Winter Volume 5.2 STATE CORPORATION COMMISSION
BUREAU OF FINANCIAL INSTITUTIONS

Quarterly Newsletter

THE CREDIT UNION REFLECTION

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BUREAU'S CREDIT UNION SECTION RECEIVES NASCUS ACCREDITATION

The Bureau recently received notification from the National Association of State Credit Union Supervisors that Virginia has earned accreditation as a State Credit Union Supervisory Agency. An award ceremony will be scheduled early in February 2003, and further recognition will be received at the annual NCUA/NASCUS Regulators Conference to be held March 9-11, 2003 in Savannah, Georgia. Virginia is the 27th state to be accredited by NASCUS.

NASCUS's accreditation program applies national standards of performance to a state's regulatory program. There are considerable benefits of accreditation for state agencies. A state's self-analysis of the functional areas required for accreditation can lead to a self-improvement of the agency. Accreditation is credible evidence to the agency's capabilities. Accreditation benefits state-chartered credit unions as well. An accredited state agency represents more effective and efficient examinations. Accreditation means that the state regulator has taken the initiative to improve its level of regulatory proficiency by meeting the high standards established in the program. NASCUS-accredited states supervise over 76 percent of the total assets of all state-chartered credit unions.

To earn accreditation the Bureau completed a comprehensive Self Evaluation Report for Accreditation (SERA). Supporting documentation was developed as well. This effort of several months was then analyzed for accuracy and for compliance with standards by an on-site review team composed of peer state regulators. Their report and recommendation of approval was then submitted to the NASCUS Performance Standards Committee (PSC). The PSC then recommended to the NASCUS board approval for accreditation. The accreditation is valid for five years subject to approval of annual updates.

"NASCUS accreditation is a noteworthy designation, and establishes Virginia's Bureau of Financial Institutions at a higher level among recognized peers. It is also a well-deserved tribute to the good work of our professional staff," said Deputy Commissioner George Latham. "Principal Review Analyst Carl Gustafson is to be especially commended for putting the SERA together and coordinating the application process."

"This is something we should have done years ago. As a member of a number of review teams over the years, I saw what other agencies looked like, and I delayed the application process while I tried to correct perceived deficiencies. Then I realized no one is perfect, but the high standards of NASCUS accreditation are achievable and consequential. The Bureau is pleased and privileged to have earned this designation from NASCUS."

RISK BASED EXAMINATIONS REQUIRE NEW METHODS OF ESTIMATING ALLOWANCE

In the Summer issue of "The Credit Union Reflection" it was announced that the Bureau would be changing the way it performs examinations. The new "risk focused" examination analyzes management more closely and evaluates how management addresses potential risks associated with the credit union.

Until risk based examinations began the Allowance for Loan and Lease Losses (ALLL) account was evaluated by examiners and credit union managers using a combination of a historical loss ratio and an individual classification of delinquent loans. The ALLL is an estimate of credit losses inherent in the credit union's loan portfolio. Federally insured state chartered credit unions are required by their insurance agreement with the National Credit Union Share Insurance Fund to establish and maintain an ALLL account to meet regulatory requirements of full and fair disclosure.

Under the new risk based examination procedures the Bureau plans to change from the historical ratio/individual classification method to a "pooling" method to determine the adequacy of the ALLL account. The Bureau's examination approach will provide sufficient flexibility to permit credit unions to chose whether to pool their loan portfolio, or to utilize individual loan classifications, or to use some combination of these approaches, provided the overall approach taken is reasonable. The Bureau will not require credit unions to pool their loan portfolios if credit unions can demonstrate that other methodologies are more appropriate. Since estimating the amount in the ALLL account is a highly subjective matter, factors such as credit union size, loan portfolio characteristics, management expertise, business environment, loan policies and administration, and data processing systems will be reviewed by the examiner to determine reasonableness.

Guidance for funding the ALLL may be found in the Financial Accounting Standard Board (FASB) Statement No. 5, Accounting for Contingencies, and the FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan. The provisions of Statement 5 and Statement 114 provide sufficient flexibility to permit differences in interpretation of these pronouncements. Credit union management should be familiar with these FASB statements, and should adopt appropriate methodologies and provide documentation to maintain an adequate ALLL.

Credit unions may also use as a resource NCUA's Interpretive Ruling and Policy Statement (IRPS) No. 02-3 (http://www.ncua.gov/ref/IRPS/IRPS02-3.html). This IRPS provides guidance on the ALLL methodologies and supporting documentation practices for federally insured credit unions. The IRPS recognizes that credit unions should adopt methodologies and documentation practices that are appropriate for their size and complexity. The IRPS does not change existing accounting GAAP guidance or modify documentation requirements. The IRPS supplements--not replaces--current guidance. The IRPS also does not address or change current guidance regarding loan charge-offs.

The examiner will review management's methodology in arriving at the ALLL balance and he/she will verify the adequacy of the ALLL account. Written policies and procedures will be reviewed as well to determine if the ALLL process is communicated properly to all applicable personnel. The examiner will also determine if the board of directors has assured that the policies specifically address the credit union's unique goals, systems, risk profile, personnel, and other resources before approving them. The examiner will determine if the Provision for Loan Loss expense and the ALLL posting have been properly reviewed and approved by the board of directors. To ensure the methodology remains appropriate for the credit union, the board should have the methodology periodically validated and appropriately revised, and the examiner will also look to see if this process has been done.

Those credit unions that are not currently following GAAP will need to adopt methodologies and documentation practices that conform to GAAP and are appropriately tailored to the size and complexity of the credit union and its loan portfolio. Further, the supervisory committee should oversee and monitor the internal controls over properly estimating the ALLL balance.

COMMISSIONER FACE ELECTED CHAIR OF STATE FINANCIAL REGULATORS ROUNDTABLE (SFRR)

At its December 9, 2002 meeting, Virginia Commissioner of Financial Institutions E. J. Face, Jr. was elected Chairman of the State Financial Regulators Roundtable (SFRR) for 2003. SFRR was started to provide a forum for communication, coordination, and cooperation among state regulatory associations in the promotion of effective state regulatory oversight of financial service providers. Mr. Face represents the Conference of State Bank Supervisors (CSBS) on the Roundtable.

Members include CSBS, the National Association of State Credit Union Supervisors (NASCUS), the American Association of Residential Mortgage Regulators (AARMR), the American Council of State Savings Supervisors (ACSSS), the Money Transmitter Regulators Association (MTRA), the National Association of Consumer Credit Administrators (NACCA), the National Association of Insurance Commissioners (NAIC), and the North American Securities Administrators Association (NASAA).

The roundtable meets quarterly and discusses a variety of issues. Most recently SFRR focused on 1) pending/recent federal agency rulemakings that impact SFRR members, and 2) recent "attacks" on the state financial regulatory system, including H.R. 5621, the GAO Study of the NCUA, and Congressman Richard Baker's preemption effort of state securities authority. The next SFRR meeting is scheduled in Savannah, Georgia, on March 7, 2003. Expected issues to be discussed include AARMR's national license/registration program, the OCC's preemption and proposed nationwide predatory lending rule, and an update on state banking agencies' efforts to ensure compliance with Patriot Act rules.

SEG ACTIVITY REBOUNDS IN FOURTH QUARTER

After only one SEG approval during the third quarter of 2002, the Bureau approved eleven SEGs for four credit unions during the fourth quarter of 2002. A total of 3,738 new potential credit union members were approved for the quarter. Since legislation to permit SEG expansion went into effect on July 1, 1999 there have been 211 SEGs approved for total new potential membership of 42,188. The average group size has been about 199. In 3 ½ years there has been only one SEG request submitted that was not approved. In that case additional information requested was never submitted.

Among the eleven approvals in the fourth quarter were two that, because of the size of the group, were published in the Bureau's Weekly Information Bulletin and thus subjected to a 15 day comment period. The other nine requests were processed on average within 3 business days, except for three requests that were delayed due to Christmas holidays and vacations.

All filings on the appeal of the Commissioner's approval of DuPont Community Credit Union's community field of membership expansion were received by November 15, 2002 as required. The Commission is reviewing these briefs. It is not anticipated that a hearing will be set since none of the parties requested one. The Commission is therefore expected to make its decision based on the briefs alone.

There were no mergers involving Virginia state-chartered credit unions in the fourth quarter. The Bureau is currently working with credit unions that may result in three mergers. There were no community field of membership expansion requests during the quarter.

BUREAU OF FINANCIAL INSTITUTIONS OPERATIONS ARE SUCCESSFUL FOR 2002 FISCAL YEAR

With the merger of Crestar into Suntrust Banks in 2000, the Bureau lost about 20% of its annual revenue. Commissioner E. J. Face, Jr. initiated a cost containment program at that time in an effort to help make up the difference by reducing expenses. The Bureau has since been able to operate at better than break even, and has been able to make some mandated transfers into the Commonwealth's General Fund.

For Fiscal 2002, which ended June 30, 2002, the Bureau had revenues of $10.3 million and expenses of $9.4 million. Net revenue was about $880,000. Revenues increased nearly 12% from Fiscal Year 2001, primarily because of asset growth in banks and credit unions, along with increased application fees for new licenses and structural changes. The mortgage licensee assessment grew substantially as well because of the low interest rate environment. Expenses, on the other hand, grew only 7.3%. The number of full time employees dropped by attrition over 10% since the Crestar merger. Since the costs associated with employees and their travel are nearly 70% of the Bureau's expenses, savings were realized. Other cost containment measures that were developed also proved to be successful.

The Bureau 's goal is to maintain a reserve equal to approximately 75% of annual expenses. This target was met as of the end of Fiscal 2002. The reserve level is deemed prudent given the Bureau's heavy reliance upon a small number of large banks for funding in a market environment of rapid industry consolidation. The Bureau plans to use some of the reserve fund for technical and support projects that will improve operations.

The Bureau endeavors to manage its revenues and expenses in a responsible and efficient manner. Just as the Bureau requires good fiscal management of the financial institutions it regulates, it expects no less of itself. In the past 18 years, the Bureau has reduced assessment fees for various industry groups 35 times yielding industry savings exceeding $10.1 million. The Bureau will continue to strive to be a good steward of the money regulated institutions pay to it in assessments and application fees.

"Important Numbers"

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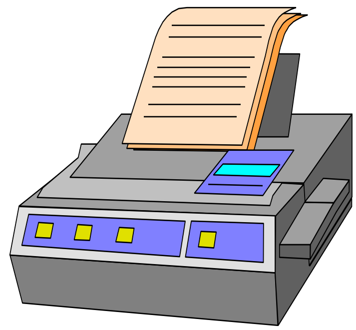

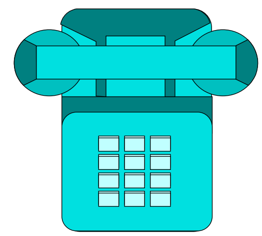

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(applications or notices for mergers, relocations, name changes, and branch openings and closings)

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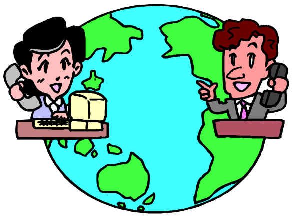

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