

THE CREDIT UNION REFLECTION



Highlights

- ▶ Mexican Examiners participate in Virginia Examination
- ▶ Photocopying Driver's Licenses

Inside

- ▶ IRS Discontinues UBIT Audits
- ▶ Exam Concern
- ▶ SEG and Merger Activity

MEXICAN EXAMINERS PARTICIPATE IN VIRGINIA EXAMINATION



Through a cooperative agreement between the National Association of State Credit Union Supervisors (NASCUS), the World Council of Credit Unions (WOCCU), and the Bureau an internship team of examiners from the Mexican National Bank Commission will participate during October 2003 in the examination of a Virginia state-chartered credit union. Bureau examiner Antonio Muñoz-Pérez will be Examiner-in-Charge and serve also as interpreter. Separately, the Mexican

Supervisor of Examiners will travel with NASCUS and WOCCU staff to Richmond for a briefing on state examination programs, supervision and monitoring of credit unions, oversight of problem credit unions, and the use of technology in the examination, regulation and supervision of credit unions.

As host to the Mexican delegation, NASCUS will during the week also conduct sessions with them on educational opportunities, accreditation, and the legislative process. They will also attend an NCUA board meeting and make some Capitol Hill visits. Members of the delegation will also spend one day visiting the Pennsylvania Department of Banking in Harrisburg, Pennsylvania, and follow a similar agenda to the Richmond visit.

The Bureau welcomes this opportunity to share regulatory techniques with our Mexican neighbors. The Bureau hopes that the Mexican regulators will benefit from their visit with us and from the educational and training exercises.

PHOTOCOPYING DRIVER'S LICENSES: FOLLOW THE LAW



Bureau examiners have recently found that some credit unions have been photocopying driver's licenses. Many financial institutions in recent years have used driver's licenses as a form of identification. With the October 1, 2003 compliance date of new provisions of the U. S. Patriot Act, credit unions must find acceptable forms of identifying new members. Section 326 of that Act requires reasonable procedures to verify the identity of any person seeking to open an account. While driver's licenses can help to identify an individual, the Code of Virginia prohibits reproduction of driver's licenses without permission of the Division of Motor Vehicles.

Section 46.2-346 A (4) of the Code states that no person shall "reproduce by photograph or otherwise, any driver's license, temporary driver's permit, or learner's permit issued by the (Division of Motor Vehicles [DMV]) without obtaining prior written consent of the (DMV)." DMV staff has advised the Bureau that based on the current statutory language covering this requirement, every credit union (not each branch of each credit union) must apply for permission to photocopy driver's licenses.

Credit unions may apply for permission by writing to Commissioner D. B. Smit, Virginia Department of Motor Vehicles, P. O. Box 27412, Richmond, Virginia 23269-0001, Attention: Pat Deluke.

IRS DISCONTINUES UBIT AUDITS

Bureau staff was recently advised during a NASCUS training seminar that the Internal Revenue Service has temporarily halted its Unrelated Business Income Tax (UBIT) activities. This is welcome news for state chartered credit unions since UBIT audits have intensified recently. Whereas previously sporadic UBIT audits were made, in the past year the IRS entered many credit unions in Connecticut, Alabama, and Texas. The IRS generally focuses its review on credit disability and life insurance as well as ATM and other fees that it considers unrelated to the business of operating a credit union.

The disparity of application of UBIT between federal and state-chartered credit unions has produced over the years many requests for IRS technical advice, rulings, and guidance. None of these requests has produced relief or resolved the problem. Because of the potential damage to the dual chartering system, and because the IRS mistakenly has substituted its judgement for state law, the credit union industry has rallied to the cause. Recently a UBIT Coordinating Group (consisting of CUNA & Affiliates, CUNA Mutual Group, the American Association of Credit Union Leagues [AACUL], and NASCUS) was formed to combine their resources and focus on this issue. This group is considering more drastic strategies such as statutory changes and litigation.

The UBIT Coordinating Group will conduct a Webinar on October 29 at 2 p.m. EST entitled “UBIT: What It Means for Your Credit Union When the IRS Calls.” This Web-based educational program will inform you about what it means when the IRS wants to audit credit union books for UBIT purposes, how you should respond, what the credit union system is doing to protect you, and where the group stands on efforts to resolve the issue with the IRS. The Internet presentation will consist of a PowerPoint explanation of the UBIT issue, comments from four expert panelists and moderator, and an interactive question-and-answer session. Following the live presentation, the recorded program will be accessible for viewing on the Internet. The Webinar is limited to 500 computer ports. If you are interested in participating register soon to be sure of securing a spot by visiting this link:
http://placeware.viewcentral.com/events/cust/single_event.asp?cid=UBIT&pid=2&cbClass=1

EXAM CONCERN: FIXED RATE FIRST MORTGAGE LOANS

Most Virginia state-chartered credit unions have experienced strong share growth in recent years (18.7% in Virginia as of June 30, 2003). However, a smaller portion of this share growth has been reinvested in loans (11.6% growth), and credit unions' liquidity has increased instead. Traditional credit union lending in the automobile market has become very competitive, with other lenders increasing their market share. With low interest rates, asset yields have fallen to their lowest level in years.

One area of loan growth, however, is in mortgage loans. With low interest rates there is a very active market for both new home purchase mortgages and refinances. In fact, credit unions nationwide now have nearly 26% of their assets in residential real estate loans. This ratio is now higher than the nationwide ratio for banks, which is about 22.5%. Currently for the credit union industry total first mortgages are about 160% of all industry net worth.

The regulatory concern is proper management of the inherent risk in making and holding fixed rate mortgage loans in the current interest rate market. Rising interest rates will have a dramatic effect on the returns in this highly concentrated mortgage portfolio. Examiners will be evaluating this area closely as part of the risk focused examination process. Further information on this subject can be found in NCUA's Letter to Credit Unions No. 03-CU-15 which can be linked at <http://www.ncua.gov/download/download.html#software>.

SEG AND MERGER ACTIVITY

During the second and third quarters of 2003 the Bureau approved nineteen SEGs for six credit unions. A total of 39,205 new potential credit union members were approved for these two quarters. This total is inflated by 30,000 public school students in Loudoun County and two other groups of 3,600 potential members or more. Since legislation to permit SEG expansion went into effect on July 1, 1999 there have been 244 SEGs approved for total new potential membership of 83,326. Not counting the three large groups just noted, the average group size has been about 191.

Two mergers occurred involving Virginia state-chartered credit unions. On April 3, 2003 Alexandria Postal CU merged into CommonwealthOne FCU. On May 23, 2003 D.I.R. Credit Union merged into Richmond FCU. The mergers in 2003 of three small credit unions with total assets of about \$6.6 million leaves 67 Virginia state chartered credit unions. While the number of state chartered credit unions continues to decline, total assets continue to increase and were nearly \$3.8 billion as of June 30, 2003.

There have been no community field of membership requests in over a year. There is an appeal to the Virginia Supreme Court by the Virginia Bankers Association of the State Corporation Commission's decision to affirm the Commissioner Face' approval of DuPont Community CU's expansion request. Briefs from both sides have been filed with the Supreme Court, which has not set a date yet to hear the case.



CARL S. GUSTAFSON
PRINCIPAL FINANCIAL INSTITUTIONS ANALYST

Many credit union people have gotten to know Carl Gustafson in recent years as they have asked him on the phone for answers to their many questions. Carl came to the Bureau in 1988 after working for the Virginia Department of Taxation for eight years. After examining credit unions for several years, Carl was brought into the office and promoted to his current title in 1996. He reviews and edits examination reports, checking them for accuracy, content, and quality. He also works on examiner development as he spends time with the field examiners helping them to understand how to do examinations differently and better. Carl also spends time helping credit unions to resolve problems they experience and monitoring their performance.

Carl is also the Credit Union Section’s resident accounting specialist. He earned his Certified Public Accountant license in 1994, and he keeps up with accounting circulars, rulings, and issues. The credit union examining staff respects Carl’s expertise in accounting and go to him for answers to accounting questions.

Using his professional credentials, including being a NASCUS Certified State Credit Union Examination Supervisor, Carl was assigned the responsibility of completing all the documentation in the self evaluation process as the Bureau earned accredited status from NASCUS in 2002.

Carl has an extensive and valuable knowledge of credit unions and credit union people. His regulatory approach is fair but “by the book.” He tries to look at the “big picture.” He is respected as a technician of his craft, but is also friendly and helpful with his fellow workers.

Currently, Carl extols the importance of having an active supervisory committee, or even an internal auditor in larger credit unions, to monitor internal controls. The Bureau has experienced a number of problems in this area in the past year or so with fraud found in a few credit unions.

Carl is a native Richmonder and went to college at Virginia Commonwealth University. He married in 2001, and he and his wife Beth Ann enjoy walking their two dogs, traveling, and hiking. Carl’s interest’s when he is not at work include church and working out at the YMCA. Carl is a true team player, well respected, and a valuable asset to the Bureau’s Credit Union Section.

“Important Numbers”



FAX
804-371-9416

George H. Latham, **Deputy Commissioner**..... 804-371-9698
Internet e-mail: glatham@scc.state.va.us

Jeanette J. Sanders, Principal Office Technician804-371-9267
Internet e-mail: jsanders@scc.state.va.us

Nicholas C. Kyrus, Deputy Commissioner804-371-9690
Corporate Structure and Research
Internet e-mail: nkyrus@scc.state.va.us

(applications or notices for mergers, relocations, name changes, and branch openings and closings)



CONTACT US AT OUR WEBSITE

[www.state.va.us/scc division/banking](http://www.state.va.us/scc%20division/banking)

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.

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
BUREAU OF FINANCIAL INSTITUTIONS
POST OFFICE BOX 640
RICHMOND VA 23218-0640

**IMPORTANT
INFORMATION
INSIDE**

