



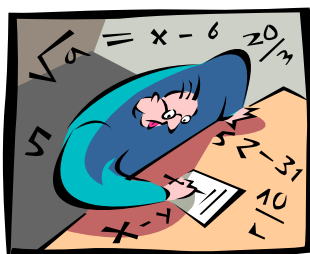
THE CREDIT UNION REFLECTION

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- ◆ Answers to Check 21 questions

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INDEPENDENT TESTING: A CRITICAL PART OF A BSA/AML COMPLIANCE PROGRAM

As reported in the previous issue of the “Credit Union Reflection,” the first step to having a sound Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance program is for management to perform a risk assessment. This assessment should review not only the credit union’s membership but also all of its services and products offered. From that analysis management must then establish and maintain a written compliance program that, at a minimum, includes:

- Board approved written policies and procedures
- A system of internal controls
- Designation of an employee to monitor BSA compliance
- Training of personnel including the board of directors
- Independent testing.

Once the above elements have been established, and personnel are trained in implementing the credit union's BSA/AML compliance program, independent testing for compliance with the BSA/AML policy must be done at least annually. An outside auditor, consultant, internal auditor, or a qualified person may do the testing, but they must not be otherwise involved in any part of the credit union's BSA/AML compliance program.

The independent testing or audit should, at a minimum, be able to affirm the effectiveness of the credit union's internal controls for monitoring compliance with the BSA/AML program by:

- A review of a sample of Suspicious Activity Reports (SARs) filed for completeness
- A review of a sample of large currency transactions traced to Currency Transaction Report (CTR) filings
- A review of the Customer Identification Program for verification of information obtained from members
- A review of money transfer services (wire transfers) of \$3,000 or more
- A test of employees' knowledge of regulations and procedures
- A review of the completeness of the training program.

The findings from the independent testing or audit should then be incorporated into a report for management, the supervisory committee, and the board of directors. If any deficiencies in the BSA/AML compliance program are found, appropriate follow-up must be promptly ensured.

Examiners will review the independent testing or audit report and supporting working papers. They will also review any deficiencies identified during the independent testing or audit and how the deficiency was resolved. For example, if a CTR was inadvertently not filed with the Financial Crimes Enforcement Network (FinCen) within 15 days as required, did management complete a CTR of that transaction and do a late filing?

For information on independent testing, credit union managers can reference http://www.ffiec.gov/bsa_aml_infobase/default.htm which is the Federal Financial Institutions Examination Council's Bank Secrecy Act/Anti-Money Laundering InfoBase web page. The narrative explains that the "Bank Secrecy Act Anti-Money Laundering Examination Manual" (Manual) is a resource examiners use to determine BSA/AML compliance. However, since it is publicly available, credit union managers can reference the Manual for guidance in ensuring their own BSA/AML program is in compliance. Clicking on "Online Manual" will bring up the Manual's "Table of Contents." An independent test or audit of a credit union's BSA/AML program should be guided by the Manual's instructions in any particular area of the credit union's risk assessment profile. Appendix O, for example, gives guidance for independent testing of transaction testing.

Designation of Exempt Person Update: FinCEN has issued a new Designation of Exempt Person form for CTR exemptions. The new form, FinCEN form 110, will replace the old form, TD F 90-22.53. Either form is acceptable at this time; however, effective January 1, 2006, only the new form will be accepted. The form can be downloaded at http://www.fincen.gov/reg_bsaforms.html. --Thanks to Werner Paul for submission of this article



Staff of the Bureau's credit union section recently has fielded a number of questions about the Check Clearing for the 21st Century Act (Check 21). Check 21 is a federal law that is designed to enable depository institutions to handle more checks electronically, which should make check processing faster and more efficient.

A list of frequently asked questions regarding everything from the purpose of Check 21, to what changes members will see in their credit union statement, and what their consumer rights are, can be viewed at: <http://www.federalreserve.gov/paymentsystems/truncation/faqs2.htm#ques15>.

NASCUS TESTIFIES AGAIN ON REGULATORY RELIEF

On September 22, 2005 the National Association of State Credit Union Supervisors (NASCUS) was asked again to testify on regulatory relief before the House Subcommittee on Financial Institutions and Consumer Credit. Deputy Commissioner George Latham again testified on NASCUS's behalf.

NASCUS continues to support capital reform, and recommended the inclusion of risk-based capital in the regulatory relief bill. NASCUS also continues to support member business lending reform. Latham cited to the members of the Subcommittee the need for regulatory relief using the recent Hurricane Katrina as an example. With heavy property losses expected, loan defaults are expected that will result in a drain on the net worth of credit unions. Temporary regulatory tolerance would seem to be appropriate instead of compounding an unforeseen problem by requiring rigid compliance to Prompt Corrective Action rules and regulations.

Latham also pointed out NASCUS' relief efforts to the Hurricane Katrina tragedy. NASCUS has a "reserve examiner program," which is a pool of both recently retired and active state credit union examiners who are available to go to areas of the country where disasters have occurred. Local examiners can then give attention to their personal needs while the NASCUS examiners can help effected credit unions restart operations and do necessary examination work. NASCUS has also coordinated with NCUA and local officials to provide cooperative relief efforts.

SEG , FIELD OF MEMBERSHIP, AND MERGER ACTIVITY

During the second and third quarters of 2005 the Bureau approved 19 small employee groups (SEGs). The two credit unions requesting these groups added 3,677 new potential credit union members. The average size of the approved SEGs was 193 members, which is well below a threshold of 600 the Bureau has determined is necessary for a new credit union charter to be feasible. Since 1974, when the Bureau first started approval of SEG additions to existing credit union fields of membership, the Bureau has also chartered 30 new credit unions, the last being chartered in 1983. Only four of these credit unions still exist. Of the 26 failures only seven had more than 600 members when they liquidated or merged, and the largest of the 26 credit unions was only \$4 million in assets after 27 years in business. Since formal legislation to permit SEG expansion went into effect on July 1, 1999 there have been 365 SEGs approved for total new potential membership of 114,259.

On August 1, 2005 Lynchburg Postal and Federal ECU (LPFECU) completed its merger into Roanoke Postal Employees FCU. Having been chartered in 1926 LPFECU was one of the oldest credit unions in Virginia. After its merger, there are currently only two state chartered credit unions that are older: Richmond Postal CU and Norfolk, VA., Postal CU. Roanoke Postal CU was also originally a state chartered credit union and was chartered the year before LPFECU. LPFECU reported \$3.2 million in assets on its June 2005 Call Report. This merger reduced the number of state chartered credit unions operating in Virginia to 60 as of September 30, 2005. However, assets grew over \$9 million, or at a 0.9% annual growth rate, for the second quarter of 2005, and were over \$4.1 billion at the end of the quarter.

In August 2005, Newport News Shipbuilding ECU received approval of its community field of membership request to serve 16 cities and counties in the Hampton Roads/Tidewater area. The potential membership in this community is 1.57 million people. However, the credit union still only has a little over 84,000 members as of the end of September 2005.

One area the Bureau looks at before approval of a community field of membership is a credit union's business and marketing plans. These plans are analyzed for reasonableness in achieving success in penetrating the credit union's new community market. In addition, during the examination the examiner will review the business and marketing plans to determine if management of the credit union is adhering to its plans, or if it has adjusted the plans based on the results from the original plan. A good marketing plan is a key to planning growth in membership and assets.

The following chart reveals that member growth in Virginia state-chartered community credit unions (including The Richmond Postal CU, which is an "underserved area" credit union) has only been at a 5.54% rate in 2005. In one-half of these ten credit unions membership has actually decreased in 2005. Further, penetration into their respective potential market is only 4.87%.

	Members 9/05	Member Growth 12/04-9/05	Potential Members 9/05	Penetration
BEACON CU	13,837	-1.44%	225,000	6.15%
DUPONT COMMUNITY CU	49,976	8.05%	286,000	17.47%
GWALTNEY ECU	1,083	1.98%	30,000	3.61%
MARTINSVILLE DUPONT ECU	24,097	-1.06%	250,000	9.64%
THE NANSEMOND CU	1,886	-1.72%	3,000	62.87%
NEWPORT NEWS SHIPBUILDING ECU	84,006	16.80%	1,570,000	5.35%
NORTHERN STAR CU	21,990	-10.75%	1,400,000	1.57%
THE RICHMOND POSTAL CU	8,588	3.23%	194,729	4.41%
TIDEWATER TELEPHONE ECU	5,786	-1.40%	1,100,000	0.53%
UNIVERSITY OF VIRGINIA COMMUNITY CU	46,907	1.45%	238,049	19.70%
	258,156	5.54%	5,296,778	4.87%

"REG FLEX" FOR STATE-CHARTERED CREDIT UNIONS

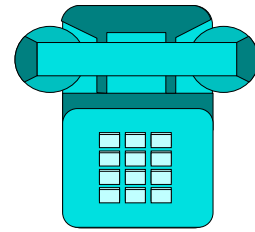
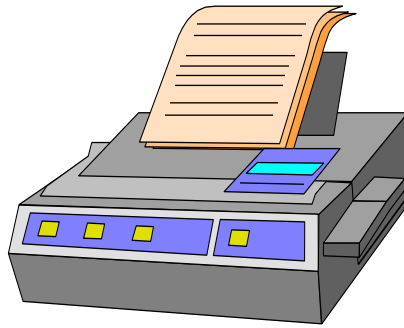
Part 742 of NCUA's Rules and Regulations exempts federally chartered credit unions with a 9.0% net worth ratio and a CAMEL 1 or 2 ratio from certain NCUA regulations, and grants certain additional powers to eligible federal credit unions. NCUA's RegFlex program does not apply to Virginia state-chartered credit unions.

In its review of Part 742 the Bureau has determined that Virginia credit union law is already similar to or even less restrictive than federal law in many areas covered by RegFlex:

- Virginia law is less restrictive than federal law on making charitable contributions;
- Virginia law does not currently allow for non-deposit or public unit accounts;
- Virginia law and NCUA regulations are very similar regarding fixed asset investments;
- Virginia law is less restrictive than federal law on usage of investment advisors;
- Virginia law does not require the monitoring of the fair market value of investment securities;
- Virginia law is conservative in prohibiting such investments as derivatives, zero coupon investments, and mortgage service rights depending on the issuer;
- Virginia law appears to be permissive (but does not specifically mention) on borrowing repurchase agreements;
- Virginia law permits investment in stripped mortgage-backed securities and residual interest in collateralized mortgage obligations depending on the issuer;
- Virginia does not have limits on the purchase of certain types of loans mentioned in the RegFlex rule.

This comparison to the exemptions and additional powers of NCUA's RegFlex rule indicates that the State Corporation Commission does not need to issue regulations in these areas. The Bureau will consider the wishes of state-chartered credit unions who want to obtain specific authority or who feel restricted from engaging in certain activities as long as the request is reasonable, within legal guidelines, and sound from a regulatory perspective.

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The mission and purpose of the Credit Union Section is to effectively and efficiently supervise, regulate, and educate credit unions chartered by the Commonwealth of Virginia in order to:

- 1. Protect the financial interests of credit union members.*
- 2. Ensure compliance with applicable laws.*
- 3. Ensure adherence to safe and sound operating procedures and principles.*

These three objectives are to be pursued so as to safeguard a financial environment within Virginia worthy of the public's confidence in credit unions and the financial system as a whole.



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