Banker Economic and Business Survey

Corporate Account Takeovers...

Review Corner

TEXAS BANK REPORT

Texas Department of Banking, Commissioner, Charles G. Cooper

Data as of June 30, 2010

Commissioner's Comments

The good news is that the Texas economy and Texas state-chartered banks, in general, continue to reflect financial strength and vitality greater than many of the other populated areas of the country. The bad news is that some of our banks are reflecting problems ranging from significant to critical, and our perception is that neither these institutions nor the economy will strengthen dramatically over the next twelve months. What this means is a probable period of protracted fragility. We envision that bank business models will need to be thoroughly reevaluated with greater emphasis on risk management. Bank operations will need to become better planned and executed. No longer will gaining market share and/or asset growth be the benchmarks to evaluate performance. Rather, conservative loan underwriting, diversification of investments, operating efficiencies, cost controls, capital preservation and risk selection will be the buzz words at least for the foreseeable future.

I mention the above as nearly every Monday morning the media reports on the recently failed banks as of the prior Friday. While some states have experienced failed banks in the double digits, other states have managed to steer clear of any closures. Since 2008, Texas has only suffered a handful of bank failures, primarily due to our economy, but also because many Texas bankers remember lessons learned in the eighties and are more risk adverse. As of October 15, 2010, 132 banks have failed nationwide, with only one in Texas. Further, the FDIC is projecting the number to not peak until later this year. As mentioned above, Texas has some problem institutions but this does not mean that our problem institutions are headed for failure. The Department has adopted a philosophy of "fair but tough" and is working diligently to ensure that Texas state-chartered financial institutions operate in a safe and sound manner. We have been proactive in addressing issues, but recognize that each institution is unique and employ a regulatory response for each individual situation.

Widely reported, the federal government took actions to further stabilize our national economy and protect the financial security of Americans with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act. This sweeping financial regulatory reform bill will affect almost all aspects of our financial industries, both in their activities and regulatory framework. Much remains to be determined and guidance will be needed before the law's effects are completely known. Our legal team is busy digesting the 2,300-page bill and has attempted to capture the essence of the Act within this report. Rumors estimate the number of new regulations resulting from this bill to be anywhere between 300-500. No one really knows the number of new mandates and actions the states will need to take to comply. How-

Continued on Page 2

ever, as things develop and new interpretations and rules are released, we will work to keep our entities informed. I would also like to thank the Conference of State Bank Supervisors (CSBS) for giving the states the support and voice during this crucial legislative action.

Amidst the continuing efforts to place the financial services industry back on the right path, the nation's economic progress is less than favorable with Americans fearing a double-dip recession. Texas has held up better than other states, managing to maintain a relatively stable economy. In May, Texas was ranked the top state for job growth and business development for the sixth year in a row in a survey of CEOs by Chief Executive Magazine. Today, the state's economic recovery shows signs of strengthening, with the state experiencing its third month of positive annual employment growth.

The Agency

The agency completed its first fiscal year as a Self-Directed, Semi-Independent (SDSI) agency. We recognize the significance of this status and the level of responsibility granted to the agency by the Legislature. It has been a learning experience to say the least, but one that has allowed the agency to demonstrate its ability to operate efficiently and responsibly. Focused on emphasizing transparency and accountability, a public budget hearing was held in July, leading to the Finance Commission's approval of the agency's budget for fiscal year 2011. Only increasing by 3.2% over the previous year, agency operations will continue without an increase in assessments to our regulated entities. I would like to thank our regulated entities along with the Texas Bankers Association and the Independent Bankers Association of Texas for their support during this process and throughout the years.

We believe the SDSI status has helped us sustain and retain trained and tenured financial examiners. These examiners not only look for instances of fraud or malfeasance, but also ensure banks are not adopting the kind of behavior that has proven disastrous historically. The agency has hired 24 financial examiners since May 2009, preserving its creditability with federal counterparts. Of the 24 new hires, 12 have a combined average experience level of over 15 years.

Charles G. Cooper
Banking Commissioner

Evolving Liquidity - Management and Regulation

Gary May

The Basel Committee on Bank Supervision (BCBS) is an arm of the Bank for International Settlements (BIS). The membership of the BCBS is comprised of 27 of the world's leading industrial nations, including the United States. The group works to promote globally consistent standards for prudent and effective bank management and regulation. In late 2008, increased concern over funds management practices by banks prompted the BCBS to issue an updated pronouncement on liquidity, its first major issuance on this topic in the last eight years.

In the United States, regulators responded to the new BCBS liquidity guidelines by issuing a significant piece of supervisory guidance in March of 2010. All the members of the Federal Financial Institution Examination Council (FFIEC) jointly signed off on the new "Interagency Policy Statement on Funding and Liquidity Risk Management", including the Federal Reserve, the FDIC, and the Conference of State Bank Supervisors (CSBS). The FDIC version of this was issued through Financial Institution Letter (FIL) 13-2010 (which supplements but does not replace FIL 84-2008, "Liquidity Risk Management"), while the FRB issued it as SR 10-6.

At its core, the new FFIEC guidance continues to stress longstanding principles such as maintaining a cushion of liquid assets; having a robust and current contingency funding plan; and ensuring that management and the board are kept adequately informed of the bank's present and prospective liquidity situation. However, in the words of FIL 84-2008, "Recent disruptions in the credit and capital markets have exposed weaknesses in liquidity risk measurement and management systems." In the last five years, the onsets of Hurricanes Katrina and Ike exposed previously unsuspected deficiencies in civil authorities' disaster management plans. In much the same way, the financial crisis of the last few years has revealed hidden blind spots and faulty assumptions in the liquidity management plans of banks around the world.

Damage to banks from anemic earnings or weak capital is serious, but often takes place over a somewhat extended time frame. A liquidity crisis, in contrast, can represent a much more immediate threat to an institution's existence. As such, much of the thrust of both governmental bailout efforts and private sector acquisitions during the recent crisis was directed towards emergency liquidity relief, in a variety of situations. These differing manifestations include:

- cancellation of longstanding wholesale funding lines from other financial institutions which had become uncertain about their borrowers' condition;
- sudden demands to provide collateral to derivative counterparties;
- 'slow-motion runs' by retail depositors;
- unanticipated needs for funds by subunits; the drying up of wholesale funding conduits such as commercial paper, securitizations, and auction rate securities; and,
- operational delays in obtaining liability funding from governmental sources.

The latest round of guidance addresses how to better prepare for and manage these newly-acknowledged weaknesses. In particular, an increased emphasis is placed upon:

- modeling dynamic scenarios;
- recognizing the potential impacts of linkages among institutions and markets;
- anticipating correlations between different classes of assets and liabilities; and,
- maintaining awareness of potential operational bottlenecks and breakdowns.

Banks are expected to be able to reasonably support their own specific assumptions and conclusions; at present, clear numerical guidelines or mandatory ratios for liquidity are still lacking. This may or may not continue to be the case; very recently, the Basel Committee proposed two explicit liquidity benchmarks, which are currently out for comment:

- The "Liquidity Coverage Ratio" would require banks to keep enough (specifically-defined) high quality liquid assets on hand to continuously meet or exceed net cash outflows over a 30 day time horizon, given various shocks. It stipulates that certain assumptions should be modeled for runoff rates under stress for both retail and wholesale deposits. This has been nicknamed the "Bear Stearns Ratio."
- The "Net Stable Funding Ratio" would require banks to ensure that they will have stable funding available over a one year time horizon under stress conditions, in light of their individual funding profiles. Again, certain assumptions are stipulated, this time for anticipated "haircuts" on asset values. This has been named the "Northern Rock" ratio, after the British savings bank which suffered a lengthy "slow-motion" run that resulted in its eventual failure.

Likewise, the recently-passed Dodd-Frank Wall Street Reform and Consumer Protection Act does not contain specific liquidity guidelines, but does require the Federal Reserve to formulate prudential standards and reporting requirements in this area. It is thus possible that more explicit expectations for liquidity management may be forthcoming in the near future. The language of the most recent FFIEC guidance makes recurring references to the need for banks to have systems and plans commensurate with their individual complexity and risk levels. For example, a retail-funded community bank is less likely to need advanced intraday liquidity monitoring than a money-center bank; however, both should still periodically test their lines of wholesale credit for continued availability and operational effectiveness. Likewise, both types of banks need to have robust contingency funding plans, but that of the money center bank would predictably have many more component parts.

The central theme here is that liquidity management by banks is continuing to evolve, and regulatory supervision is evolving along with it. One aspect of this process is the ongoing convergence of national regulatory standards with global ones, reflecting the realities of a more interconnected financial world. What happens at banks in New York, London, and Madrid increasingly has ripple effects felt in community banks. Going forward, bankers and their regulators alike will be called upon to exercise vigilance, good judgment, and imagination to ensure safe and sound management of this crucial function.

Banker Economic and Business Survey

Reporting Period: First Quarter 2010

Kurt Purdom

Each month, the Department sends out an economic survey to a representative sample of Texas bankers asking for their feedback about the economy and current conditions in their local community and market area.

They are also asked to provide a narrative response to questions relating to factors that they believe will have the most effect, both positive and negative, on their institution in the next year, along with a question about what issue(s) constitutes the most significant risk to their bank. In the first quarter of 2010, sixty-two institutions responded to the survey, representing an 81% response.

Bankers' responses in the first quarter of 2010 are consistent with the responses we received in previous surveys since the onset of the recession, though there are some notable exceptions. Economic conditions continue to be strained, as bankers are less pessimistic than in previous periods, providing further support for a slowly improving economy. In addition, narrative responses about the economy, at least at the local level, reflect more positive than negative responses. Commercial and residential real estate sales activity and employment responses are consistent with previous surveys, indicating continued weak conditions. Bankers again report higher volumes of loans on their internal problem asset watch list and increases in provisions for possible loan and lease losses. Responses about earnings are, on average, more positive than negative this quarter. More respondents expect improvement in their return on assets (ROA) than deterioration. Reflecting this gradual improvement in earnings, almost half of the bankers (45%) expect to post an ROA of greater than 1% for the quarter, which is very similar to the responses from last quarter.

Overall, the survey results and underlying metrics continue to foreshadow pessimism in the industry, though results point to slowly improving conditions. Bank performance is typically a lagging reflection of the economy as a whole. Although signs of stabilization in the economy are encouraging, the forecast for the industry for the remainder of 2010 is guarded. A continued soft job market, especially in the major metropolitan areas of Dallas–Fort Worth and Houston and weakness in commercial real estate combined with very limited quality loan demand, foreshadow continued negative factors for many bankers.

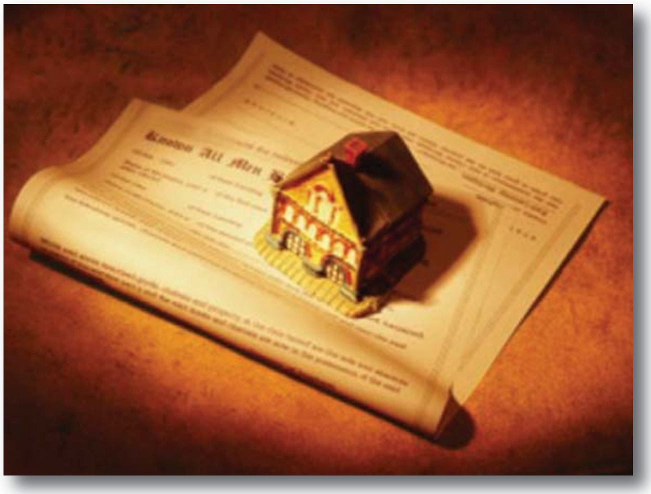
Local Economy

- Bankers remain cautious about the economy, however, on a positive note, their responses are less pessimistic than in previous quarters as a reduced percentage of respondents reported decreasing or significantly decreasing activity. When asked about the state of general business activity, only 17% of the bankers report deteriorating conditions compared to 27% in the fourth quarter of 2009 and 34% in the third quarter of 2009. These results are in stark contrast to the 42% that reported a deteriorating economy one year ago. Still, most bankers (75%) report that economic conditions are about the same as the previous quarter and only 8% report that conditions are improving. Narrative comments provided by bankers indicate that most do not plan any significant changes to their business plan in the near future, and only one bank indicated plans to open a branch. In fact, terms like "hunkered down," "survival mode," and "conservative posture" were reflective of the position adopted by some institutions. Twenty bankers indicated that their local economy would have a positive impact on their bank in the coming year, but some expressed concern about national economic conditions. When asked what issue represented the greatest risk to their institution in the coming year, several bankers mentioned regulatory burden and the expected changes brought about by regulatory reform efforts.

• Responses relating to residential real estate markets are still relatively pessimistic and are very similar to the last quarter. However, responses are more positive than a year ago when 62% of the respondents reported decreasing or significantly decreasing activity. In the latest survey, only 37% reported decreasing or significantly decreasing activity, while 50% reported conditions as about the same and 11% reported conditions as improving.

• Bankers continue to report weak conditions in the commercial real estate markets as well, and survey results are similar to the last quarter. 50% of the respondents report either significantly decreasing or decreasing sales activity, 42% report sales activity at about the same level, and only 2% of the respondents report increasing sales activity. By comparison, in the second quarter of 2008 before the onset of the recession, only 12% of the respondents reported decreasing commercial real estate sales activity.

• Responses relating to area wide employment are still relatively negative as 21% of the respondents reported decreasing employment, 69% report conditions as about the same, and 8% report increasing employment. However, as with residential and commercial real estate sales activity, the results are less pessimistic than in previous quarters. Last quarter, 48% of the respondents reported decreasing area wide employment, and only 49% reported conditions as about the same and 3% as conditions improving.



... terms like "hunkered down," "survival mode," and "conservative posture" were reflective of the position adopted by some institutions.

Economic Indicators

• Again this quarter, the vast majority of bankers (70%) expect market interest rates to remain about the same over the next six months, while 28% expect rates to increase. Only 2% of the bankers expect rates to decrease. These survey results represent a significant shift with regards to the expectation of interest rate movements from last year. In the fourth quarter 2008 survey, 62% of the bankers believed that rates would decrease over the next six months. Obviously, bankers now believe that rates have bottomed out, and if any movement occurs, it will be upward.

• Optimism concerning the equity markets, as reflected in the Dow Jones Industrial Average (DJIA), reported by bankers in the second quarter of 2009 has waned. In the second quarter of 2009, 42% of the bankers believed that the DJIA would increase over the next six month period. This quarter, positive responses slightly outweigh negative responses with 28% believing that the DJIA will increase and 15% believing that the average will decrease. 57% believe that the average will stay at about the same level over the next six months.

• A greater percentage of respondents (70%) believe that fuel prices will increase over the next six months, compared to 59% in the fourth quarter and 49% in the third quarter who believed that prices would increase.

• Continuing a trend from the last three surveys, a significant percentage of respondents (42%) believed that inflation will increase over the next six months. In the last three surveys, this percentage has been 40%, 42% and 46%, respectively, dating back to the second quarter of 2009. This represents a significant shift from the first quarter when only 24% expected consumer prices to increase over the next six months. Still, slightly over half (56%) of respondents believe that inflation will stay about the same over the next six months.

• Bankers' narrative comments about the economy were mixed with twenty respondents expressing optimism about primarily local economic conditions, while ten respondents expressed concern about mostly national economic trends. Eleven respondents were concerned about increasing interest rate risk, though some referenced the recent stable but low interest rate environment as having a positive effect on their institution.

Competition

• Survey results relating to competition for financial products indicate reduced levels of competition over previous surveys. Of the products surveyed, competition for deposits

remains the most significant as more respondents report increased competition. Competition for commercial and consumer loans appears to have subsided somewhat. The reason for this is reflected in the narrative comments, as some respondents believe that decreased lending by their competitors has created opportunities for their institution. Competition reported in the survey responses:

* Deposit competition – 5% significantly increasing; 26% increasing; 58% about the same; and 11% decreasing;
* Commercial loan competition – 2% significantly increasing; 13% increasing; 63% about the same; and 19% decreasing; and 3% significantly decreasing; and,
* Consumer loan competition – 2% significantly increasing; 19% increasing; 62% about the same; 15% decreasing; and 2% significantly decreasing.

Bank Growth Characteristics – 1Quarter 2010 versus 4Quarter 2009

• Bankers continue to report very good asset growth trends: 2% significantly increasing; 44% increasing; 39% about the same; and 15% decreasing. These results are similar to the last quarter.

• Responses relating to loan growth are relatively neutral as about half of the bankers report conditions about the same and an almost equal number report increasing and decreasing trends: 27% increasing; 50% about the same; 21% decreasing; and 2% significant decreasing.

Earnings – Performance in 1Quarter 2010 versus 4Quarter 2009

• Expectations of earnings performance remain upbeat. A greater percentage of bankers (36%) expect their return on assets (ROA) to be better in the first quarter than expect it to be worse. However, this is slightly reduced from the fourth quarter of 2009 when 45% expected their ROA to be better. In this survey, 46% expect their ROA to be about the same, and 18% expect their ROA to decrease.

• Results about net interest margins are significantly different from the previous quarter when 40% of the respondents reported an improved margin from the prior quarter. However, in the first quarter, only 21% report an improved margin, while 52% report a margin that is about the same, and 27% believe that it decreased.

• In the narrative comments, a number of respondents (20) mentioned regulatory burden as a negative external factor affecting their institution and performance, with a number of respondents specifically referring to the increased FDIC premiums.

Asset Quality Indicators

• Asset quality weaknesses expressed by bankers in the last seven surveys were again pronounced this quarter: a reduced 34% of the respondents indicate that internal watch list loans are increased, while 63% report them to be about the same, and only 3% indicate that they are decreased.

• 57% of the bankers indicate that they are increasing their loan loss provisions, compared to 39% who are keeping provisions about the same and 4% who are decreasing provisions.

• More bankers (29%) report increases in nonaccrual loans than report decreases (11%), with less than half (42%) reporting little to no change. Though a majority of the bankers (58%) report their past dues at about the same level as last quarter, more respondents are reporting increases (32%) compared to those reporting decreases (8%). Responses concerning repossessions and customer bankruptcies are similar to the last survey's responses with slightly more negative responses than positive.

• Concerns about credit quality continue to affect loan underwriting standards as 58% of the respondents indicate that they are tightening loan underwriting standards, and 42% report keeping standards about the same. No bankers report an easing of credit standards.

Corporate Account Takeovers ...

... the only thing missing is the gun.

Phillip Hinkle

In the last issue of the Texas Bank Report we addressed the evolution of bank robberies toward silent electronic thefts that require developing a corporate culture of information security. This culture of information security requires the training, discipline, and endurance of a marathoner. Reviewing and discussing IT Security issues once a year with your staff and Board, does not prepare you for the road ahead. Management, staff, and the Board should be receiving periodic briefings throughout the year regarding the changing threats and mitigation strategies.

Unfortunately, many bankers are unaware of a fast growing electronic crime involving ACH origination and/or wire transfer services through the internet banking system. It is especially important to begin to protect your bank if it offers this service. These thefts, known as Corporate Account Takeovers, provide thieves with relatively large profits and little risk of being caught or prosecuted. Typical thefts have been $100,000 or more, and the number of incidents that occurred during late 2009 and early 2010 show these crimes are not slowing down.

Corporate Account Takeovers are when thieves compromise the computer of your business customer to acquire their user ID and password. The thieves then log on to your online banking system using your customer's user ID and password and transfer money out from your customer's account that ultimately reaches the thieves. Most existing multi-factor authentication methods in use have not been effective in preventing this type of crime. There are several variations and techniques, but the basics and end results are the same: large thefts and bankers having to explain what happened to their customer.

The best practices for both corporate customers and banks to minimize the risk of these crimes are still in the early development phase and are evolving; however, you should not wait for a turn key solution before taking action. The Department of Banking is developing a plan to help strengthen the industry against these crimes. However, until the plan can be implemented in the coming months, it is important to be aware that if your institution offers customers the ability to transfer money from their account through Internet banking, changes in your practices will likely be needed to protect you against these crimes.

State-chartered banks and trust companies having questions regarding this and other IT security issues may contact Chief IT Security Examiner Phillip Hinkle at (817) 640-4050 or via email itex@dob.texas.gov.

Review Corner

Bank & Trust Review Staff

Review Corner is dedicated to providing insight into what the Review Examiners are seeing as systemic issues affecting the financial institutions supervised by the Department. Review examiners are charged with reviewing examination reports of problem banks and the larger Texas state-chartered banks. Let's start off with examining asset quality as most banks have suffered some decline in asset quality due to the downturn in the economy.

Asset Quality

Banks that have significant concentrations in commercial real estate, in general, and particularly those banks with high concentrations in land, land development, and lot loans have been particularly hard hit by this economic cycle. With the value of these properties predominantly based on the sales of lots for home construction, collateral values supporting these loans have been heavily affected as the housing market continues to struggle.

With the value of these properties predominantly based on the sales of lots for home construction, collateral values supporting these loans have been heavily affected...

Many banks have seen their other real estate portfolios swell, necessitating bank officers to re-acquaint themselves with the Supervisory Memorandum – 1008, Policy for Other Real Estate Owned (OREO). The Memorandum was revised as of September 1, 2009, and outlines a number of policy requirements pertaining to OREO including accounting, evaluation, and permitted holding period. The guidance also describes the Department's classification guidelines for OREO.

Appraisals

Federal regulations provide detailed appraisal and valuation requirements for real estate related financial transactions. We continue to see violations cited for not obtaining necessary appraisals or valuations at renewal. Not only are the appraisals and evaluations required in accordance with federal regulations, a current valuation of collateral is an important aspect in determining the amount of impairment in loans reflecting exposure. Additionally, a sound analysis of the collateral is an important tool for evaluating collection options for problem loans.

Allowance for Loan and Lease Losses (ALLL)

The historical loss factor used to support the balance in a bank's ALLL account is another common examination finding this past year. Examiners are asking bank management to determine the weighted average historical loss factor based on the most recent twelve quarters, but should apply a heavier weight to the most recent quarters. The logic is that the weighted average loss factor is indicative of the more current economic conditions prevalent today.

Nonaccrual and Troubled Debt Restructuring

Lastly, another recurring issue often found in examinations is that management has either failed to identify, or has been slow to recognize nonaccrual loans and/or Troubled Debt

Restructurings (TDRs). Admittedly, many of us have had to refamiliarize ourselves with the complexities of the regulatory and accounting guidance regarding these two topics. Nevertheless, it remains important to promptly identify problem assets and recognize income appropriately. Therefore, bank management should ensure that they are familiar with the concepts and requirements of regulatory guidance, call report instructions, and accounting treatment of loans meeting the definition of nonaccrual and TDRs. Furthermore, banks should have systems and processes in place to identify nonaccrual loans and TDRs on a timely basis and ensure that they are reported appropriately.

The Policy Statement on Prudent Commercial Real Estate Loan Workouts released by the Federal Financial Institutions Examination Council in October of 2009 is a good reference tool regarding nonaccrual loans and TDRs.

Bankers are encouraged to contact their respective Regional Director or assigned Review Examiner about any questions or concerns.

Bank and Trust Supervision
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Regulatory Questions by Email:
Commercial Banks: bats@dob.texas.gov
Trust: trustex@dob.texas.gov
Information Technology: itex@dob.texas.gov

FASB 166 and Legal Lending Limits

The Department issued Regulatory Guidance 3010 on September 13, 2010, which addresses the effects of FAS 166 on the legal lending limit for Texas state-chartered banks. FAS 166, which went into effect January 1, 2010, addresses when transfers of financial assets may be accounted for as a sale. Loan participations that do not possess the characteristics set out in FAS 166 cannot be treated as a sale and would therefore remain on the balance sheet of the transferor. Because of its affect on which assets remain on a bank's balance sheet, this accounting change will impact a bank's regulatory capital ratios and allowance for loan and lease losses. This change in accounting standards is unrelated to the requirements for the determination of legal lending limit for a Texas state-chartered bank. Therefore, despite this change in accounting treatment, the Department's treatment of loan participations for legal lending limit purposes has not changed.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Kaylene Ray

On July 21, 2010, President Obama signed the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.* The Act changes the regulatory structure of the U.S. financial system in response to the current financial crisis. The effective dates of the provisions of the Act vary and implementation will involve extensive rulemaking and required studies. This process is likely to go on for a number of years. It will be important to pay close attention to the rulemaking process as it goes forward. The following is a list of major features in the Act that are of significance to state bank regulation and the dual banking system.

- Dual banking system was preserved through the Federal Reserve's role as a supervisor of state member banks.

- Banks now have de novo interstate branching authority.

- The federal thrift charter was preserved; however, the OTS will be merged into the OCC.

- Bank holding companies with $15 billion and under will have permanent grandfathering of capital treatment for existing trust-preferred securities.

- The 10% nationwide deposit cap that limits bank acquisitions will now apply to acquisitions by federal thrifts.

- State banking commissioners, as well as state insurance and securities regulators, will have a non-voting representative on the Financial Stability Oversight Council.

- The Federal Reserve will now be responsible for conducting bank-like examinations for certain non-bank subsidiaries of bank holding companies. The Fed will be required to coordinate with state regulators for subsidiaries that are state-chartered/licensed, and may conduct joint and alternating exams with the States.

- Noninterest-bearing transaction accounts will be fully insured by the FDIC effective December 31, 2010, but this provision will be repealed effective January 1, 2013.

- Effective July 22, 2011, depository institutions will be permitted to pay interest on demand deposits.

- Basic FDIC insurance coverage permanently increased to $250,000 per depositor.

Dual banking system was preserved through the Federal Reserve's role as a supervisor of state member banks.

The Bureau will be required to coordinate with state regulators in various aspects of its responsibilities, including supervision and registration.

Bureau of Consumer Financial Protection (Title X)

- Bureau created on July 22, 2010.

- The Bureau must propose rules which combine Truth in Lending Act and Real Estate Settlement Procedures Act disclosures into a single document.

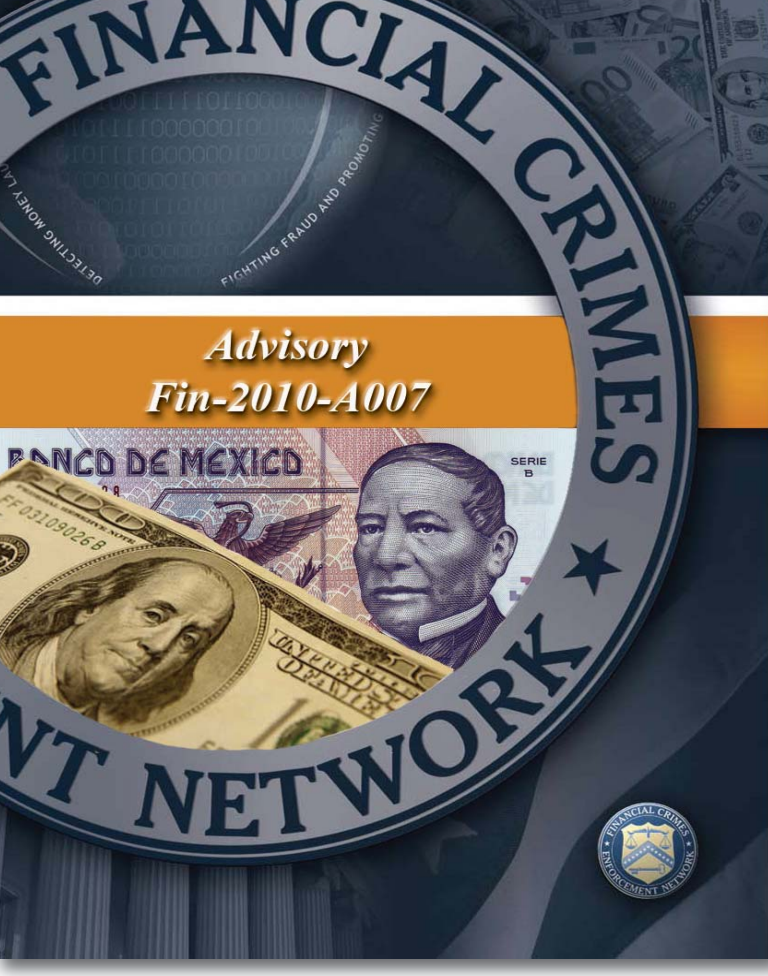
- The Bureau will be required to coordinate with state regulators in various aspects of its responsibilities, including supervision and registration.

- Should the Bureau choose to pursue registration of covered entities, the Bureau will be required to coordinate and consult with the states.

- The state-federal balance with regard to national bank preemption has been significantly re-balanced with a new requirement that preemption for national banks may only occur on a case-by-case basis and according to the Barnett decision's "prevent or significantly interfere" standard.

- State AGs will have the authority to enforce the Bureau's rules against national banks.

- Small banks with $10 billion or less in assets are carved out from the Bureau's supervision and enforcement, both of which are left to prudent regulators.



Mexican Regulations Imposing Restrictions on Mexican Banks for Transactions in U.S. Currency

Dianne Dennis

The Financial Crimes Enforcement Network (FinCEN) issued Advisory FIN-2010-A007 on June 21, 2010. The advisory advises U.S. financial institutions of a recent change in Mexican financial regulations applying to Mexican banks that could affect the operations of U.S. financial institutions. The new Mexican anti-money laundering (AML) regulations will restrict the amounts of cash (banknotes and coins) denominated in U.S. dollars that Mexican banks may receive. The regulations will still allow certain transactions up to relatively low value thresholds. The regulations do not restrict noncash transactions denominated in U.S. currency (e.g., wire transfers, ACH payments, credit card transactions, traveler's checks, etc.). A significant portion of the U.S. currency in Mexico is derived from illegal activity, specifically the sale of narcotics in the United States. Therefore, the regulations are intended to mitigate risks of laundering proceeds tied to narcotics trafficking and organized crime.

The restrictions on U.S. currency transactions by Mexican banks with individuals went into effect June 22nd. The restrictions on U.S. currency transactions by banks with legal entities and trusts will go into effect 90 calendar days after official publication (on or about September 14, 2010).

The change in Mexican regulations could have a significant impact on the operations of U.S. financial institutions, both directly with respect to the nature of activity and relationships with Mexican customers and financial institutions, and indirectly with respect to possible changes in activity both within the United States and through intermediary countries. U.S. financial institutions are advised that some changes in transaction activity may occur. In addition, financial institutions should consider the possible impact of the restrictions when reviewing financial activity and monitoring transactions. While the transactional activity that U.S. financial institutions may experience as a result of the new Mexican restriction may not be indicative of criminal activity, U.S. financial institutions should consider the potential of this type of activity in conjunction with other information, including transaction volumes, and sources of funds, when determining whether to file a suspicious activity report.

For more specific information regarding the limits of U.S. currency that Mexican banks may receive per calendar month from individuals, legal entities, and trusts, and examples of potential activity, the Advisory in its entirety is located on FinCEN's website under Advisories/Bulletins/Fact Sheets as FIN-2010-A007.

Announcemets

Congratulations Commissioner Cooper!
The Department is pleased to announce that Texas Banking Commissioner Charles G. Cooper has been selected by CSBS to serve as Chair of District 4. The District includes North Dakota, South Dakota, Wyoming, Colorado, Nebraska, Kansas, Oklahoma, New Mexico, and Texas. As Chairman of District 4, he is also a voting member of the CSBS Board of Directors and will be participating in meetings periodically throughout the year to discuss regulatory issues that affect state-chartered banks across the nation.

Domain Name Change
Effective September 1, 2010, the State of Texas is moving to a uniform domain name. The Texas Department of Banking's new web address will be www.dob.texas.gov. Departmental e-mail addresses will also change to firstname.lastname@dob.texas.gov. The address for the informational prepaid funeral website maintained by the Department will be www.prepaidfunerals.texas.gov.

New Finance Commission Member
Governor Rick Perry appointed H.J. "Jay" Shands III of Lufkin to the Finance Commission of Texas for a term to expire Feb. 1, 2012. Mr. Shands replaces Riley Couch III as the Banking Executive on the Commission.

Retirement
After serving 17 of years as the Corporate Director, Ms. Lynda Drake retired on August 31, 2010. We wish her well in all her future endeavors!

Financial Education Award
For the agency's efforts in financial literacy, the Dallas-Fort Worth Federal Executive Board awarded the Department with a Public Service Excellence Award in recognition of Significant Accomplishments Made in Service to Our Nation. Nominations for this award are received from federal agencies such as the FDIC, Federal Reserve Bank, OCC and OTS.

Closed Account Notification System Statistics
March 2009 - September 2010

Type of Institution	Number Enrolled	Number of Reported Accounts
Texas State-Chartered Banks	301	1,325
Texas State-Chartered Savings Banks	27	79
Federal Savings Banks	12	77
State Credit Unions	158	1,224
Federal Credit Unions	229	1,190
National Banks	182	704
Out-of-State State-Chartered Banks	14	3
Out-of-State National Banks	5	38

SDSI Budget

Stephanie Newberg

As a Semi-directed Self-independent (SDSI) agency, the Department was required to develop a 2011 operating budget. The budget was created using historical, current and forecasted information. A public hearing on the proposed budget was held in July 2010. The agency received positive endorsements from the banking trade organizations at this hearing. The budget was then presented to the Finance Commission at their August meeting and was unanimously approved. Highlights of the 2011 budget include:

- Expenditures total $22.9 million. Salaries and employee benefits account for $18.9 million of this amount or 83% of the budgeted expenses while travel accounts for $2.1 million or 9% of the budgeted expenses.
- The current assessment structure at $23.6 million is a sufficient revenue stream to cover this expenditure budget and may allow for a modest rebate of assessments.
- Projected expenditures for 2011 are 3% higher than the 2010 budget. The largest components of the increase include: (1) two additional financial examiner positions including salary, benefits, and travel and education costs; (2) financial examiner and related director pay increases to remain competitive with the FDIC; (3) nominal salary increases for administrative staff; and (4) the purchase of Bloomberg and SNL subscriptions to enhance our supervisory efforts.

Under this budget structure, the agency can carry out its mission, meet examination priorities, sustain our current levels of service and maintain a competitive salary structure.

TEXAS DEPARTMENT OF BANKING
BUDGET FOR FISCAL 2011

	Budget FY 2011
REVENUE:	
Bank and Trust Regulation	$21,144,029.32
Nonbank Regulation	$2, 490,963.77
Miscellaneous Revenues	$10,000.00
TOTAL REVENUES:	$23,644,993.09
EXPENDITURES:	
Salaries and Wages	
Exempt Salaries	$ 180,000.00
Classified Salaries	14,919,081.42
Longevity	200,700.00
Other	153,719.31
	$ 15,453,500.73
Travel	
In-State	$ 1,582,710.00
Out-of-State	533,590.00
	$ 2,116,300.00
Other Expenditures	
Professional Fees & Services	$ 71,498.00
Postage	15,050.40
Consumable Supplies	77,340.00
Telephone	220,445.00
Utilities	43,574.00
Rent-Buildings	220,906.44
Rent-Machinery & Other	35,263.52
Other Operating	362,881.00
Subscriptions	20,205.00
Employee Training/Reg. Fees	142,602.00
Temporary Support Services	0.00
Claims & Judgments	16,326.00
Capital Expenditures	124,850.00
	1,350,941.36
Expenses outside Appropriations	
Employee Benefits (Less BRP)	$ 3,458,493.46
SWCAP	310,350.00
Deferred Maintenance	65,050.00
State Auditor’s Office	50,000.00
Attorney General’s Office	56,000.00
TOTAL EXPENDITURES:	$22, 860,635.55
EXPENDITURES (OVER)/ UNDER REVENUE:	$ 784,357.54
FTEs	196

TAX LIENS

Doug Austin-Weeks

HB 2491 enacted in the 79th Texas Legislative Session, pertained to ad valorem tax liens and contracts for foreclosure of tax liens. Years later, financial institutions are experiencing the impact of this legislation. The comfort provided by a title policy at closing, which states that no prior year's taxes are due and that the current year's taxes are not yet due and payable, diminishes if the borrower seeks aid from a third party to pay taxes on the property after you close your loan. Once taxes are paid by the third party, the lender may not know their lien position has been superseded by a tax lien, and in a few cases, have lost the collateral.

Property tax liens have several attributes which distinguish them from federal and state tax liens. The property tax lien attaches only to the tract of land creating the property tax delinquency. More important to real estate lenders, however, is the fact that the lien has automatic superiority over all prior security interest liens. Section 32.05 of the Texas Tax Code is clear, with a few exceptions, that a property tax lien takes priority over the claim of any creditor of a person whose property is encumbered by the lien, and the claim of any holder of a lien on property encumbered by the lien. The Texas Tax Code is clearly at odds with the old axiom of "first in time is first in right," as it states that the property tax lien prevails over other liens regardless of whether the other debt, lien, future interest or other encumbrance existed before attachment of the property tax lien.

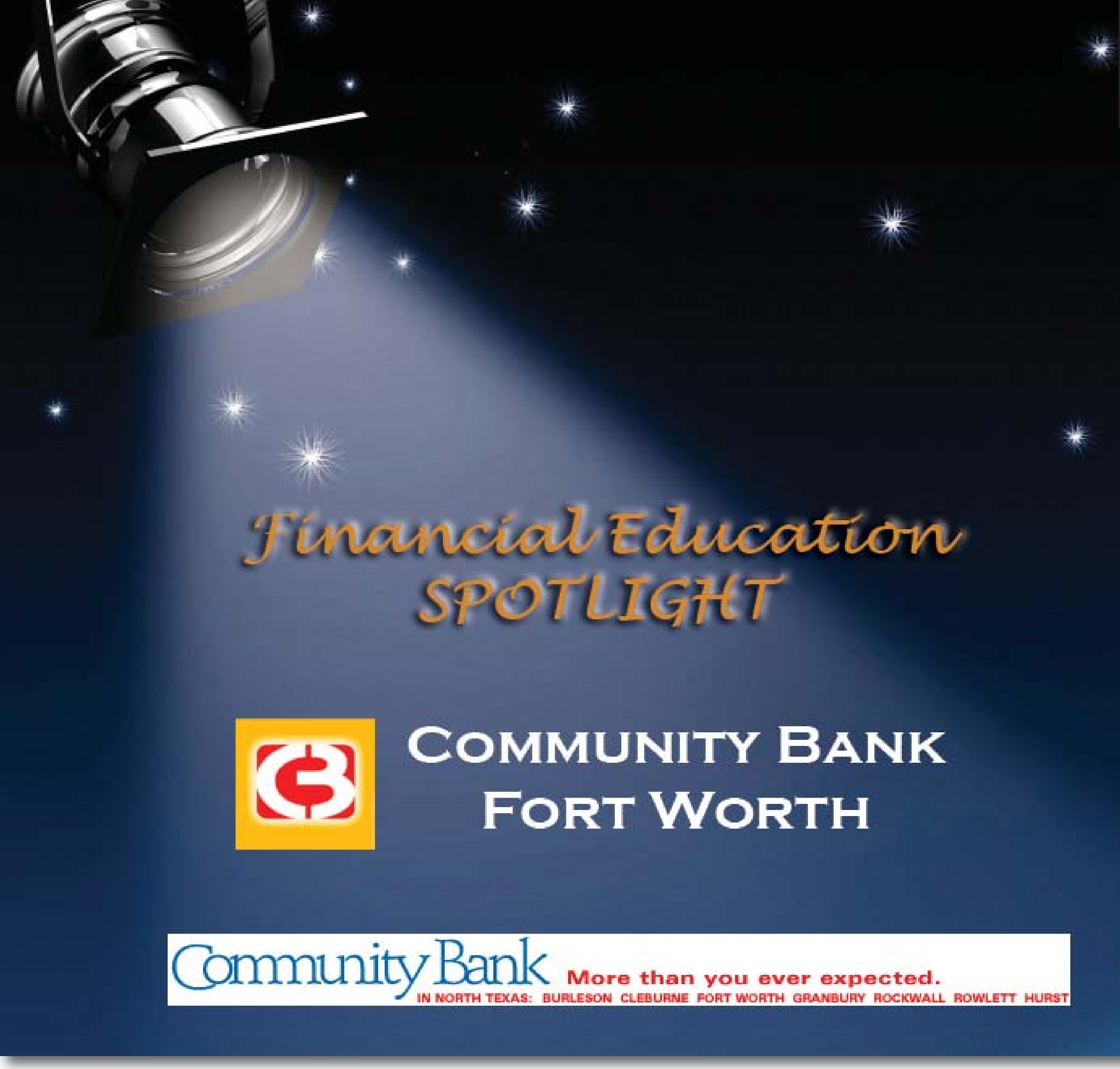
What this means to the lender is that while you may have been in a first lien position at the inception of the loan, failure to ensure timely payment of real property taxes by you or your borrower throughout the life of the note can compromise your lien priority. A third party who pays your borrower's property taxes, assuming the legal requirements of Section 32.06 of the Texas Tax Code are met, takes a transfer of the tax lien and steps in front of the real estate lender, possibly before the lender is aware of it. To protect its position, the lender has to deal with an uninvited partner: a partner who in at least one banker's experience can be less than cooperative. It has been reported that tax lien lenders have been less than forthcoming with payoff information asserting that requests must come from the borrower rather than from the borrower's bank.

There are some things that banks can do to try to protect their lien priority, but these are not without costs. While it is standard practice to inform the borrower at closing that failure to pay property taxes, permitting tax lien transfers or property tax deferrals or payment plans are all acts of default, it is important to remind borrowers on a regular basis of those contractual terms. This can generally be accomplished through envelope stuffers. One large institution sends out such mailers to borrowers on a quarterly basis. Keeping in communication with your borrower is the key.

A second way to protect the bank is to establish an escrow department that oversees the collection and payment of property taxes. Again, this is not an inexpensive solution, and should be justified by the volume of real estate lending underwritten by the institution. This solution will minimize the risk of being leapfrogged by a tax lien lender but will involve additional investment in personnel, software and other overhead expenses. However, by having an escrow department, the bank maintains control of the tax payment process and ensures that tax lien lenders do not step in front of their lien position.

Either way, it is important that bankers be proactive whenever they learn their borrower is not paying property taxes promptly. Everyday's delay increases the chances that your lien priority may vanish. Communicate with your borrowers and never underestimate the importance of making sure your customers are paying their property taxes on time.

If you have any questions about this article, please call Doug Austin-Weeks at 817-640-4050.



Leilani Lim-Villegas

Community banks are in a fortunate position to reach out and financially improve the lives of the areas they serve. From basic banking to car loans and mortgages, banks are key players in the success and future of families in each community. "As a respected institution, a bank should not simply limit their relationship with their clients solely with the products and services they offer, but rather a good example of leader quality is when a bank goes above and beyond their call of duty of community involvement to provide financial literacy, an important life skill, and we encourage all of our banks to do the same," said Texas Banking Commissioner Charles G. Cooper.

In this edition, the Department is pleased to highlight **Community Bank**, Fort Worth, as they step up their efforts to make a major difference to the Texans they serve.

Jimmy Campbell, Chief Executive Officer said, "We are proud of Community Bank's financial literacy program that provides training to children and adults about the basics of savings, spending, budgeting, and credit. Every branch has a dedicated financial literacy representative that goes out to schools, church groups, Photo courtesy of Community Bank

and networking groups to talk about financial literacy. Because we live, work and play in these communities, we realize the importance of this service." He continued, "We use several programs including Teach Children to Save, Get Smart About Credit, and Money Smart. Several of our branches offer tours of their vault. We reach 1,000 students annually with our in-school financial literacy programs."

The Teach Children to Save (TCTS) Program, from the American Bankers Association Education Foundation (ABAEF), provides different lesson plans on savings and spending by grade level. Community Bank uses this curriculum primarily for elementary schools and provides presentations each April. For high school students, the Get Smart About Credit (GSAC) Program, also from the ABAEF, provides credit basics through case studies and evaluations. Community Bank makes presentations of the GSAC program each October. The Burleson branch's financial literacy representative gives a two-day presentation to all seniors at a local high school.

Presentations of both programs are not limited to April and October. Community Bank will present either program upon request throughout the year.

The "Money Smart" program, from the Federal Deposit Insurance Corporation (FDIC), provides banking, borrowing, budgeting and money basics through learning modules. It is available in an instructor-led format, self-paced CD, and online. There is also a "Money Smart for Young Adults." Community Bank uses both Money Smart programs with local church groups, networking groups and when schools request additional financial literacy presentations.

In addition, Community Bank began partnering with a local children's theatre in 2009. "We set up a financial literacy booth in the lobby with handouts including the 'Money Talks' Newsletters, along with our own Community Bank financial literacy handout," shared Community Bank's VP and Director of Marketing Lizz Larsen. "We were also given 90-seconds to talk about financial literacy prior to each show. We used TCTS and GSAC materials to create a basic PowerPoint and then the children's theatre tech department created a DVD that matched the theme for each show. Eighty thousand children attended the 2009-2010 season and we're hoping to reach 90,000 in 2010-2011."

For more information on Community Bank's Financial Literacy Program, contact Lizz Larsen at (817) 698-7182 or by email at llarsen@community-bank-tx.com.

"The Texas Department of Banking maintains a database of financial literacy curricula and related programs that can assist any bank with finding the right teaching tools to deliver financial education in their communities. If your bank is interested in jumpstarting a financial education program, we are here to help," said Commissioner Cooper.

For additional information regarding financial education opportunities in Texas, contact Financial Education Coordinator Leilani Lim-Villegas at (512) 475-1337, e-mail at financial.education@dob.texas.gov.

TABLE I

Quarterly Balance Sheet and Operating Performance Ratios

for Texas State-Chartered Banks 9/30/09 Through 9/30/08

ACCOUNT DESCRIPTIONS (IN MILLIONS OF $)	9/30/09	6/30/09	3/31/09	12/31/08	9/31/2008
Number of State-Chartered Banks	322	326	325	327	329
Total Assets of State-Chartered Banks	162,657	163,230	167,287	164,676	156,132
Number of Out-of-State, State-Chartered Banks Operating in Texas	20	23	23	23	23
Total Texas Assets of Out-of-State, State-Chartered Banks Operating in Texas	36,686	50,490	28,108	28,108	28,108
Subtotal	199,343	213,720	195,395	192,784	184,240
Less: Out-of-State Branch Assets/Deposits	-37,343	-39,086	-39,086	-39,086	-39,086
**Total State Banks Operating in Texas	162,000	174,634	156,309	153,698	145,154
BALANCE SHEET (Tx. State-Chartered Banks)					
Interest-Bearing Balances	6,747	7,202	6,279	4,075	1,023
Federal Funds Sold	1,948	2,415	2,298	1,891	2,606
Trading Accounts	591	750	865	774	408
Securities Held-To-Maturity	7,180	6,924	6,855	6,928	5,478
Securities Available-for-Sale	28,324	26,447	30,396	28,770	24,961
Total Securities	36,095	34,121	38,116	36,472	30,847
Total Loans	104,466	106,413	107,290	108,749	107,897
Total Earning Assets	149,256	150,151	153,983	151,187	142,373
Premises and Fixed Assets	2,847	2,828	2,799	2,733	2,648
Total Assets	162,657	163,230	167,160	164,676	156,132
Demand Deposits	13,462	13,379	13,494	13,891	13,608
MMDAs	46,325	43,817	42,289	40,059	40,839
Other Savings Deposits	10,113	9,809	9,806	9,305	8,687
Time Deposits < 100M	19,970	20,790	22,018	22,519	15,956
Time Deposits > 100M	23,865	24,814	25,043	24,250	23,796
Brokered Deposits	5,637	7,457	9,473	10,593	6,173
Total Deposits	122,040	120,802	120,768	118,490	108,847
Federal Funds Purchased	4,662	4,914	5,336	4,795	6,312
Other Borrowed Funds	13,781	16,269	19,646	20,413	20,492
Total Liabilities	145,581	146,661	150,611	148,593	140,550
Total Equity Capital	17,051	16,545	16,549	16,083	15,579
Loan Valuation Reserves	1,755	1,601	1,503	1,429	1,326
Total Primary Capital	18,806	18,146	18,052	17,512	16,905
Past Due Loans > 90 Days	338	358	315	207	183
Total Nonaccrual Loans	2,294	1,894	1,707	1,569	1,406
Total Other Real Estate	593	500	423	329	253
Total Charge-Offs	990	614	256	700	480
Total Recoveries	46	29	12	60	42
Net Charge-Offs	944	585	244	640	438
INCOME STATEMENT					
Total Interest Income	5,292	3,552	1,780	7,962	6,025
Total Interest Expense	1,427	992	523	2,899	2,238
Net Interest Income	3,865	2,560	1,257	5,063	3,787
Total Noninterest Income	1,903	1,047	522	1,929	1,477
Loan Provisions	1,260	745	308	978	676
Salary and Employee Benefits	1,904	1,264	632	2,440	1,809
Premises and Fixed Assets Expenses (Net)	498	329	166	618	454
All Other Noninterest Expenses	1,182	795	357	1,537	1,166
Total Overhead Expenses	3,584	2,388	1,155	4,595	3,429
Securities Gains (Losses)	300	185	42	-24	-22
Net Extraordinary Items	1	2	1	1	0
Net Income	954	541	269	1,086	864
Cash Dividends	336	363	116	667	569
RATIO ANALYSIS					
Loan/Deposit	85.60%	88.09%	88.84%	91.78%	99.13%
Securities/Total Assets	22.19%	20.90%	22.80%	22.15%	19.76%
Total Loans/Total Assets	64.22%	65.19%	64.18%	66.04%	69.11%
Loan Provisions/Total Loans	1.57%	1.40%	1.15%	0.90%	0.81%
LVR/Total Loans	1.68%	1.50%	1.40%	1.31%	1.23%
Net Charge-Offs/Total Loans	0.90%	0.55%	0.23%	0.59%	0.41%
Nonperforming+ORE/Total Assets	1.98%	1.69%	1.46%	1.28%	1.18%
Nonperforming+ORE/Primary Capital	17.15%	15.17%	13.54%	12.02%	10.90%
Net Interest Margin	3.37%	3.41%	3.27%	3.35%	3.46%
Gross Yield	5.75%	5.63%	5.51%	6.01%	6.25%
Return on Assets	0.76%	0.66%	0.64%	0.66%	0.72%
Return on Equity	7.27%	6.54%	6.50%	6.75%	7.21%
Overhead Exp/TA	2.86%	2.93%	2.76%	2.79%	2.86%
Equity/Total Assets	10.48%	10.14%	9.90%	9.77%	9.98%
Primary Capital/Total Assets+LVR	11.44%	11.01%	10.70%	10.54%	10.74%

*Unrealized gains/losses are already included in equity capital figures.

**Total State Banks Operating in Texas includes branches of out-of-state, state-chartered banks.

Data was derived from the FDIC website.

TABLE II
COMPARATIVE STATEMENT OF CONDITION
COMMERCIAL BANKS DOMICILED IN TEXAS
SEPTEMBER 30, 2009 AND SEPTEMBER 30, 2008

ACCOUNT DESCRIPTIONS (In Millions of $)	9/30/2009 STATE CHARTERED		9/30/2009 NATIONAL CHARTERED		9/30/2009 ALL BANKS		9/30/2008 ALL BANKS	
Number of banks	322	% TA	264	% TA	586	% TA	598	% TA
BALANCE SHEET								
Interest-Bearing Balances	6,747	4%	5,160	5%	11,907	4%	2,308	1%
Federal Funds Sold	1,948	1%	3,306	3%	5,254	2%	5,325	2%
Trading Accounts	591	0%	137	0%	728	0%	830	0%
Securities Held-To-Maturity	7,180	4%	1,817	2%	8,997	3%	7,296	3%
Securities Available-For-Sale	28,324	17%	20,293	18%	48,617	18%	42,978	16%
Total Securities	36,095	22%	22,247	20%	58,342	21%	51,104	20%
Total Loans	104,466	64%	69,658	63%	174,124	64%	177,697	68%
Total Earning Assets	149,256	92%	100,371	91%	249,627	91%	236,434	90%
Premises & Equipment	2,847	2%	2,374	2%	5,221	2%	4,935	2%
TOTAL ASSETS	162,657	100%	110,444	100%	273,101	100%	261,530	100%
Demand Deposits	13,462	8%	10,593	10%	24,055	9%	23,853	9%
MMDAs	46,325	28%	36,226	33%	82,551	30%	71,799	27%
Other Savings Deposits	10,113	6%	7,463	7%	17,576	6%	15,632	6%
Time Deposits<100M	19,970	12%	12,066	11%	32,036	12%	28,815	11%
Jumbo Deposits	23,865	15%	18,183	16%	42,048	15%	39,810	15%
Brokered Deposits	5,637	3%	2,988	3%	8,625	3%	7,983	3%
Total Deposits	122,040	75%	90,476	82%	212,516	78%	193,003	74%
Fed Funds Purchased	4,662	3%	2,495	2%	7,157	3%	10,360	4%
Other Borrowed Funds	13,781	8%	3,760	3%	17,541	6%	24,607	9%
TOTAL LIABILITIES	145,581	90%	97,781	89%	243,362	89%	234,225	90%
Equity Capital	17,051	8%	12,662	11%	29,713	11%	27,306	10%
Allowance for Loan/Lease Losses	1,755	1%	1,238	1%	2,993	1%	2,155	1%
Total Primary Capital	18,806	12%	13,900	13%	32,706	12%	29,461	11%
Past due >90 Days	338		145		483		256	
Nonaccrual	2,294		1,494		3,788		1,956	
Total Other Real Estate	593		503		1,096		437	
Total Charge-Offs	990		370		1,360		647	
Total Recoveries	46		39		85		81	
INCOME STATEMENT	Y-T-D		Y-T-D		Y-T-D		Y-T-D	
Total Interest Income	5,292	100%	3,821	100%	9,113	100%	10,287	100%
Total Interest Expense	1,427	27%	927	24%	2,354	26%	3,670	36%
Net Interest Income	3,865	73%	2,894	76%	6,759	74%	6,617	64%
Total Noninterest Income	1,903	36%	1,309	34%	3,212	35%	2,771	27%
Loan Provisions	1,260	24%	661	17%	1,921	21%	930	9%
Salary & Employee Benefits	1,904	36%	1,432	37%	3,336	37%	3,219	31%
Premises & Fixed Assets (Net)	498	9%	389	10%	887	10%	834	8%
All Other Noninterest Expenses	1,182	22%	1,749	46%	2,931	32%	2,075	20%
Total Overhead Expenses	3,584	68%	3,570	93%	7,154	79%	6,128	60%
Securities Gains(losses)	300	6%	(24)	-1%	276	3%	(195)	-2%
Net Extraordinary Items	1	0%	0	0%	1	0%	1	0%
NET INCOME	954	18%	(116)	-3%	838	9%	1,681	16%
Cash Dividends	356		354		710		991	
Average ROA	0.76%		-0.14%		0.40%		0.84%	
Average ROE	7.27%		-1.19%		3.67%		8.00%	
Average TA ($ Millions)	505		418		466		437	
Average Leverage	10.48%		11.46%		10.88%		10.44%	
Dividends/Net Income	37.32%		-305.17%		84.73%		58.95%	

*Unrealized gains/losses are already included in equity capital figures.

TABLE INCLUDES ONLY BANKS DOMICILED IN TEXAS. BRANCHES OF OUT-OF-STATE BANKS ARE NOT INCLUDED.

Data was derived from the FDIC website.

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