WASHINGTON STATE
DEPARTMENT OF
FINANCIAL
INSTITUTIONS

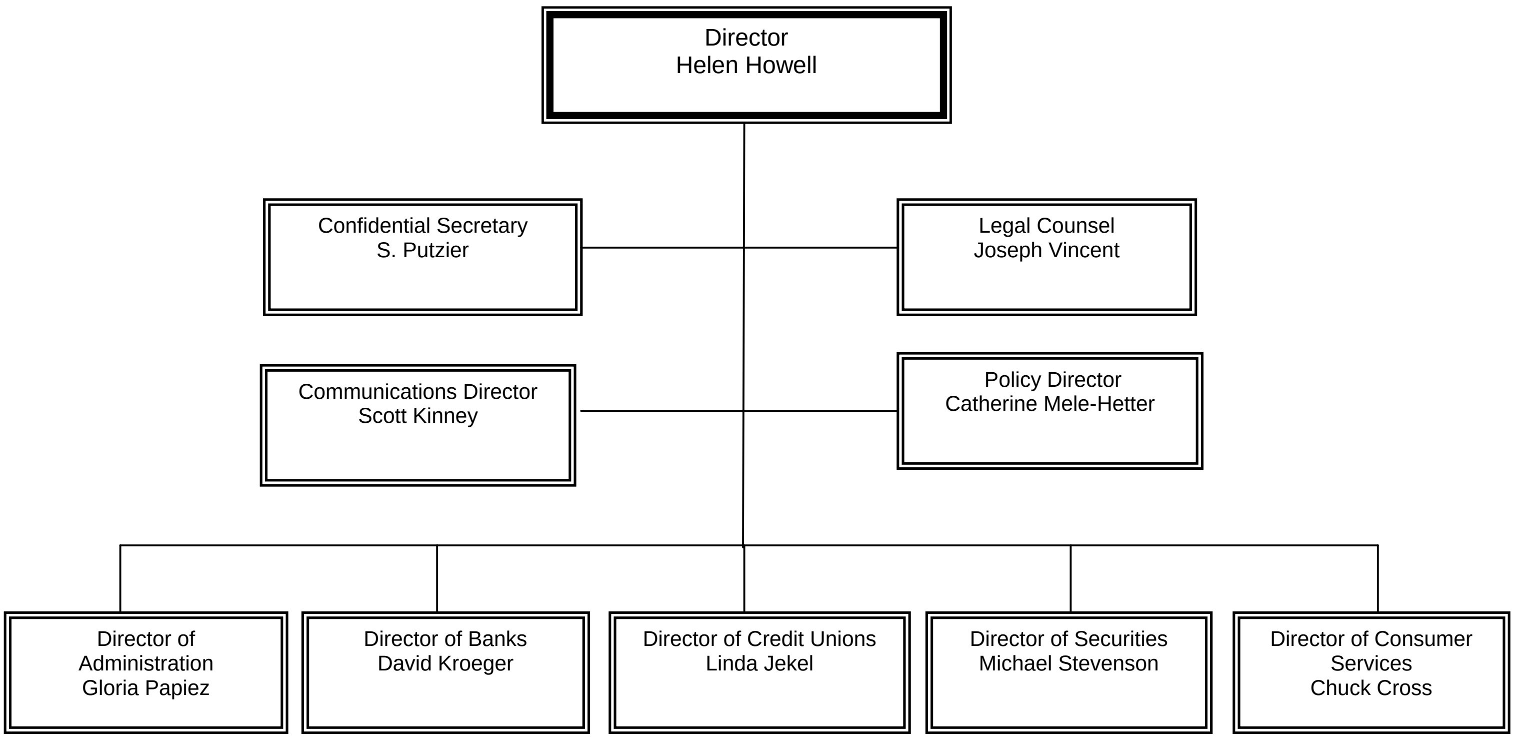
TIER 2 INFORMATION

OCTOBER 29, 2004

AGENCY INFORMATION

Agency Name:	Department of Financial Institutions (DFI)
Physical Address:	
Headquarters:	150 Israel Rd. SW Tumwater, WA 98501 PO Box 41200 Olympia, WA 98504-1200
Satellite Office:	2033 6th Ave. Suite 826 Seattle, WA 98121
Website Address:	http://www.dfi.wa.gov
Contact Name:	Gloria Papiez Director of Administration gpapiez@dfi.wa.gov (360) 902-8820

DEPARTMENT OF FINANCIAL INSTITUTIONS
Executive Team
October 29, 2004



EXECUTIVE TEAM BIOS

Helen Howell, Director
Agency Director since September 2002. Over 15 years public policy experience including: Deputy Chief of Staff to Governor Locke; Counsel to U.S. Senator Patty Murray; and Special Assistant to the President and Deputy Staff Secretary in the Clinton White House. B.A., Vassar College; Diploma in Legal Studies, Oxford University; J.D., Columbia University Law School.

Susan Putzier, Confidential Secretary
Susan has served as the Confidential Secretary to the Director of the Department of Financial Institutions since it was formed in 1993. She has worked for three directors. Prior to that, she worked in the Division of Banking as an Administrative Assistant to the Supervisor of Banking.

Joseph Vincent, Legal Counsel
Expertise: banking; real estate; mortgage lending; land development; information technology; litigation; government relations. Experience: DFI (03/01/03-present); IT firms (3 years); mortgage broker (2 years); bank corporate counsel (11 years); private practice (6 years). B.A., high honors, U.C. Berkeley; J.D., Golden Gate University Law School.

Michael Stevenson, Director of Securities
Member of the North American Securities Administrators Association Corporate Finance Section and the Uniform Securities Act Work Group. Member, Securities Committees of the WSBA and ABA. Board of Directors Alternate, National White Collar Crime Center. Former Washington State Assistant Attorney General. Law Clerk to Hon. Judge Powell, USDC. JD Gonzaga University. BA University of Washington.

Linda Jekel, Director of Credit Unions
Regulatory experience since 1989. Board Member of the National Association of State Credit Union Supervisors and member of regulator development committee. Worked in private sector for 14 years at various management positions with Heritage Federal Savings and Loan Association and Continental Mortgage Company. M.B.A., finance concentration, Pacific Lutheran University.

Chuck Cross, Director of Consumer Services
Former federal and state bank examiner. Managed a mid-size mortgage broker and escrow company. President of the American Association of Residential Mortgage Regulators. Responsible for over 200 regulatory enforcement actions and criminal referrals. Key investigator/negotiator in country's largest predatory lending case.

Gloria Papiez, Director of Administration
Director of Administration since 2000. Prior public service: 6 years, Assistant Director for Administration, Washington Utilities and Transportation Commission; 10 years, Assistant Director, Division of Audit, Washington State Auditor's Office. BA in Business Administration, University of Washington. Accounting Concentration, Pacific Lutheran University. CPA 1985. Board Member, Financial Managers Advisory Council.

Scott Kinney, Director of Communications
Scott Kinney joined DFI in 2003 to develop a communication and outreach program. Prior to his move to Washington State, Scott's career included public relations, marketing, and advertising positions at the Iowa Insurance Division, Saks Incorporated, and Bugle Boy Industries.

David Kroeger, Director of Banks

Director of Banks since 2000. Spent thirty-two years with the Federal Deposit Insurance Corporation and was the Seattle Field Supervisor. Board member of the Conference of State Bank Supervisors (CSBS). Chairs the CSBS State Federal Regulatory Task Force and belongs to the Legislative, Regulatory, and Strategic Planning Committees.

Catherine Mele-Hetter, Director of Policy

Director of Policy since 2002. Spent twelve years with State Senate as non-partisan counsel to various standing committees. J.D., Seattle University Law School. Areas of policy expertise: financial institutions, insurance, gambling, liquor law, consumer protection, and identity theft.

Budget Summary

03-05 Biennium

Agency Level

(Note: Numbers shown are budgeted figures.)

	FTEs	FY 2004	FY 2005	Total
Revenue				
Examinations (Banks, Consumer Services)		2,433,020	2,626,276	5,059,297
Applications/Licenses (Banks)		69,633	71,090	140,723
Applications (Consumer Services)		393,544	582,959	976,503
Licenses (Consumer Services)		112,441	166,560	279,001
Asset Assessments (Credit Unions)		2,161,023	2,162,467	4,323,490
Securities Revenues:				
Business Opportunities		2,463	2,555	5,018
Franchises		112,081	116,242	228,322
Franchise Brokers		3,695	3,832	7,527
Exemptions & Opinions		4,927	5,110	10,036
Investment Companies		3,334,026	3,457,805	6,791,830
Qualifications		10,752	11,152	21,904
Coordinations		23,894	24,781	48,675
Franchises-Securities		23,496	24,368	47,864
Broker Dealers		306,641	318,026	624,667
Securities Salesperson		167,259	173,468	340,727
Investment Advisors		21,106	21,890	42,997
Investment Advisor Salesperson		27,478	28,498	55,977
Exemptions & Opinions		67,700	70,213	137,913
Fines		100,000	100,000	200,000
Assessments (Banks, Consumer Services)		3,199,708	4,146,675	7,346,384
Mortgage Lending Fraud (Consumer services)		617,496	617,496	1,234,992
Miscellaneous		84,331	124,920	209,251
Subtotal-Revenue		13,276,714	14,856,383	28,133,097
Expenditure				
Admin. Allocation	24.1	2,444,376	2,604,417	5,048,793
Program Expenditures	123.4	12,259,190	12,725,607	24,984,797
Subtotal-Expenditure	147.5	14,703,566	15,330,024	30,033,590
Excess (deficiency) of revenues over expenditure		-1,426,852	-473,641	-1,900,493
Program Fund Balance July 1, 2003		5,936,644	4,509,792	10,446,436
Program Fund Balance June 30, 2005		4,509,792	4,036,151	8,545,943

Budget Summary
03-05 Biennium
Division of Banks

	FTEs	FY 2004	FY 2005	Total
Revenue				
Examinations		2,123,808	2,168,237	4,292,045
Application/License		69,633	71,090	140,723
Assessments		1,288,211	1,315,160	2,603,371
Subtotal-Revenue		3,481,652	3,554,487	7,036,139
Expenditure				
Admin. Allocation	5.89	598,435	642,836	1,241,271
Program Expenditures	29.70	2,880,000	3,065,661	5,945,661
Subtotal-Expenditure	35.59	3,478,435	3,708,497	7,186,932
Excess (deficiency) of revenues over expenditure		3,217	-154,010	-150,793
Program Fund Balance July 1, 2003-2004		1,354,459	1,357,676	2,712,135
Program Fund Balance June 30, 2004-2005		1,357,676	1,203,666	2,561,342

The Division of Banks has responsibility for supervising and examining commercial banks, trust companies, savings banks, savings and loan associations, and alien banks incorporated under the laws of the State of Washington.

Division of Credit Unions

	FTE's	FY 2004	FY 2005	Total
Revenue				
Asset		2,161,023	2,162,467	4,323,490
Subtotal-Revenue		2,161,023	2,162,467	4,323,490
Expenditure				
Admin. Allocation	3.54	358,558	382,634	741,192
Program Expenditures	16.70	1,868,000	1,918,623	3,786,623
Subtotal-Expenditure	20.24	2,226,558	2,301,257	4,527,815
Excess (deficiency) of revenues over expenditure		-65,535	-138,790	-204,325
Program Fund Balance July 1, 2003		752155	686,620	1,438,775
Program Fund Balance June 30, 2005		686,620	547,830	1,234,450

The Division of Credit Unions supervises and examines state chartered credit unions.

Budget Summary
03-05 Biennium
Division of Securities - Fund 300

	FTE's	FY 2004	FY 2005	Total
Revenue				
Franchise Licenses				
Business Opportunities		2,389	2,555	4,944
Franchises		108,718	116,242	224,960
Franchise Brokers		3,584	3,832	7,416
Exemptions & Opinion		4,779	5,110	9,888
Subtotal-Franchise Licenses		119,471	127,738	247,209
Security Licenses				
Investment Companies		3,334,026	3,457,805	6,791,830
Qualifications		10,752	11,152	21,904
Coordinations		23,894	24,781	48,675
Franchises-Securities		23,496	24,368	47,864
Broker Dealers		306,641	318,026	624,667
Securities Salesperson		167,259	173,468	340,727
Investment Advisers		21,106	21,890	42,997
Investment Adviser Salesperson		27,478	28,498	55,977
Exemptions & Opinion		67,700	70,213	137,913
Subtotal-Security Licenses		3,982,352	4,130,202	8,112,554
Subtotal-Revenue		4,105,518	4,257,940	8,363,458
Expenditure				
Admin. Allocation	9.17	927,230	999,996	1,927,225
Program Expenditures	49.05	4,304,313	4,569,826	8,874,139
Subtotal-Expenditure	58.22	5,231,543	5,569,822	10,801,364
Excess (deficiency) of revenues over expenditure		-1,126,025	-1,311,882	-2,437,907
Program Fund Balance July 1, 2003		2,025,137	899,112	2,924,249
Program Fund Balance June 30, 2005		899,112	-412,770	486,343

The Division of Securities regulates the offer and sale of investments and escrow services to Washington state residents.

Division of Securities
Fund 06J - Securities Prosecution Account

	FTE's	FY 2004	FY 2005	Total
Revenue				
Fines		100,000	100,000	200,000
Subtotal-Revenue		100,000	100,000	200,000
Expenditure				
Admin. Allocation	0.1	6,000	5,000	11,000
Program Expenditures		50,000	100,000	150,000
Subtotal-Expenditure		56,000	105,000	161,000
Excess (deficiency) of revenues over expenditure		44,000	-5,000	39,000
Program Fund Balance July 1, 2003		0	44,000	44,000
Program Fund Balance June 30, 2005		44,000	39,000	83,000

The Securities Prosecution Fund is comprised of fines and penalties collected by DFI under the Securities Act of Washington. The fund is used to financially assist local prosecutors in the prosecution of securities and other investment related fraud.

Budget Summary

03-05 Biennium

Division of Consumer Services

	FTE's	FY 2004	FY 2005	Total
Revenue				
Examinations		309,213	458,039	767,252
Applications		393,544	582,959	976,503
Licenses		112,441	166,560	279,001
Assessments		1,911,497	2,831,515	4,743,012
Miscellaneous		84,331	124,920	209,251
Subtotal-Revenue		2,811,025	4,163,993	6,975,018
Expenditure				
Admin. Allocation	5.46	554,153	573,951	1,128,105
Program Expenditures	27.93	2,564,377	2,478,997	5,043,374
Subtotal-Expenditure	33.40	3,118,530	3,052,948	6,171,479
Excess (deficiency) of revenues over expenditure		-307,505	1,111,045	803,539
Program Fund Balance July 1, 2003-2004		1,804,893	1,497,388	3,302,281
Program Fund Balance June 30, 2004-2005		1,497,388	2,608,432	4,105,820

The Division of Consumer Services regulates the business activities of consumer loan companies, mortgage brokers, money transmitters and currency exchangers, check cashers, check sellers and payday lenders.

Fund 07A- Mortgage Lending Fraud Prosecution Account

	FTE's	FY 2004	FY 2005	Total
Revenue				
Mortgage Lending Fraud		617,496	617,496	1,234,992
Subtotal-Revenue		617,496	617,496	1,234,992
Expenditure				
Admin. Allocation	0	0	0	0
Program Expenditures	0	592,500	592,500	1,185,000
Subtotal-Expenditure	0	592,500	592,500	1,185,000
Excess (deficiency) of revenues over expenditure		24,996	24,996	49,992
Program Fund Balance July 1, 2003-2004		0	24,996	24,996
Program Fund Balance June 30, 2004-2005		24,996	49,992	74,988

The Mortgage Lending Fraud Prosecution Account is comprised of monies collected by county auditors and is used to aid county prosecutors in the prosecution of mortgage lending fraud.

AUTHORIZING ENVIRONMENT

General	Ch. 43.320 RCW
Securities Division	
Securities Act	Ch. 21.20 RCW
Franchise Act	Ch. 19.100 RCW
Business Opportunity Act	Ch. 19.110 RCW
Commodities Act	Ch. 21.30 RCW
Escrow Agent Registration Act	Ch. 18.44 RCW
Division of Banks	
Banks and Trust Companies	Title 30 RCW
Mutual Savings Banks	Title 32 RCW
Savings and Loan Associations	Title 33 RCW
Federally Guaranteed Small Business Loans	Ch. 31.40 RCW
Industrial Development Corporations	Ch. 31.24 RCW
Agricultural Lenders, Loan Guaranty Program	Ch. 31.35 RCW
Division of Credit Unions	
Credit Union Act	Ch. 31.12 RCW
Central Credit Unions Act	Ch. 31.13 RCW
Division of Consumer Services	
Mortgage Broker Practices Act	Ch 19.146 RCW
Consumer Loan Act	Ch. 31.04 RCW
Check Cashers and Sellers Act	Ch. 31.45 RCW
Uniform Money Services Act	Ch. 19.230 RCW
Mortgage Fraud Prosecution Account	Ch. 43.320.140 RCW

ENVIRONMENTAL SCAN

DFI regulates Washington State's financial services industry. This responsibility includes examining and supervising state-chartered commercial banks, credit unions, savings and loan associations, savings banks, and foreign banks. In addition, the department regulates the securities industry in Washington, issuing licenses, permits and exemptions for securities broker-dealers, investment advisers and their agents, securities issuers, franchises, franchise brokers, and business opportunities. The department also regulates consumer loan companies and check cashers and sellers (which include payday lenders) as well as mortgage brokers and escrow agents and officers operating in this state. As a result of recent legislation, the Department has begun: regulating Money Transmitters and Currency Exchangers; administering a new Mortgage Fraud Prosecution Account established to fund criminal prosecutions of mortgage lending fraud; and administering a new Securities Prosecution Fund to assist local prosecutors in the prosecution of securities and other investment related fraud.

The department conducts 5 main activities in carrying out its statutory responsibilities: examination; enforcement; chartering, licensing, and registration; education and public outreach; and agency management and administrative services. The operating environment for the Department of Financial Institutions has undergone significant changes over the last decade. The Department is continually evolving to meet the multitude of changes and growing complexities that continue to emerge in the financial services industries that we regulate.

Economic Changes

Long-term economic performance affects the condition of Washington's regulated financial institutions and financial services providers, and how these entities execute their business plans and strategies. Economic conditions are important determinants of inflation rates, interest rates, balance of trade, and credit and financial market performance. This in turn influences lending decisions, funding strategies, capital market decisions, and off-balance sheet activities of financial services providers. Economic conditions also play a part in the number of applications for new banks and branches. In the last two years, problem bank and credit union levels have increased, but appear to be stabilizing and showing signs of improvement. The majority of insured financial institutions reported sound conditions as of year-end 2003. However, profitability levels are susceptible to increasing interest rate sensitivity with financial institutions expected to show less robust earnings as interest rates rise. That sensitivity will have an impact in two ways. First, as interest rates rise, the liability side of many financial institutions' balance sheets will re-price more quickly than the asset side placing significant pressure on profitability. Second, although interest rates continued at historical lows that perpetuated the refinance boom in the mortgage industry, as interest rates begin to rise, we can anticipate reduced business volumes for those licensees engaged in mortgage lending and ancillary services (e.g. escrow agents). This may reduce cash flows, and increase pressure for embezzlement or other fraud against consumers. In addition, rising rate environments may result in a surge of consumer complaints as interest rate locks expire and consumers are faced with higher interest rates than they were originally promised. The Department has already received complaints in this area.

Mortgage activity is also a significant piece of the earning assets, fee income, and employment needs for many financial institutions. Pressures from rising interest rates may translate directly into the need for additional regulatory attention on the management and health of the mortgage industry and Washington's regulated financial institutions. In recent years lending institutions have ventured further into a variety of products and pricing structures designed to accommodate highly leveraged and sub-prime consumers. This has provided opportunities for these consumers and contributed to the strength of the economy while interest rates have been trending down for several years. However, there is now growing concern that as rates rise, consumers from these segments of the market may be unable to maintain the payments for which they have contracted, especially those consumers with adjustable rate mortgages. This suggests the possibility of increased delinquency and loan charge offs in coming years. This too may call for additional regulatory attention on the management and health of financial institutions.

Legislative and Regulatory Changes

Legislative and regulatory changes alter the way financial institutions conduct business and the manner in which the Department operates. The banking industry remains one of the most highly regulated industries, and is continuously subject to increased legislative and regulatory changes. The Sarbanes-Oxley Act of 2002, the USA Patriot Act of 2001, and the Gramm-Leach-Bliley Act of 1999 are major pieces of legislation that require significant resources to implement.

Federal Preemption

Federal preemption of state financial institutions laws is a controversial issue that is currently receiving much attention. The OCC recently adopted rules to preempt a number of state laws. The rules include subsidiaries of national banks. The impact of the change may alter the dual banking system in place today. Banks that operate in multiple states may choose to switch charters to a national charter to avoid state regulations. Opposition to the OCC's rule has been voiced by a number of groups including, the Conference of State Bank Supervisors, National Governors Association, National Conference of State Legislatures, National Association of Attorneys General, North American Securities Administrators Association, and various consumer advocacy groups.

Innovation of Products and Funding Strategies

Over the last decade there has been a major shift in lending brought about by expanding secondary markets and securitization. In residential real estate lending, the explosive growth and accounting practices of secondary market government sponsored entities are receiving scrutiny by the U.S. Congress. Reforms are likely and they will have an impact on how the banking industry operates. The expansion of secondary markets and securitization has brought on increasing complexities and risks. This is forcing regulators to redefine their ways of analyzing risks, and is requiring regulators to devote significant resources to developing examiners' skills so they are capable of examining complex financial transactions.

Funding strategies have also changed over the last decade. Core deposit growth has not kept pace with the increases in lending volumes. Banks have been able to cover the shortfall by increasing borrowings and nontraditional deposit sources. The Federal Home Loan Bank (FHLB) has been a major source of funding for community banks. Brokered deposits and Internet deposit offerings have increased as sources of additional bank funding.

Traditional income generated from interest spreads between lending and deposits are eroding. Banks are increasing their reliance on non-interest related revenues. Banks are responding to declining net interest margins by diversifying into such things as packaging and selling loans, performing loan servicing, expanding retail sales of securities and insurance products, and generating fee income from deposit accounts.

Increased Competition From Non-Bank Financial Services Providers

Non-bank financial services providers continue to control an increasing share of the financial services market. Banks and Credit Unions that historically competed against each other now face heightened competition with insurance companies and brokerage houses, as well as non-traditional financial services providers, such as auto dealers and technology companies offering a variety of financial services. Many of these competitors have better financial resources, technology and expertise to offer a variety of services at the point of purchase. This increased competition has led to an increase in consolidations with many financial institutions branching out across state lines, which in turn has increased our need to conduct more multi-state and out-of-state exams.

Technological Changes

Expanding technology is changing the way the financial services sector structures, delivers, and services its products. The use of technology in financial transactions continues to raise a host of issues. As the lines between the providers of financial products are blurred by technology, the Department may have to realign resources and cross-train its employees. The growth of electronic banking must also be responsive to the concerns raised for privacy and the issues surrounding the USA PATRIOT Act. The ease and speed of obtaining information highlights the need to protect customer privacy and provide guidance on information sharing. The major regulatory challenge that lies ahead will be to ensure that regulated entities are equipped to secure and manage new technological solutions while at the same time ensuring that the regulatory structure does not inhibit change that is in consumers' best interest.

Money Laundering and Criminal Activity

With the advent of the war on terrorism, money laundering and the financing of criminal activity have taken on increased importance. A host of new regulations have been promulgated at the federal level under the USA PATRIOT Act. Implementing and monitoring compliance with these new regulations places increased demands upon the Department's resources. In addition, as the result of legislation, the Department recently began the regulation of money transmitters and currency exchangers. Literally thousands of locations across the state are used to transmit money throughout the United States and around the world. Regulation of this activity will require licensing, examination and enforcement resources. The Department will have to develop new ways to coordinate with state and federal authorities focused on money laundering and other criminal activities. The goal is to leverage our examination and enforcement capacity by working with others with specific expertise in regulation and investigation of money transmission and currency exchange companies.

Predatory Lending

Lending and mortgage origination practices become "predatory" when the borrower is led into a transaction that is not what they expected. Predatory lending practices may involve lenders, mortgage brokers, real estate brokers, escrow agents, appraisers, attorneys, and home improvement contractors. Their schemes often target people who have small incomes but substantial equities in their homes. The Department has been aggressive in its enforcement of predatory lending. However, these cases are difficult to bring forward because they involve substantial resources and time. Formation of regulatory partnerships, both with other agencies in our state and with regulators in other states, is key to increasing our capacity to address these harms. In addition, the Department believes that an informed consumer will exhibit better financial protective behaviors and avoid transactions that lead to harm. Predatory lending is seldom possible without "unwitting" assistance by the consumer. Therefore the battle against predatory lending must also be fought with consumer education. It is a long-term challenge for the Department to develop outreach programs that break down technical and complex concepts to the public in a way that helps consumers modify self-destructive borrowing decisions.

Customer Characteristics

The citizens of Washington are demanding a broader array of financial services from their financial institutions. Citizens have greater access to more credit than ever before in the history of this country. With great opportunity also comes increased risk. While home ownership is at the highest level ever in the history of this country, many citizens find themselves entering a cycle of debt that can lead to bankruptcy or loss of the home they worked so hard to obtain. Unsophisticated borrowers face greater exposure to predatory lending practices that target groups such as senior citizens and low-income individuals, and prey on individuals' sense of desperation. The Department must continue its aggressive enforcement against predatory lenders and we must become more visible to low and moderate-income communities, immigrant communities, and with the public as a whole.

Population growth will continue to be driven by non-white, non-English speaking immigrants and minorities possessing an increasing share of economic influence. These minority groups are forecasted to comprise 50% of the US population by the year 2020. The Department must improve accessibility to our services, especially for customers that do not speak English or speak English as a second language.

More citizens are managing their own investments than ever before, and have a larger percentage of their funds exposed to market risk than has historically been the case. Many retirement plans now allow or require the employee to participate in the management of his or her funds. Today's investors rely more on government for information on investing and for assistance with complaints regarding those investments and the firms and representatives who sold them the investments. Many elderly investors have sought higher yields and have fallen prey to financial swindles. Other investors continue to trade for short-term profits rather than holding for the long-term. This trading pattern is inherently risky and has resulted in an increase in complaints. Individual investors expect that information regarding investing in securities will be available from their state regulator. They also expect the availability of information to be immediate and comprehensive, whether via the Internet or otherwise.

Mergers, Consolidations and Conversions

The citizens of Washington are increasingly demanding a broader array of financial services from their financial institutions. At the same time, the financial institutions must address new demands for protection of individual privacy and increased federal government regulation. These factors are increasing the pressure on small institutions to provide more services and protection with fewer resources. Mergers with larger institutions with greater resources are becoming a way to meet these pressures. Consolidation is likely to continue in the future and may even accelerate. There will be fewer financial institutions, but they will be larger, more complex, and more difficult to supervise. During this time of transition, regulators are faced with the task of regulating a wide variety of institutions offering a wide variety of services.

MAJOR PARTNERS

In carrying out its mission, the Department partners with several national and state entities, including:

- The American Association of Residential Mortgage Regulators (AARMR), the National Association of Consumer Credit Administrators (NACCA), and the Money Transmitter Regulators Association (MTRA). These are non-profit organizations whose memberships are made up of state regulatory agencies and with whom regulatory issues are discussed.

- The Consumer Protection Division of the Office of the Attorney General and the Office of the Insurance Commissioner with whom we frequently share information and cooperate on cases.

- Federal and State law enforcement agencies including the FBI when criminal charges are likely. We can provide investigative expertise and law enforcement can assist us in obtaining investigative materials. In addition, we assist local prosecutors in presenting their cases.

- State and Federal Prosecutors with whom the enforcement staffs of the Securities and Consumer Services Division work closely on criminal cases. Prosecutors refer cases to the Securities and Consumer Services Divisions for investigation and preparation. Securities Division enforcement attorneys at times participate in the prosecution as Special Assistant United States Attorneys or Special Deputy Prosecuting Attorneys. Recently, the Securities Division has joined corporate and investment fraud task forces directed by the offices of the US Attorneys. The cases and assignments the Securities Division receives have become more complex such that these partnerships can last for years and involve many law enforcement agencies.

- Federal banking partnerships that involve joint examinations and acceptance of each other's reports to meet examination requirements including:
  - Federal Deposit Insurance Corporation, FDIC, that oversees the deposit insurance fund for all banks, and is the primary federal regulator for state nonmember banks.
  - Board of Governors of the Federal Reserve System, FRB, that regulates financial and bank holding companies, foreign banks, and state chartered banks that are members of the Federal Reserve Board System.
  - State banking and non-depository departments in the other 49 states, District of Columbia, and United States territories.
  - Office of Thrift Supervision, OTS, that regulates thrift holding companies, and is the primary federal regulator for state chartered savings associations.
  - Office of the Comptroller of the Currency, OCC, that regulates national banks.
  - Conference of State Bank Supervisors, CSBS, the nation's leading advocate for the state banking system.
  - Federal Financial Institutions Examination Council, FFIEC, that prescribes uniform principles, standards, and report forms for the federal examination of financial institutions and makes recommendations to promote uniformity in the supervision of financial institutions.

- The National Credit Union Administration (NCUA), the federal regulator and insurer of federally insured credit unions, such as our state credit unions; and the National Association of State Credit Union Supervisors (NASCUS), an association of state regulators. In addition, we partner with credit union regulators in other states when examining out-of-state credit unions that have branched into Washington, or into neighboring states.

- Securities and Exchange Commission (SEC) and the National Association of Securities Dealers (NASD) with whom we routinely coordinate the examination of broker-dealer offices and headquarters. The Securities Division engages in frequent "sweeps" and joint investigations with the SEC, NASD, the Federal Trade Commission (FTC), and other state regulators.

- The North American Securities Administrators Association (NASAA) that comprises the securities regulators of each of the United States, Puerto Rico, Mexico, and Canada. NASAA acts on behalf of its members in a wide variety of regulatory spheres in order to promote investor protection and to foster uniform and innovative regulation.

- The National White Collar Crime Center (NW3C) of which we are a voting member. The NW3C is a non-profit corporation that falls under the administration of the United States Department of Justice and provides assistance to state and local law enforcement agencies in the detection and investigation of economic crime. The NW3C provides training, research and intelligence services used by the Department as well as administers the national Securities Investigations Database.

STRATEGIC PLAN HIGHLIGHTS

DFI MISSION STATEMENT

DFI regulates our State's financial services industry to protect the public, promote economic vitality, and preserve integrity in the marketplace.

GOALS

- Support a highly skilled and diverse workforce.
- Operate in an efficient and effective manner.
- Promote a stable and competitive financial system that enhances economic vitality.
- Implement and enforce state financial institutions and consumer protection laws.
- Educate consumers.
- Provide information on financial services regulation.
- Advance a relevant state role in the regulation of financial services.
- Leverage technology to fulfill our mission and enhance access to information.

OBJECTIVES AND STRATEGIES

1. Conduct efficient and effective examinations to deliver timely and useful information to agency management and regulated entities.
   Strategies:
   - *Perform examinations of all regulated institutions within statutory timeframes.*
   - *Process all reports within divisional timeframes.*
   - *Survey institutions as to effectiveness of examinations.*

2. Return problem institutions to a safe and sound condition.
   Strategy:
   - *Take prompt supervisory actions to address problems found during examinations.*

3. Maintain a regulatory environment that is effective at identifying and resolving excessive risk, yet hospitable to financial institutions viability, competitiveness and growth.
   Strategy:
   - *Provide appropriate supervisory action to financial institutions with unsatisfactory exam ratings.*

4. Successfully recruit and retain employees who have the skills, knowledge and opportunities to be successful.
   Strategies:
   - *Implement Washington Works and an approved performance management system, which clarifies and delineates performance management expectations, roles, accountabilities, and competency requirements, and provides viable training for supervisors and employees.*
   - *Attract a skilled and diverse workforce through participation in career fairs.*

5. Expand consumer education/outreach and raise awareness of DFI.

   Strategies:

   - *Increase consumer education and outreach through DFI sponsored speaking engagements and projects that target areas of high risk for consumers, and by forming partnerships with other state agencies and community groups.*
   - *Effectively use the media to deliver messages and alert consumers to high risk or unscrupulous financial activities and practices.*

STRENGTHS, WEAKNESSES, OPPORTUNITIES, THREATS

STRENGTHS

1. **Professional and Dedicated Staff –** DFI considers employees to be its most important and valuable resource. The department invests significant resources in training to ensure a highly trained staff with specialized expertise in all areas of financial regulation.

2. **Partnerships –** In addition to Major Partners identified above in the Environmental Scan, DFI has developed partnerships with other state agencies, private groups, and educational institutions to perform outreach and consumer education. Entities include: the Attorney General's Office, the Department of Labor and Industries, the Better Business Bureau, the King County Coalition for Responsible Lending, the Federal Trade Commission, the Consumer Counseling Federation, the Northwest Justice Project, the National Endowment for Financial Education, Junior Achievement, and the Washington State Commission on African American Affairs, to name a few.

3. **Technology Focus** – DFI continues its focus on automating and becoming more efficient and effective in our processes. Consolidating data bases, expanding imaging and document management capabilities, development of an optical storage system, and the deployment of new and emerging technologies needed to keep pace with changes in the industries we regulate are all helping to alleviate resource issues faced by the Department.

4. **Leadership and Advocacy -** DFI is recognized as a leader among regulators across the country. The Department continues to develop innovative approaches to regulation and is regularly represented on the national front. DFI is considered a leader among state agencies regulating financial services providers and has assumed a lead position on a variety of projects such as advocating against the federal government's plan to preempt state laws. Recently, DFI's guidance on overdraft protection programs, examination of payday lenders, and enforcement actions against certain entities in the securities industry have been cited as excellent state regulatory work at national forums and among other state regulators. Washington State has a vibrant and strong state charter/license for banks, credit unions, consumer loan companies, and the securities industries due to modern statutes and fair regulation. In addition, the executive team actively participates on a cross section of national industry committees and boards.
   - Helen Howell – State Liaison Committee, Federal Financial Institutions Examination Council, www.ffiec.gov
   - Chuck Cross – President, America Association of Residential Mortgage Regulators, http://www.aarmr.org
   - Linda Jekel – Board of Directors, National Association of State Credit Union Supervisors, www.nascus.org
   - Dave Kroeger – Conference of State Bank Supervisors Supervisory Committee, www.csbs.org
   - Mike Stevenson – North American Securities Administrators Association Corporate Finance Section, http:/www.nasaa.org Board of Directors Alternate, National White Collar Crime Center, www.nw2c.org

5. **Self-supported Funding –** DFI is self-supported through fees and assessments charged to regulated entities. The Department receives no state general fund or federal monies to support its operations. Revenues are deposited in the Department's Financial Services Regulation Fund – a dedicated, non-appropriated fund to be used for carrying out our statutory mandate. Being self-supported and non-appropriated allows the Department the flexibility necessary to regulate and react in today's financial services environment.

WEAKNESSES

1. **Emerging Issues and Regulatory Challenges -** DFI faces the constant challenge of keeping pace, both resource- and knowledge-wise, with financial services providers that are experiencing

phenomenal growth, inventing new products/services, becoming more sophisticated in technology, and crossing into other industries. Major regulatory concerns include ensuring that: regulated entities are equipped to secure and manage new technological solutions; we are equipped with the expertise we need to regulate these products and services; consumer protection laws exist to cover new products; and that regulated entities crossing into other industries comply with applicable laws.

2. **Turnover -** Loss of experienced staff to the industry and to our Federal counterparts. While competitive at entry-level positions, salary and benefits for senior positions has not kept pace with either the private sector or the Federal regulators. This increases the likelihood of additional examiner turnover.

3. **Resource Challenges** – Like many other state agencies, DFI has historically been challenged to carry out its regulatory responsibilities with limited authorized FTE levels. The emerging issues and regulatory challenges referred to above will continue to tax our limited resources. Because staff resources have been so seriously stretched, and because our work is complex and often time-sensitive, we run the risk that important regulatory issues will not be properly identified and mitigated, that deadlines will be missed, or that untrained or fatigued staff may make incorrect decisions. This risk has been increased by our desire to continue to perform all of the functions that we have traditionally, while at the same time addressing new issues and regulatory initiatives. To mitigate our risk we continue to look for ways to become more efficient and effective in our processes, for example, through implementing the use of new technology such as imaging, and by going to a more risk-based approach for examinations of financial institutions.

OPPORTUNITIES

1. **Education and Outreach -** As the department continues to experience increases in consumer complaints and enforcement cases, it becomes more evident that prevention through education must be coupled with enforcement efforts. Given the complexity of the various financial products now available in the marketplace, consumers are unknowingly entering into risky financial situations. Educating consumers before they enter into financial transactions is key to preventing financial fraud.

2. **Streamline -** DFI has the opportunity going forward to streamline its organizational structure to better regulate the blending of the banking, insurance, securities and other financial services industries.

3. **Innovative Regulation -** Traditional regulation is to schedule examinations based on a cycle or based on consumer complaint. Because financial services providers are in a state of rapid innovation of products and delivery systems, regulators need to be proactive, flexible in approach, and demonstrate the ability to react quickly, rather than waiting for the next exam cycle or receipt of the next consumer complaint. Recently, the agency implemented an examination questionnaire on overdraft protection programs to determine how Washington state financial institutions were implementing such programs and whether appropriate consumer protections were in place. The agency is brainstorming other ideas to keep its regulation fresh and effective.

4. **Transparency -** As financial services expand and new players merge with existing markets, the Department has the opportunity and responsibility to expose good and bad practices and direct regulated entities towards responsible consumer protection. Greater understanding of these services will translate into more effective consumer awareness tools such as better disclosures, more useful public reporting and enhanced financial literacy.

THREATS

1. **Federal Preemption & Uniform Standards -** Federal banking and securities authorities continue to expand their powers and to seek preemption of state consumer protection and financial services laws. Additionally, states are being asked to adhere to rigid national standards that diminish protection of their citizens and dampen innovation of state regulation.

2. **Consolidation -** Financial services providers are trending toward one-stop shopping. Smaller financial institutions are now pressured to merge into larger institutions that have a full array of products. Drawbacks of consolidation include the loss of local community focus, and less competition. Financial institutions will continue to experience consolidation, resulting in consumer financial products becoming more commodity-priced, which may offset the disadvantage of less competition and less community focus.

3. **Outsourcing –** An emerging trend across the financial services front is the outsourcing of services to other countries such as India. Outsourcing experts claim that corporations are embracing outsourcing to access foreign markets, align business operations in a worldwide economy, manage costs, gain benefits of scale and cut overhead. Potential threats to consumers are a decrease in the standard of service and inaccessibility. For regulators, inaccessibility and accountability of foreign service organizations may prove to be the greatest threats.

4. **Rising interest rates -** This is a bit of a two-edged sword. A rising rate environment, at least for the short-term, will improve margins and earnings for banks, credit unions, and mortgage companies. The potential for problems arises for both consumers and businesses that qualified for adjustable rate or short-term loans when interest rates were low. Unless additional income offsets the increase in interest expense, many may not be able to meet their obligations which could have a negative impact on the condition of some financial services providers and, in turn, affect DFI through reduced revenues or additional cost of supervisory actions.

5. **Predatory Practices -** Predatory practices continue to erode public equity and confidence in our financial systems. Although “predatory lending” has been met with responsive government action, it remains a threat to consumers and the marketplace through the conversion of home equity. Other predatory practices such as unethical or illegal servicing of the payment streams on consumer debt (most often exhibited by fraudulent accounting practices, overcharges and failures to perform), affinity and elder fraud (especially as our state transitions to an older populace), investment schemes and business opportunity fraud convert life savings and investments causing irreparable public harm.

6. **Terrorism -** On the terrorism front, in order for the economy to recover and thrive, consumers need to have confidence that their money and investments are safe in financial institutions and financial markets. Although disaster recovery is a high priority for financial institutions, more work needs to be done so citizens have access to their money to take care of immediate health and safety needs after a terrorist attack. Regulators and financial services providers are working together to minimize a threat to the US financial system due to terrorism. In addition, DFI is a member of the Washington State Committee on Homeland Security (CHS) Infrastructure Protection Subcommittee that is working to protect Washington State’s critical services and minimize damage from a terrorist attack.

EMERGENT ISSUES

The following lists DFI issues that could confront the new administration in the first 90 days of 2005.

1. **<u>Metropolitan Mortgage & Securities, Co. and Pacific Security Companies</u>** (Contact: Mike Stevenson, Director of Securities)
   Spokane's Metropolitan Mortgage & Securities Co and affiliates, involving at least 15 thousand investors and $550 million dollars of debentures and other securities, entered bankruptcy in February 2004. Metro's insurance subsidiary, Western United Life, was taken over by the Office of the Insurance Commissioner. The companies are under investigation by the Securities and Exchange Commission, our office and other regulators. Bankruptcy papers indicate that investors will receive only a small fraction of their investments. Pacific Security Companies has entered receivership in Spokane and owes over $7 million to investors and creditors. Official actions by the bankruptcy court, receiver, regulators, or prosecutors as well as complaints by investors may be expected.

2. **<u>Escrow Agent Regulation</u>** (Contact: Mike Stevenson, Director of Securities)
   At the start of 2005, DFI will begin charging hourly fees for the examination of escrow agents. Examination fees have not been charged to date and other program fees fall short of funding the program. Since inception in 1997, the escrow regulation program has an accumulated deficit of over $1.3 million dollars. The Escrow Commission that advises the department has reluctantly agreed that charging examination fees is necessary. The initial reaction of the escrow companies has been cool and a few have contacted their legislators. Contacts from escrow agents may be expected.

3. **<u>Court Actions</u>** (Contact: Mike Stevenson, Director of Securities)
   The Securities Division has been the subject of a number of claims and tort actions stemming from investor losses. The tort actions allege the state's duty to investors based on statute, failure to enforce the law, and special relationship. Tort actions were filed in 2002 and are consolidated under the names Halleran and Kaleas versus the State of Washington. Other actions are pending in the trial court and still others may be filed. The claims of the investors in these matters exceed $100 million. The Court of Appeals recently ruled that the state had no liability. Risk management would be affected if the Washington Supreme Court were to reverse and hold in favor of the investors.

4. **<u>Complex Legislation</u>** (Contact: Mike Stevenson, Director of Securities)
   Uniform Law Commissioner Judge Marlin Appelwick of the Washington Court of Appeals is expected to introduce a major regulatory bill in the 2005 session. The bill contains a new uniform securities act that is intended to replace existing law. The bill involves many policy and investor protection issues, including, the setting of registration and filing fees, which may impact agency operations and revenue to the general fund, and the scope of civil and criminal actions and the length of statutes of limitation, which affect the rights of plaintiffs and defendants. A wide number of interest groups have participated in the drafting of the proposed act. The provisions of the bill will have a substantial impact on investors and industry groups for many years to come.

5. **Predatory Lending Investigations** (Contact: Chuck Cross, Director of Consumer Services) The Division of Consumer Services has been involved in two large multi-state predatory lending investigations since the end of 2003. These cases are being worked in conjunction with other state regulators and attorneys general. One of these cases (and possibly both) is expected to reach filing stage within the first 30 days of the new administration. Charges likely will entail issues of deception and misrepresentation, appraisal fraud and overcharges. Typically these types of cases carry very large amounts of consumer restitution and/or fines and will receive a significant amount of media and marketplace attention. Additionally, one of these cases may involve criminal charges against some of the individuals in Washington State.

6. **Uniform Money Services Act** (Contact: Chuck Cross, Director of Consumer Services) The Uniform Money Services Act was passed in 2003 and the rules to this Act finalized and implemented in 2004. This new law licenses and regulates money transmitters and currency exchangers. The Department expects to begin routine examinations of these financial service providers in January or February 2005.

7. **Payday Lending Near Military Bases** (Contact: Chuck Cross, Director of Consumer Services) Payday Lending near military bases has become a growing concern for base commanders, consumer advocates and members of the Washington Legislature. The Department has been participating in information sessions with other state and federal agencies on this matter.

8. **Refund Anticipation Loans (RALs)** (Contact: Chuck Cross, Director of Consumer Services) Refund Anticipation Loans (RALs) are high cost loans made to tax filers in anticipation of an IRS tax refund. RALs are primarily made to Earned Income Tax Credit (EITC) filers, and consumer advocacy groups argue that they are harmful to low-income taxpayers and to the EITC program. The House Financial Institutions and Insurance Committee has asked the Department for information related to RALs and to consider the need for legislation in this area. Recently, the City of Seattle enacted an ordinance requiring RAL facilitators to post fees, and provide certain disclosures to consumers considering a RAL.

9. **Public Disclosure Legislation** (Contact: Chuck Cross, Director of Consumer Services) In the last Legislative Session, certain financial services providers proposed a bill protecting specific types of financial and audit information from public disclosure and discovery. While this bill was unsuccessful in committee, the Department believes that non-depository financial institutions may seek an amendment to the public disclosure law (RCW 42.17) providing protections for their financial information similar to the protections provided to banks and credit unions.

10. **Mortgage Broker Legislation** (Contact: Chuck Cross, Director of Consumer Services) The Mortgage Broker industry has stated that it intends to seek an amendment to the Mortgage Broker Practices Act (RCW 19.146) requiring the Division to issue branch licenses within five days and possibly establish a licensing structure for all loan originators. Such a bill would pose resource impacts on the Division and may inhibit the Division’s ability to treat all license applicants equally. Early estimates of additional licensees if loan officers are included in the statute are 5,000 to 20,000. Such additions would require a significant fiscal and FTE increase for the Division.

11. **Consumer Loan Act Rulemaking** (Contact: Chuck Cross, Director of Consumer Services)
The Consumer Loan Act (RCW 31.04) was significantly amended in 2001. The existing rules to this law, while operable, are inconsistent with the statute and somewhat outdated. The Department has been working with the industry on a timeline for drafting and implementing new rules and expects the filing of a CR102 with the first two months of the new administration.

12. **Payday Lending Rulemaking** (Contact: Chuck Cross, Director of Consumer Services)
Following the Legislature's 2003 amendment to the Payday Lending section of the Check Cashers and Sellers Act (RCW 31.45), DFI has worked diligently to amend the rules. This work seeks to gain greater understanding of the industry, and to that end we have developed a revised system of reporting loan volume and activity. The rollout of these new reporting requirements is expected to occur in April 2005. While the Division expects the new reporting process to proceed efficiently, it is likely that there will be some disagreements with the industry regarding the new reporting system.

13. **Banking Legislation** (Contact: David Kroeger, Director of Banks)
The banking industry is considering two legislative proposals. One proposal would allow out-of-state banks to branch into Washington only if the home state where it is headquartered has a reciprocity statute providing equal access to Washington State chartered banks. Increasingly, banks chartered in Washington have been denied branching rights in other states while any out-of-state bank can establish a branch here.

    The second proposal being explored would permit a bank to be chartered as a limited liability company (LLC). The FDIC recently finalized its rule that allows state-chartered banks organized as an LLC to be eligible for deposit insurance. An LLC would have similarities to a Sub-chapter S Corporation but provides for a greater number of shareholders.

14. **Implementation of HRMS** (Contact: Gloria Papiez, Director of Administration)
All of state government will implement the Personnel System Reform Act of 2002 that takes effect on July 1, 2005. In March of 2005, DFI is tentatively scheduled for transition to the new Human Resource Management System (HRMS), a new payroll and personnel system that supports civil service reform.

15. **05-07 Budget Request** (Contact: Gloria Papiez, Director of Administration)
DFI's 05-07 budget request was submitted in August of 2004. During the first 90 days of 2005, our staff will be working with the Office of the Governor and with legislative staff in support of this request. Total amount requested for 05-07: $7 million, 23.1 FTE's. The 05-07 request reflects a balanced effort to protect the public through effective enforcement and examination as well as through outreach and education. A sound financial services industry is the foundation for economic development and improves the quality of life for the citizens of the state.

16. **USA PATRIOT Act** (Contact: Linda Jekel, Director of Credit Unions)
The USA PATRIOT (Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism) Act of 2001 amends select provisions of the Bank Secrecy Act (BSA). The following sections of the USA Patriot Act are of particular interest to banks and credit unions:
    - Section 312 requires expanded due diligence on personal banking accounts containing more than $1 million in deposits and accounts held by foreign nationals.

- Section 314 requires information sharing between financial institutions and law enforcement through the Financial Crimes Enforcement Network (FinCen).

The Division of Credit Unions and the Division of Banks examine financial institutions for compliance with the BSA and USA PATRIOT Act, which are critical to the safety and soundness of our financial services industry. We want to ensure that the state's financial system is not used for illegal purposes.

17. **Credit Unions Corporate Governance Rules** (Contact: Linda Jekel, Director of Credit Unions) The Division of Credit Unions is working with a task force to research corporate governance for credit unions and will likely begin rule-making in early 2005. Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the corporation, such as the board, managers, shareholders, and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. Doing this also provides the structure through which company objectives are set.

A credit union dispute, between the board of directors and a group of dissident credit unions members, is raising questions on corporate governance. In particular, credit union members have asked the following questions:

- What credit union records are available to their members?
- Can members attend board meetings?
- What is a member's right to campaign for election to the board of directors?
- Which deposit account owners are members and can vote at the membership meeting to elect board of directors?
- If a valid member petition requests a vote to remove all the board members, should the members' vote be by mail or in person at a special membership meeting?

Several credit union regulators from other states have asked for copies of Washington State's proposed and final rule on corporate governance to assist them if they are faced with a similar situation.