Charge".

As part of the research for this sunset review, the Department of Regulatory agencies contacted regional officials of the National Credit Union Administration. They believe that the present process of cooperative examination is working well.

Savings and Loan Examination

Examination of savings and loan associations is somewhat different although some state cooperation is required.

The Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), passed by Congress in 1989, transferred federal regulation and insurance authority over savings and loan associations to the Treasury (Office of Thrift Supervision or OTS), and the Federal Deposit Insurance Corporation. Some state regulators have referred to this as "triple whammy regulation" because of the interplay of the two federal regulators and the state regulator.

No time requirement exists in state statute for examination of savings and loan associations. In practice, federal regulators examine insured associations every calendar year. Since all Colorado state chartered savings and loan associations are required to maintain federal deposit insurance, they must therefore undergo a federal examination yearly. It is the Division's policy to join these annual examinations.

The Colorado Division of Financial Services' savings and loan examiner participates in these examinations as a team member. One report is produced as a result of the examination. In most cases, the state examiner will serve as a member of a team looking at one of the component areas such as management or liquidity. Contact with other state regulators reveals that a similar process exists in most states in the region as federal regulators have taken the lead in regulating federally insured associations.

An important part of state regulation of savings and loan associations is the examinations conducted to determine compliance with Colorado's Public Deposit Protection Act. The Division of Financial Services is charged with determining compliance with this act, by state chartered as well as federally chartered savings and loan associations.

Credit Unions are not permitted to accept public deposits because credit unions exist to serve a limited membership and not the general public.

This Act is administered through off-site monitoring of deposit and collateral levels and on-site examinations and collateral verifications. Savings and Loan Associations are required to report quarterly the total public deposits, insured and uninsured. Any deposits not covered by FDIC insurance require a breakdown of collateral market value. FDIC insurance covers a maximum of $100,000 of a deposit.

The Division accepts three types of non-cash collateral to secure public deposits.

1. Securities
2. Insured and guaranteed loans
3. Conventional mortgage loans

Collateral pledged to uninsured public deposits is placed with a trustee. The Division conducts annual direct verification of collateral pledged at each third party custodian.
No public depositor has lost any money deposited in a Colorado savings and loan. Since 1988, there have been five instances in which the Division liquidated collateral to pay public depositors. However, these actions are decreasing, and 1992 required no such state intervention to protect public deposits.

Credit Unions

The number of credit unions has declined since FY 89-90 by a total of seven. The Division is required by statute to examine credit unions once every 18 months. This results in an examination of approximately 80% of all credit unions per fiscal year.
Follow-up examinations have increased significantly over the same period of time. Three follow-up examinations were conducted in FY 89-90. This number jumped to 12 and then 16 examinations in the succeeding two years.

Problem credit unions. A credit union that receives a 4 or 5 CAMEL rating (a low rating indicating that the institution may be experiencing problems) is examined once every 12 months. Also, the Division monitors such credit unions on-site two to three times between examinations.

Troubled credit unions are placed under more direct oversight through a Letter of Understanding and Agreement (LUA). At the conclusion of the examination, the Examiner In Charge meets with officers and management of the credit union to discuss the findings. If the results indicate that an LUA is required, this information is conveyed to the credit union at the close of the examination. The examination is then completed and the report produced at the Division. The Division's Supervisor of Examinations and the Commissioner if necessary, meet with virtually all of the officers of the credit union, including the members of the supervisory committee, to discuss the examination and the corrective measures stated in the LUA. Receipt of this document immediately places the credit union in a twelve month review cycle. However, follow up examinations occur with much more frequency, and it is up to the examiner to conduct limited scope examinations as often as needed.

Failure to comply with the terms of the LUA may result in a cease and desist order and eventual charter revocation from a technical point of view. In fact, The Colorado Credit Union League will most often step in, working with the Division, to help correct the credit union's problems by providing management expertise while simultaneously working to merge the troubled credit union with a strong, healthy credit union. The Division reports that virtually all credit unions that do not comply with the terms of the LUA do not comply because of a lack of expertise and not because of efforts to damage the members of the credit union.

CREDIT UNION AND SAVINGS AND LOAN DATA

Table F

CREDIT UNIONS	LUA	CEASE AND DESIST ORDERS	CHARTER REVOCATION	TOTAL
1988	0	0	1	1
1989	14	0	2	16
1990	19	0	1	19
1991	4	3	0	7
1992	2	1	0	3
TOTALS	38	4	4	46
SAVINGS AND LOANS	**PDPA COLLATERAL SEIZURE**	**CEASE AND DESIST ORDER**	**CHARTER REVOCATION**	**TOTAL**
1988	1	2	1	4
1989	1	3	0	4
1990	2	1	0	3
1991	1	0	0	1
1992	0	0	0	0
TOTALS	5	6	1	12

Table G

CREDIT UNIONS	FY 89-90	FY 90-91	FY 91-92	FY 92-93
Institutions	90	85	83	83
Exams to be conducted	60	57	55	55
Examinations conducted	63	67	55	55
Follow-up exams conducted	3	12	16	14
Number of examiners	4	4.25	4.25	4.25
Assets (millions)	$1,564	$1,464	$1,537	$1,614

Table H

PROBLEM CREDIT UNIONS	FY 89-90	FY 90-91	FY 91-92	FY 92-93
Beginning Balance	26	22	17	14
New problems added	6	2	2	2
Problems deleted*	8	6	5	4
Credit unions closed	2	0	0	0
Credit unions merged	0	1	0	0
Ending Balance	22	17	14	12
* LUA eliminated or upgraded to MOA				

Table I

SAVINGS AND LOAN ASSOCIATIONS (Including PDPA)	FY 89-90	FY 90-91	FY 91-92	FY 92-93
Associations (Main Offices)	10	8	7	7
Branch offices	14	14	14	15
Assets (millions)	$531	$446	$470	$490
Number of examiners	1	.75	.75	.75
Eligible public depositories	28	26	23	22
Uninsured public deposits (millions)	$279	$124	$120	$125
Events of default (collateral liquidations)	2	2	2	0

IV. CREATION OF THE FINANCIAL SERVICES BOARD

The regulation of state chartered credit unions was significantly altered by House Bill 1275 (laid over for third reading in the second house as of 4/30/93). HB 1275 created a Financial Services Board in the Division of Financial Services.

Why was this board created? There are several good reasons for the creation of an oversight board for financial services institutions. In fact, such a proposal would have likely been recommended in this sunset review. There appears to have been one significant concern that resulted in HB 1275; community charter credit unions. The question being, How do these institutions fit with the genesis of the Financial Services Board?

In June of 1992, the Commissioner of Financial Services approved an application for the conversion of Lowry Federal Credit Union (LFCU) from federal to state charter. It appears that the credit union's employee base, provided by the Lowry Air Force Base, is subject to virtual elimination through closure of the base. This results in the need for a community charter if the credit union is to survive. Of course, Lowry Federal Credit Union could have merged with another credit union, but apparently management did not decide that a merger would be in the best interest of the credit union's membership.

This decision may have been because of the large size of Lowry Federal Credit Union. Many mergers in the credit union industry involve smaller credit unions but LFCU is a $100 million credit union that has served the civilian and military population of the Lowry Air Force Base for over 40 years.

The Commissioner of Financial Services approved a community charter field of membership consisting of the residents of Aurora, Colorado, who were not members of any other credit union in Aurora, Colorado. A total of ten other credit unions exist there currently.

This approval led to much criticism, especially from the banking industry. In hindsight, and after litigation of the matter, there is no doubt that the Commissioner of the Division of Financial Services acted legally in approving the conversion of Lowry to state charter.

There are numerous public policy issues involved in this situation. The most basic issue is the openness of the credit union chartering procedure. This appears to be the driving force behind the creation of the Financial Services Board and is reflected in the Board's duties, all of which will be discussed later in this report.

The broader public policy issue, however, is the community charter itself. Opponents criticize the community charter, at least in the form it takes when it includes any person living in Aurora, Colorado, who is not a member of another credit union. Providing financial services to this population is a lucrative market. Field of membership and the common bond should drive the charter, not the other way around. There is a vast difference between the shared similarities, or common bond, of all employees of a corporation and the similarities among the residents of Aurora, who may not even be employed or who may be wealthy.

Opponents do not argue against all community chartered credit unions, though. Take, for example, the recently approved state charter of the Denver Community Development Credit Union. This credit union will serve the financially disenfranchised portion of northeast Denver. This, opponents claim, is the type of role that a community charter should play in the financial arena.

It is probably fair to say that most proponents of credit unions believe that every person ought to belong to a credit union. Since credit unions are financial cooperatives, proponents do not believe that the opponents objections to community charters should prevail. Why should a credit union that seeks to serve Aurora be treated differently, in terms of chartering by the state, than a credit union that serves northeast Denver?

It is optimistic to believe that Colorado's new Financial Services Board can resolve the friction that exists nationwide between financial institutions that often find themselves competing for the same customer. The Board has been granted certain powers and assigned certain duties, though, that may help to alleviate political tension surrounding community charter credit unions.

HB 1275 creates The Financial Services Board. The 1993 session of the General Assembly passed legislation creating a Financial Services Board. The Board is located in the Division of Financial Services in the Colorado Department of Regulatory Agencies. A five member Board is created by HB 1275 and the membership of the Board is:

1. Three members who are executive officers of state credit unions and who have at least five years practical experience as a credit union executive officer;

2. One member who is an executive officer with a state savings and loan association; and

3. One member who serves as a public member with expertise in finance.

Appointments are made by the Governor with senate confirmation.

Powers of the Board. The Financial Services Board is empowered to make policy and to establish rules for the regulation of credit unions, savings and loan associations, life care institutions, small business development credit corporations, and the protection of public moneys deposited in savings and loan associations.

The Financial Services Board has a wide variety of powers regarding establishing fees, issuing declaratory orders, and restricting credit unions and savings and loans from engaging in certain activities. Further, the Board is empowered to make all final decisions with respect to a variety of

regulatory matters including suspension or liquidation of credit unions, denial, suspension, or revocation of licenses issued to small business development credit corporations, modify or reverse orders of the Commissioner acting pursuant to authority delegated by the Board,establish fees and assessments, issue cease and desist orders, and other regulatory powers including review of certain actions of the Commissioner. The Board is also empowered to promulgate rules and otherwise directly regulate public depositories although the majority membership of the board is

Board required to hold public hearings. The Financial Services Board is required to hold public hearings prior to granting a community charter or approving a credit union merger involving a community charter. Notice by registered or certified mail thirty days prior to the hearing is required by statute. In addition to the applicant, notice of the hearing must be given to each credit union, savings and loan association, bank or industrial bank within the geographical area proposed to be served by the credit union and to any others designated by the Board.

The Board also must provide notice of the hearing in a newspaper distributed within the community proposed to be served by the credit union. If, ten days prior to the scheduled hearing, the Board receives no written protest against the proposed charter, the Board can elect to dispense with the hearing.

V. THE NEED FOR REGULATION

Recommendation 1: The General Assembly should continue the Division of Financial Services. In light of the complex issues and possibility of federal regulatory changes which may directly affect state regulation, the next sunset date for the Division of Financial Services should be July 1, 1999.

The need for regulation of the financial services industry, particularly oversight of credit unions and savings and loan associations, is compelling. This section of the sunset review will discuss the general theory supporting continued regulation of these industries.

Beyond the need for continued regulation, this section will explore alternatives to the existing regulation. In particular, elimination of state chartering will be discussed. Further, this section will explore the advantages and disadvantages of an alternative regulatory structure. Specifically, would it be more efficient to consolidate financial institutions regulation in Colorado? Some feel that separate regulators of banks and credit unions, to mention the most obvious example, creates duplicate bureaucracy and eliminates possible economies that could be realized through combination of the Division of Financial Services and the Division of Banking.

The fundamental reason for regulation of financial institutions is protection of depositors' money. In Colorado, credit unions hold approximately $1.6 billion in assets; savings and loans account for another $490 million. In the case of credit unions, close to $1.5 billion of the total assets is in the form of deposits. The potential for catastrophic consequences to individual depositors without regulation is enormous.

One factor in regulatory theory that argues for oversight considers the ability or inability of consumers to distinguish between good and bad institutions. This is clearly the case in the industries regulated by the Division of Financial Services.

The CAMEL and MACRO examinations, discussed in greater detail earlier in this report, require detailed analysis of numerous ratios, including the extremely important capital to assets ratio. While it might be argued that a very small percentage consumers might be capable of such analysis, it is not reasonable to assume that virtually any members of credit unions or savings and loans associations could conduct such analysis.

Depositors rely on regulatory oversight to assure that financial institutions are healthy. If such institutions begin to experience problems, depositors rely on regulatory intervention to establish corrective procedures while avoiding a "run" on the institution to withdraw deposits. Unlike transactions where goods and services are bought and sold, depositors become closely allied with the health and future of the financial institution.

Also, regulation of financial institutions contributes to a stable foundation upon which individuals conduct monetary transactions. Essentially, this means that regulation ensures that a stable payment system is in place. A stable payment system includes meeting the public's financial needs while discouraging or preventing practices that might disrupt the system. It can be reasonably argued that good regulation of financial institutions, including credit unions and savings and loan associations, generally equates with good operating practices of those businesses. State regulation oversees these practices and intervenes if the public or the depositors are at risk.

The Dual Chartering System

Colorado credit unions, either when applying for a charter or through later conversions, can choose between federal and state charter. Like most choices, there are advantages and disadvantages to each. The Colorado credit union industry is strongly supportive of the continuance of the dual charter. In any discussion of the appropriate regulatory format for Colorado, a discussion of whether or not to allow state chartering to be replaced by federal chartering is an appropriate consideration.

Arguments in favor of eliminating state-chartering.

The strongest argument for this position is that it would save money in the state budget. The budget for credit union supervision is about $450,000.

Colorado credit union depositors would still be protected, the argument continues, because the NCUA examines all federally chartered credit unions. In fact, the NCUA examines more frequently than Colorado - every twelve months instead of every eighteen months.

By having the federal government regulate the industry, all credit unions will be treated the same. For instance, federal credit unions pay less in fees than state chartered credit unions.

The dual charter option creates an unhealthy "regulatory auction" situation, where the bidders (the credit unions) essentially call the shots. Both federal regulators and state regulators need someone to regulate or their programs will be unneeded. Credit unions can threaten to move from one jurisdiction to the other in order to find weaker regulation. This is bad for depositors as well as bad public policy, according to this line of argument.

Arguments against elimination of the state charter option.

Proponents of the dual chartering system say state regulation is accessible and that it is good for Colorado citizens. If federal regulation is the only option, credit unions will be forced to deal with regulators out of state. This can be time-consuming and costly. Furthermore, it is not reasonable to expect federal officials to have as keen a grasp of Colorado's economic environment as would a state commissioner or board.

Examination questions and other issues can be resolved quickly by state-chartered credit unions, often by a simple phone call to the Division of Financial Services. Federal regulation is administered regionally and federal officials may be less accessible.

There is also a political accessibility that is good for Colorado credit union members. The state commissioner, and the industry, have more direct access to lawmakers. In terms of accountability, lawmakers have more access to the regulators if he or she has a question or concern. When it comes to passing legislation, this communication is even more important. Credit unions are non-profit institutions and legislation that benefits credit unions directly benefits the members; it doesn't result in increased profits to out of state shareholders. Therefore, political accessibility is good for the citizens of Colorado.

Cost. Even though state expenditures might be reduced somewhat if the state charter option were eliminated, it would provide very little benefit to the citizens of Colorado. Credit unions still would pay federal fees and those costs are borne by the depositors. Also, the credit unions have little input into setting federal fees so the future costs are uncertain.

Examinations would continue at the federal level, of course. However, there are no distinct advantages to this. In fact, state chartered credit unions appear a little healthier as a group than federal credit unions at this time.

As it stands now, there are two separate levels of oversight because state chartered credit unions are federally insured. State and federal regulators work together to provide sound oversight. State and federal regulators work together so that there are no duplicate examinations which might result in increased operating costs for credit unions.

Federal fees are less than state fees primarily because they are subsidized by the federal insurance fund (which includes fees paid by state credit unions that do not enjoy the benefits of the federal overhead transfer). Still, eighty-three credit unions choose to pay higher fees and keep a state charter. Because credit unions are democratically controlled, their members support this choice. The responsiveness, professionalism and innovation of the Division of Financial Services make the state charter a viable option for many credit unions.

The Commissioner of Financial Services, in conjunction with the Colorado Credit Union League, created an advisory board to increase communication. This board has been successful for over two years. Even federally chartered credit unions are represented.

The present dual-charter option creates a type of "checks-and-balances" system. It serves to prevent heavy handed, red tape wrapped regulation that is expensive for credit unions and therefore bad for depositors. Credit unions, as mentioned previously, have the option of converting their charter if regulators do not address these concerns. The number of credit unions that convert their charter is historically small. Further, they tend to cancel each other out. In other words, an equal number convert from federal to state and from state to federal if one takes the long view.

Since Colorado requires all credit unions to maintain federal insurance, state regulators and federal regulators are forced to work together to carry out their respective missions. This provides optimum

oversight and gives Colorado depositors the most bang for their buck.

State regulation is a laboratory for innovation. Since regulation at the federal level affects all federal credit unions across the nation, all with differing memberships and local economies, innovation is not always forthcoming. In fact, credit unions were first chartered at the state level. Also, innovations such as ATM access, real estate mortgage lending, home equity loans and field of membership expansions came from the state level. All of these innovations have been positive for credit union members.

If only a handful of credit unions maintained state charters, it might be reasonable to eliminate the state system. In fact, if substantial attrition did occur, a point would be reached where a small number of state charters could not reasonably pay the fees required to run the regulatory program. However, the numbers of state chartered credit unions and the strong interest in maintaining the dual charter system by the industry are persuasive arguments to maintain the dual charter system. After all, the choice of state charter is not simply the decisions of 83 credit union managers, but the collective voices of the majority of members of each of those credit unions.

Furthermore, the numbers of federal and state charters are fairly consistent. The NCUA reports that historically, the numbers of credit unions changing charters, either federal to state or state to federal, have been equal. Most Colorado charter conversions have occurred because of mergers, in which the smaller credit union is absorbed into the larger credit union's field of membership.

Consolidation of Regulation

Some believe that consolidation of state regulation would result in the state saving money through reduced regulatory costs. In particular, proponents of this type of consolidation argue that consolidating Colorado's Division of Financial Services and Colorado's Division of Banking would result in a more efficient and cost effective regulation.

Consolidation would not save significant amounts of money. In essence, it appears that consolidation of Colorado's Division of Financial Services and the Division of Banking would result in total yearly savings of less than $100,000. This assumption is based on the elimination of one commissioner and a percentage of staff support for that commissioner. Even that assumption is subject to some questioning, though. It is difficult to understand how one commissioner could reasonably be expected to assume the duties of another full time position, without some adverse impact to his or her duties. Perhaps additional staff could be added to handle delegated duties, but this would erode any cost savings realized by consolidating positions.

Credit unions were recently regulated by the Banking Commissioner. Regulation of credit unions was transferred to the Division of Financial Services in 1988. The General Assembly could easily have moved the Division of Financial Services into the Division of Banking at that time because credit unions were under the regulatory authority of the Banking Commissioner at that time. There have been no significant changes since 1988 that justify reversing the General Assembly's actions.

In fact, the General Assembly decision appears to have been the right one. The numbers of problem credit unions are diminishing and the number of healthy credit unions are increasing.

Colorado's regulatory philosophy does not lend itself to this type of consolidation. Colorado tends to regulate through regulatory boards, the majority membership of which is made up of industry representatives. It is hard to visualize a regulatory "super board" in Colorado that could fairly balance the needs of multiple competing industries. The recent Lowry Credit Union issue, ultimately resolved by a decision of the court, underlines the contentious atmosphere between credit unions and banks. The issues that would require resolution in creating a regulatory oversight board of only credit unions and commercial banks boggles the mind.

Therefore, it must be established *a priori*: that one industry would not be allowed to regulate its competitor. In other words, there must be some type of equal representation on the board. To do otherwise would simply invite a major conversion to federal charter. This would create numerous disadvantages for Colorado depositors.

How, then, to achieve parity? Banks would certainly argue that their enormous control of deposits requires that their industry be the majority on a board of multi-institutional regulators. It is hard to argue with such a contention. Board members with a lack of knowledge of banking could, through regulatory action or omission, create significant problems in Colorado's economy and direct injury to depositors.

On the other hand, credit unions would not accept regulation by their most fierce competitors: the banking industry. They believe that this would mark the end of this unique, cooperative credit union, if not the collapse of the Colorado industry itself. A large portion of Colorado citizens are members of credit unions. Good public policy would not force the collapse of these citizens' credit unions. However, as stated previously, Colorado credit unions would probably convert to federal charter rather than submit to regulation by the banking industry.

There is little doubt that, even if some board were created, it would result in dramatic increase in issues before the Colorado General Assembly as the competing industries look after their best interests. This could easily create an unstable, politically charged environment which could have the effect of reducing the stability of regulation.

Financial industries are changing at a rapid pace. Washington's efforts to deregulate the once conservative thrift industry led to a massive crisis that could only be tackled by an equally massive bailout by taxpayers.

Government intrusion into the financial market is segmented by industry. Insurance, credit unions, thrifts, banks and securities all answer to separate regulators. However, many agree that competition

and the changing face of the American economy point to a day in the near future when such artificial distinctions are ancient history. Banks may sell insurance or securities, services provided by insurance companies may become diverse. Consolidation of the entire financial services industry is occurring, and accelerating, today.

Given the nature of the financial services industry, it appears that significant restructuring of state regulation at this time would be premature. It is likely that Colorado in the future will be required to respond to the shifting landscape of the financial markets in the state and the country. That will be an appropriate time for further restructuring of state financial regulation.

Recommendation 2: The General Assembly should allow the regulation of Small Business Development Credit Corporations to terminate.

As this sunset report has discussed, the regulation of Small Business Credit Development Corporations by the Division of Financial Services has not been embraced by the public. There have been no licenses issued since the inception of this regulatory scheme. In fact, there have been no applications for a license. The regulation of these businesses was begun so that more companies could qualify for federal loan guarantees to back loans made to small businesses.

Some states have experienced success with similar programs. A significant difference between Colorado's approach and the programs in these states is that they provide funds to supplement the applicant's capitalization. In other words, states that have successfully promoted small business development through such programs have subsidized the businesses with state funds.

Some believe that the program could be marketed more forcefully and that might increase response to the program. Although this is possible, it seems unlikely. It is just as likely that the two million dollar capital requirement in order to receive a license serves to eliminate applications. Furthermore, the federal Small Business Administration is exploring ways to revitalize a similar federal program. In fact, it was the discontinuance of the federal program that prompted the creation of the SBDCC in Colorado.

VI. STATUTORY RECOMMENDATIONS

If the General Assembly continues the Division of Financial Services, the following recommendations are made to improve the statutes and improve regulation.

Require the Division to conduct thorough investigations before chartering Credit Unions.

Recommendation 3: Amend section 11-30-101(3) to by adding the following new language: The commissioner shall make or cause to be made a careful investigation to determine that the incorporators and organizers are qualified by character and experience and that the qualifications and financial experience of such persons are consistent with their responsibilities and duties. The commissioner may establish by rule and regulation the content of such investigations and what, if any, investigations by other agencies or authorities are substantially equivalent to an investigation conducted by the commissioner and may be accepted in lieu of the Commissioner's investigation.

The Division of Financial Services has no formal policies and procedures for chartering a financial institution. In particular, there are no procedures for investigating the background of organizers of a credit union. As credit unions grow and evolve into complex financial institutions, more stringent approaches to chartering may help to increase protection of the public.

A 1989 Business Week report stated that 85% of credit union failures are do to poor management and that fraud is starting to appear more and more in the credit union industry. The same article stressed that about 5% of credit union failures are due to fraud.

Examination by the Division plays an important part in preventing such failures. However, careful scrutiny at the application and approval stage is also a significant tool in protecting the public.

Remove Outdated Language

Recommendation 4: Repeal "For the fiscal year beginning July 1, 1992, and for each fiscal year thereafter," from C.R.S. 11-30-106(1)(b).

C.R.S. 11-30-106(1)(b) contains a reference to July 1, 1992 and each fiscal year thereafter, regarding assessment fees of credit unions. The starting date is no longer needed in statute.

Recommendation 5: **Repeal references to requirements that took effect in 1981 and 1982 from C.R.S. 11-30-117.5(1) and (3).**

C.R.S. 11-30-117.5(1) and (3) contain date requirements for obtaining credit union share insurance. Specifically, July 1, 1982 and July 1, 1981 are cited. Both dates should be removed from statute.

Appeals Should Be Heard by Court of Appeals

Recommendation 6: **The General Assembly should amend C.R.S. 11-30-106(4) to provide that the judicial review of any final Financial Services Board action or order shall be within the jurisdiction of the Colorado Court of Appeals.**

Recommendation 7: **The General Assembly should amend C.R.S. 11-44-101.8 to provide that the judicial review of any final Financial Services Board action or order shall be within the jurisdiction of the Colorado Court of Appeals.**

Section 11-30-106(4) C.R.S. pertaining to credit unions and section 11-44-101.8 C.R.S. (new language added by HB 1275) provide for judicial review of the decisions of the Financial Services Board to District Court. All institutions regulated by the Financial Services Board would benefit from direct judicial review by the Colorado Court of Appeals. Judicial review of administrative rulings further clogs the dockets of District Courts, which generally have a greater backlog of cases than does the Court of Appeals. Additionally, decisions of the Financial Services Board will have been thoroughly addressed through the administrative process. Appeal and review of those decisions is more appropriately performed by the Court of Appeals and not the District Court, which is a trial court.

Remove archaic provision requiring state approval

Recommendation 8: **Amend section 11-41-115(3) by repealing " No association shall commit itself to service loans... other than for the making of loans."**

Section 11-41-115(3), C.R.S., requires a Savings and Loan Association to secure approval by the Commissioner of Financial Services before contracting to service loans that were not held or originated by the association. Theoretically, such a requirement helps to keep the association from making risky investments. In fact, there are many transactions conducted by an association on a daily basis that are just as risky and require no pre-approval by the state. State oversight in the area of capital compliance is generally designed to regulate institutional safety and soundness issues such as this without state involvement in the day to day business of the association. It may be that

an S&L may lose business because of this requirement. If an S&L is competing with another business that is not an S&L, the seller may not choose the S&L simply because of the delay in seeking the Commissioner's approval or the fear that such approval would not be granted. The deal would fall through and the seller would have to conduct another sale.

Specific report dates should be removed from statute

Recommendation 9: Amend Section 11-47-111 to read: "Every eligible public depository shall file a report with the commissioner, on a date specified by the commissioner,...."

Section 11-47-111, C.R.S. requires that every eligible public depository shall file a certain report with the commissioner within twenty days after each valuation date. This same section gives the commissioner authority to require more frequent reports. Placing such a date in law is inflexible and may result in administrative problems and increased costs for the Division and financial institutions. Time frames for reports should be established by the Commissioner and communicated directly by him or her to the institution.

Allow more thrifts to accept public deposits

Recommendation 10: Amend section 11-47-103(6), C.R.S. by striking "having its principal office in this state."

The existing language requires that only a savings and loan association that has its principal office in Colorado may accept public deposits.

Associations from other states have purchased savings and loans in Colorado. These institutions' principal offices are located in other states even though the institution serves Colorado citizens. While it may be argued that such institutions succeed to the merged institutions' right to accept public deposits, these associations should be clearly permitted to accept public deposits. The Division inspects all savings and loan associations for compliance with Colorado's Public Deposit Protection Act so the public deposits would be as safe as any other deposits even though the principal offices are not in Colorado.

Repeal obsolete requirement

Recommendation 11: Amend section 11-41-115(3) by striking the last sentence that begins, "The limitation upon the sale..." through "...making of loans."

This is an obsolete reference pertaining to a requirement that associations secure approval of the commissioner before selling loans with recourse. Selling a loan with recourse means that the seller agrees to buy back the loan if the loan goes into default. This means that the loan is easier to sell but it also increases the risk of the association selling the loan. Under the previous statutory requirements, an association could only sell a loan with recourse if approved by the commissioner. The obsolete language refers to approval if the association were in need of cash for purposes other than making loans.
Under present statutes, savings and loan associations may sell loans with or without recourse as they deem fit. There is no requirement that the commissioner's approval be secured.

Allow the Commissioner to determine the required filing date for credit unions' annual financial reports.

Recommendation 12: Amend the relevant section of Section 11-30-106(2) to read:

> Annually, every credit union shall file a financial report with the commissioner on a date established by the commissioner.

Section 11-30-106(2) requires every credit union to file a report with the Commissioner of Financial Services on or before February 1 of each year. There are two problems with this language.

First, the statute sets a February 1 deadline, which makes it difficult for the Division to provide credit union financial data to the federal deposit insurer on as timely a basis as necessary. The insurer may need a financial report for review at any time that it appears that the credit union may be in financial trouble.

Second, the statute does not specify that the credit union must file a financial report as opposed to any other type of report. This lack of clarity could create a situation in which a credit union files a "report" simply to comply with the statute. The substantive financial report would be filed later in compliance with the statutory requirements. The statute should permit the Commissioner to require a financial report when such a report is needed.

Statute is ambiguous regarding interest refunds

Recommendation 13: The General Assembly should amend section 11-30-109(1)(b) by repealing "prior to any transfer to reserves...."

Some credit unions issue interest refunds on loans although this practice is not as common as it once was in the industry. The statute should be clarified to allow credit unions the flexibility to pay dividends and make required reserve transfers monthly but to pay interest refunds on loans only at the end of the year, when complete financial results are available. The present statute can be read to require monthly interest refunds in some cases, which could be an unsafe and unsound practice.

Make grounds for discipline up to date and equal to federal grounds

Recommendation 14: Amend Section 11-30-106(8)(a) to read:

> The commissioner may suspend or remove a director, officer, or employee of a credit union who, in the opinion of the commissioner, violates the provisions of this article or a lawful regulation or order issued thereunder... and the credit union has suffered or will PROBABLY suffer ~~substantial~~ financial loss... thereby, OR WHO HAS RECEIVED FINANCIAL GAIN BY REASON OF SUCH VIOLATION OR PRACTICE OR BREACH OF FINANCIAL FIDUCIARY DUTY, AND SUCH VIOLATION OR PRACTICE OR BREACH OF FIDUCIARY DUTY IS ONE INVOLVING PERSONAL DISHONESTY ON THE PART OF SUCH DIRECTOR, OFFICER, OR EMPLOYEE, OR ONE WHICH DEMONSTRATES A WILLFUL OR CONTINUING DISREGARD FOR THE SAFETY OR SOUNDNESS OF THE CREDIT UNION. A suspension or....

Recommendation 15: Amend Section 11-44-106.5(1) by repealing "substantial" financial loss or other damage.

Section 11-30-106(8)(a) pertaining to credit unions and section 11-44-106.5(1) pertaining to savings and loan associations require a finding that the credit union has suffered or will suffer "substantial financial loss or other damage" due to a particular violation or unsafe and unsound practice that otherwise may merit suspension or removal of a credit union official. This is a much more onerous standard than federal regulators must meet and has frustrated efforts to remove credit union officials engaged in self-dealing activities and other conflicts of interest.

If "substantial financial loss or other damage" has occurred, then the Commissioner is attempting a remedy after the fact when the damage could have been prevented through proactive measures. On the other hand, proving that "substantial financial loss or other damage" is going to occur may be a nearly impossible burden for the Commissioner to meet prior to taking action.

Extend grounds for removal to include certain acts or omissions in other jurisdictions.

Recommendation 16: Amend section 11-44-106.5 by adding a new subsection (1.5) which reads:

> "The Commissioner may suspend or remove a director, officer, or employee of an association who has been convicted of a felony, or entered a plea of guilty or nolo contendere, or who has been administratively disciplined or fined for an act or omission that would have been a violation of Colorado law.

Recommendation 17: Amend section 11-30-106 by the addition of a new subsection (8)(b) which reads:

> The commissioner may suspend or remove a director, officer, or employee of a credit union who has been convicted of a felony, or entered a plea of guilty or nolo contendere, or who has been administratively disciplined or fined for acts or omissions that would have been a violation of Colorado law.

Since all credit unions must comply with federal insurance requirements, Colorado statutes should provide the full range of disciplinary options to the Commissioner of Financial Services against state chartered credit unions for acts or omissions that would have been a violation of Colorado law had the acts or omissions occurred in this state.

Similar language appears in many regulatory statutes administered by the Department of Regulatory Agencies and provides an additional layer of public protection.

A director, officer, or employee of an institution in another state may be facing action in that state while they continue to operate in Colorado. If the individual is facing or has been found guilty of a serious charge that would be a violation of Colorado law, the Commissioner should have the authority to remove this person, if, in the Commissioner's discretion, the person poses a threat to the public in this state.

The individual removed by order of the Commissioner of Financial Services is granted a hearing and also has the right to appeal any decision to judicial review. This provides significant due process to the officer, director, or employee in the unlikely event that an unjustified removal should be commenced by the Commissioner of Financial Services.

Civil Money Penalty language is unclear

Recommendation 18: Amend C.R.S. 11-30-106.5(3) to provide that fines accrue for each day that the person assessed is found to be in violation, as determined by the Commissioner.

This section should be clarified to state that the maximum amount of a civil money penalty that can be assessed against a credit union or official is based on the number of days a credit union or official was found to be in violation of a cease and desist order or a suspension/removal order. The present language does not speak directly to this issue and invites costly litigation.

Eliminate commissioner's seal

Recommendation 19: The General Assembly should repeal sections 11-44-108 and 11-44-101.7 which require the Commissioner and the Financial Services Board to have a seal of office.

The statute provides that the commissioner and the newly created Board shall have a seal of office. Such a seal has no legal meaning or authority. Sunset reviews have historically recommended removal of such administrative provisions in statute when they serve no purpose.

VII. ANALYSIS OF STATUTES

Credit Unions

The article defines credit union, commissioner and division of financial services. It establishes requirements for the organization of a credit union and empowers the commissioner to issue a charter after making certain determinations.

The law empowers the commissioner to establish standard bylaws and requires all credit unions to operate under those bylaws. Certain credit union activities may vary from the standard bylaws including name, field of membership, board of directors, credit committee membership and other activities associated with the daily operations of the credit union.

The statute establishes membership requirements. Membership requirements include common bond of employment or association or groups which reside within a well defined neighborhood, community, or rural district having a population of no more than 25,000 or as authorized by the commissioner. Groups too small to form a credit union are authorized to join an existing credit union.

Credit unions are granted powers to make loans to members and other credit unions, receive savings and hold membership in a central credit union. The statute authorizes credit unions to make certain investments.

Title protection is provided for the use of the term, "credit union." Violation is a misdemeanor.

The commissioner is required by statute to examine each credit union at least once every 18 months. The act permits the commissioner to charge credit unions, based on a schedule, an amount to cover the expenses of supervision. It provides for judicial review of the commissioner's decisions to district court and gives the commissioner power to issue subpoenas, require attendance and answer questions relating to the credit union and to issue cease and desist orders.

The commissioner is authorized to suspend or remove officers or employees of a credit union for a variety of offenses. The commissioner may assess fines against credit unions and those fines are credited to the general fund.

The act provides that each member of a credit union has one vote, whatever their shareholdings. Credit unions are required to hold elections for appointment to the board of directors, supervisory committee, and credit committee.

The statute prescribes the duties of the board of directors of credit unions including setting loan policies and surety bond requirements for elected and appointed officials of the credit union and credit union employees.

The duties of the credit committee are provided in statute. Committee approval by a majority vote is required by law for loans except that the credit committee may delegate such powers to a loan officer within prescribed loan limits.

The statute describes the duties of the supervisory committee. Significant duties include annual audits and reports, and suspension of credit union officers.

Section 112 defines a credit union's capital to be the share payments that have been made by the members. This section permits credit unions to charge an entrance fee and an annual membership fee but the statute requires that such fees must be the same for all members.

Sections 115 and 116 concern a credit union's authority to borrow and loan money. A credit union may borrow money from any source but the amount cannot exceed fifty percent of the credit union's shares, deposits, and undivided earnings.

A credit union is prohibited from loaning more than ten percent of its assets to one member or another credit union. The statute establishes who may borrow from a credit union. Importantly, section 117 requires that any loan or aggregate of loans to certain key officials of a credit union may not exceed twenty thousand dollars plus the member's pledged shares. The statute permits the board of directors to authorize loans in excess of this amount.

Credit union reserve requirements are established in section 117. Reserve requirements are fairly detailed; credit unions fall into one of two reserve schedules.

* If a credit union has assets of five hundred thousand dollars or more and has been in operation four or more years, it must set aside ten percent of gross income until the regular reserve equals four percent of the total of outstanding loans and risks assets. Once this requirements has been achieved, the credit union must set aside five percent of gross income until the regular reserve equals ten percent of the total outstanding loans and risk assets.

* If a credit union has assets of less than five hundred thousand dollars and has been in operation less than four years, it must set aside ten percent of gross income until the regular reserve equals seven and one half percent of the total of outstanding loans and risks assets. Once this requirements has been achieved, the credit union must set aside five percent of gross income until the regular reserve equals ten percent of the total outstanding loans and risk assets.

The commissioner is empowered to decrease the reserve requirements or require special reserves to protect members in some cases.

The statute requires credit unions to acquire share insurance as provided by the national credit union administration board or comparable insurance approved by the commissioner.
Section 117.5 of the statute permits the commissioner to make available to insurers credit union reports of condition and examination findings.

Regarding suspension, Section 120 of the act provides suspension and liquidation provisions for credit unions. In general, the commissioner must issue and order by registered or certified mail requiring a credit union to show cause why its operations should not be suspended if its operations appear to be insolvent. A credit union may request a stay of execution of any order by filing an action in district court.

If a credit union charter is revoked and the credit union is liquidated, the commissioner is required by section 120 to appoint a liquidating agent and liquidation of the assets must be accomplished according to statute. The statute authorizes any credit union to be voluntarily dissolved and liquidated by majority vote of the entire credit union membership.

Section 120.5 establishes procedures for conversion from state to federal credit union. Such conversion must first be approved by the credit union's board of directors and then approved by a two-thirds affirmative vote of the credit union membership. Section 122 establishes certain procedures for the merger of credit unions. At least two-thirds of the members present at a meeting that has been called and meets statutory notification requirements is required. The applicants for the merger must create a certificate of merger and bylaws. Both documents must be approved by the commissioner.

Credit unions are exempt from taxation except as to real estate owned according to section 123. The section further provides that the shares of a credit union are not subject to a stock transfer tax when issued by the corporation or when transferred from one member to another.

Savings and Loan Associations

Article 40 of Title 11 defines foreign and domestic savings and loan associations (S&L) and other entities and terminology associated with the profession. The statute allows the commissioner to assess each association and apply charges accordingly.

A fiscal year and closing dates for each association is established and definition of an association's net earnings is established in statute. Requirements of an S&L to file and publish an annual report and guidelines for the report are established in statute as well as penalties for untimely reports.

Article 40 establishes the payment of fees annually in an amount to be determined by statutory criteria and to be enforced by the commissioner.

Section 107 of the article provides that it is a misdemeanor to willfully circulate any falsities concerning the management of a savings and loan association or the financial state of an S&L. Any suits interfering with the business of an association must be approved by the attorney general and the commissioner.

Article 41 of Title 11 establishes statutory criteria concerning organization and powers of savings and loan associations. The law restricts the use of the title "savings and loan association" and makes it unlawful for any entity to use that title unless it meets the statutory criteria for doing business as a savings and loan association.

The statute establishes the requirements for articles of incorporation for a savings and loan association and defines the guidelines for practice. It also states that all appropriate documentation regarding the articles of incorporation must be approved and deposited with the commissioner. The statute requires the commissioner to file all necessary documents that prove incorporation in the Office of the Secretary of State.

Section 112 of the article lists the powers of a savings and loan association including the acquisition, holding, and mortgage of real estate and personal property. The article also outlines the powers of savings and loan associations to become members of a federal home loan bank and to borrow funds, up to a certain limit, from that bank subject to the approval of the commissioner.

Statutory guidelines are established relating to how savings and loan associations may invest funds and defining how a S&L may determine and charge interest rates on loans.
The article states that a savings and loan association must obtain insurance of its shares and requires the commissioner to furnish insurance corporations with the necessary documents to complete said insurance. The articles also establishes the maintenance of insurance of its obligations and requires the commissioner to investigate the affairs of the savings and loan association at least once a year.

The article states that savings and loans are authorized to make loans, advances of credit and investment in notes or bonds and states the guidelines to which such transactions may be made.

The article defines the types of loans which may be made by savings and loan associations, specifies conditions for said loans and states requirements for receiving loans and guidelines for loan repayment.

The article requires each savings and loan association to annually file a report with the commissioner and states the information that should be included and the guidelines by which the report should be filed.

The article states the conditions under which affiliated branches may be opened.

The conditions under which mergers, transfers and consolidations may be executed are defined by the statute. The commissioner must approve request for action and an affirmative vote of 2/3 of the eligible voting members is required before any action is taken.

The article states that their shall be no fee of any kind to obtain membership in a savings and loan association. A board of directors with no less than five members must be established and there must be public notice of all special elections, meetings and vacancies of offices. The article also states that all members on record are entitled to vote by proxy or in person and a majority of votes is necessary to determine any issue.
No officers or directors of any savings and loan association may receive any gifts or commissions, neither may the negotiate any loan for themselves without approval from the commissioner as stated by the article. No public officer shall be disqualified to take acknowledgements or proof of an instrument in writing because of their membership or office in a savings and loan association.

The article requires a vote to be called for any amendment to the articles of incorporation (Section 129) or reorganization (Section 130). There must be a 2/3 approval of voting members and a signed certificate of approval by the commissioner shall be submitted before any such changes may be adopted. Any obligations held before the reorganization are binding after its completion, the article also states guidelines for the cessation of business.

Guidelines for the dissolution of a savings and loan association are given in Section 131 of the article. It states that an affirmative vote of the majority of the directors is required and an affirmative vote of a majority of its members is required to proceed with its dissolution. The board of directors shall act as trustees for liquidation and the association is subject to the supervision of the commissioner. Escheat proceedings are outlined in the article as well.

The article discusses the requirements, restrictions, guidelines and criteria for acquisition of a majority control over an existing association and defines the associated terminology. The article establishes that savings and loan associations and its officers may have the same "powers, rights, and obligations and shall be subject to the same limitations as apply to corporations for profit."

Small Business Development Credit Corporations

Article 36 of title 11 defines small business development credit corporations and creates a regulatory scheme for these corporations. Examination requirements, criteria for a license, reporting requirements, and other requirements are all established in the Small Business Development Credit Corporation Act of 1988 (Act).

An important discussion regarding the need for regulation of small business development credit corporations (SBDCC) is contained in the legislative declaration. Accordingly, the purpose of the Act is promote sound economic development, maintain employment, and encourage job opportunities throughout the state by encouraging and assisting the creation and growth of small business. The declaration further states that small and moderate sized companies have inadequate access to working capital and capital for acquiring and equipping facilities.

Section 103 of the Act defines SBDCC to be a corporation licensed under the Act to provide financing and business assistance to firms. In order to secure the state license, section 111 of the Act requires the applicant to meet certain requirements and receive approval of the Commissioner of the Division of Financial Services which is located in the Colorado Department of Regulatory Agencies. Foremost of the licensing requirements is that the applicant be capitalized with at least two million dollars. Also, applicants must provide a loan loss reserve of not less than two percent of the total portfolio not guaranteed by the United states government or an agency of the United States government. Third, directors, officers and controlling persons must be determined by the Commissioner to be financially sound, competent, and of good moral character. The review by the Commissioner prior to granting the license includes review of the applicant's business plan to include at least three years of detailed financial projections.

The Act provides title protection for those holding a license. Section 113 prohibits any person from using the title or calling themselves an SBDCC unless licensed.

The SBDCC must keep certain books, records, and financial sheets. Other requirements including the length of time that records must be kept may be ordered by the Commissioner.

Section 104 of the Act, in defining the powers of a licensed SBDCC, prohibits an SBDCC from engaging in any business other than providing financing and management assistance to business firms. However, section 104 states that a licensee may enjoy all the rights and privileges conferred by its incorporating statute that do not conflict with or are limited by the Act.

Licensees may secure funding in a variety of ways. Section 104 permits licensees to borrow money, issue corporate bonds or notes, and may involve equity features. However, licensees are not limited to these sources. Similarly, the licensee is afforded wide choice in determining what terms and conditions of financial assistance to provide to a business firm.

Section 106 of the Act identifies certain instances in which a licensee may hold control of a business firm. Such actions must be approved by the Commissioner. Alternatively, permission to take control of a firm is granted by subsection (2) of section 106 if the Commissioner fails to issue an order of approval or denial within ninety days of receipt of application to hold control of the business firm. Section 107 authorizes the Commissioner to designate in what form such application shall be made.

Section 106 provides that a licensee may hold control of a business form in order to protect the interest of the licensee as a creditor or investor in the firm. The Act identifies business firms that may be subject to this provision as small business investment companies and local development companies licensed or in accordance with the federal "Small Business Development Act of 1958" or a business firm which provides management assistance and financing to business firms or other, unspecified

business firms approved by the Commissioner.

SUNSET STATUTORY EVALUATION CRITERIA

(I) 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;

(II) 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;

(III) Whether the agency operates in the public interest and whether its operation is impeded or enhanced by existing statutes, rules, procedures and practices of the Department of Regulatory Agencies and any other circumstances, including budgetary, resource and personnel matters;

(IV) Whether an analysis of agency operations indicates that the agency performs its statutory duties efficiently and effectively;

(V) 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;

(VI) The economic impact of regulation and, if national economic information is available, whether the agency stimulates or restricts competition;

(VII) 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;

(VIII) Whether the scope of practice of the regulated occupation contributes to the optimum utilization of personnel and whether entry requirements encourage affirmative action;

(IX) Whether administrative and statutory changes are necessary to improve agency operations to enhance public interest.