

Remark of Beth Dooley, Deputy Commissioner, Credit Unions

California Department of Financial Institutions

Pacific Sun Educational Conference

Wailea, Hawaii June 11, 2002

Events at DFI Affecting Your CU

First of all, I would like to thank the California Credit Union League for inviting me here to speak to all of you. I always appreciate the opportunity to get together with folks from the credit union movement so that I can hear directly from you your concerns and expectations. And I must say that, although it was a long flight, I do not mind coming to Hawaii to address you all!

Secondly, I want to thank all of you for coming in here to listen to me – I know that, generally speaking, regulators are not the most exciting item on the agenda!

I will, however, do my best to update you on what has been going on at the DFI and the various projects that we have been working on in order to better meet the needs of you, our credit union licensees. Additionally, I will discuss some of the industry trends that we at the DFI see, and make suggestions as to how to avoid some of the commonly occurring problems. Next, I will discuss terrorism and its impact on credit unions, including some of the requirements flowing from both new and existing laws in this area. Finally, I will discuss a couple of new laws that are coming in to effect July 1st and touch on a few other miscellaneous items.

Before I get started, though, I want to encourage anyone who has a question at any time during the presentation to please feel free to ask it at that time. First of all, if one person has a question, there is a good chance that others have that question – or a similar one – as well. Secondly, everyone – including me – will thank you for giving them a momentary break from my prepared comments! So please, feel free to ask a question at any time.

Also, just so I have an idea of the makeup of the audience, I would like to ask for a show of hands: How many of you are Board members? Supervisory Comm. Members? CEOs? And other credit union staff?

Well, as Kim mentioned, I have been at the DFI since December of 2000. So I have been there for a year and a half now. And during that time I have learned a tremendous amount about how the Credit Union Division operates - both its strengths and weaknesses. Throughout that time, I have also been working with both members of the industry as well as individuals within the DFI to begin to implement changes that I believe will be beneficial for everyone. Before I touch on that, though, let me give you some background information.

When the Credit Union Division first moved from the Dept. of Corporations to the Department of Financial Institutions in July of 1997, there were 193 state-chartered credit unions with assets of \$15.9 billion. Up until the beginning of 1997, the trend for conversions within the state of California was from State to Federal charter (the opposite of what we are seeing now), due in large part to the tax issues. The California state-charter was, for all intents and purposes, a declining industry at that time.

Around the time that the regulation of Credit Unions moved from the DOC to the DFI, a couple of things happened that changed the course of conversions in California. First of all, the California Credit Union movement successfully passed legislation granting some tax parity between State-chartered credit unions and federally-chartered credit unions. Additionally, the American Bankers Association had prevailed in its lawsuit against the NCUA and HR 1151 was passed. Consequently, Federal credit unions were then very limited in their ability to expand their Fields of Membership.

The occurrence of these two events resulted in the California State Charter becoming much more attractive than it had been in most of the prior decade. As a result, over the last 5 years there have been more than 50 FCUs that have converted to California State Charter, with assets of approximately \$12.5 billion. However, during that time

the staffing level of the Credit Union Division has not changed.

Additionally, partly as a result of these conversions, the structure of the California State-Chartered Credit Union industry has changed significantly. In June of 1997, 13% of total assets in CA SCUs were in credit unions with assets of \$50 million or less. In December of 2001, that number had dropped to 5.15%. On the other end, in June of '97 just under 80% of total assets were in institutions of \$100 million or more, whereas in December of 2001, over 90% of total assets were in institutions of \$100 million or more. During that same period, the number of institutions with assets of \$500 million or more nearly quadrupled, from 7 to 27.

I tell you this because the size and complexity of an institution has a tremendous bearing on the amount of time necessary to examine the institution. As a result, the amount of staff time necessary to adequately examine all of the California State-chartered credit unions has increased significantly over the last 5 years. However, as I mentioned earlier, the number of staff positions allocated to the Credit Union Division has remained static. As a result, more staff time has had to be allocated to examinations, thus leaving less time to tend to other matters.

STREAMLINING APPLICATION PROCESSING

Given this background, I have been working to find ways to streamline application processing and to accomplish tasks in a more efficient manner, as well as to balance the use of staff positions to try to better meet the needs of the industry.

Some of the steps that we have already taken to shorten the turn-around time are:

1. Most variance requests no longer go through the legal department – they are handled at the administrative and policy levels.
2. Most Bylaw requests, other than FOM requests, go directly to the legal department, thus bypassing the administrative area.
3. I have brought in additional people from the field to work on applications. For example, in Southern California I now have one examiner who comes in every Monday to work on applications.
4. Finally, the authority to approve SEG requests for employer groups of 1000 or fewer has been given to the Assistant Deputy Commissioners, Beverly Ryan in Northern Calif. and Joni Kimbrell in Southern Calif. So these SEG requests should be turned around much more quickly now.

I know that a number of you have already seen the benefits of these changes – I appreciate your comments to that affect - and I am sure that the rest of you will begin to see these benefits in the near future.

Additionally, we have focused on coming up with some "suggested" forms and other types of guidance to help credit unions when they need to file an application with the Department. There are currently very few application forms put forth by the Department to aid credit unions in submitting applications to us. Consequently, credit unions are in the position of trying to guess the type of information the DFI wants to see for various types of requests. This leads to a lot of wasted time, where the DFI staff has to go back and forth with credit unions – often several times for each application – trying to acquire the necessary information. It is our hope that these suggested applications will, at a minimum, provide guidelines to credit unions as to the type of information we need in order to act upon their applications.

The first of these suggested forms is now available on the DFI's web site. Actually, this is a package of forms, not just one form, and a couple of the forms, along with the "Directions", if you will, are hand-outs in the back of the room.

The first type of application that we chose to tackle was mergers. This is due in large part to the fact that we were contacted by the Secretary of State's office last fall and told of their concern regarding a form that has been circulating through the industry for a number of years that requires some changes. That form, the Certificate of Merger form, did not adequately address the need for the surviving credit union to set forth the total number of members in that credit union. The Secretary of State's office indicated that they might begin to refuse processing these applications if the problems were not corrected. Thus, we decided that Merger forms were a good place to start!

So what you should now find under the Forms section for Credit Unions on the DFI's web site is 6 different forms

that can be used in the merger process, along with a set of "directions". The yellow sheets in the back of the room, titled "Mergers", are the directions. It basically walks you through the requirements for a merger, and references the applicable form number for each step. I have also included the "Important Notice to Members" form (the green sheet – **Form 3**) which is a notice that informs members that, if the disappearing credit union is not able to get the participation of a majority of the outstanding members to participate in the vote, then – pursuant to a specified section of the financial code – the credit union can receive permission from the Commissioner to move forward with the merger if the majority of those members who in fact voted approved the merger.

I would really like to hear from any of you who choose to use these forms, to let us know if they are helpful or if there are any changes that should be made.

Now, it is important to note that there are no requirement to use these forms – they are merely suggested forms to provide guidance as to the type of information necessary to complete the particular transaction. However, I do hope that people find them helpful.

In addition to suggested forms, the Department is also in the process of putting *Frequently Asked Questions*, or FAQs, on our web site. I plan to address a variety of issues in this way. For example, what type of information should a Credit Union provide when it is seeking a community FOM expansion? Although these are not yet finalized, I hope to address a number of issues in this format. (For your information, in case you are wondering about the type of information to provide for a community FOM expansion, call the Department. We have a standardized letter addressing this issue.)

Communications

Along with streamlining our applications processes and seeking efficiencies in our processes, I am also trying to enhance communications between the credit union community and the DFI. I believe that the more we communicate with one another, the better we will understand one another.

One way we are attempting to increase our communications with the industry is to have more information regarding credit unions in the DFI's Monthly Bulletin publication. Many credit unions are on the mailing list and/or e-mail list for this publication already, but if you are not, please feel free to sign up for it. It is also available on the DFI's web site. A copy of the April edition is available in the back of the room (it is the pink sheet). In this edition, you will see that some of the articles apply to all of the DFI's licensees while others are industry specific. For instance, in the April edition there is an article discussing the documentation involved in a name change for a credit union. We wanted to let the community know that the Secretary of State's office will no longer accept amendments to a credit union's Articles of Incorporation without an endorsement on the Articles from the DFI. The law has required this for a number of years (FC 14101.2); however, in the past the Secretary of State's Office has accepted an approval letter from the DFI stating that the changes are acceptable. They are now requiring the endorsement actually on the document. So we are trying to inform the credit union community of this change. I believe that communicating this information to you will help both you – the credit unions – and the DFI in that we will not have to process the same documents more than once.

I am also working to increase the presence of credit unions on the DFI's web site. Not only are we putting application forms and FAQs on the web site, but we are also trying to put other information of interest to credit unions on there as well. For instance, there is now information about the Credit Union Advisory Committee on the web site, including who the members are and how you can reach them.

Additionally, starting in 2001, the DFI initiated a new public information function. The goal of this function is to improve public awareness through outreach and partnerships with organizations that have an interest in promoting financial literacy and preventing unfair consumer practices. To help achieve this goal, the Department has devoted a section on its web site to help publicize the "good deeds", if you will, of its licensees. To date, there are several articles about credit unions and the work they do in their respective communities.

I encourage all of you to notify the Department of community activities in which your credit union is involved. We are always looking for information to help show the public that financial institutions are indeed good corporate citizens. To access this information, go to the DFI's web page and click on "Press Releases and Publications" and then on "Community News".

Finally, I am also trying to get out and meet with members of the credit union community. I enjoy coming to functions such as this, but I am also interested in meeting with folks in their own communities. For instance, I met with a group of CEOs in Bakersfield in March, and am working on setting up some other meetings. If any of you are interested in working with me to set up a meeting, I would love to hear from you. Alternatively, I am open to attending chapter meetings.

REVISING CREDIT UNION REGULATIONS

Another major project that the Credit Union Division has been working on for the past year that will both help with the processing of applications as well as to reduce other regulatory burdens is the revising of the Credit Union Regulations. The proposed changes to the regulations were published for comment in the California Regulatory Notice Register on April 26, 2002. There is also information about this in the pink April Monthly Bulletin in the back. The comment period closes in about a week (either June 18 or 19).

1. Streamlined Select Group Applications

One of the most exciting changes being proposed in these new regulations, at least from my perspective, is a streamlined applications process to expedite applications for Select Employee Groups. This new process will apply to occupational or employer groups of up to 1000 people.

In order to partake in this expedited applications process, a credit union must first file for and be granted eligibility. The primary factors considered in determining eligibility are that the credit union has a CAMEL rating of 1 or 2, and that there has been no material change in the condition of the credit union since the last examination. Additionally, the credit union's Board of Directors must have adopted a policy setting forth guidelines for adding select groups pursuant to the regulations.

Once a credit union has been granted this eligibility status, it simply submits to the DFI the required documentation set out in the regulations and, if this documentation is not rejected by the Commissioner within 10 business days, it is deemed approved.

An important note regarding this eligibility status is that it is only valid as long as the credit union meets the stated requirements. So if, for example, a credit that had been granted this status receives a CAMEL rating of 3 or lower at its next exam, the credit union would automatically lose this eligibility status. At that point, the credit union would simply revert back to the currently existing process for adding select groups.

2. Reserve Requirements

Another change beneficial to federally-insured, state-chartered credit unions (FISCUs) deals with the State's reserve requirements. When PCA came into effect, FISCUs were required to comply with both the net worth requirements under PCA as well as continuing to be subject to the State's Regular Reserve requirements. The new regulations will take the burden of having to comply with both requirements off of FISCUs, as long as the credit union maintains equity capital at the level required for an adequately capitalized credit union under PCA.

3. Real Estate Loans

There are several changes in the proposed regulations relating to real estate loans. Under Section 30.802, dealing with Obligations Secured by Real Property, the new proposed regulations would allow a credit union to obtain an abbreviated loan guarantee (like a FLAG or PERT) rather than a full policy of title insurance, for junior liens where the aggregate of all junior liens held by the credit union does not exceed \$100,000. This should be beneficial to both credit unions and the DFI in that in the past, credit unions have had to apply for variances from the regulations in order to be able to do this. Once the regulations become effective, they will no longer have to request a variance for this.

Another proposed change to the real property section of the regulations would exempt from that regulation any obligation with a principal balance of \$50,000 or less. The effect of this change is that credit unions that want to implement a program like the Auto Equity program or the Equity Card program, where the credit union places a lien on real property as an "abundance of caution", will no longer have to apply for a variance from this regulation

if the size of the loans are capped at \$50,000 or less.

4. Audit Reports

Proposed section 30.1000 implements Financial Code section 14252, which requires all credit unions to undergo and submit to the Commissioner an annual audit report performed in accordance with GAAP by an independent certified public accountant or an independent public accountant. This required audit report will include an opinion letter and a management letter prepared by the CPA or public accountant. The reports are due within 105 days after the end of the fiscal or calendar year.

I want to point out here that the Commissioner expects all credit unions to periodically undergo an audit by an independent accountant – regardless of size. I mention this because a number of credit unions have, in the past, only used an audit by the Supervisory Committee. The Commissioner feels that it is important for all credit unions to periodically be audited by an outside accountant. As a result, it is important for those credit unions that have not done so in the past, to begin factoring in to their budget projections the cost of an outside audit every few years.

1. Investment Policy

Proposed section 30.300, which deals with investments, changes the requirement for the Board of Directors to review the investment policy from a quarterly basis to an annual basis. However, it is very important to remember that simply because the required review period has been extended, that does not relieve the Board from its duty to have an appropriate investment policy in place. It is especially critical that the Board be attentive to the investment policy in times of volatility, such as we have experienced within the last year or so. With interest rates having dropped 400 basis points in less than a year's time, it is extremely important that the Board be attentive to the credit union's investment policy. Additionally, given that fact that most credit unions have realized a decline in loan demand, credit unions are becoming more dependent upon the income earned from their investments. Consequently, it is an extremely important area currently.

2. Investments in Fixed Assets and Service Companies

One proposed change that seems to have concerned a few people is the change from 20 to 10% of unimpaired capital that a credit union can invest in a combination of fixed assets and/or CUSOs without the Commissioner's authority. This proposal was made because the Department has seen a few situations where credit unions became too deeply invested in non-core investments, to their detriment. It is important to realize that this provision does not prohibit investments greater than 10%. It simply requires the credit union to gain authorization ahead of time. In the few cases where credit unions currently exceed these limitations, those investments will be grandfathered. However, the credit union will still need to gain authorization before making any future investments of this type.

There are a number of other changes, such as allowing the Board to charge-off a number of obligations at one time, rather than having to go through each charge-off individually, however I have hit a lot of the points that I think are of the most interest to you.

I know that these changes have been a long time in the making, and there have been several attempts to get them finalized. However, we are determined to actually get these proposed changes implemented this time around! Additionally, we feel that it would be more effective to make changes to the regulations more frequently but on a smaller scale. It is hoped that this would allow the regulations to better keep up with the changes in the market place (or at least not fall so far behind!) and it would also be less of an undertaking for both the Department as well as the industry. So hopefully you will see actual changes to the regulations more frequently than you have in the past.

Industry Trends

Overall, state chartered credit unions in California – like most across the country – have realized tremendous asset growth during this last year. In December of 2000, total assets of CA state chartered credit unions were \$35.8 billion – by year-end, that number had increased 22%, or \$7.9 billion, to \$43.7 billion. That growth in assets, however, has not always been accompanied by a commensurate growth in capital. As a result, we have seen a trend of declining capital at many institutions. This appears to be due at least in part to lower loan demand and significantly lower interest rates. These factors are putting a real "squeeze" on earnings, and there is not a lot of room left to drop dividends. I mention this because I want you to realize that we understand that it is a difficult time to realize positive earnings. However, we do expect credit unions to maintain adequate capital levels. If you can not realize adequate growth in earnings, then you may have to control growth.

We at the DFI have also been seeing an increasing number of problem licensees. Each month we have a Problem Licensee Committee meeting, and the number of institutions on this list has been growing over the past year. This is true across the board. It includes banks as well as credit unions. It includes large as well as small institutions. Additionally, there have been comments in the press that federal regulators are also seeing this growth in problem institutions.

I mention this growth in problem institutions because I want to discuss a couple of areas where credit unions continue to get in to trouble. I prefaced this because many of you may have heard these caveats before. However, we continue to see credit unions getting in to problems in these areas, so I want to mention them again. The two areas are indirect lending and community fields of membership.

Credit unions frequently jump in to both of these areas at the same time, evidently thinking that they can serve a lot of new people in their new community field of membership via indirect lending. However, both have their own quirks which a credit union needs to learn to work through, and together they can really hurt a credit union quickly.

Indirect Lending

When becoming involved in an indirect lending program, it is extremely important for a credit union not only to set lending parameters for the indirect lending program, but to stringently enforce them. The people who work at car dealerships are there to sell cars. So they will first send business to the place where they can make the most amount of money, but second, if the customer does not have good credit, they will send the business any place that will finance the sale. So if your lending folks are not carefully reviewing all of the loan documentation being sent by the car dealerships, you may likely be receiving all of the low-grade paper. Our examiners have seen instances where credit unions have realized tremendous growth in their loan portfolio in a very short period of time, only later realizing that the vast majority of the loans were C and D paper. These situations frequently result in a significant increase in delinquencies, ultimately negatively impacting earnings. It often takes several years for credit unions to work their way out of these situations.

In order to avoid these problems, it is imperative for the credit union to scrutinize all loan applications coming in through these programs. You also need to really get to know the various dealerships with which you do business. I have heard from CEOs that some car dealerships stop sending any business to the credit union once it begins to police the loan applications. And although at first blush you may think that is not such a good idea – the point is to make loans – bad loans do not help your credit union, they hurt it.

One suggestion is that your credit union start testing a new program on a small scale. Do not let your credit union get in to the position of increasing its loan portfolio by 25 or 50 % in a very short period of time. Keep in mind that most people do not default on their car loan within the first 3 months. (Although the banking folks at the DFI have regaled me with horror stories of situations where car sales people actually made the first couple of loan payments on some loans in order to sell the car!)

Additionally, examiners have suggested that credit unions track indirect loans on a per-dealership basis, so that you learn if loans from certain dealers are realizing higher delinquencies than others. If so, you may want to stop accepting loans from that dealer, or at a minimum scrutinize those loans more carefully.

Finally, you can not just rely upon a credit score to determine whether you will grant a loan or not. You need to look at a person's debt ratio, as well. You need to determine whether this person has the ability to make

payments now – not just a good credit history.

Keep in mind that if your credit union is suddenly flooded with applications, you should be concerned. Car dealerships are not sending these applications to you because they like you. It is probably because you are not priced properly. Car dealers will send applications to wherever they can make the most money.

Community FOMs

That leads me in to issues resulting from Community FOMs. However, keep in mind that many of the problems that I am discussing are applicable to both indirect lending and community FOMs.

When you move from a sponsor and SEG based FOM to a community FOM, you are entering a new arena. We expect, based upon historical information, that credit unions new to community FOMs will realize an increase in delinquencies and subsequently a decrease in their capital. As a result, we generally require the credit union to be in a position that it can afford a drop in capital prior to granting a community FOM.

When you begin to serve a community, you are – at the risk of stating the obvious – serving a new group. As a result, you may want to consider re-writing your loan policies to incorporate these new factors. I mention this because many credit unions continue to use their same loan policies and apply the same debt ratios that they use for their existing membership to new members from the community with whom they have no history. This has frequently hurt the institution. Your established loan policies, debt ratios, etc are based upon your history with your loyal membership. However, these new members of the community have no history with you and frequently are just as likely to default on a loan with you as they are to default on a loan with Bank of America. Consequently, it is imperative for you to factor that in to your policies.

Many of the problems that I mentioned earlier with indirect lending also apply to community FOMs because both programs tend to attract individuals who have less than perfect credit histories. As a result, you really need to get to know your competition. If an individual has a particular credit score, you need to investigate 1) where else would this person go for financing and 2) what rates would those other lenders offer this person. I suggest this not because I am encouraging credit unions to start predatory lending practices, but because you need to make sure that you are pricing the loans properly. If an individual has a poor credit history, then there is an increased likelihood of default. You should understand that at the outset and price the loan accordingly. Additionally – and probably more importantly – you should establish a policy that limits the credit union's exposure to these types of loans, if possible.

Also, if you are going to make a policy decision to make some loans to people with lower credit ratings – and it is ok to consciously make that decision – you may also need to adjust your collections practices. Whereas with your existing FOM you were able to wait 60 days before calling someone who is late with a payment, you may need to make some calls within 10 days of missing a payment.

Finally, community FOMs tend to be more labor intensive than SEG and sponsor based FOMs. This is because of the diversity inherent in community FOMs. These members work for any number of employers – many of whom your credit union has not relationship. These folks come from varied socio-economic groups, different educational levels, and different ages. Consequently, their needs are much greater, and so are the potential demands. To illustrate this, a manager of a credit union that was granted a community charter recently informed the DFI that the person is moving to a different credit union due primarily to the stresses brought about by the community FOM. That person preferred not to continue handling the changes necessary as a result of the community FOM.

Speaking of changes, the next issue I would like to discuss is terrorism and its impact on credit unions.

Terrorism and Its Impact on Credit Unions

The events of September 11th have clearly impacted all of us in a number of ways, changing some of our lives more than others. At a minimum, it has become apparent to most of us that there are groups of people who are very opposed to capitalism and our fundamental way of doing business. As a result, all financial institutions in the

United States are having additional requirements imposed upon them to, in a best case scenario assist in finding some of the perpetrators or, at a minimum, inhibit their ability to conduct their business of terrorism. Some of these requirements are new and others have been around for some time but are now subject to higher scrutiny. I want to briefly touch on some of these requirements so that you are aware of them and let you know what the DFI is doing so that we can contact you if need be.

OFAC

There are several lists against which credit unions are required to check names, both for existing accounts as well as when opening new accounts. The first of these that I will mention is that for the Office of Foreign Assets Control, or OFAC. After the attacks on September 11th, the President issued an Executive Order requiring all financial institutions to immediately block any assets held in the name of individuals or organizations identified as being associated with a terrorist group. Additionally, the Executive Order requires that OFAC be notified immediately when a financial institution identifies potential or actual assets of any of the listed entities.

Although the OFAC requirements have received increased emphasis since September 11th, these requirements have been around for a number of years. However, there are names being added to the lists regularly. Consequently, it is imperative that credit unions be monitoring these lists on an ongoing basis. If a credit union finds a match, appropriate action must be taken to block or reject the account, and then notify OFAC.

In December, the NCUA issued a Letter to All Federally Insured Credit Unions discussing the OFAC requirements and included a Compliance Examination Questionnaire. I would encourage someone in your credit union to take a look at that questionnaire to ensure that your credit union is taking the necessary steps.

FBI's Control List

Following the events of September 11th, federal law enforcement agencies began compiling a separate list – called the FBI's "Control List" - in conjunction with their investigations, consisting of names of individuals and entities that are believed to be relevant to ongoing investigations. Some of these names may also be on the OFAC lists, but not all are, and vice versa. The banking community (and I am using that term generically to include credit unions!) has been asked to cooperate with law enforcement by reviewing all of their records, on a one-time basis, from January 1, 1996 to the present to determine whether there are any records indicating transactions or relationships involving anyone on the Control List. There are periodic updates to this list, so a check needs to be run each time there is a supplement to the original list. Thus far I believe that there have been 3 supplements.

It is very important to understand that this Control List must be treated with the utmost confidentiality as disclosure could compromise ongoing investigations. To emphasize this, if a match is found a credit union is instructed to send an e-mail message to a specified address at the New York Federal Reserve Bank stating only the credit union's identity and that it has a positive response to the Control List. The FRB will then contact law enforcement and a subpoena will be issued. In order to receive the names on the Control List, last October the NCUA requested that credit unions provide them with a contact name and e-mail address or fax number so that the Control List information could be sent to that person. This should be different than the credit union's general e-mail address – it should be a specified individual. As of the beginning of June, they had only received contact information for about 3600 credit unions. As a result, the remaining credit unions are not receiving this Control List information and thus not checking against those names. I encourage you all to get that information to the NCUA and want to let you know that we will be asking whether that information has been provided at the next regularly scheduled examination or contact.

Patriot Act

In addition to OFAC and the FBI's Control List, in October Congress passed and the President signed into law the USA PATRIOT ACT, which contains strong measures to prevent, detect and prosecute terrorism and international money laundering. The provisions primarily impacting credit unions deal with anti-money laundering, information sharing and verifying your customer's identification. As to money laundering, thus far it appears as though credit unions that already have a security program in place, as required by Part 748 of the NCUA's Rules and Regulations, will be in compliance.

It is important to note that privately-insured credit unions are subject to these same requirements, so they are also expected to have similar programs in place. As a side note, several weeks ago the Treasury asked NASCUS to set up a conference call with the regulators of states that allow private share insurance. During that call, we informed the folks from Treasury that we hold the privately-insured credit unions to the same standards as the federally-insured credit unions when examining them on these issues. Evidently the Treasury folks were quite relieved to hear that, since they are in the process of promulgating regulations pursuant to the Patriot Act. It is the hope of state Regulators that they do not impose significantly different regulations on the privately insured credit unions vis a vis those that are federally insured.

Regarding the information sharing aspect of the Patriot Act, there are provisions allowing law enforcement agencies to request information from financial institutions – through FINCEN – on individuals they may be investigating. There are also provisions allowing financial institutions to share with one another information on former employees who may have been involved in unlawful activity. This sharing of information with other financial institutions is voluntary, it can not be used in a malicious way or personal liability can attach, and the institution must file documents with FINCEN prior to participating in this activity. Credit unions may want to consult counsel prior to participating in this, due to other state and federal laws that may come in to play.

Finally, the regulations regarding the verifying of a customer's identification have not yet been issued, so this is still a murky area.

There are other provisions within the Patriot Act that might impact a credit union if it has members who are not US residents and/or if it wires money abroad. I would suggest that any credit unions in this category investigate the area further.

Finally, as a result of all of the issues we have discussed thus far in the terrorism arena, the DFI issued in its May Monthly Bulletin a notice of information that we are requiring from all DFI licensees. A letter is also being sent out to all licensees.

1. The first deals with background checks of employees. It is conceivable that terrorists may attempt to gain access to financial institutions by becoming employees. To minimize this possibility, the DFI is requiring that credit union management review personnel policies dealing with hiring and background checks of employees. These policies shall then be reviewed and approved by the Board of Directors, who shall then acknowledge this review in a Board Resolution which shall be sent to the DFI by September 30th.
2. Next, all DFI licensees are directed to review their business resumption and contingency planning policies and to update them in light of the recent terrorist activity. Financial institutions are, generally speaking, much better prepared in this arena than other businesses, due to the fact that they are required to have these precautions in place by regulation, along with all of the Y2K requirements you were all subject to in the last few years. Many of the Y2K requirements, however, dealt primarily with information systems issues. It has become abundantly clear that it is also important to focus on the ability to serve your members if you are unable to physically operate out of your branch. For example, some credit unions were affected by the Anthrax situation, and at least one was unable to get in to the credit union's premises for several months. In another instance, when I was speaking to one of the examiners from the New York Banking Department, he told me of an institution that was unable to get back in to its premises near the World Trade Center. When it contacted its business resumption insurer, the closest facility that was available was in Chicago! So you need to think about the new environment within which we are now living, and plan accordingly. As a result, credit union management needs to review existing business resumption and continuity policies and update them for the current situation. Those policies must then be reviewed and approved by the Board of Directors, and a Board Resolution acknowledging the review and approval must be sent to the DFI.
3. Finally, some of the recent threats against financial institutions have made it clear that we, as regulators, need to be able to notify institutions should there be a threat. You may remember back in April that the FBI issued an alert to financial institutions in the Northeast. As a result, we are asking that each institution designate a contact person to receive information regarding alerts or threats to financial institutions in California. We need the designated person's name, mailing address, e-mail address, telephone number, cell phone number, and a fax number.

NEW LAWS COMING IN TO EFFECT

There are 2 new laws coming in to effect this July 1st that I wanted to bring to your attention.

Credit Card Disclosure Law

The first is the California Minimum Payment Disclosure law. This law requires that card issuers with members in California must disclose on billing statements information allowing a member to determine the length of time it will take to pay off the balance due on an open-end credit card account, as well as the full costs associated with that payment program. There are several ways to meet these requirements which are too detailed for me to go into here. However, I suggest that you ensure that your credit card program is in compliance. (I understand that the League is – this week – issuing an updated bulletin on this issue. So hopefully it will answer some of your questions on this issue.)

A group of banks and trade associations – including NAFCU – recently sued the state of California on this issue attempting to block implementation of the law. However, to the best of my knowledge, the law is currently still effective as of July 1st.

Predatory Lending

The other law coming into effect July 1st is one dealing with predatory lending practices. The law is a consumer protection law designed to prevent predatory lending practices in the sub-prime market.

The law covers any credit union that makes or services a "covered loan". A "covered loan" is a consumer loan in which the principal balance of the loan does not exceed \$250,000 in the case of a mortgage or deed of trust, and where either 1) the annual percentage rate at consummation of the transaction exceeds the yield on Treasury securities of comparable periods by more than 8% or 2) the total points and fees payable at or before closing will exceed 6% of the total loan amount.

Generally speaking it is felt that most credit unions do not partake in these types of loans. However, the DFI has been tasked with the enforcement of this law for credit unions, banks and savings associations. As such, we must create a new examination module to test for and identify any violations of the law. As such, we will be asking licensees if they have amended their loan policies to deal with the requirements of this law. So I wanted to let you know that you need to address this issue in your policies.

MISCELLANEOUS

Finally, there are a few other miscellaneous issues that I wanted to touch on.

CU's MAKING LOANS TO NON-MEMBERS

A number of attorneys have called the Department regarding the ability of credit unions to make loans to non-members. The biggest issue appears to be where one spouse is a credit union member and the other is not. Can the non-member be a co-signor on the loan? The strict reading of the law appears to be no. However, Commissioner Meyer and I believe that when the intent of California's Community Property laws are considered in conjunction with the issue, that it is not unreasonable to permit married couples to both sign on loan documents, even though one of those individuals is not a member of the credit union.

Additionally, the Department has always found it permissible for a non-member to act as a guarantor on a loan.

SUSPICIOUS ACTIVITY REPORTS

On another matter, it has come to the Department's attention that not all credit unions are sending a copy of Suspicious Activity Reports directly to the DFI. The forms themselves do not specify state agencies. However, section 30.108 of the Regulations require that a credit union notify the Department of any alleged defalcations. So we suggest that you simply send a copy directly to us whenever you file one. That way, you are always covered.

BRANCH ACTIVITY

Finally, we have noticed that a lot a credit unions are not notifying the Department of branch closures or openings. We frequently read about them in the press. Please notify us of the opening or closing of a branch.

CLOSING

Well, as I hope that you can tell from the preceding information, there is a lot going on both at the DFI as well as within the California credit union community. At the Department we are making great strides to try to better meet the needs of our licensees through new suggested applications, FAQs and better use of other forms of communication like the Department's Monthly Bulletin and web site. Additionally, we are determined to update the Credit Union Regulations to bring them more in-line with current practices and law. As the industry trends indicate, there has been a tremendous growth in assets for state-chartered credit unions in California. However, there has also been a notable decline in capital for many institutions. And many institutions are still being detrimentally impacted through indirect lending programs and aggressive community FOM expansions. Credit unions, like so many others across the country, have been impacted by the terrorist attacks of September 11th, and they must do their part to help combat this menace. Finally, credit unions must be attentive to new laws that are coming into effect, as well as to stay on top of existing requirements.

I know that I have covered a lot today, and I hope that you have found at least some of it useful. If there are any questions, I would be happy to address them at this time.