April 2013 Volume 2, Issue 2

State of North Dakota DEPARTMENT of FINANCIAL INSTITUTIONS

A MESSAGE FROM COMMISSIONER ENTRINGER

As I write this article the Legislature is nearing the end of the session. The department-sponsored banking bill, HB 1085, was heard by the Senate Industry Business and Labor Committee the first day after crossover, March 6th. The hearing went well but we did have representatives from the Fargo and Bismarck Park Districts testify in opposition to the House Amendments related to a bank's authority to engage in lease financing for public facilities. The House Industry Business and Labor Committee amended the bill to add a voting requirement to a governing body of a political subdivision. Ultimately the Senate IBL Committee removed the House Amendment and passed the bill; the House concurred with the Senate Amendment and the bill was signed by Governor Dalrymple on April 15th. The department's budget bill was heard on March 18th and moved out of the subcommittee on the 19th; the House Government Operations subcommittee amended the budget to reduce the Governor's recommended employee compensation as they have with all agency budgets. The House and the Senate are not in agreement on the Governor's recommended compensation amounts and therefore the issue will likely be resolved in the OMB bill towards the end of the session.

The Banking Division is up for re-accreditation from CSBS this summer and we have been preparing for their visit for several months now; I am confident our staff did an excellent job on the prep work and we will be re-accredited.

Finally I would like to thank our staff who prepared the articles for this newsletter; I trust you will find the information informative and useful.

TRANSFERS OF FINANCIAL ASSETS

Due to weak loan demand, some banks are looking to repurchase or "buy-back" certain loan participations sold. Accounting Standards Codification (ASC) Subtopic 860 (f/k/a FAS 166), specifically 860-10-40, addresses the sale of financial assets and effective control, i.e. loan participations. The accounting guidance states that if a bank repurchases non-recourse loan participations (for *any* reason), it gives the appearance that effective control was not relinquished in conjunction with the initial sale, unless a written agreement was in place at the time of the sale. Repurchasing previously sold loan participations can potentially compromise the sales accounting treatment of the participations sold portfolio, which can have an impact on the bank's capital position and/or liquidity levels. Therefore, be cautious before you consider this practice.

FINCEN MANDATES ELECTRONIC REPORT FILING

Effective April 1, 2013, financial institutions were required to begin using the new FinCEN reports, which are available only electronically through the BSA E-Filing System. During the transition, the BSA E-Filing System continued to accept submissions of the legacy versions of the SAR, CTR, and DOEP until March 31, 2013. Financial institutions that continue to file mandated reports in paper format will fail to meet BSA reporting requirements and may be subject to civil money penalties. After March 31, 2013, FinCEN may reject any mandated reports filed in paper format and return them to the filing institution.

For more information about BSA E-Filing, please review the E-Filing Section on FinCEN's website at http://bsaefiling.fincen.treas.gov/main.html. General questions should be directed to the FinCEN Regulatory Helpline at 1-800-949-2732. For technology-related questions specific to E-Filing, please call the BSA E-Filing Help desk at 1-866-346-9478.

Succession Planning

Is your institution hesitant to take the time to develop a "Succession Plan" because you don't see the value given few expected retirements in the near future? If you are hesitant, your view may be flawed and more aptly named a "Replacement Plan." A "Succession Plan," in contrast, is a process that allows management to provide training for and develop qualified internal candidates to fill another's role should they be absent from their duties for an extended or indefinite period of time. A good starting point in developing the plan is to document the tasks key employees perform to ensure all critical functions are appropriately identified. Management should identify potential back-up personnel for each task and begin cross-training them to perform those tasks. If current staffing doesn't provide for a competent back-up, management should document the process they will take to obtain a qualified external candidate should the position become vacant. The succession planning process will allow for a smooth transition between management teams in the event a key employee becomes unable to perform his/her duties and can mitigate the negative impact this transition will have on bank operations.

Strategic Planning

As the saying goes, "Failing to plan is planning to fail." Increased competition, innovation, and an ever-changing regulatory environment have created uncertainty in the banking industry. Sound planning is crucial in dealing with this uncertainty and rapid change. A Strategic Plan allows management to define its business goals and establish a feasible course of action to achieve those goals, mitigating the impact uncertainty will have on the institution. An effective Strategic Plan is dynamic, well supported, and carefully attended to.

A well-developed Strategic Plan involves three phases: information gathering, documentation, and implementation. Completing a SWOT analysis will allow management to identify the institution's Strengths, Weaknesses, Opportunities, and Threats, and can form the basis for a realistic Strategic Plan. The formalized Strategic Plan should include documentation of the analysis completed and should outline specific goals and courses of action. The final step to developing a successful Strategic Plan is implementation. The plan should be communicated to bank staff; a tracking system should be established in order to monitor how the plan is progressing; and progress reports should be provided to the Board periodically. The Board of Directors and Management should review the progress towards achieving the identified goals and modify the plan if circumstances change.

It is important for the Board of Directors and Senior Management to appropriately prepare and plan for the future direction of their bank.

Due diligence for securities

Effective January 1, 2013, a credit rating by a national rating agency alone is not sufficient to support a decision to purchase municipal or corporate securities. The decision must be supported by an independent determination that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the security.

Each federal agency has provided guidance on this topic. Though federal rules eliminate national credit agency ratings as the sole source for determining whether a security is "investment grade," management can continue to use ratings as part of the independent credit decision. For example, Office of the Comptroller of the Currency (OCC) guidance notes that "if a national bank chooses to use credit ratings as part of its "investment grade" determination and due diligence, the bank should, consistent with existing rules and guidance, supplement the external ratings with a degree of due diligence processes and additional analyses that are appropriate for the bank's risk profile and for the size and complexity of the instrument." In effect, management is expected to use a similar process for securities analysis that is used for loan credit quality analysis. Sources for obtaining the issuer's credit information include, (but are not limited to):

- Rating agency write-ups
- The security's prospectus
- Broker assessments (assuming the credit department is separate from the sales department)
- The EMMA website (Electronic Municipal Market Access – http://emma.msrb.org)

Investment policies have typically referenced credit agency ratings when defining acceptable investments. The new regulations necessitate a review of the investment policy to ensure compliance with the new requirements. Revised policies should clearly define the Board's expectations for management's determination and documentation of the due diligence required to ascertain whether a security is an acceptable investment.

New rules were adopted by the OCC in June 2012 in response to the Dodd-Frank Act. On November 16, 2012, The FDIC's "Revised Standards of Creditworthiness for Investment Securities" (FIL-48-2012) noted that insured state banks generally are prohibited from engaging in an investment activity that is not permissible for a national bank.

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