

THE CREDIT UNION REFLECTION



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PROCESS OF CLEARING DRAFTS CHANGED WITH ADVENT OF CHECK 21



In October 2003, Congress signed into law the Check Clearing for the 21st Century Act (Check 21) which became effective on October 28, 2004. The goal of this federal legislation is to improve the nation's check payment system and the way financial institutions process checks. Under Check 21, any financial institution in the clearing and payment system can truncate the original draft (i.e., convert the original draft into a photocopy). The institution may then transmit the information in the draft electronically or can forward an image, front and back, through the processing system. The paper copy of the image is known as a substitute check. Any institution in the processing chain may elect to convert an original paper check or draft into a substitute check, which then travels through the system like an original paper item.

Check 21 provides legal equivalence only for substitute checks. Check 21 facilitates check truncation and electronic/image exchanges but does not provide legal equivalence for electronic check or image presentment. Systems and clearing arrangements involving electronic check or image presentment still require agreement of the parties who accept the electronic form of the instrument for value. Check 21 encourages the use of electronics by empowering financial institutions to truncate original checks, process them electronically, and, where necessary, provide paper substitute checks.

What is a substitute check? A substitute check is a paper reproduction of the original check that contains an image of the front and back of the original check and is the legal equivalent of the original check. It bears the Check 21 required legal equivalence legend: “This is a legal copy of your check. You can use it the same way you would use the original check.”

Check 21 does not require that processors truncate, so it is possible that a customer (member) may receive an original cancelled share draft if requesting one. While Check 21 is not mandatory for processors, credit unions and members do not have the option of opting out. If any financial institution in the processing system decides to truncate a draft, all institutions down the line and affected members must accept the substitute check in place of the original draft. A financial institution creating the substitute check and all subsequent financial institutions that process the substitute check provide warranties and an indemnity to subsequent parties in the collection and return processes

Check 21 requires financial institutions to provide customers (members) with a disclosure that describes substitute checks and the rights consumers (members) have when they receive substitute checks. The disclosure must describe 1) how substitute checks are the legal equivalent of original checks and 2) Check 21 consumer expedited re-credit procedures.

Model disclosures are available on the Federal Reserve Board’s web site. These samples begin on page 70 of the document located at following link: <http://www.federalreserve.gov/boarddocs/press/bcreg/2004/20040726/attachment.pdf>

Credit unions are urged to educate their staff concerning the appearance of a substitute check, its legal equivalency to an original check, and the re-credit process. Additional information can be obtained from the following links: <http://www.federalreserve.gov>, <http://www.ffiec.gov>, <http://www.eccho.org>.

Should you have any questions about Check 21, please do not hesitate to contact the Bureau of Financial Institutions.



POP-UP PROGRAM READS KEYSTROKES, STEALS PASSWORDS

Recently it was discovered that security vulnerability identified in Microsoft Internet Explorer will allow the execution of a malicious program to be installed on a PC using a pop-up ad. The malicious program then records user keystrokes that could provide access to some 50 identified banking institutions. Even though a financial institution uses an encrypted web page there is no encryption that exists between a user’s keyboard and the secure web page. At this point account numbers, PIN numbers, and any other information a user types can be recorded and sent over the Internet without the user’s knowledge to a collection website. The technical details about this vulnerability can be found at http://news.zdnet.com/2100-1009_22-5251981.html

Microsoft has since released several patches that should address this security threat. Users should frequently check with <http://windowsupdate.microsoft.com> to determine if their PC has the latest security patches. These days running security updates is not enough to protect your computer. The use of a virus scanner, spyware/adware remover, and a good firewall is also essential. Furthermore, users will need to make sure these additional products are also updated on a weekly basis.

User awareness of potential security threats is also a good skill to acquire. There are many “free” programs on the Internet that come with additional baggage. Free screen savers, games, wallpaper, file sharing programs, greeting card

and graphic programs are notorious for containing spyware and adware. When a user installs these programs other programs are getting installed in the background without the user's knowledge. Some companies will disclose that these products will be installed but this information is often buried deep in legal disclaimers that users simply click through and agree to. But many companies do not provide any information about these hidden programs or provide any type of information on how to remove them. The user may also want to consider changing their web browser. With the weekly exploits that are found in Internet Explorer users may want to consider trying alternative web browsers. This would go a long way in the prevention of spyware/adware and protect them against security vulnerabilities in Internet Explorer.

--Thanks to Mark Pinson for this story

SEG ACTIVITY, FIELD OF MEMBERSHIP, AND MERGER ACTIVITY ALL ACCELERATE

After approving 16 Small Employee Groups (SEGs) in the first quarter of 2004 and only 2 SEGs the previous quarter, the Bureau approved 55 SEGs during the second and third quarters of 2004. The six credit unions requesting these groups added 12,210 new potential credit union members. The average size of the approved SEGs was 222 members. Three SEG requests were denied during the period. Since legislation to permit SEG expansion went into effect on July 1, 1999 there have been 317 SEGs approved for total new potential membership of 99,860.

Four state chartered credit union applications for merger have been approved in 2004, including two in the third quarter. Another state chartered credit union converted to a federal charter. And the Bureau has received another merger application which is being reviewed for approval. This loss in numbers in 2004 is the largest in at least ten years. Currently there are still 62 state chartered credit unions in Virginia. However, total assets continue to increase, and were nearly \$4 billion as of June 30, 2004.

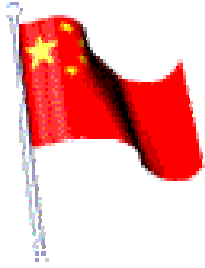
<u>Merged Credit Union</u>	<u>Merged Into/ Conversion Name*</u>	<u>Date</u>	<u>Assets</u>
Times-World ECU	Member One FCU	1-15-04	\$1.2 million
Southern States ECU	Partners Financial FCU*	3-11-04	\$27.5 million
Lynchburg General CU	V.B.H. ECU	3-23-04	\$1.7 million
Lynchburg Appalachian ECU	Beacon CU	8-02-04	\$400,000
Shenandoah County CU	DuPont Community CU	9-14-04	\$1.1 million

As seen in the chart above, the continuing trend is for small credit unions to merge into larger credit unions. These small credit unions encounter operational or managerial problems. Generally, their members benefit by receiving expanded and more convenient services after the merger.

Community field of membership activity has also increased after the Supreme Court of Virginia's January 2004 decision in the DuPont Community CU case. The request of Northern Star CU, Portsmouth, for an expansion of its community field of membership to include Chesapeake and Suffolk was approved, increasing its potential field of membership to about 370,000. Martinsville Dupont ECU's request to expand its community to include the West Piedmont Planning District (Cities of Danville and Martinsville and Counties of Franklin, Henry, Patrick and Pittsylvania) was also approved, increasing its potential membership to about 250,000. The request of Gwaltney CU, Smithfield, to change its field of membership from employees of the Gwaltney meatpacking plant to the community of Isle of Wight County was approved, increasing its potential membership to about 30,000. In addition, Newport News Shipbuilding ECU became the first credit union to

receive approval to include underserved areas in its field of membership, increasing its potential field of membership by about 456,000.

Since the end of the third quarter 2004 the Bureau has also approved two other requests. The University of Virginia Community CU, Charlottesville, expanded its community field of membership to include the Counties of Louisa, Madison, Nelson, and Orange and increase its potential field of membership to about 238,000. Tidewater Telephone ECU changed its field of membership from multiple sponsor groups to a community field of membership including Newport News, Hampton, Norfolk, Virginia Beach, Chesapeake, Portsmouth, and Suffolk with a potential field of membership of about 1.1 million. Another underserved area request was also received from The Richmond Postal CU to serve the City of Richmond and is being reviewed.



CHINESE OFFICIAL MEETS WITH COMMISSIONER FACE

The Vice Governor of the People's Government of Hunan Province, Mr. Xu Xian Ping, recently visited the Bureau of Financial Institutions. In a meeting with Commissioner Joe Face, Mr. Xu discussed financial institution regulation and supervision. Mr. Sixin Yang, who works for Chesterfield County, Virginia, served as interpreter.

Mr. Xu expressed appreciation to learn about the history and growth of the credit system in Virginia and the United States. He is spending some time this fall at Harvard University in Boston, Massachusetts, before returning to China after the first of the year to resume his responsibilities.

Over the years the Bureau has hosted a number of foreign dignitaries and officials who want to learn about the American banking and credit systems.



Above from left to right...Mr. Nick Kyrus, Mr. Xu, Commissioner Joe Face, and Locke Trigg

PUBLIC RECORDS AND THE STATE CORPORATION COMMISSION:

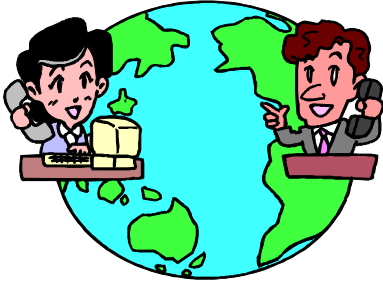


WHAT YOU NEED TO KNOW

The State Corporation Commission has voluntarily made it easier for the public to understand how to request and obtain public records from the Commission. Recently a “how to” guide was added to the Commission’s website http://www.state.va.us/scc/commission/pub_docs.htm.

The Code of Virginia provides that the records of the State Corporation Commission (Commission) are open to public examination to the same extent as the records and files of the courts of the Commonwealth. The Commission’s overall policy regarding public access to its records is to promote an increased awareness by all persons of the Commission’s activities.

Nevertheless, not all Commission documents are public documents. For instance, the Bureau of Financial Institutions maintains some documents that are exempted from public disclosure by law, regulation, rule, or policy. The Commission is unique because it was created by the Virginia Constitution as an independent state agency, so the Virginia Freedom of Information Act does not apply to it. However, the Commission strives to meet the spirit and intent of open access. The need for confidentiality is also preserved when necessary. When you need a document from the Commission, a review of “Obtaining Public Documents” on the Commission's website will expedite your request by avoiding potential procedural delays.



CONTACT US AT OUR WEBSITE

www.state.va.us/scc_division/banking

IMPORTANT COMMISSION TELEPHONE NUMBERS

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)

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

**IMPORTANT
INFORMATION
INSIDE**