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The Virginia State Banker

Regulatory news for Virginia State-chartered Banks

E.J. Face, Jr., Commissioner

Bureau of Financial Institutions - State Corporation Commission

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HACKERS FIND WAY TO BREAK ENCRYPTED PINS

The attached link will take you to some disturbing news. This development should serve as a prompt to advise your deposit customers of the steps they need to take should their debit card information fall into the wrong hands, or be accessed through this new security breach. www.wired.com/threatlevel/2009/04/pins

SECURITY FOR PUBLIC DEPOSITS

HB 1761 has passed and been signed into law. The Virginia Treasury Board is currently working on proposed rules as to how the process of opting out of the general security pool will work. When the proposal is issued, the Treasury Board is interested in your comments.

While it is likely that securities pledged will need to be in excess of 100% of the public deposits held — given current economic conditions — not participating could be disastrous.

EMERGENCY PREPAREDNESS SALES TAX HOLIDAY

The Virginia Legislature and Governor have declared a tax holiday for May 25-31 to encourage citizens to purchase items they may need for an emergency. Any assistance your bank can provide in informing your customers about this tax holiday will be helpful.

If you would like flyers to place at teller windows, the Virginia Department of Emergency Management is willing to print and mail them to you. Contact Laura Southard at laura.southard@vdem.virginia.gov.

The Sales Tax Holiday Information Center Web site is www.tax.virginia.gov/salestaxholiday.

The Virginia State Banker is published 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 welcome and should be addressed to Ginger Sandler, Bureau of Financial Institutions, P.O. Box 640, Richmond, Virginia 23218-0640, or via e-mail **ginger.sandler@scc.virginia.gov**.

ACKNOWLEDGMENTS

Thanks to the following persons for their help in producing this issue of *The Virginia State Banker:* Commissioner Face, John Crockett, Charles Dickerson, Nick Kyrus, Jon Orne, Mark Pinson, and Todd Rose.

CREDIT WORRIES

The following is an excerpt from the 4th quarter newsletter published by Steve H. Powell & Company in Statesboro, GA. While this article was written for the firm's clients, much of what is in this article can serve as information for all bankers.

Steve was an examiner with the Georgia Department of Banking and Finance. Founded in 1993, his company serves over 130 financial institutions in the southeastern U.S.

# # #

Asset quality deterioration continued in the fourth quarter of 2008. The impact of real estate deflation and construction in credit markets has spilled into the general economy. The housing sector continues its detrimental impact on banks — particularly those with concentrations in acquisition, development, and construction lending. The year ended with media focus on the deterioration of various industry sectors — including automotive and retail. Weak economic data coupled with constant media attention have served to further unnerve investors.

Real Estate Lending

The FDIC's 3rd Quarter 2008 Quarterly Banking Profile indicated charge-offs increased by 156% over the past 12 months. Charge-offs in acquisition, development, and construction lending have been noted throughout our client base.

Commercial real estate, both office and retail, may well be the next real estate sector to affect many banks. A January 8, 2009 *Wall Street Journal* (WSJ) article titled "Commercial Property Loses Shelter" indicates an increase in commercial delinquencies. As larger regional banks begun notifying many borrowers that commercial real estate loans will not be renewed, community banks have begun receiving financing requests from new customers. Why are the large banks pressuring their commercial real estate customers to refinance elsewhere? The WSJ article indicates the non-farm, non-residential market to have similar excesses to that in the 1-4 family market — including declines in the quality of securitized mortgages. The WSJ indicates many banks may have underwritten commercial projects based on pro-forma cash flows rather than actual cash flow.

In several of our client banks, retail projects' occupancy rates as well as the quality of projects' tenants are declining. Many unanchored strip centers are largely unoccupied.

Our anecdotal evidence is substantiated by actual market data. The January 2-8, 2009 edition of the *Atlanta Business Chronicle* contains a listing of Atlanta's 25 Largest Office Buildings as based on total square footage. The average vacancy rate was reported at roughly 13%. **(A recent news item indicates Richmond's rate is over 20%.)** Properties over 10 years old had an average vacancy of 16%. Vacancy rates commonly exceeding 10% in prominent Atlanta projects do not indicate favorable occupancy should be expected in non-anchored, less urban projects.

While some of the new financing requests may meet underwriting standards as based upon historic financial data or older rent rolls, the project's *current* revenue may not. Occupancy levels are declining. Rental rates per square foot will likely decline as landlords struggle to maintain fully leased properties and quality tenants. Solid underwriting is more critical than ever in this environment. Underwriting practices should include:

- Current cash flow should be confirmed. Property statements and rent rolls should be reviewed carefully. Expenses should be reviewed as property taxes and insurance rates have risen and are likely to rise further.
- Tenant quality and viability should be evaluated. Businesses such as nail salons, tattoo parlors, and those tied to troubled industry segments or discretionary spending likely do not provide the project with true stability.
- The project should be visited. Has maintenance been deferred?
- A borrowing group's current, global cash flow should be confirmed. The borrowing group's ability to meet its direct and contingent liabilities should be assessed. Borrowers actively involved in commercial real estate may have some performing projects, yet other projects' problems may require pooling of funds for debt service.
- Obtain a quality appraisal that reflects current market conditions [price per foot, rental rates per square foot, projections based on actual rental income, as well as market rents]. Community banks too often rely on an old appraisal without properly considering changes in market conditions.
- Banks should remember to appropriately price loans. As noted in a previous newsletter, *Prime* and *Libor* based financing, without rate floors, have left many banks with tight if not negative net interest margins. Some borrowers may seek to refinance loans as soon as a recovery takes place. Perhaps a prepayment penalty should be considered?
- Funding sources should be considered in pricing and loan structure.

INFLUENZA A H1N1 OUTBREAK

On April 27, 2009, State Health Commissioner Karen Remley declared a public health emergency in Virginia in response to the intensifying outbreak of influenza A H1N1. As you know, there are now three confirmed cases [14 confirmed cases as of May 7, 2009] in Virginia; and more confirmed cases are likely. Fortunately, Virginia has a very strong public health system. The Virginia Department of Health (VDH) pandemic flu preparedness and response plan was developed in close collaboration with numerous stakeholders, including representatives of the Commonwealth's business community. This plan has been frequently tested, exercised, and evaluated. Virginia's 35 local health districts, each led by an experienced public health physician, have developed strong relationships with businesses — both large and small — in their areas. VDH greatly values the partnerships forged with the private sector in order to protect the health of their employees, vendors, customers, and surrounding communities. VDH is prepared to respond effectively to this rapidly evolving public health emergency and are doing so around the clock.

Virginia businesses likely have many questions concerning what this outbreak means for them and their employees, and how they should respond. VDH is well-equipped to be the best single point of contact within the Commonwealth for accurate answers to such questions, and to provide detailed information and guidance concerning the H1N1 outbreak. In addition to the information contained on the VDH website, www.vdh.virginia.gov you and your employees are encouraged to refer to more detailed information, guidance, and recommendations on the U.S. Centers for Disease Control and Prevention (CDC) website, www.cdc.gov/h1n1flu. The CDC has issued guidance and recommendations on a wide range of topics related to the H1N1 outbreak, including face mask and respirator (i.e., the N-95) use in certain community settings where H1N1 influenza virus transmission has been detected, cdc.gov/h1n1flu/masks.htm. The CDC has also issued guidance and recommendations related to travel. VDH is ready and willing to help you understand the wide range of guidance and recommendations that have been issued by the CDC. Another source of workplace planning information that businesses may find useful for preparedness and response purposes is www.pandemicflu.gov/plan/workplaceplanning/index.html.

You are encouraged to share with your customers the following simple, every day steps to protect themselves and their families and friends. Review emergency plans at home and at work. Wash your hands frequently. Cover your cough with a tissue or your arm. Stay home if you are sick. Individuals who think they need medical attention should call their health care providers in advance to allow them to take necessary infection-control actions.

VDH will continue to monitor this situation and will keep the business community informed. Thank you for your continued strong support and assistance. If you have additional questions, please contact either VDH's influenza information hotline at 1-877-275-8343, or your local health department.

LICENSING OF MORTGAGE LOAN ORIGINATORS

Beginning August 3, 2009, the State Corporation Commission's (SCC) Bureau of Financial Institutions ("Bureau") will begin participation in the Nationwide Mortgage Licensing System (NMLS) for the licensing of mortgage loan originators (as defined by § 6.1-431.1 of the Code of Virginia), in accordance with Chapter 16.1 of the Virginia Code (http://leg1.state.va.us/cgi-bin/legp504.exe?091+ful+CHAP0453) and the federal Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act).

The Bureau is developing plans to license mortgage loan originators, as required by legislation passed by the Virginia General Assembly in February and signed by Governor Timothy M. Kaine in March. The legislation prohibits an individual from acting as, or holding oneself out to the public as being a mortgage loan originator on or after July 1, 2010, unless one has obtained a license from the SCC and is registered in the NMLS. On May 6, 2009, the SCC proposed regulations to further the purposes of this new legislation. Interested parties will have an opportunity to provide written comments by June 22, 2009 and to participate in a public hearing on July 9, 2009 at 10 a.m. in the Commission's courtroom. Mortgage loan originators working for banks and their subsidiaries are exempt from the licensing requirements, provided they register as mortgage loan originators and obtain a unique identifier from the Registry through the NMLS.

Also beginning August 3, 2009, the Bureau will require mortgage loan originators to complete an application for a license in NMLS. Once the application is completed, the NMLS will submit it to the Bureau for investigation; and if the Bureau determines that the licensing requirements are met, a license will be granted. An individual wishing to apply for a license must do so through NMLS beginning August 3, 2009. Applications for Virginia mortgage lender/broker licenses will not be processed through the NMLS at this time but will continue to be processed directly through the Bureau.

The Bureau has a dedicated telephone line (804-371-0484) and E-mail address (mlo@scc.virginia.gov) to answer questions concerning the licensing of mortgage loan originators.

IMPORTANT TELEPHONE NUMBERS

- Banks and Savings Institutions (804) 371-9704
- Consumer Finance and Mortgage Companies (804) 371-9701
- Licensing (applications, name changes, annual reports) (804) 371-9690
- Consumer Complaints (804) 371-9705
- Corporate Information (SCC Clerk's Office) (804) 371-9733
- Bureau's FAX number (804) 371-9416
- TDD (804) 371-9206

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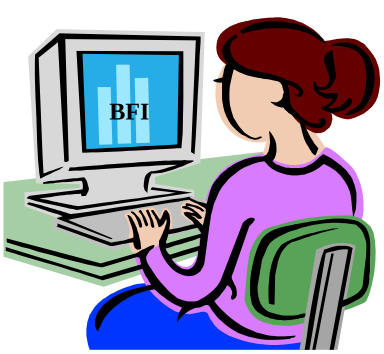

Check out our website at http://www.scc.virginia.gov/bfi.