

THE CREDIT UNION REFLECTION

Highlights

- ☛ Prompt Corrective Action (PCA)
- ☛ NHEMA vs Face

Inside

- ☛ Select Employee Group Update
- ☛ Bureau Reduces Conversion Fee

Implementation of Prompt Corrective Action (PCA)

NCUA and the State Corporation Commission will officially begin classifying credit unions based upon their net worth ratio (NWR) during the first quarter of 2001. The net worth ratio means the ratio of the net worth of the credit union to the total assets of the credit union. Net worth is defined under generally accepted accounting principles as Undivided Earnings, Regular Reserves, and any other appropriations designated by management or regulatory authorities. **Net worth does not include the Allowance for Loan Losses account.** The Bureau will base this classification on data credit unions reported on their December 2000 Call Report, reflecting activity for the fourth quarter of 2000. A PCA Net Worth Calculation Worksheet was developed and added to the Call Report in December 2000 to aid credit unions in measuring the NWR. While the PCA Worksheet will automatically calculate the credit union's NWR, the credit union may elect among three alternative methods of calculating total assets that involve averaging instead of the default denominator quarter-end total assets.

For credit unions exceeding \$50 million in assets, the Bureau will begin implementing the Risk Based Net Worth (RBNW) requirement for "complex" credit unions using data from the March 2001 Call Report that will reflect activity for the first quarter of 2001. For all other credit unions exceeding \$10 million in assets, the RBNW requirements first will be implemented using data from the June 2001 Call Report that will reflect activity for the second quarter of 2001.

To comply with PCA all credit unions need to understand Part 702 of the NCUA Rules and Regulations. Copies of Part 702 can be obtained from NCUA's Website at www.ncua.gov/ref/rules_and_regs/ncua_rules_regs.pdf. Credit unions should also obtain a copy of NCUA Letter to Credit Unions, Letter No. 01-CU-01, "Prompt Corrective Action (PCA) Implementation" for additional information.

Requirements of Section 6.1-225.58 of the Code of Virginia: The implementation of PCA does not change the current Regular Reserve funding requirements for Virginia state chartered credit unions. Part 702.1(d) of the NCUA Rules and Regulations and Section 1790d of The Federal Credit Union Act do not limit the authority of the Commonwealth of Virginia to take action in addition to (but not in derogation of) the PCA requirements. Therefore, Virginia state chartered credit unions will have to continue to make reserve transfers in compliance with Section 6.1-225.58 of the Code of Virginia. Note that this transfer amount may be larger than what federally insured credit unions may be required to make under PCA.

Differences in Accounting for the Transfer Requirements: The PCA criterion for reserving is different from what credit unions are currently doing. Credit unions will increase their Regular Reserves as noted above when their NWR falls below the "well capitalized" level of 7%. The PCA earnings retention requirement will have credit unions close income and expense accounts into net income, post net income (loss) into Undivided Earnings, and then make the reserve transfer. **However, the Post Closing Provision for Loan Losses Expense Adjusting Entry from Regular Reserves to Undivided Earnings will not be made to recover loan losses expensed during the period.** Since this entry was an NCUA requirement, and not a requirement of state law, state-chartered credit unions will no longer make this entry. Part 702.402 (d) (4) of the NCUA Rules and Regulations states that the maintenance of an Allowance For Loan Losses account shall not affect the requirement to transfer earnings to the credit union's Regular Reserves when required under PCA. A federally insured credit union that is not "well capitalized" must increase its net worth quarterly by at least 1/10th percent (0.1%) of its total assets for the current quarter, and must quarterly transfer that amount (or more by choice) from Undivided Earnings to its Regular Reserve account until it is "well capitalized."

The amount of the transfer to Regular Reserves may be larger than 1/10th percent of assets since Virginia state-chartered credit unions still have to comply with Section 6.1-225.58 as stated above. The Code of Virginia continues to require the funding of Regular Reserves by a percentage of gross income until the Regular Reserves equal 6.0% (7.5% for a credit union in operation less than four years or having assets less than \$500,000) of outstanding loans and risk assets. In the past, credit unions have been allowed to make the Post Closing PLL Expense Adjusting entry. **However, to avoid conflict with PCA, Virginia state chartered credit unions will discontinue making the Post Closing PLL Expense Adjusting Entry from Regular Reserve to Undivided Earnings for the PLL expense during the period.**

Any questions related to the implementation of PCA or the statutory reserve requirements under Section 6.1-225.58 of the Code of Virginia should be directed to the Bureau of Financial Institutions.

NHEMA vs. Face, Hancock & Early:

In our Summer 1999 issue of this newsletter, we reported a ruling in the case of NHEMA v. Face, Hancock, and Early. The United States District Court for the Eastern District of Virginia had entered a permanent injunction against Commissioner of Financial Institutions E. J. Face, Jr., Deputy Commissioner Susan Hancock, and the Attorney General of Virginia prohibiting them from enforcing the limitation in Virginia's prepayment penalty laws against licensed mortgage lenders that entered into so-called "alternative mortgage transactions" in compliance with regulations of the Office of Thrift Supervision. The trial court's ruling was based upon its view of the preemptive effect of a federal law known as the Alternative Mortgage Transaction Parity Act of 1982.

Commissioner Face, Deputy Commissioner Hancock,
and the Attorney

General appealed the case to the United States Court of Appeals for the Fourth Circuit. That Court heard oral argument in the case and has now affirmed the ruling of the District Court. Whether or not the appeal should be pursued is under consideration. In the meantime, the Bureau will continue to assure conformity with Virginia prepayment penalty laws in connection with non-alternative mortgage loan transactions.



SELECT EMPLOYEE GROUP UPDATE

During the fourth quarter of 2000 the Bureau approved 16 small employee groups (SEGs) to be added to the fields of membership of five credit unions. Seven other SEG expansion requests were filed but not yet approved at quarter end. All the requests were published in the Weekly Information Bulletin (<http://www.state.va.us/scc/division/banking/weekly.htm>) and

were subject to a 15 day comment period. No comments or objections were received on any of the requests.

A total of 3,671 new potential credit union members were approved during the quarter. The average group size for the fourth quarter was about 229, but adding the Parent Teachers Association to a public school credit union skewed the average. Not considering that group, the average size was about 78, which is about one-half the average of about 147 for the third quarter. Since legislation to permit SEG expansion went into effective July 1, 1999, 16,851 new potential credit union members have been approved for Virginia state-chartered credit unions.

In addition to these SEG filings, the Bureau also received a request from a multiple sponsor group credit union to convert to a community field of membership. After a revision of the request, this filing was still being reviewed at the end of the quarter. A community field of membership of the City of Portsmouth was approved for The Navy Yard Credit Union in the first quarter of 2001. This change is the first community field of membership approval under the new field of membership statute which become effective July 1, 1999.

BUREAU REDUCES CONVERSION FEE



Recently, on request of Commissioner Joe Face, the State Corporation Commission approved a reduction in the application fee for conversion of a national bank to a Virginia state bank. This is but another of many internal changes the Bureau has made since Face took office July 1, 1997. Methodically, the Bureau is transforming itself to keep pace with continuous changes in the financial services industry, and Commissioner Face still has other ideas in mind.

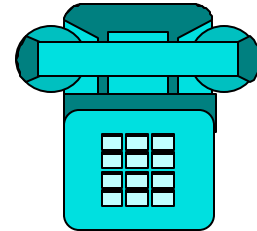
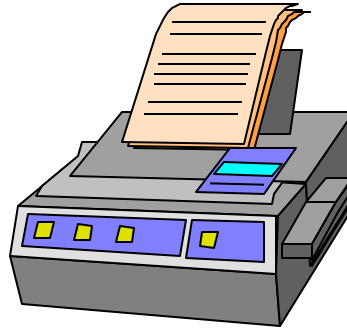
“I firmly believe in change. If you don’t change, you will be left behind.” Face is often reminded of the wisdom of Bobby Bowden, Florida State’s legendary head football coach who once said, “I’m not too proud to change. I like to win too much!” Face said he still has a number of things to do, all in the fullness of time, all designed to keep the state bank and credit union charter the charter of choice. The advantages of the state charter still remain – easier access to the primary regulator, greater response to requests, parity of banking and credit union statutes, efficiency of regulatory operations, and significantly lower assessments.

In the last few years, the Bureau has steered through a period of unprecedented industry consolidation and loss of banking assets. Despite those losses, the Bureau enjoyed an outstanding year in Fiscal 2000. Revenue was up 4.7%, expenditures were well contained advancing only 1.4%, staffing was reduced 8.3%, and the reserve boosted to a record level. Policies were set in place, processes were rigorously examined for efficiency improvements, and great strides were made in reliance upon technology to enhance timely and efficient operations. The Bureau is well positioned for the potential loss of another large bank provided it adheres to its cost containment plan.

Other accomplishments of note include the Virginia Bank Director’s College, the annual Banker CEO Meetings, reducing various application fees and streamlining applications, receiving Conference of State Bank Supervisors’ Accreditation, opposing federal fees on state-chartered banks, helped develop new streamlined, on-site examination software, and quarterly newsletters to regulated institutions.

“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

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www.state.va.us/scc/division/banking

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

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