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**TESTIMONY OF**  
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**ACTING COMPTROLLER OF THE CURRENCY**  
**Before the**  
**COMMITTEE ON BANKING AND FINANCIAL SERVICES**  
**of the**  
**U. S. HOUSE OF REPRESENTATIVES**  
**September 17, 1998**

Statement required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

## **Introduction**

Mr. Chairman, and members of the Committee, I welcome this opportunity to report on the progress the Office of the Comptroller of the Currency (OCC) is making in its efforts to ensure that national banks address the problems associated with the century date change and to describe the challenges that remain.

The OCC is committed to vigorously addressing the challenges posed by the century date change. This means supervising national banks effectively to reduce the risks associated with the Year 2000 problem, and working diligently to ensure that our own internal systems are Year 2000 compliant. We have been aggressive in our examination efforts; enforcement actions; internal examiner training program; and educational outreach programs for bankers and other groups. In addition, we have actively participated in the coordinated efforts of the Federal Financial Institutions Examination Council (FFIEC) member agencies to develop policies, procedures, and guidance for all insured depository institutions.

The OCC's efforts will intensify during the balance of 1998 through the first quarter of the Year 2000 as we review the banks' testing, renovation, and contingency planning efforts. In preparation for those activities, the OCC provided advanced, formal training to a large number of examiners and reallocated examiner resources to perform Year 2000 reviews. We have also established a Year 2000 hotline and formed a special team of technical experts to answer questions our examiners pose and to go onsite at national banks, if necessary.

The overwhelming majority of national banks have demonstrated good faith efforts to address Year 2000 issues, and most are on schedule in dealing with the issues. Nonetheless, some of the toughest work associated with Year 2000 lies ahead. Correction of problems that banks identify during the testing phase may be time-consuming and expensive. In addition, correction of any problems found will need to be made quickly, just at the time when qualified programming specialists and consultants will be in high demand. Software vendors and systems providers may not be readily available, willing, or able to provide customized replacement software and hardware systems.

As we head toward 1999, the OCC is also evaluating how national banks could be affected by the Year 2000 problems of critical bank customers, such as large corporate borrowers, as well as external entities providing vital infrastructure, such as telecommunications and utility companies. For many larger banks, another critical and complex issue of concern is their exposure to foreign governments and international companies. Banks can address the credit risk associated with domestic customers by implementing appropriate credit risk management controls. With respect to external infrastructure providers and foreign parties, institutions, and their supervisors, are making conscientious efforts, through interagency and international coordinating groups, to ascertain which external entities and international parties have Year 2000 problems and what, if any,

corrective action they are taking. However, U.S. financial regulators have no direct control, and limited indirect influence, over the corrective action of many of these external entities and international parties.

The discussion that follows briefly describes the Year 2000 problem and its impact on the banking industry; provides an overview of the OCC's supervisory initiatives; highlights the significant Year 2000 challenges going forward; discusses the remediation of OCC internal systems; and concludes with our response to the Committee's request regarding suggested legislative remedies.

### **Year 2000 Problem and Its Impact on the Banking Industry**

Because information technology is an integral part of almost everything we do, the Year 2000 problem impacts virtually all businesses and their customers. Any automated, computerized system that uses dates as key data elements, including computer hardware and software of all types, other communications systems, transportation services, elevators, vaults, and security systems, is potentially subject to Year 2000 risk.

As you are well aware, the crux of the Year 2000 problem is that many computer systems currently in use were not programmed to recognize or process information with dates beyond December 31, 1999. To conserve computer memory space, programmers used two digit codes for storing years rather than four digit codes. As a result, software programs and computer chips may interpret the Year 2000 date code of "00" as "1900". Furthermore, many mainframe computers are programmed to read "99" as a code for setting up special files or storing or rejecting the data processed, so problems could arise three months before the Year 2000 when, on September 9, 1999, the date and year fields might be read as "9/9/99". Also, some systems may not recognize the Year 2000 as a leap year.

Obviously, the banking industry is highly dependent upon computer systems, and dates are an integral part of virtually all areas of bank operations, transactions, and record keeping. The banking system's readiness is especially important because banks are at the center of our payments systems and directly affect credit flows throughout the economy. Banks use computer systems to perform financial calculations, track deposits and loan payments, transfer funds, and make direct deposits. The failure of the banking industry to address and solve Year 2000 problems thus could have serious repercussions throughout our economy.

### **Overview of OCC Supervisory Initiatives**

As you know, the OCC has been working closely with other federal banking agencies under the auspices of the FFIEC to address the Year 2000 problem. The FFIEC has adopted a program to ensure a consistent and effective approach among the FFIEC member agencies in

supervising and examining depository institutions' Year 2000 efforts. The six major FFIEC Year 2000 initiatives now underway include coordinating policy; developing and issuing guidance for banks and service providers; conducting examinations of service providers and software vendors; developing examination procedures and training programs for examiners; developing regulatory contingency plans; and conducting outreach activities with trade associations.

The OCC is aggressively implementing the FFIEC program to ensure that national banks will be ready to handle the century date change. Although our focus is on the national banks and their vendors, our supervisory strategy also addresses external connections that banks rely upon to conduct business. Thus, we expect banks to test external telecommunication systems; interfaces with credit bureaus, the Internet, clearing houses, and business partners; and environmental systems such as vaults, heating/cooling systems, and security. We also expect banks to develop remediation contingency plans and business resumption contingency plans in case internal or external systems fail or are disrupted. I am pleased to report to the Committee that, on the whole, the banking industry has vigorously attacked the Year 2000 problem.

The OCC began to address Year 2000 supervisory issues in 1996. We have an extensive monitoring program that tracks, at least quarterly, the progress of national banks and their vendors in making their systems Year 2000 compliant. We met our target to complete by June 30, 1998, onsite examinations of every national bank and regional data center and assessed where they stand in their Year 2000 efforts. We will follow up as needed with every institution with which we have supervisory concerns, and we will take prompt action if any fall behind schedule. In 1999, when testing is underway, our Year 2000 examinations will include reviews of testing results and contingency planning efforts. The OCC also is working closely with the other members of the FFIEC to ensure that the third-party providers of bank data processing products and services have comprehensive Year 2000 project management programs in place and that they successfully complete their remediation and testing efforts.

*Status of Examinations.* As planned, we completed our initial Year 2000 examinations of banks, federal branches and agencies, and service providers by June 30, 1998. As of that date, nearly 96 percent of the institutions examined by the OCC received a summary evaluation of satisfactory on their progress in addressing Year 2000 problems, four percent of institutions were rated needs improvement, and eight institutions were rated unsatisfactory. These ratings are likely to fluctuate as we examine the banks' testing plans, testing results, and contingency plans. As we have done to date, the OCC will continue to take aggressive and comprehensive action to ensure that an institution rated needs improvement or unsatisfactory adequately addresses its Year 2000 risks.

Because nearly 70 percent of banks rely, in part or wholly, on service providers and software vendors for their mission-critical data processing needs, regulators must be well informed about the Year 2000 compliance of the services these firms provide to financial institutions. The OCC and the other FFIEC agencies, therefore, have divided up responsibility for examining the largest service providers and the largest software vendors. In the course of the OCC's first round of examinations, completed June 30 of this year, five out of the 109 service providers and software vendors that the OCC examined received less than satisfactory ratings on their progress. Of these five firms, four were rated needs improvement and one was rated unsatisfactory. The OCC has been working closely with these service providers to ensure that they take steps to address the deficiencies we identified.

*Enforcement.* Financial institutions must recognize that a failure to make adequate preparations for the Year 2000 will have serious consequences -- from both a business and a regulatory perspective. Unlike other types of supervisory issues which may be addressed through regular procedures, the timing inflexibility of the Year 2000 problem requires that national banks and their vendors focus on achieving year 2000 compliance without delay. In April 1998, the OCC adopted an enforcement policy specifically designed to address Year 2000 concerns. In addition to the full range of enforcement actions already available to the OCC, we are employing a new informal enforcement action. This document, a Supervisory Directive, focuses directly on the actions that banks need to take to remedy Year 2000 deficiencies. Our enforcement policy requires that we process Year 2000 enforcement actions expeditiously. We are using Supervisory Directives and other enforcement tools whenever necessary to effect prompt remedial action by banks, independent service providers, and federal branches which are rated less than satisfactory.

The OCC's choice of supervisory response is determined largely by the institution's Year 2000 summary evaluation; its progress in complying with any previously issued supervisory directive or other informal or formal enforcement action; the cooperation, responsiveness, and capability of the institution's management and board of directors; and the time remaining until the Year 2000.<sup>1</sup>

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<sup>1</sup>A Supervisory Directive is a written instruction from the OCC to bank management ordering the bank to take specific corrective actions necessary to effectively remediate a noted Year 2000 deficiency. It is considered an informal enforcement action. A Commitment Letter and a Memorandum of Understanding are two-party agreements between the OCC and the bank that are used to reflect the bank's commitment to correct its problems. They are also considered informal enforcement actions. A Formal Agreement is an agreement between the OCC and the bank that the OCC uses to require the bank's commitment to correct deficiencies and its violation can be used as the basis for a cease and desist order and result in the imposition of a civil money penalty (CMP). A Consent Order is a Cease and Desist Order issued with the consent of the institution. It is similar in content to a Formal Agreement but, in addition to the assessment of CMPs for violations, the order can be enforced through an action for injunctive relief in federal district court. A Safety and Soundness Order is similar in all aspects to a Consent Order, but it is imposed unilaterally by the agency following notice of failure to adhere to safety and soundness guidelines. Under 12 U.S.C. §1831p-1, the Federal banking agencies

The OCC's enforcement actions have been effective in improving Year 2000 readiness. Of the 278 Supervisory Directives issued through September 15, 1998, 141 were terminated because the institutions made the necessary changes. As of September 15, 1998, the OCC had issued one Commitment Letter, four Memoranda of Understanding, four Formal Agreements, and one Consent Order. One bank and its affiliated data service provider are operating under an approved safety and soundness plan. We monitor compliance with all enforcement actions on a regular basis.

*Outreach.* The OCC is devoting substantial resources to the important task of sharing Year 2000 information among members of the financial community. From May 1997 through August 1998, OCC representatives participated in 54 outreach meetings with various groups of financial institutions, service providers, and trade associations. Each of our six district offices has sponsored outreach programs for their local communities, and OCC district managers are participating in additional outreach meetings being sponsored by the FFIEC and state bankers associations. Starting in March of this year, over 9,000 bankers have participated in meetings held in 38 states. These meetings have fostered better communication among critical parties involved in the financial industry's Year 2000 remediation efforts. Moreover, they have helped the OCC raise issues, such as common industry concerns, in a more timely and efficient manner.

*Resource allocation, expertise, and training.* The OCC's Year 2000 bank examinations and related activities have resulted in unprecedented resource requirements. To meet our Year 2000 supervisory responsibilities during the remainder of 1998 and 1999, the OCC reallocated significant planned resources from less crucial scheduled examination activities and other projects to Year 2000 efforts. As a result of this reallocation, some of our regular onsite exams at small banks with low risk ratings were rescheduled for later dates. However, we did not alter our scheduled off-site safety and soundness quarterly reviews of national banks, and we continue to update all national banks' financial conditions and risk profiles quarterly.

Almost 600 examiners recently received intensive, specialized training to prepare them for Year 2000 examinations and reviews. With the assistance of external information technology experts, the OCC expanded an FFIEC training course to better meet the needs of

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may require a bank that violates safety and soundness guidelines or regulations to file an acceptable plan. Further, if the bank fails to submit or implement a plan, the agency may issue a "safety and soundness order." To implement §1831p-1, the agencies issued in 1995 the "Interagency Guidelines Establishing Standards for Safety and Soundness." See 12 C.F.R. Part 30, Appendix A. The OCC believes that national banks that fail to implement an adequate Year 2000 remediation program violate these Guidelines and, accordingly, OCC has commenced actions under 12 U.S.C. 1831p-1 against such banks. The OCC and the other FFIEC agencies are exploring the further use of safety and soundness guidelines. Formal Agreements, Consent Orders, and Safety and Soundness Orders are public documents; Supervisory Directives, Commitment Letters, and Memoranda of Understanding are not.

its examiners. Additional OCC follow-up training is being developed, with classes expected to begin during the first quarter of 1999.

To ensure that our examiners have a comprehensive understanding of Year 2000 issues, in addition to periodic written guidance, the OCC developed training videos and computer-based training packages; scheduled conference calls where examiners can raise questions as well as share valuable information on their findings; and set up a conference board for questions and answers allowing examiners to interact with Year 2000 compliance experts.

While many staff members in our headquarters and district offices are devoting significant time to Year 2000 activities, we are supplementing our examiners' expertise with support from technical experts, both within and outside the OCC. For example, the OCC formed a rapid response team of internal and contracted information technology experts to help examiners who request assistance on particular issues during examinations. This team will be particularly useful in assessing the impact of Year 2000 problems identified during the testing phase, and will be available, when appropriate, for onsite assistance to examiners. This month, a team of examiners and Year 2000 consultants is reviewing the testing plans of service providers and software vendors supervised by the OCC. This centralized review will provide consistent and timely analysis of testing plans, and will help us identify key issues and appropriate supervisory actions. The OCC also established a Year 2000 "help desk" to respond to questions examiners raise in the course of their Year 2000 examinations. Staff from our policy, operations, and information technology units will address these questions and post responses on the OCC's internal Year 2000 webpage.

### **Remaining Year 2000 Challenges**

The OCC's actions thus far have been effective; most of the institutions we supervise are making good progress on their Year 2000 remediation programs. But important challenges remain.

*Testing.* Financial institutions are now entering perhaps the most critical phase of their Year 2000 preparation process. As these institutions move through the testing phase, we will have a much clearer picture of whether they will be ready for the turn of the millennium. One of the OCC's particular concerns is that, since most testing will take place in the first quarter of 1999, there could be a significant supervisory challenge if a large number of banks have difficulties during that peak period of testing reviews and analysis. The testing phase, for most banks and service providers, will consume over 60 percent of the cost and time spent to address Year 2000 problems.

Earlier this year, the bank supervisors developed a coordinated approach, through the FFIEC, called the Workprogram Phase II. This program consists of examination procedures

which specifically address testing and contingency planning. The Workprogram Phase II procedures include a review of the bank's testing plans and evaluation of testing progress; an assessment of the bank's ability to successfully implement its testing program; a review of the bank's customer due diligence process; a review of the bank's responses to the Self-Assessment Survey previously distributed to all national banks; a discussion of the bank's progress in developing a customer awareness strategy; and a follow up on any prior outstanding issues.

The OCC's supervisory strategy for completing the Workprogram Phase II procedures calls for completion of two additional onsite examinations for each national bank by June, 1999. The first set of examinations, to be completed by year-end 1998, will ensure that each institution has an adequate testing plan in place prior to the beginning of testing. The second set of examinations, scheduled for the first half of 1999, will take place after institutions have tested their systems and will assess testing results and contingency planning efforts. We made the decision to conduct two onsite examinations related to testing within this time period in order to catch and help correct problems in banks' testing plans and testing efforts as soon as possible.

The OCC and the other FFIEC agencies are also taking steps, where appropriate, to encourage industry coordination of testing. We are working closely with the bank trade groups regarding their efforts to conduct bank-to-bank and bank-to-counterparty testing. Also, the supervisory agencies are monitoring the efforts of the Mortgage Bankers Association to coordinate testing of mortgage banks and mortgage-related government sponsored enterprises. The OCC is also actively participating in the President's Council on Year 2000 Conversion. The Council has been helping to encourage testing efforts. One such initiative involves proxy testing between representatives from the financial services industry and the telecommunications industry. The test process and accompanying results will be made available to interested parties and should provide other non-participant financial institutions a means to evaluate the readiness of its telecommunications providers.

*Contingency Planning.* Regulators must develop contingency plans that outline steps to address problematic Year 2000 situations. The OCC is involved in several interagency contingency planning efforts. We participated in an interagency working group that included representatives of the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (Fed), and the Office of Thrift Supervision (OTS), and addressed the issue of what conditions must exist for the appointment of a receiver for a financial institution that fails to remediate its Year 2000 problems. The findings of the group yielded information that will be useful in the identification of institutions with significant potential to fail because of Year 2000 problems and that will be the foundation for more targeted interagency contingency planning in the future.



The OCC also is developing contingency plans to deal with the industry's capacity to absorb non-Year 2000 ready institutions. As we examine bank data centers and non-bank service providers, we will also assess their capacity to service new clients experiencing Year 2000 problems. The OCC and the other FFIEC agencies are beginning to compile a "bidders list" for Year 2000 purposes that will include institutions that have a demonstrated, well managed Year 2000 program and the capability to acquire other institutions.

The OCC established an internal working group to develop regulatory options for addressing bank-specific and systemic risk concerns. This group will outline plans for dealing with local problems that might temporarily disable banks in particular areas (e.g., the failure of a local utility or telephone company). We are also working on contingency plans for dealing with Year 2000 problems in individual national banks, such as a bank's failure to complete the remediation phase of mission-critical systems or its business resumption plan. Finally, the OCC's legal staff is finalizing a review of our legal authority to close banks due to Year 2000 failures.

Addressing the Year 2000 problem is consuming significant human and monetary resources of regulators, financial institutions, service providers, hardware and software vendors, and other affected businesses. The limited time frame in which to deal with the many, sometimes conflicting, demands for remediating all systems and applications presents additional challenges. However, we believe that the time table we have established for banks to meet specific requirements and our aggressive examination schedule represents the best approach to enable institutions -- and, if necessary, regulators -- to take corrective action if testing plans, results, and contingency planning efforts prove inadequate.

*Public Confidence.* Educating bank customers about the Year 2000 problem is critical to minimizing unnecessary public alarm, which could cause serious problems for financial institutions and their customers. The OCC and the other FFIEC agencies have issued guidance instructing financial institutions to provide complete and accurate responses to questions and concerns raised by their customers. The OCC asked each national bank to develop a customer awareness program by September 30, 1998. This program should include appropriate communications channels to effectively respond to customer inquiries. The program also should address how the bank will respond to its customers should unfavorable events occur, whether those events are caused by internal bank problems (e.g., system breakdown) or external (e.g., adverse media coverage of Year 2000, computer problems elsewhere). The OCC and FFIEC will continue to consider further efforts to encourage banks to educate their customers about the Year 2000 problem.

*Credit risk.* The efforts bank customers, particularly large corporate borrowers, take to prepare for the Year 2000 will affect banks directly. Banks' credit portfolios will weaken if loan customers are unable to meet their obligations to the banks because of the borrowers' own

Year 2000 malfunctions. The examinations we have conducted to date show that most large banks have implemented Year 2000 credit risk management controls, but the sophistication of those controls differs widely. Also, while community banks are generally aware of this issue, they are not as far along in their preparations as large banks. National banks were to have in place a due diligence process to control the Year 2000 risks posed by their customers by June 30, 1998. At the conclusion of the third quarter of 1998, our examiners will be able to confirm whether the institutions they supervise did, in fact, put in place adequate controls to address customers' Year 2000 related credit risk.

The OCC continues to gather information on how institutions are addressing the credit risk aspects of the Year 2000 problem from the shared national credit review, which we conducted in the second quarter of 1998. A second quarter survey of 45 large national banks and federal branches and agencies revealed that about eighty percent of those banks have a process in place to evaluate their customers' Year 2000 readiness, and all banks expect to complete their assessment of that readiness by the end of this month. Generally speaking, these banks use the size of their relationship with a customer as a ranking factor in identifying their most critical customers. They are also using a given customer's reliance on technology to determine that customer's Year 2000 risk. Banks are training loan officers to perform basic assessments of Year 2000 customer risk and to determine which aspect of that customer's financial condition would most likely be affected. Some banks are also adopting risk control measures, such as developing covenants on adequate resources to achieve Year 2000 compliance, increasing reserves to the ALLL, reducing credit lines, and shortening credit maturities.

Currently, credit markets are sufficiently liquid so that many borrowers can readily obtain funding without Year 2000 restrictions. Therefore, in assessing their customers, most banks have been viewing the Year 2000 problem as one additional credit factor to be considered along with other, more traditional factors. We anticipate that this factor will increase in weight from the bankers' perspective as the century date change approaches.

*International Remediation Efforts.* Awareness of the Year 2000 problem is increasing around the world, but unfortunately, some countries are just now initiating Year 2000 awareness programs encompassing their financial markets, clearing and settlement systems, and important infrastructure platforms. Therefore, we are concerned about the global state of Year 2000 preparedness and the potential adverse impact that Year 2000 problems could have on international financial markets, clearing and payments systems, financial institution liquidity, and overall economic performance. Global financial market participants are intricately connected through automated linkages with correspondent banks and customers through the global clearing and payments systems. Operational breakdowns caused by insufficient Year 2000 preparations by any major clearing organization, settlement agent, or securities depository in these systems could cause significant liquidity pressures for market

participants. In addition, possible overreaction by market participants and the general public to their perceptions of Year 2000 risk could precipitate instability in the global financial markets.

If Year 2000 issues are not addressed properly, public confidence in banks and other financial institutions around the world could be undermined, particularly if the global media sensationalizes the potential problems that could develop. Thus, it is critical for foreign countries to make progress on their Year 2000 preparations and build market confidence in those efforts.

U.S. bankers have found it difficult to ascertain the Year 2000 status of some foreign countries for a number of reasons. First, many developing countries are preoccupied with domestic economic troubles and thus are unable to focus adequately on the problem. Often, these countries lack public and private sector organizations that could provide the market with reliable information on their Year 2000 efforts. Second, some developed countries have stated publicly that the Year 2000 problem is not a serious issue, further alarming bankers who recognize, based on first-hand experience, that the Year 2000 risks in those countries are significant. Third, it is not clear how extensively countries preparing for the introduction of the Euro have been able to also fully address the Year 2000 issue at the same time.

OCC examiners assigned to our largest and most internationally active national banks report that these institutions are working diligently, as FFIEC guidance directs, to develop appropriate contingency plans to mitigate risks to those foreign agencies, customers and counterparties that are not testing their Year 2000 readiness thoroughly or successfully. Although U.S. banks' contingency plans for global Year 2000 risk are not yet completed, the next phase of our Year 2000 examination program will focus on banks' efforts to develop appropriate contingency plans for potential problems arising from Year 2000 induced failures.

Several international Year 2000 groups, particularly the Global 2000 Coordinating Group<sup>2</sup> and the Joint Year 2000 Council<sup>3</sup>, are helping countries focus on the many aspects of the Year 2000 preparation process that will require careful, effective cross-border coordination

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<sup>2</sup> The Global 2000 Coordinating Group includes representatives from financial services firms that are located in and operate across multiple markets (including banking, securities and insurance markets) and jurisdictions. The group is hosted by the Swiss Bank Corporation, and it currently consists of 77 institutions and associations representing 18 countries. The U.S. Steering Committee members are Bankers Trust, Citibank, Chase, J.P. Morgan, Lehman Brothers, Merrill Lynch, Morgan Stanley Dean Witter, Salomon Smith Barney, and the Securities Industry Association.

<sup>3</sup> The Joint Year 2000 Council is a multilateral group of international financial market regulatory authorities that is focusing on increasing information sharing on regulatory and supervisory Year 2000 strategies, discussing possible contingency measures, and establishing linkages with national and international private sector initiatives.

of initiatives. Through these multilateral groups of international financial market regulatory authorities, the OCC is working with foreign bank supervisors to encourage more information sharing on regulatory Year 2000 strategies, discuss contingency measures, establish linkages with national and international private sector initiatives, and promote more aggressive international Year 2000 remedial action.

The OCC is collecting global Year 2000 readiness information through a series of outreach activities with market participants and domestic and foreign financial industry regulators. We also established within the OCC a Global Banking Coordinator's office staffed by full-time senior large-bank examiners with responsibility for researching and maintaining data on Year 2000 risk in foreign countries and assessing market perceptions of risk and potential market reactions. This unit is building a Global Year 2000 Risk Analysis database to support our supervisory efforts and will help the OCC identify potential problem areas as well as market perceptions regarding global Year 2000 readiness. The database will include regional and country specific information on foreign public- and private-sector Year 2000 preparations and will help the OCC identify and assess consensus market perceptions regarding the Year 2000 progress of key foreign governments, financial systems, clearing and settlement systems, and infrastructure that could have an impact on the operations of U.S. banks.

*Infrastructure.* Both in the U.S. and abroad, another source of potential Year 2000 risk is the infrastructure upon which the public, private, and government sectors rely. Hence, it is important to ascertain the status of telecommunication and power companies, in particular, and to make sure they are making adequate progress.

Earlier this year, many banks expressed concerns that telecommunications and power companies were not disclosing sufficient information on their Year 2000 remediation efforts. In response, the OCC and the other FFIEC agencies began meeting with government officials to discuss infrastructure concerns. Through our participation in the President's Council on Year 2000 Conversion, telecommunications and power companies have been urged to share information on the readiness of these critical industries.

Over the past quarter, national banks and federal branches and agencies indicate that they have received increased information on the Year 2000 readiness efforts of telecommunications providers, and many national banks and federal branches and agencies report that their telecommunications providers appear to be making adequate progress towards remediating and testing telecommunications networks. Bankers are telling the OCC that less information has been forthcoming from power companies, however.

Our most immediate concern at this time is that many companies providing critical infrastructure will not be ready for external testing until well into 1999. For some, we understand that testing with their customers may not begin until the second or third quarter of

1999. Such a time schedule increases the risks to the banking system because it provides only limited time to remedy problems that surface during testing.

The OCC will continue to remind national banks and federal branches and agencies to gather information and assess Year 2000 readiness efforts of all mission-critical service providers, including telecommunications providers and power companies. When we identify problems, we will work diligently to address them.

Let me now turn to the other issues you asked me to address in your letter of invitation. First, I will describe the status of the OCC's internal remediation process; then I will discuss our views on proposed legislative measures to facilitate progress on the Year 2000 phases that lie ahead.

### **Remediation of OCC Internal Systems**

The OCC has pursued an aggressive strategy for Year 2000 remediation of its own internal systems. We expect our total outlay for this effort to be approximately \$8 million.

The OCC identified 13 mission-critical information technology (IT) systems that support the key business functions of the agency. Of these systems, one will be retired, nine have been renovated, validated, and implemented, and the remaining three have been renovated, with implementation to occur shortly. This is well in advance of the Treasury Department deadline of December 31, 1998.

We also reviewed mission-critical non-IT systems. Mission-critical non-IT systems are those systems that are located at primary OCC sites and directly support the continuous operations of the building infrastructure as well as the life and safety of OCC personnel. We identified and assessed 29 of these mission-critical non-IT systems, six owned directly by the OCC with the remaining 23 being leased from other parties. Of these systems, 17 were compliant, eight were non-compliant, and four are currently being assessed. One of the non-compliant systems has already been repaired, two are awaiting repair, and five will be replaced. The OCC is updating its Business Continuity Plan to ensure we are adequately prepared for all eventualities.

*Testing.* Agency testing of our internal systems has been successful to date. Testing of renovated program code, particularly mission-critical systems, has demonstrated that those systems are Year 2000 compliant, and generally in need of little further revision. We are scheduled to complete the testing and implementation of all mission-critical IT systems, non-mission-critical IT systems, commercial-off-the-shelf packages, and telecommunications equipment by October 31, 1998.

*Contingency planning.* To ensure that we will be able to continue operations in the event of mishaps affecting our internal systems, the OCC developed contingency plans for all mission-critical and non-mission-critical systems and applications, as well as for internal and external data exchange partners. All of the OCC's mission-critical IT system contingency plans will be tested in the first quarter of 1999.

*Independent validation and verification.* The OCC also developed an independent validation and verification program, which consists of three steps. First, OCC's application systems scheduled to be renovated will be reviewed and assessed by a team including contractors and OCC programmers. Second, after this team's work is complete, a separate test team of contractors and OCC personnel will independently validate and verify the systems' Year 2000 compliance. As a third check, an implementation team consisting of system user representatives will validate and confirm the operation of the system at the end of the implementation phase.

*Certification.* The final phase of OCC's Year 2000 internal compliance process is certification. Each phase of the Year 2000 compliance process creates documentation and an audit record of compliance activities. The OCC's certification process entails reviewing this documentation, conducting spot checks of systems to verify reported results, and interviewing participants to ensure process compliance. This added process will ensure that all planned compliance steps were completed.

## **Legislative Remedies**

You specifically asked, Mr. Chairman, for our views on Year 2000 liability and whether any legislative remedies are needed to facilitate our Year 2000 efforts.

*Year 2000 Liability Issues for Banks.* The Administration's Year 2000 disclosure bill, the "Good Samaritan" bill (H.R. 4355 and S. 2392) is intended to encourage the disclosure and exchange of information on Year 2000 issues. Under the bill, to recover in a civil suit based on an allegedly false or misleading Year 2000 statement, a claimant must establish certain specific elements, including knowledge that the statement was false, inaccurate, or misleading and that there was an intent to mislead or deceive. The OCC believes that this legislation will encourage voluntary disclosure and a meaningful exchange of information on Year 2000 remediation activities, such as information exchanges among power and telecommunications companies and the financial institutions they serve.

*Additional Year 2000 Legislative Remedies.* We also recommend that the Bank Service Company Act (BSCA) be amended to clarify that, under current law, when a bank causes an entity to provide services to it that are covered by the BSCA, under contract or otherwise, the entity is subject to enforcement actions with respect to the performance of those services to the

same extent as if the services were performed by the bank on its own premises. Such an amendment would clarify that the appropriate Federal banking agency that has examination authority for a bank, or a subsidiary or affiliate of that bank also has the authority under the BSCA to bring an enforcement action under 12 U.S.C. § 1818 against the entity that is providing such services under contract or otherwise to the bank or its subsidiary or affiliate. The appropriate Federal banking agency's ability to bring such an action could encourage a service provider to take the necessary actions to achieve Year 2000 readiness.

The Examination Parity and Year 2000 Readiness for Financial Institutions Act, enacted earlier this year, gave the Office of Thrift Supervision (OTS) and National Credit Union Administration (NCUA) authority to take enforcement action against service providers. Although this authority was designed to parallel the current authority of the banking agencies under the BSCA, the different format and terminology used in that Act have resulted in a clearer, more direct statement of enforcement authority being made available to the thrift and credit union regulators, making it desirable to clarify again that all of the banking agencies have comparable authority to take such actions on an ongoing basis. We have prepared draft legislative language which we would be happy to share with the Committee for your consideration.

## **Conclusion**

The OCC is committed to vigorous action to address the challenges posed by the century date change. We have devoted significant resources to supervising national banks to ensure that they are ready for the Year 2000, and we are working diligently to ensure that our internal systems are Year 2000 compliant. Throughout the remainder of 1998 and through the first quarter of the Year 2000, when we review the national banks' testing, renovation, and contingency planning efforts of Year 2000 problems and solutions, we will intensify our efforts significantly.

We also recognize that banks have exposures to external entities, including telecommunications and utility companies, and, in particular, foreign governments and international companies over which we have no direct control and, in many cases, limited indirect influence. Banks could also be affected by the Year 2000 problems of large corporate borrowers. We are participating in interagency and international groups to help address these concerns. Importantly, the institutions we supervise are making conscientious efforts to ascertain which external entities and international parties have Year 2000 problems and what, if any, corrective action they are taking.

The attention you, Mr. Chairman, and this Committee, have focused on the Year 2000 problems contributes to the effort to ensure that our nation's financial system will function

smoothly when we reach the Year 2000. I appreciate the opportunity to keep you apprised of our efforts to support that goal.