



VIRGINIA STATE BANKER

Regulatory News for Virginia State-chartered Banks
State Corporation Commission - Bureau of Financial Institutions
Commissioner E.J. Face, Jr.
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IN THIS ISSUE:

General Assembly-1998.....	1
Federal Fees on State Banks....	2
Va. Banks' Capital Ratios.....	2
Mr. Bailey Commended.....	3
Legal lending limit.....	4
EFT Notice Requirements.....	4
Call Report Revisions.....	5
Y2K (mis)information.....	6
Performance Reports.....	7
Commissioner's Corner.....	8

The Virginia State Banker is published quarterly by the Virginia Bureau of Financial Institutions to provide useful information to the banks and savings institutions that it regulates, and any of their related interests. Reader comments and suggestions are strongly encouraged and should be addressed to:

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OVERVIEW OF THE 1998 GENERAL ASSEMBLY SESSION

This year the Bureau of Financial Institutions requested a moderate legislative package with eight bills affecting banks, credit unions, mortgage companies, money transmitters, and small loan companies.

The Bureau was asked to comment on some fifty other bills which directly or indirectly affected financial institutions or the Bureau, including bills involving for-profit cemeteries, subordinate mortgage loans, credit insurance, pawnbrokers, deeds of trust, joint accounts - rights of survivorship, broker's liens, escrow funds, real estate settlement services, possessing or carrying dangerous weapons in banks, perpetual care trust funds, pre-need burial contracts, qualified equity and subordinated debt investments, tax credits, recovery costs and fees for bad checks, electronic filing of information, digital signatures, money laundering, computer invasion of privacy, payment of wages and salaries by electronic automated funds transfers, controlled insurance subsidiaries, private mortgage insurance, funds from telephone services or credit cards, and rehabilitation tax credits, among other things.



**GENERAL ASSEMBLY COMMENDS
FORMER COMMISSIONER BAILEY
FOR HIS PUBLIC SERVICE**
(see page 3)

Each of the Bureau's eight requested bills was passed by both bodies of the General Assembly and awaits the signature of the Governor. Once signed, the bills will become law effective July 1, 1998. A summary of the Bureau's legislative package follows:

1. SB87 - Amend Code §6.1-13, removes the requirement of establishing a separate capital account labeled "reserve for operation" before a bank receives a certificate of authority from the SCC. **Patron – Colgan**
2. SB88 - Amend Code §§6.1-94, 6.1-194.85, and 6.1-194.149, permits SCC to reduce by order or(Continued on Page 5)

FEDERAL FEES ON STATE-CHARTERED BANKS



In February, Commissioner Face wrote to Virginia's Senators and Congressmen expressing strong opposition to an item in President Clinton's FY1999 budget proposal that would impose new federal fees on state-chartered banks and bank holding companies. It appears that the letter helped contribute to a successful lobbying effort since the item has now been removed from the Administration's FY1999 budget.

The Administration had proposed that state-chartered banks and all bank holding companies pay a federally imposed tax for examination costs. Commissioner Face noted that imposing additional direct federal fees on state institutions would not increase safety and soundness. No additional examinations would occur, only additional costs. He also noted that state bank examination fees are generally much lower than those charged by the OCC. In fact, the examination fees of national banks charged by the OCC have remained 50% higher than Virginia state bank examination fees.

Finally, Commissioner Face wrote that the proposed fee could have a negative effect on credit availability and economic growth. The nearly \$900 million in new taxes would not come out of thin air; they would come from the banks, their stockholders, and their customers, potentially decreasing the amount of bank capital available to leverage additional lending to small businesses and consumers. Contrary to the Administration's and Congress' efforts, this would neither encourage continued economic growth nor help create new jobs.

Enactment of this proposed fee would undermine the dual banking system by undercutting the value of a state charter, without any policy justification. Costs to financial institutions and their customers would rise, product innovation could be lost, and consumers would lose the benefits of our competitive dual banking system.

SCC Judges Miller, Morrison, and Moore endorsed Commissioner Face's comments in a separate letter to Virginia's Senators and Congressmen and agreed that the proposed budget language raised "serious implications" for the dual banking system. The SCC urged Congress to protect against passage of this item.

COMMISSIONER FACE'S SPEAKING SCHEDULE

April 21, 23, 27-29 - VBA/BFI Community & Savings Bank CEO Briefing & Roundtable - various sites

May 7 - VBA Legal Seminar - Charlottesville, VA

May 15 - Virginia Association of Community Bankers Annual Convention - Landsdowne Resort, VA

May 19 - Kiwanis Club Luncheon - Petersburg, VA

VIRGINIA STATE BANKS STRENGTHEN CAPITAL RATIOS

In 1997, Virginia state-chartered banks strengthened their capital position according to consolidated data compiled by the Bureau of Financial Institutions. This was mainly the result of higher profitability.

Total equity capital as a percentage of average assets increased from 8.06% at the end of 1996 to 8.45% at the end of 1997. In 1997, net income as a percentage of average assets increased to 1.60% from 1.38% in 1996. At the end of 1997, there were 122 state-chartered banks in Virginia with \$4.6 billion in equity and \$54.5 billion in assets. Net income amounted to \$833,349,000 in 1997 compared to \$761,400,000 in 1996.



An analysis of operating results of Virginia state-chartered banks shows higher profits to be mainly the result of rising non-interest income and a decrease in total salaries. Non-interest income increased to 3.09% of average assets in 1997 from 2.67% in 1996. Salaries and employee benefits as a percentage of average assets declined to 1.37% in 1997 from 1.54% in 1996. Profitability increased despite a decline of net interest income from 4.45% in 1996 to 4.22% in 1997.

PLEASE NOTE!!!!

APPLICATION FORMS FOR VARIOUS CERTIFICATES OF AUTHORITY CAN NOW BE DOWNLOADED FROM THE INTERNET-----CHECK OUR HOME PAGE AT: WWW.STATE.VA.US/SCC

**FORMER COMMISSIONER OF THE BUREAU OF FINANCIAL
INSTITUTIONS SIDNEY A. BAILEY IS COMMENDED FOR HIS SERVICE TO
THE COMMONWEALTH BY THE 1998 GENERAL ASSEMBLY**



Sidney A. Bailey
Commissioner of Financial Institutions
1977 to 1997

The Following is a copy of SENATE JOINT RESOLUTION NO. 150 Commending Sidney A. Bailey, which was agreed to by the Senate on January 29, 1998 and by the House of Delegates on February 6, 1998:

WHEREAS, Sidney A. Bailey, the head of Virginia's Bureau of Financial Institutions, retired following 20 years at the helm of the agency that oversees the operation of the Commonwealth's banks; and

WHEREAS, Sidney Bailey joined the Bureau of Financial Institutions after a 19-year career with the federal Office of the Comptroller of the Currency, a unit of the Treasury Department that regulates banks with national charters; and

WHEREAS, clearly well qualified, Sidney Bailey has rendered distinguished service to the Commonwealth for two decades, during which banking institutions were severely buffeted by the savings and loan crises of the 1980s; and

WHEREAS, Sidney Bailey's greatest challenge during his tenure was dealing with the impact of the collapse of the thrift system and with the public confusion over the differences between commercial banks and savings and loan institutions; and

WHEREAS, that Virginia escaped relatively unscathed from a national crisis is due in part to the skills and dedication of Sidney Bailey, who coped with the impending crisis with calm professionalism; and

WHEREAS, throughout a distinguished 40-year career in the arcane world of banking regulation, Sidney Bailey has served with great competence the citizens of the Commonwealth and the nation; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the General Assembly commend Sidney A. Bailey on the completion of an exemplary career of public service; and, be it

RESOLVED FURTHER, That the Clerk of the Senate prepare a copy of this resolution for presentation to Sidney A. Bailey as an expression of the General Assembly's gratitude for his years of service to the Commonwealth.



THE LEGAL LENDING LIMIT

The Bureau regularly fields calls regarding Virginia Code Section 6.1-61, Limitations on Obligations of Borrowers. The state bank lending limit is slightly more restrictive than the national bank lending limit at the current time. This is due to the inclusion of only bank stock and surplus, and undivided profits as of the last call report date. Undivided profits is adjusted (up or down) to remove the FASB Statement No. 115 amount for available-for-sale securities (Call Report Schedule RC-Balance Sheet, Line 26.b.). The state lending limit is then calculated by taking 15% of this adjusted capital amount. We will refer you to the Comptroller of the Currency for an exact definition and calculation of the federal lending limit. To put it simply, the federal limit is most often higher because it includes (we think incorrectly) the reserve for loan losses as part of capital.

Another frequent question arises regarding aggregating debts and including debt endorsed or guaranteed. This was the subject of Administrative Ruling #0207 issued November 1, 1978. Basically, the Bureau's position is that endorsed and guaranteed debt is not aggregated with a borrower's other debt unless the borrower receives proceeds of the endorsed or guaranteed debt directly or indirectly. That pretty much cleared it up for you, right? Well, maybe except for the "indirectly" part. What is considered indirect receipt of proceeds?

One particular indirect receipt of proceeds has been identified. This occurs when there is an underwriting necessity, for credit quality purposes, for an endorsement or guarantee. That is, a borrower would not qualify for a loan without the endorsement or guarantee. Therefore, our endorser or guarantor receives the indirect benefit of funds (proceeds) extended to the entity or person for which they provided the endorsement or guarantee. Indirect receipt of proceeds does not include situations in which an endorsement or guarantee is obtained out of an abundance of caution or to meet loan policy guidelines dictating that business owners or officers must endorse or guarantee business debt.

How will examiners determine whether an endorsement or guarantee is needed? If there is a question at the time the loan is made, examiners will usually err on the side of the endorsement or guarantee being needed; therefore, the debt will be aggregated with the endorser's or guarantor's other debt. Examiners will be looking for intent, so the file should be documented with a memorandum of the reasons for an endorsement or guarantee and the financial numbers to back up the position. Examiners will also be looking for sufficient, stable cashflow to service the debt and available assets or collateral as a secondary repayment source. Strength in these areas will generally make it obvious that endorsers or guarantors were obtained out of an abundance of caution.

Finally, if you have any questions regarding the state legal lending limit, please feel free to contact Financial Analysts Jay Russell and Charles Dickerson or Deputy Commissioner John Crockett. We will also provide a written response regarding legal lending limit questions when requests are submitted in writing.

EFT NOTICE REQUIREMENTS

Effective July 1, 1997, the application/notice requirements for Electronic Funds Transfer (EFT) facilities have been modified. (See § 6.1-39.4:1 of the Virginia Code.)

Banks are no longer required to apply to or notify the Bureau for establishment of off-premises EFT facilities which do not receive or record deposits or disburse loan proceeds. On-premises EFT facilities (Automated Teller Machines) are also exempt from the notice requirements. However, the Virginia Code requires 25-days notice prior to the establishment of an off-premises EFT facility which will receive or record deposits or disburse loan funds. EFT notice forms as well as other application forms may be downloaded from our internet site or obtained by calling us at (804) 371-9690.

DID YOU KNOW??

Commissioner Face has been asked to represent state bank commissioners and the Conference of State Bank Supervisors on the Federal Financial Institutions Examination Council's Information Sharing Task Force which was established to develop policies and procedures that will facilitate data sharing among the federal regulatory agencies.

1998 GENERAL ASSEMBLY

(Continued from page 1)

by regulation the fees charged to banks, savings institutions, and savings banks for investigating various applications. **Patron - Colgan**

3. SB95 - Amend Code §6.1-416.1, makes technical and clarifying amendment with respect to control and acquisition threshold of 25% or more of a licensed mortgage lender or broker. **Patron - Y. Miller**

4. SB112 - Amend Code §6.1-225.6, authorizes credit unions to electronically file annual reports with the SCC. **Patron - Holland**

5. SB243 - Amend Code §§6.1-398 and 6.1-399, and to repeal §§6.1-400, 6.1-402, 6.1-405, and 6.1-407, provides that acquisitions of Virginia banks by out-of-state bank holding companies are subject to the same application review process as acquisitions of Virginia banks by other entities. **Patron - Watkins**

6. HB443 - Amend Code §6.1-249, to limit the applicability of the licensing requirements of the Consumer Finance Act to loans made to individuals for personal, family, household, or other non-business purposes. **Patron - Keating**

7. HB444 - Amend Code §6.1-370, to require persons seeking to acquire 25% or more of a money order/money transmitter licensee to first file an application with and obtain permission from the SCC. **Patron - Keating**

8. HB599 - Add Code §6.1-225.61:1, allows the Bureau to examine out-of-state credit unions conducting business in Virginia and to enter into cooperative agreements with other credit union supervisors and federal agencies having concurrent jurisdiction. **Patron - Morgan**

Questions about any legislation affecting financial institutions or the Bureau can be directed to Senior SCC Counsel William F. Schutt (804-371-9671) or Commissioner Face.

CALL REPORT REVISIONS

BFI examiners and analysts breathed a sigh of relief when the Federal Financial Institutions Examination Council (FFIEC) issued a single set of call report instructions applicable to all banks in the fall of 1997. Prior to this time, four books existed, commonly known by their numeric names 031, 032, 033, and 034. Each book included instructions on preparing the call report for a bank of a defined asset size or a particular structure. When the instructions were changed, examiners were required to update each of the four books. Although a bank was only required to maintain a single set of call report instructions, bank personnel still had the responsibility of updating the instructions.

So when the FFIEC announced its intention to issue call report changes once per year, we concurred. Although the call reports are a necessary regulatory monitoring tool, preparation time is significant, and less frequent changes should help to reduce the reporting burden.

The 1998 revisions have been released and, subject to Office of Management and Budget approval, will be effective with the March 31 report. We have reviewed the revisions, and of the announced changes, only two appear to apply to a large number of institutions.

Allowance for Credit Losses

The American Institute of Certified Public Accountants' *Audit and Accounting Guide for Banks and Savings Institutions*, issued as of April 1, 1996, requires the allocation on the balance sheet of the allowance for credit losses between on-balance sheet financial instruments and off-balance sheet credit exposures.

During 1997, the FFIEC advised banks to allocate the allowance for credit losses on Schedule RC -- Balance Sheet consistent with their allocation methodology for other financial reporting purposes. Portions of the allowance related to off-balance sheet credit exposures that are reported as liabilities are to be included in item 20 of Schedule RC--Other Liabilities, and in item 4 of Schedule RC-G -- Other Liabilities. Banks also were advised to aggregate these components of the allowance for credit losses when completing Schedule RI-B, part II -- Changes in Allowance for Loan and Lease Losses. Institutions have been encouraged to disclose the amounts of these components in item 9 of Schedule RI-E--Other Explanations.

The FFIEC is retaining this method of reporting the allowance for credit losses. Schedule RI-B, part II, will be retitled Changes in Allowance for Credit Losses, and item 4.a of Schedule RI -- Income Statement will be recaptioned "Provision for credit losses." However, Schedule RI-B, part I -- Charge-offs and Recoveries on Loans and Leases will not be changed. In part I, banks will continue to disclose only their loan and lease charge-offs and recoveries. (Continued on Page 7)

“... shift your money into a national bank.”

Bet we got your attention with this statement. The statement certainly caught our attention. A February 1998 *Money* magazine article entitled *The Year 2000 Bug* gives this advice to certain bank customers. This portion of the article begins by hypothesizing that Federal Reserve contingency plans to assist banks that may be “crippled” by computer problems in January 2000 is an acknowledgment by banking regulators that eliminating all Year 2000 bugs at financial institutions is unlikely. We know plans by the central banker are prudent in that it is quite likely some, hopefully few, institutions will face significant problems, and that Federal Reserve intervention may be necessary to support individual institutions or to stem systemic problems. The article continues by quoting federal agency statistics regarding the number of community banks (9% doing nothing or are only beginning to develop plans) and credit unions (criticized by the GAO for “dragging their feet”) unprepared for Year 2000.

The article advises bank customers to find out whether “your bank” will be ready for Year 2000 by the end of this year; and, if you can’t get this assurance by the end of 1998, “shift your money into a national bank.” Then, the article states, without any support, that a national bank “...is more likely to have completed Y2K fixes” and the “Fed is prone to give it [a national bank] top priority for bailouts if problems do occur.”

Every significant issue in banking produces some information, and usually some misinformation as well. Clearly, this section of the article was filled with misinformation. The Bureau, as are our regulatory partners, is devoting additional resources to ensuring Year 2000 is being addressed in a timely manner at all Virginia-chartered financial institutions. We discuss these efforts in the adjacent column on this page.

Since the misinformation is already out there, the *Money* magazine article suggests the time to begin communication with bank customers regarding Year 2000 is now. We don’t know how many thousands or millions read *Money*, but we know that many Americans heed its advice. Training bank personnel in responding to customers concerns may be as important as ensuring your backroom will be up to par when the millennium arrives. Statement stuffers about Year 2000, or information on your website, if your institution has one, might go a long way in erasing any concerns your customers may have.

EDITOR’S NOTE: *Commissioner Face wrote a letter to Money Magazine expressing his concerns about the article. Apparently due to some of the negative responses to the article, the magazine issued a retraction in its April 1998 issue.*

UPDATE: Year 2000

A third interagency statement addressing Year 2000 concerns has been issued /1. Dated December 22, 1997, *Safety and Soundness Guidelines Concerning the Year 2000 Business Risk* was issued to:

- Ensure institutions are focusing on enterprise-wide Year 2000 risk, rather than concentrating solely on information systems. These include risks due to system interdependencies, and those posed by vendors, business partners, counterparties, and loan customers.
- Further define the responsibilities of the board and senior management. Quarterly reporting to the board by senior management is mandated, and must include information on internal Year 2000 efforts and the ability of major vendors to provide Year 2000 compliant products and services.
- Clarify the guidance that suggested financial institutions seek certification from their vendors that their products and services are Year 2000 compliant. Formal certification is not required as it alone is not sufficient to ensure a product or service would operate properly in the institution’s unique environment. Institutions are expected to implement their own internal testing or verification processes with the compliant product or service. Contingency plans should be developed for all vendors servicing mission-critical applications. Also, a trigger date should be set for implementing alternative solutions should the vendor not complete its conversion efforts on time.

1/ The previous statements were from the *Interagency Statement on the Effect of Year 2000 on Computer Systems* dated July 3, 1996 and *Year 2000 Project Management Awareness* dated May 5, 1997.

Year 2000 reviews will be conducted during all examinations. Institutions may also be contacted or visited regarding Year 2000 by BFI examiners and analysts, or by representatives of the other regulatory agencies. Onsite Year 2000 reviews will focus on the following.

- The level of awareness senior management and the board of directors have of Year 2000 issues.
- The individual(s) assigned responsibility for Year 2000 project....(Continued on next page)

(Continued from previous page)...management efforts, and the amount of time devoted to Year 2000 efforts.

- Whether the institution has a formal Year 2000 plan and the date of approval by the board.
- Projected dates set for Year 2000 remediation, validation, and implementation of mission-critical systems.
- The bank's progress in implementing its plan.
- The timeliness and adequacy of status reports provided to the board.
- Problems anticipated by management in becoming Year 2000 compliant.
- Efforts to monitor the progress of data servicers, software vendors, and service providers in becoming Year 2000 compliant.
- Exceptions or weaknesses with the bank's Year 2000 program and management's response detailing commitments for corrective action.
- The extent to which management has considered the impact of the Year 2000 problem on credit risk, loan review, and the adequacy of the allowance for loan and lease losses.
- The examiner's assessment of reasonableness of the Year 2000 plan, and the bank's ability to meet its goals for Year 2000 compliance.

Please contact our office for copies of any of the interagency statements or for guidance in your Year 2000 remediation efforts.

PERFORMANCE REPORTS

Usefulness of the Uniform Bank Performance Report (UBPR) and Bank Holding Company Performance Report (BHCPR) After Business Combination Transactions

Calculations based on averages in the UBPR and BHCPR are not accurate if a combining or acquisition transaction occurred during the year. Each quarter's call report or consolidated financial report covers a discrete period. Restatement of a prior quarter's data is only permissible to correct an error. When a bank combines with another bank, or a holding company acquires a subsidiary, the amounts of the combining entities are simply summed on the first regulatory report following the combination. The average assets figure is not recalculated, thus a lower average assets number becomes the basis for calculations. Unless the combination occurred during the first quarter, ratios based on averages are inaccurate for the remainder of the year. Many income analysis ratios are based upon average assets. It is important to know the dates and types of combinations to assess the usefulness of UBPR and BHCPR financial information. A notation appears on page 1 of the UBPR if a combining or acquisition transaction has occurred during any period presented.



CALL REPORT REVISIONS (Continued from Page 5)

Categorization of Industrial Development Bonds (IDBs) on the Balance Sheet

The call report instructions currently require all IDBs that are rated by a nationally recognized rating service to be reported as securities in item 3.c of Schedule RC-B -- Securities. The instructions also state that nonrated IDBs meeting the definition of a "security" in Financial Accounting Standards Board (FASB) Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities," must be measured in accordance with Statement No. 115. Unless a bank chooses to review the characteristics of each nonrated IDB it holds, the bank must report its nonrated IDBs as loans in Schedule RC-C -- Loans and Lease Financing Receivables. If a bank decides to review each nonrated IDB, those with more of the characteristics of a security are to be reported in Schedule RC-B while those with more of the characteristics of a loan are to be reported in Schedule RC-C.

In order to achieve greater consistency between a bank's Call Reports and its other public financial statements and to reduce the reporting burden, the call report instructions governing the treatment of IDBs will be revised. As revised, the instructions will indicate that IDBs (both rated and nonrated) should be reported as securities in Schedule RC-B or as loans in Schedule RC-C, consistent with the manner in which the bank reports IDBs on the balance sheet for other financial reporting purposes. All IDBs that meet the definition of a "security" in FASB Statement No. 115 must continue to be measured in accordance with Statement No. 115.

For the full text of the 1998 call report revisions, see FDIC Financial Institutions Letter 8-98 dated January 20, 1998. Contact Carol Foster in our office at 371-9704 for a copy, or print from the FDIC internet website at <http://www.fdic.gov/banknews/fils/1998/fi19808.html>

E. J. Face, Jr.



“THE LIBERTY BILL”

Earlier this year, I was contacted by an eighth-grade teacher from Liberty Middle School in Hanover County asking for help and advice about changing the back of the one dollar bill. The teacher, Randy Wright, said his “Citizenship Class” had been studying the United States Constitution and learned that most Americans could not recite their rights under the Constitution. The students came up with the idea of putting the Constitution on the back of the one dollar bill to help Americans remember their liberties and rights.

The students had already contacted U.S. Congressman Tom Bliley and State Delegate Frank Hargrove and invited them to a breakfast meeting to introduce their plan. Both Congressman Bliley and Delegate Hargrove were so impressed they both agreed to support the idea. Congressman Bliley agreed to sponsor a bill in Congress, and Delegate Hargrove patroned a House of Delegates Resolution in support of the idea. Congressman Bliley stated, “I have visited a lot of schools, but this is the best presentation I have ever witnessed by secondary schools.” Delegate Hargrove said, “This is probably the finest presentation that I have been privileged to be a part of.”

I agreed to make several telephone calls in support of the proposal and arranged a meeting between the students and Al Broaddus, President of the Federal Reserve Bank of Richmond. The students gave a moving and inspiring presentation to Al Broaddus and me, and we both agreed to help with the idea in any way possible. Mr. Broaddus said he would contact the appropriate people in Washington and urge their support. I pledged to continue my support, and advised that the legislative process can be long and arduous; but don’t get discouraged, never give up, and continue to follow the dream.

At last contact the students had produced a video about the “Liberty Bill” and had begun a vigorous letter-writing campaign to all members of Congress, with several Congressmen lining up to sponsor the bill with Congressman Bliley. Perhaps, one day, banks everywhere will be dispensing one dollar bills with the Constitution on the back -- an idea (like many ideas throughout our nation’s history) originated in Virginia by Virginians. If you would like more information about the project or are interested in helping, contact Randy Wright, Liberty Middle School, 13496 Liberty School Road, Ashland, Virginia 23005-9225, 804-752-6020.



THE VIRGINIA STATE BANKER

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