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Background

The Office of the Comptroller of the Currency (OCC) was established in 1863 as a bureau of the Department of the Treasury. The OCC is headed by the Comptroller, who is appointed by the President, with the advice and consent of the Senate, for a five-year term.

The OCC regulates national banks by its power to:

- Examine the banks;
- Approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure;
- Take supervisory actions against banks that do not conform to laws and regulations or that otherwise engage in unsound banking practices, including removal of officers, negotiation of agreements to change existing banking practices, and issuance of cease and desist orders; and
- Issue rules and regulations concerning banking practices and governing bank lending and investment practices and corporate structure.

The OCC divides the United States into six geographical districts, with each headed by a deputy comptroller.

The OCC is funded through assessments on the assets of national banks, and federal branches and agencies. Under the International Banking Act of 1978, the OCC regulates federal branches and agencies of foreign banks in the United States.

The Comptroller

Eugene A. Ludwig took the oath of office on April 5, 1993, as the 27th Comptroller of the Currency.

By statute, the Comptroller serves a concurrent term as director of the Federal Deposit Insurance Corporation and the Neighborhood Reinvestment Corporation. The Comptroller also serves as a member of the Federal Financial Institutions Examination Council.

Mr. Ludwig joined the OCC from the law firm of Covington and Burling in Washington, D.C., where he was a partner beginning in 1981. He specialized in intellectual property law, banking, and international trade. He has written numerous articles on banking and finance for scholarly journals and trade publications, and served as a guest lecturer at Yale and Harvard law schools and Georgetown University's International Law Institute.

Mr. Ludwig grew up in York, Pennsylvania, where he attended York Suburban High School. He earned a B.A. magna cum laude from Haverford College in Pennsylvania. He received a Keasbey scholarship to attend Oxford University, where he studied politics, philosophy, and economics and earned a B.A. and M.A. He holds an LL.B. from Yale University, where he served as editor of the Yale Law Journal and as chairman of Yale Legislative Services.

The *Quarterly Journal* is the journal of record for the most significant actions and policies of the Office of the Comptroller of the Currency. It is published four times a year in March, June, September, and December. The *Quarterly Journal* includes policy statements, decisions on banking structure, selected speeches and congressional testimony, material released in the interpretive letters series, statistical data, and other information of interest to the administration of national banks. Suggestions, comments, or questions on content may be sent to Rebecca W. Miller, Senior Writer-Editor, Communications Division, Comptroller of the Currency, Washington, DC 20219. Subscriptions are available for $100 a year by writing to Publications—QJ, Comptroller of the Currency, P.O. Box 70004, Chicago, IL 60673–0004.

Quarterly Journal

Office of the Comptroller of the Currency

Eugene A. Ludwig

Comptroller of the Currency

The Administrator of National Banks

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Condition and Performance of Commercial Banks

Stable interest rates and strong economic growth contribute to record bank earnings and performance in 1997

The U.S. economy grew for a seventh consecutive year in 1997 with real gross domestic product (GDP) rising 3.8 percent. Employment growth lowered the unemployment rate to 4.6 percent, the lowest level in the last 20 years. In spite of robust growth, estimated inflation dropped to a three-decade low: 2.1 percent. Commercial banks contributed to these macroeconomic developments with earnings totaling a record $59.2 billion and bank employment rising above 1.5 million for the first time since the last U.S. recession (1990–91).

Although credit quality concerns, particularly with respect to underwriting, remain, several indicators suggest that credit quality improved during 1997. Non-performing assets as a percent of assets and non-current loans as a percent of loans dropped to the lowest levels since the 1980s. Meanwhile, commercial banks increased their equity to record levels.[1]

Commercial bank performance was tied to U.S. economic growth during 1997, but will this trend continue in 1998? The condition of the economy and commercial banking appears at a turning point with both deflationary and inflationary factors affecting the 1998 economic outlook.

On the deflation side, economic troubles in Asia continue to disrupt U.S. markets.[2] Some U.S. firms report negative earnings, influenced, in part, by overseas events and declining exports. Domestic price levels, as measured by the producer price index (PPI), declined during the last quarter, reflecting both surplus production and declining demand in world markets.[3] These trends could well continue into 1998.

On the inflation side, investment demand remains strong even as consumer demand has picked up. Even as the PPI declined in 1997, the consumer price index (CPI) began to nudge upwards during the fourth quarter. Labor costs have also begun to rise, particularly in high-tech sectors and among high-tech employees. Fourth quarter GDP of 4.1 percent and the lowest unemployment rate since 1969 suggest that the economy, if left unchecked, could overheat in 1998 with higher prices and inflation.[4]

Our 1998 baseline envisions a modest economic growth scenario with commensurate bank performance. Although the overall outlook for 1998 is cautiously optimistic, we are compelled to offer two alternative scenarios to the baseline: a deflation-recession scenario (banks suffer greater losses) and inflation-excess growth scenario (banks grow rapidly but suffer smaller losses than they do in the recession scenario). The prominence of both alternatives suggests that banks will need to be nimble to thrive in the evolving market environment.

Last quarter, we discussed the implications of the Southeast Asia financial crisis for U.S. commercial banks and lessons learned over the past decade. This quarter, we monitor changes in Asia and review potential effects of a federal budgetary surplus.

This report has three parts:[5]

Part I, Macro-Economic Overview. Part I presents a baseline U.S. forecast that calls for stable to slightly declining prices and moderate economic growth. It features a federal budgetary surplus that may offset the effect of the Asian crisis. This baseline suggests continued strong bank earnings and asset growth. It is the least risky of three scenarios considered.

Part II, The Implications for National Banks. Part II discusses the potential performance of national banks, given the baseline and alternative scenarios presented in Part I. The outlook remains favorable if tenuous.

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[1] Equity capital increased to record $417.9 billion. Equity to asset ratios increased to the highest level in a decade, 8.3 percent.

[2] Deflation is a reduction in the price level during a specified period of time—the opposite of inflation. A reduction in the rate of inflation or the rate at which the price level increases is disinflation.

[3] The Board of Governors of the Federal Reserve System, *Beige Book* (March 18, 1998).

[4] Council of Economic Advisers, *Economic Report of the President,* February 1997.

[5] The Financial and Statistical Analysis Division of the Economics Department in OCC provides this report to give an overview of recent developments in the U.S. economy and the commercial banking industry. The report includes a current macroeconomic overview and outlook, an analysis of what this implies for national banks, and a featured discussion based upon recent research results and financial analysis of the condition of the banking industry. This quarter's featured discussion on whole bank risk is the joint product of the Bank Research Division and the Financial and Statistical Analysis Division of the Economics Department.

Part III, Featured Discussion: Recent Findings of Market to Book Valuations for Industry Aggregates. The third part compares market value financial ratios and book value financial ratios using a new analytical procedure developed at the OCC.

Part I. Macroeconomic Overview

The U.S. economy continues to improve even after 28 consecutive quarters of expansion. While the Asian crisis casts doubt on continued strong economic growth, the economy exhibits considerable resiliency, generates new jobs, and reveals solid corporate earnings and increases in productivity.

The Asian turmoil. The events in Asia dominated macroeconomic discussions during the first quarter. The general question remains: "How much will the Asian downturn affect growth in the United States?" The consensus among analysts is that the U.S. growth rate will decline by 0.5 to 1.0 percent during 1998 relative to what it would have been otherwise. These effects should become more pronounced in the third and fourth quarters of 1998 or 1999.[6] Recent studies focus more on why the crisis developed in Pacific Rim countries, than on its U.S. macroeconomic consequences. Generally, a combination of external shocks, underdeveloped financial regulatory structures, excess lending for real-estate speculation, and inappropriate industrial policies and foreign currency policies precipitated this crisis.

Although most analyses indicate that the Asian economies are basically sound and further deepening of the crisis is unlikely, financial reform is not guaranteed. Two of the more poignant illustrations as to why financial reform is not guaranteed are the Indonesian intransigence to International Monetary Fund (IMF) agreements and the increasing pressure on China to devalue its currency. Lack of progress in resolving the Indonesian crisis poses a potential threat to political stability in the region. The threat of a Chinese devaluation raises the specter of competitive currency devaluations throughout the region. Either concern would undermine carefully crafted IMF agreements to stabilize Asian economies.

The Federal Reserve System has resisted the downward pressure on domestic U.S. interest rates posed by foreign capital inflows and a declining federal deficit. Keeping the Fed discount rate above short-term market interest rates has strengthen the U.S. dollar and helped moderate domestic investment demand. The strong dollar has strengthened U.S. imports from Asia and, as a consequence, kept domestic price levels from rising because of to increased import competition.

In the 1970s, the economy labored under the persistence of high inflation and unemployment. Budget deficits were measured in the billions. The federal budget and trade deficits became the primary macroeconomic problems of the 1980s. Budget deficits started to be measured in tens and then hundreds of billions. The 1990s began with a weakened banking sector and a recession. Still, the federal deficits persisted.

The economy turned a corner after the last recession. Since 1992, the federal deficit has been shrinking steadily as a percent of GDP, a result of expenditure restraint and increases in tax revenues due to steady economic growth. In 1998, the Administration and Congress can finally point to the first federal budgetary surplus in since 1969.[7]

What are the effects of deficit reduction? Those who conclude that continuous deficits are bad, particularly during economic expansions, generally believe that federal budgetary deficits contributed to and exacerbated the negative economic events of the late 1980s and early 1990s.[8]

Logic suggests that if deficits during expansions produce negative consequences, such as higher interest rates and lower real investment, deficit reductions or even surpluses could have the opposite effects. Reducing the deficit in the late 1990s should lower interest rates and stimulate investment. Some anecdotal evidence supports the notion that this process may have already begun.

Since deficit reduction began in earnest in 1992, the real cost of capital and investment has fallen. (See Figures 1 and 2 in the appendix.) Real investment and productivity have grown rapidly since 1992. (See Figures 3 and 4 in the appendix.)

Continued deficit reduction during 1998, therefore, should encourage positive economic growth, lower interest rates, and encourage a pro-investment atmosphere—the story behind our baseline.

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[6] "A U.S. recession is possible if the economies of Asia collapse more than we now expect," *Review of the U.S. Economy,* Standard & Poor's, DRI division of McGraw Hill. (January 1998). See also: Board of Governors of the Federal Reserve System, *The Blue Chip Economic Indicators* (January, February, and March 1998) and the Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1998–2007* (January 1997).

[7] Council of Economic Advisers, 1997, p. 367.

[8] See Benjamin Friedman, *Day of Reckoning,* Random House, (1988) for a discussion of why the deficit may have adverse economic consequences. For an opposing point of view, see Robert Barro, *Macroeconomics*, John Wiley & Sons (1990).

Review of the Forecast

In this section, we present three very different scenarios for the U.S. economy:

- Stable to slightly declining prices and moderate economic growth (baseline),
- A lower price level with lower economic growth (deflation and recession), and
- Rising prices with temporarily faster economic growth (modest inflation and strong near-term economic growth).

The key indicators determining which scenario is likely to emerge during 1998 are:

- The level of inflation: do prices remain stable, rise, or fall?
- The situation in Asia: does the IMF succeed in getting Asian countries to discipline their economies?
- Will Japanese investors repatriate investments in an orderly fashion?
- Will the U.S. federal budget surplus produce the opposite effects of a budget deficit?

Three points can be made with some confidence:

- The U.S. economy will likely continue growing, but at a slower pace.
- The market volatility faced by financial institutions will likely rise.
- Lower interest rates will likely continue to stimulate corporate investment.

Scenario 1: Stable Prices, Moderate Growth, and a Federal Budgetary Surplus (Baseline)[9]

Key indicators of this scenario are:

- Growth in the U.S. economy remains positive,
- Prices remain stable to slightly decreasing and interest rates fall, thereby stimulating corporate investment,
- Foreign investors maintain their foreign investments in U.S. Treasury securities,
- The IMF succeeds in containing the crisis in Southeast Asia, and
- The Peoples Republic of China maintains its current exchange rates.

Economic growth. The baseline scenario suggests moderate economic growth and lower interest rates. Real GDP growth stays in the 2.3 to 2.7 percent range. Interest rates drop slightly and remain relatively fixed as the federal budgetary surplus helps to offset the Asian crisis. Unemployment rates rise slightly and the CPI index indicates modest inflationary pressure.

Commodity prices. Commodity prices, as measured by the producer price index (PPI), fell throughout most of 1997 and early 1998.

Small decreases in the PPI are generally positive and indicate that inflation is modest. Small changes in the PPI are positive because commodity inputs into manufacturing processes, such as oil, cost less and stimulate corporate profits. Large decreases in the PPI signal deflationary pressure is building and provide a leading indicator of recession. Large declines in the PPI suggest excess supply and may indicate that competing suppliers abroad are dumping product on the world market below the cost of production. Prolonged price deflation can therefore undermine corporate profits and lead to layoffs.

A key concern in appraising the current outlook for prices is whether the Peoples Republic of China maintains its existing exchange rate. The Chinese currency is currently pegged at rates that have prevailed since before the devaluations of other Asian nations this past year. This policy has placed China in the position of relative strength within the region, but has come at the cost of a loss of export competitiveness. Domestic tensions in China have, however, brought this policy into question in recent weeks. Should the Chinese devalue their currency, there is concern that other Asian nations would be pressured to follow suit with competitive devaluations like those experienced in the West during the 1930s. Such an event would lead to a further cycling down of currency values and, with them, world market prices.

Bank supervisors will want to watch for price decreases in two asset classes: land and equity prices. *Falling land prices* undermine bank loan collateral and raise the probability and cost of loan default.[10] While it is

[9] The three scenarios provided reflect a consensus projection derived from a variety of sources including the *Blue Chip Economic Indicators,* Data Resources Incorporated, and discussions with financial analysts.

[10] "In Focus This Quarter—Trends in Commercial Real Estate Loan Pricing and Underwriting," *Regional Outlook* [for eight regions], Federal Deposit Insurance Corporation, first quarter 1998. Falling capital goods prices have the same general effect. However, equipment and machinery are less important than real estate in most bank portfolios.

unclear that all land markets have begun to respond to events in Asia, exports of products, such as agricultural commodities, are clearly down. *Falling equity prices* reduce consumer wealth and encourage cut backs in demand for all manner of expenses, including loans, which directly lowers GDP. Equity markets continue to be whipsawed by events in Asia and, consequently, it remains unclear whether the net effect would be positive or negative.

Corporate earnings and exports. Asia accounts for only 5 percent of U.S. total corporate earnings. The firms likely to be hardest hit export infrastructure materials, machinery, and services to Asia. Capital goods account for 42 percent of U.S. exports. Although exports of capital goods make up 15 percent of total U.S. exports to Asia, much of that is in technology components, which are assembled into computers and other products in Asia and re-exported to the U.S. and other countries. Therefore, while local purchases of technology products will slow down, U.S. companies could benefit from lower costs on goods assembled in Asia.

Commercial bank lending. According to the Federal Reserve, Asian loans outstanding account for less than 3 percent of total bank assets. The direct effects of the Asian crisis on credit quality are minimal and relegated to a few larger banks. Alternatively, the indirect effects that appear as loan losses to U.S. export industries may be more important. The lower overall growth in real output reflects this concern in the baseline.

Effect on bond markets. Japan's central bank and private investors hold about 10 percent of all U.S. Treasury securities. How likely are the Japanese to divest themselves of their U.S. bond holdings?

A Japanese sell-off is currently unlikely because of the interest rate premium on U.S. bonds. Long-term interest rates are still higher in the United States than in Japan. For this reason, most analysts believe that Japanese investors are more likely to raise cash by borrowing against these securities than by selling them.

This analysis focuses on the primary effects of Japanese debt repatriation. There are, however, also secondary effects: the Japanese have large investments worldwide. The effect of Japanese repatriation of investments in Southeast Asia no doubt helped spook Asian security markets this past fall. The U.S. economy is, however, more sensitive to capital flights out of Latin America. Japanese repatriation of Latin American investments has already affected those markets and may serve to reduce U.S. exports to that region further during 1998.

Scenario 2: Falling Prices and Negative Economic Growth (Deflation, Recession, and Deficits)

Key indicators of this scenario are:

- U.S. prices begin to fall rapidly (deflation),
- The Federal Reserve raises interest rates,
- The Chinese devalue their currency,
- Japanese investors begin repatriating their investments in U.S. bonds in a disorderly manner, and
- The IMF fails to contain problems in Southeast Asia either because of a lack of Asian cooperation or a lack of funds.

Economic contraction. If a recession occurs in 1998, it will be characterized by insufficient investment and export demand and it will develop in the second half of the year. In this scenario, the yield curve flattens and slowly begins to rise. Export demand declines with the strong dollar and competition from Asian producers reduces rates of return on domestic investment, which, in turn, cuts corporate investment. Layoffs rise and the unemployment rate increases. The CPI index continues to fall.

Corporate lending and the federal budget surplus. In this scenario, the Asian crisis deepens severely and U.S. exports decline abruptly. The combined direct and indirect effects of the crisis reduce the demand for corporate loans and erode credit quality. The federal budget surplus quickly dissipates as federal tax revenues fall with lower corporate profits, rising unemployment, and rising interest payments on the national debt. Investment demand declines with reductions in export demand and in consumer demand.

Effects on the bond markets. Bond investors will benefit from the deflationary environment likely to develop from a more pronounced Asian crisis.[11] Bond market analysts have been expecting a weakening in industrial production and consumption demand as the first quarter of 1998 closes.

A budget surplus reduces the need for the Treasury to issue new debt. Treasury debt paydown directly reduces the liquidity in bond market and, as a consequence, adds additional uncertainty in the pricing of all classes of debt instruments. This uncertainty arises because, in finance theory, Treasury bonds are considered a risk-free

[11] Bonds return fixed interest payments and a fixed principal amount that is more valuable when prices and interest rates decline.

asset. Any addition of risk to the risk-free asset affects pricing of all other assets associated with it. Many corporate debt instruments are priced as a spread over Treasury securities of the same maturity. These effects have already been noticed by market observers.[12]

The U.S. Treasury Department announced on March 18, 1998, that the government plans to retire $7 billion in outstanding debt (2-year and 5-year notes) in March. Treasury expects to retire a total of $28 billion worth of debt in 1998.

As a result, the supply of bonds has been shrinking with the decline in the federal deficit. Bondholders who want to buy new bonds must compete for a smaller supply. Bond prices rise accordingly. Derivative products priced by using these bonds will likely become more volatile with the reduced bond liquidity.[13]

As the recession deepens, federal expenditures rise and tax receipts fall creating a new federal deficit and prompting the U.S. Treasury to expand bond sales.

Scenario 3: Rising Prices and Stronger Growth (Inflation, Expansion, and Balanced Budget)

Key indicators of this scenario are:

- U.S. price levels (inflation) rise and the dollar weakens,
- Foreigners continue investing in U.S. Treasury securities,
- Tax cuts (or increased federal spending) stimulate domestic demand, and
- Prompt recovery of Southeast Asian country economies from the recent crises.

Economic growth. Real GDP grows between 2.5 and 3.5 percent over the next year and unemployment rates continue to decline. The 30-year Treasury bill rises from 6.2 to 7.7 percent over the next year and the CPI increases 3.2 percent

Corporate lending and the federal budget surplus. Demand for loans increases as a result of either tax cuts or increases in government spending. The Asian crisis moderates and import prices do not fall as much as in the baseline scenario. The federal surplus declines and the cost of capital to U.S. corporations rises slightly.

Effects on the bond markets. Bond prices fall with the growth of inflation but not to the extent seen in past years because stable federal spending limits the supply of bonds and because foreign investors have fewer good alternatives. Corporate investment drops off with reduced export growth and renewed inflation fears.

Part II. Implications of the Macro Economy for National Banks

As 1998 began, 2,597 commercial banks held national bank charters. These banks hold approximately 58 percent of the industry's assets, employ 60 percent of its employees, and represent only 28 percent of its charters. National banks began the year in excellent financial condition.

This section explores three components of the outlook for national banks: the short-term, quarter-to-quarter view, and our three macroeconomic scenarios. The implications of our scenarios are summarized in an appendix table: Summary of Macroeconomic Effects on National Banks.

Short-Term Effects: Quarterly Risk Outlook

The OCC bank calculator program permits us to simulate quarterly changes in the probability that national banks will fail, given various assumptions about the economy, bank condition, and structural variables.[14]

Assume that the economy follows the baseline projections and that all banks with an estimated probability of failure exceeding 10 percent over the next 5 years are *at risk of failure.* The total number of national banks at risk over the next 5 years is 34, down almost 30 percent from last quarter's projections. The annual number of national banks at risk over the next 5 years is roughly 7 per year. This improvement reflects a decline in unemployment rates and an improved financial condition of national banks during the fourth quarter of 1997: more capital, better earnings, higher ROE, and higher ROA. The combination of these effects reduces the estimated likelihood of failure relative to last quarter.

[12] Libor (London interbank offered rate) rates are also used for this purpose, but their usefulness is limited to very short-term instruments. See Jane Locke, "Interest Rates: Surplus to Requirements," *Risk Magazine,* March 1998, pp. 29–32.

[13] Locke, 1998, pp. 29–32.

[14] The OCC bank calculator is an OCC Windows-based program constructed and programmed in the OCC Financial and Statistical Analysis Division. It employs coefficients from an econometric model/analysis of national bank failures over the period 1985–1996. It simulates the effects of changing economic and banking circumstances on the relative frequencies of national bank failures. See: Stephen Hiemstra, Stephen Kane, Thomas Lutton and P.A.V.B. Swamy, "A New Method for Forecasting Bank Failures and Insurance Fund Losses," OCC memorandum, January 15, 1998.

Five-year outlook: risk assessments under alternative macroeconomic scenarios. National banks are most at risk under conditions of recession with deflation, as articulated in our second scenario. In this case, we assume unemployment rises to an average of 6 percent and the interest rate spreads on Treasury bonds drop 10 basis points during 1998. The number of national banks at risk rises almost 60 percent over the baseline to a total of 54 banks. If we additionally assume that capital-asset ratios of national banks drop an average of 1 percent with this recession, the number of banks at risk rises to 82—almost double our baseline estimate.[15] Banks in the Central and Southwestern districts are most vulnerable to recession in this analysis (see table—Summary of Macroeconomic Effects on National Banks, in appendix).

The third scenario, higher inflation and economic expansion, is more comparable to the recession scenario than to our baseline. The actual number of national banks at risk in Scenario 3 increases to 44 banks at risk over 5 years (see table—Scenario 3: Rising Prices and Stronger Growth, in appendix). This suggests one to two additional national banks at risk per year over the baseline, but these results also assume no additional capital deterioration.

While these scenarios may provide some comfort that the national banking system is relatively secure in its ability to handle diverse macroeconomic conditions, several points need to be made:

- Our bank calculator projects only probabilities or relative frequencies of failure. It does not examine expected rates of return, income, or market equity of banks. It does not, for example, examine the reduction in capital or income associated with specific macroeconomic events. Nor does it measure the volatility or the degree of uncertainty associated with alternative scenarios.
- Book value capital-to-asset ratios should not be confused with market values. In either case, capital-to-asset ratios do not remain fixed, particularly in financial duress. Such ratios deteriorated rapidly during the 1980s and early 1990s just prior to bank resolutions. The bank calculator uses projections of deterioration in the ratios of capital to assets, as part of the simulation exercise, but results presented here assume little additional capital deterioration beyond the forecast period and therefore may not be sufficiently sanguine.

[15] During these regional economic downturns and recession, capital asset ratios dropped even more precipitously and national bank failures hit triple digits. In the 1980s, even apparently well-capitalized banks failed quickly.

Part III. Featured Discussion: Recent Findings of Market-to-Book Valuations for Industry Aggregates

Since enactment of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), supervisors have been legally required to close troubled banks at minimum cost to the insurance fund. To do this, examiners must close banks when they become *market value* insolvent. The Prompt Corrective Action (PCA) provisions in FDICIA specify that regulators are to consider banks critically undercapitalized when *book value* capital falls below 2 percent.[16]

The 2 percent rule is a legal acknowledgement that the market values of troubled institutions usually reach zero long before the book value does. Recent research suggests that the speed of book equity capital declines during the 1980s and 1990s occurred sufficiently rapidly and that virtually all national banks resolved between 1985 and 1994 became insolvent before the book value thresholds prescribed by PCA would have been breached.[17]

Although basic to the regulator mission, market values are not directly observed in call reports or other data series. Market values must be estimated and unfortunately doing so means they are likely to contain errors.[18]

The OCC recently developed a new method that provides hope that these errors may be reduced. This approach to risk assessment is known as whole bank risk.[19] Whole bank risk employs a risk-based supervision strategy that uses a return on equity (ROE) accounting

[16] Under FDICIA, any bank with total risk-based capital under 2 percent or a leverage ratio under 2 percent is considered critically undercapitalized.

[17] Stephen W. Hiemstra, Kevin T. Jacques, and Stephen A. Kane, "Implications from Bank Failure Estimates for Capital Adequacy Standards," OCC memorandum, January 1998.

[18] Book values are the acquisition prices of assets purchased by the bank. As historical values, there is no presumption that the assets appreciate over time or, for that matter, provide an indication of the current value of these assets. Market values measure the current value of assets. Market values should, however, be distinguished from salvage values, which may prevail if a bank is liquidated rather than purchased by another institution. Clearly, the method by which a bank is resolved (or failed) by the regulator can influence the value of its assets.

[19] This section summarizes results from a larger work: P.A.V.B. Swamy, Thomas J. Lutton, and Philip F. Bartholomew, "Theory and Measurement of Whole Bank Risks and Their Components," OCC memorandum, March 1998. See also P.A.V.B. Swamy, Thomas J. Lutton, and Philip Bartholomew "Whole Bank Risk: A Risk Measurement Technique," OCC Draft Working Paper presented at Western Economic Association meeting in Seattle, WA (July 1997). The work

identity with time series data to determine how ROE is related to return on assets, a leverage ratio, interest expense on liabilities, and taxes.[20]

To illustrate this approach with aggregate data, we examine how book value time series data on two strata of banks may be connected to market values. Stratum 1 consists of banks that generate positive returns and pay taxes (financially sound). Stratum 2 consists of banks that generate negative returns and do not pay taxes (financially weak banks). Some banks, of course, can generate positive returns and pay no taxes or generate negative returns and pay taxes, but we exclude these from consideration for purposes of illustration.

We examined these two strata of banks for each quarter from 1984 to 1996. We estimated the ratios of market value return on assets to interest expenses on liabilities (the higher the ratio, the better the financial condition) to the book values of the same variables. See Figure 5 in appendix for stratum 1 results and Figure 6 for stratum 2 results. We chose these extreme cases to make the point that we already brought prior information to these two cases. Before we even tested the approach we knew that risks associated with stratum 1 should be much less than stratum 2. We also knew that book values may be more useful in financially sound banks than in financially weak or compromised banks. Our empirical results supported these "priors."

Not only are the ratios higher for stratum 1 than stratum 2 as expected, but also the volatility of the market values is more pronounced in stratum 2. The greater the volatility, the greater the risk. Many of the banks in stratum 2 had to be resolved during this period. Note also when comparing Figure 5 (stratum 1) to Figure 6 (stratum 2), the book values in stratum 1 serve as better indicators of market ratios than do those in stratum 2. Indeed, book value ratios are generally positive in stratum 2, but market value ratios are frequently negative and much more volatile than book value ratios.

Figures 7 and 8 compare book and market value equity to asset ratios for strata 1 and 2, respectively. Note that for only a very brief period in the last recession, the market values for banks in stratum 1 exceeded book values. Moreover, the market value ratios often exceeded 6 percent for these banks. See Figure 7 in appendix. By contrast, the market to book ratios for stratum 2 banks were generally much lower. Book values technically never hit zero, but market values did so with some frequency. In addition, the volatility of the book value equity to asset ratios was close to zero, compared to the extremely volatile market value ratios.

Book values frequently overstate the financial position of the weaker banks in stratum 2, even to the point of showing positive equity when the bank has no market equity at all.

In principle, we can take the underlying equations and use them to project ROE and measure various components of risk. These approaches are documented in the cited studies and model validation continues to determine whether this approach is useful for individual banks.

In conclusion, whole bank risk provides a simple way to compare market value financial ratios to book value ratios. Although only used in an illustrative fashion in this analysis, the approach is easily generalized to individual banks, or groups of banks. More testing is needed but the initial results appear promising. This approach may be used to forecast individual bank returns and the volatility of those returns. Ultimately, if it passes out of sample forecasting tests, the model may be used to examine risk-return tradeoffs and a bank's appetite for risk.

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on whole bank risk was developed jointly by the Financial and Statistical Analysis and the Bank Research divisions, Economics Department, OCC.

[20] This procedure dovetails with the OCC's supervision by risk procedures. Risk is defined as a potential loss in returns conditional upon anticipated or unanticipated events. This procedure starts with whole bank return and examines how returns are affected by internal and external events. The approach permits a disaggregation of risk into various components including interest rate risk, business risk, financial risk, leverage risk, and tax risk. Ultimately it permits risk to be explicitly measured or quantified in a dollar-denominated, time-specific fashion.

Appendix

Table 1—Scenario 1: Stable Prices and Moderate Growth

Item	97:3	97:4	98.1	98:2	98:3	98:4	99:1
				Percentage change			
Gross domestic product[1]	3.5	4.3	2.3	2.5	2.7	2.7	2.5
Treasury bills:							
1 year	5.85	5.15	5.00	5.00	5.00	5.00	5.00
30 year	6.93	6.15	5.70	5.60	5.55	5.70	5.80
Spread	1.08	1.00	0.70	0.60	0.55	0.70	0.80
Consumer price index	2.0	2.1	1.3	1.4	1.7	1.7	1.8
Unemployment rate	4.9	4.7	4.8	5.0	5.1	5.1	5.1

[1] Percentage change in real 1992 dollars in $Billions, SAAR.
Source: Financial and Statistical Analysis Division, OOC

Table 2—Scenario 2: Falling Prices and Lower Growth

Item	97:3	97:4	98.1	98:2	98:3	98:4	99:1
				Percentage change			
Gross domestic product[1]	3.5	4.3	1.0	–1.5	–2.0	–2.5	1.0
Treasury bills:							
1 year	5.54	5.15	5.00	4.90	4.20	3.50	3.00
30 year	6.93	6.15	5.30	5.00	5.00	5.00	4.80
Spread	1.08	1.00	0.30	0.10	0.80	1.50	1.80
Consumer price index	2.0	2.1	1.0	0.0	–0.5	–1.0	–1.0
Unemployment rate	4.9	4.8	5.1	5.5	6.0	6.5	6.7

[1] Percentage change in real 1992 dollars in $Billions.
Source: Financial and Statistical Analysis Division, OOC

Table 3—Scenario 3: Rising Prices and Stronger Growth

Item	97:3	97:4	98.1	98:2	98:3	98:4	99:1
				Percentage change			
Gross domestic product[1]	3.5	4.3	2.7	3.0	3.5	2.8	2.5
Treasury bills:							
1 year	5.54	5.15	5.65	6.00	6.25	6.50	6.50
30 year	6.93	6.15	6.85	7.45	7.55	7.55	7.70
Spread	1.08	1.00	1.30	1.45	1.35	1.05	1.20
Consumer price index	2.0	2.1	2.3	2.5	2.8	3.1	3.2
Unemployment rate	4.9	4.8	4.8	4.7	4.5	4.6	4.8

[1] Percentage change in real 1992 dollars in $Billions, SAAR.
Source: Financial and Statistical Analysis Division, OOC

Table 4—Summary of Macroeconomic Effects on National Banks

	No change from Q4	Baseline	Macroeconomic scenarios Recession	Growth
Key assumptions:			Percentage	
Interest rate spread	1.00	0.67	0.90	1.27
Unemployment rate	4.7	5.02	5.96	4.68
Banks at risk:			Number of banks	
Total	34	34	54	44
			District distribution in percent	
Northeastern	8.8	8.8	7.4	6.8
Southeastern	8.8	8.8	13.0	9.1
Central	23.5	23.5	25.9	27.3
Midwestern	17.6	17.6	11.1	13.6
Southwestern	20.6	20.6	24.1	22.7
Western	20.6	20.6	18.5	20.5
Total	100.0	100.0	100.0	100.0

Source: OCC

Table 5—Commodity Market Prices, Annual 1990–97 and Monthly 1997

Annual:	1990	1991	1992	1993	1994	1995	1996	1997				
CPI, 1982–84=100	130.8	136.3	140.4	144.6	148.3	152.5	157.0	160.6				
PPI, 1982–84=100	116.3	116.5	117.2	118.9	120.5	124.8	127.7	127.6				
Crude Oil	$21.48	$20.56	$20.56	$18.46	$17.19	$18.43	$22.15	$20.60				
Gold	$383.54	$362.24	$343.67	$359.19	$384.29	$384.43	$387.81	$331.59				
Aluminum	$0.75	$0.60	$0.58	$0.54	$0.71	$0.86	$0.72	$0.78				
Wheat	$3.41	$3.15	$3.83	$3.53	$3.78	$4.57	$5.44	$4.12				
Cotton	$0.71	$0.71	$0.54	$0.57	$0.73	$0.93	$0.80	$0.70				
Monthly:	**Jan–97**	**Feb–97**	**Mar–97**	**Apr–97**	**May–97**	**Jun–97**	**Jul–97**	**Aug–97**	**Sep–97**	**Oct–97**	**Nov–97**	**Dec–97**
CPI, 1982–84=100	159.4	159.7	159.8	160	160.1	160.4	160.6	160.9	161.3	161.6	161.8	161.9
PPI, 1982–84=100	129.7	128.5	127.3	127	127.4	127.2	126.9	127.2	127.5	127.8	127.8	126.7
Crude Oil	$25.17	$22.03	$20.99	$19.72	$20.83	$19.17	$19.64	$19.93	$19.79	$21.26	$20.17	$18.32
Gold	$356.20	$345.68	$351.81	$344.59	$344.50	$341.95	$325.81	$324.05	$323.62	$323.31	$308.20	$289.31
Aluminum	$0.76	$0.77	$0.80	$0.77	$0.79	$0.77	$0.76	$0.82	$0.78	$0.78	$0.78	$0.76
Wheat	$4.59	$4.52	$4.55	$4.77	$4.45	$4.11	$3.52	$3.81	$3.83	$3.86	$3.79	$3.68
Cotton	$0.70	$0.70	$0.71	$0.69	$0.70	$0.72	$0.73	$0.72	$0.71	$0.69	$0.68	$0.64

CPI = All urban consumers, seasonally adjusted, 1982–84 = 100. PPI = All commodities, not seasonally adjusted, 1982–84 = 100
Crude Oil = West Texas intermediate crude spot price, dollars per barrel. Gold = London spot price, P.M. fix, dollars per troy ounce
Aluminum = Ingot spot price, Tuesdays, Midwest, dollars per pound. Wheat = Number 2, Hard, Kansas City spot price, dollars per bushel.
Cotton = 1 1/16 inch string, low–medium grade, Memphis spot price, dollars per pound.
Source: Haver Analytics

Figure 1—Federal Deficit (Surplus)

Percent of GDP

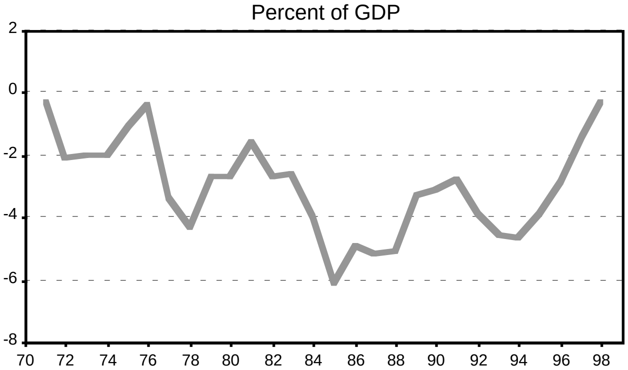


Figure 2—GDP and Investment

Normalized (1970:1=1.00)

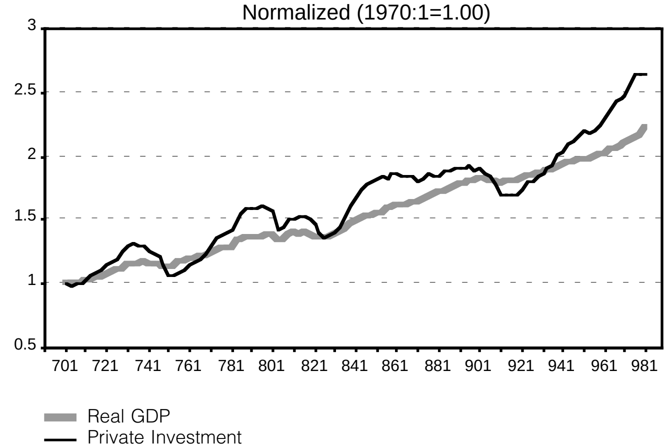


Figure 3—Private Fixed Investment

Qty. vs. Price: (1970:1=1.00)

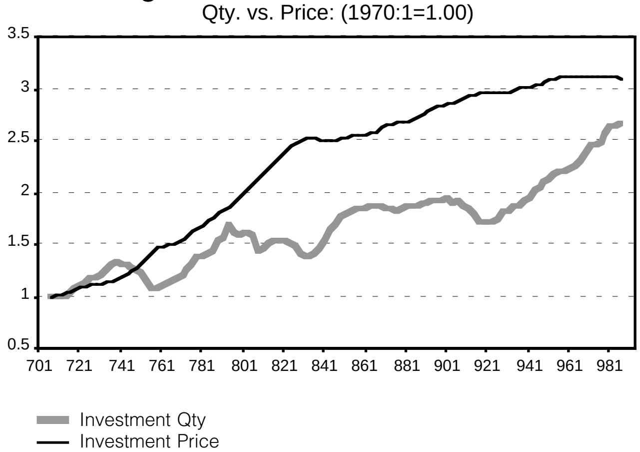


Figure 4—Labor Productivity

1992=100

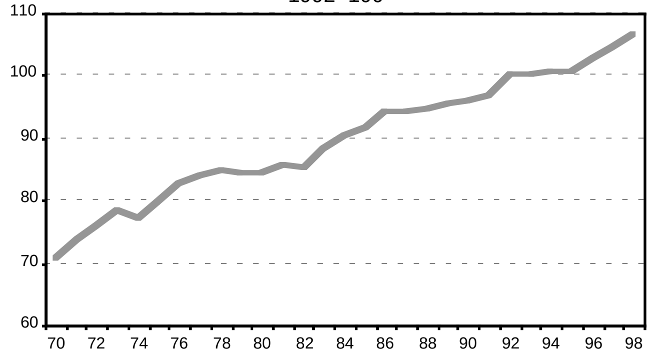


Figure 5—Return on Assets/IOL

Stratum 1: Whole Bank Risk

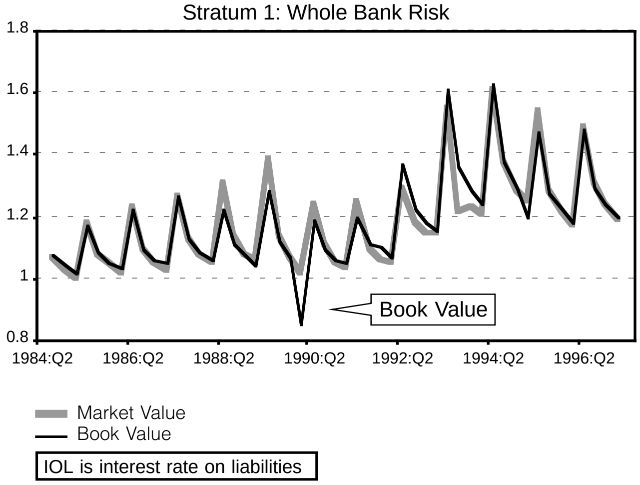


Figure 6—Return on Assets/IOL

Stratum 2: Whole Bank Risk

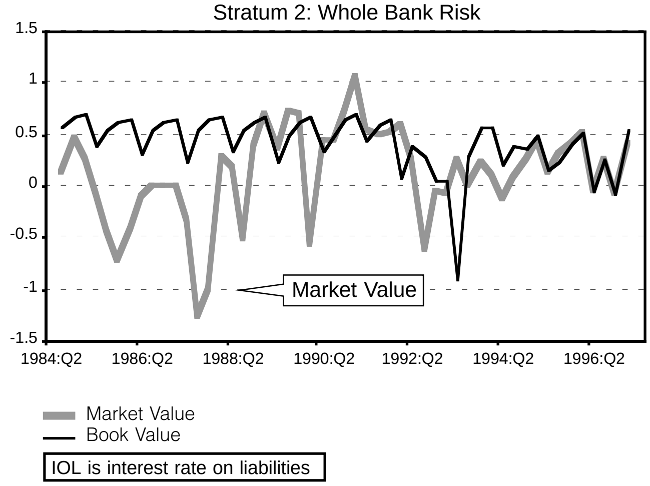


Figure 7—Equity to Asset Ratios

Stratum 1: Whole Bank Risk

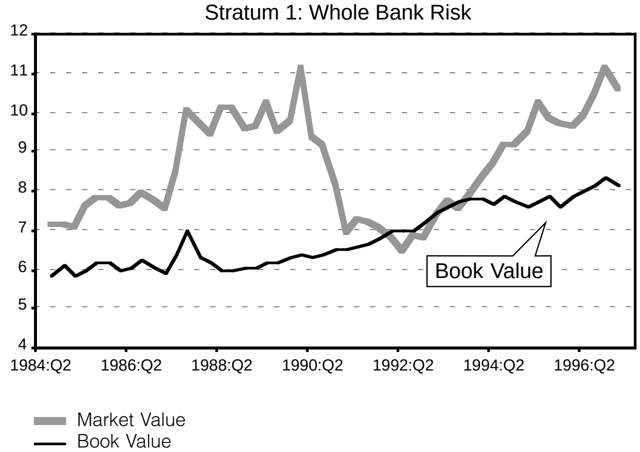
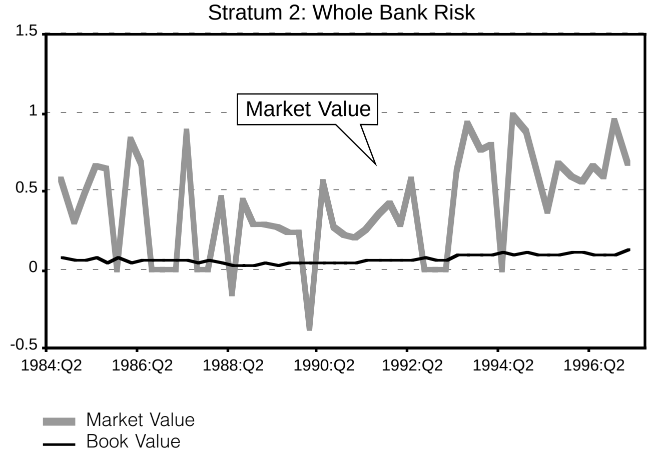


Figure 8—Equity to Asset Ratio

Stratum 2: Whole Bank Risk



Key indicators, FDIC-insured national banks
Annual 1993–1996, year-to-date through December 31, 1997, fourth quarter 1996, and fourth quarter 1997
(Dollar figures in millions)

	1993	1994	1995	1996	Preliminary 1997 YTD	1996Q4	Preliminary 1997Q4
Number of institutions reporting	3,304	3,075	2,858	2,726	2,597	2,726	2,597
Total employees (FTEs)	868,305	851,311	840,699	850,737	911,425	850,737	911,425
Selected Income Data ($)							
Net income	$25,553	$26,803	$28,584	$30,498	$35,816	$8,035	$9,343
Net interest income	80,141	83,958	87,080	94,565	106,641	24,359	26,952
Provision for loan losses	9,158	5,500	6,335	9,598	13,032	2,708	3,581
Noninterest income	45,342	45,906	51,079	56,102	65,425	15,412	17,241
Noninterest expense	82,199	83,941	87,591	93,691	104,670	24,699	27,302
Net operating income	22,742	27,027	28,541	30,097	35,027	7,915	8,918
Cash dividends declared	13,278	17,669	20,516	25,279	28,575	8,206	11,261
Net charge-offs to loan and lease reserve	10,053	5,994	6,459	9,968	12,649	2,822	3,444
Selected Condition Data ($)							
Total assets	2,100,548	2,256,008	2,401,017	2,528,057	2,893,910	2,528,057	2,893,910
Total loans and leases	1,269,271	1,382,855	1,522,677	1,641,464	1,840,662	1,641,464	1,840,662
Reserve for losses	31,520	30,990	31,142	31,992	34,836	31,992	34,836
Securities	436,703	414,264	390,549	380,615	452,111	380,615	452,111
Other real estate owned	10,229	5,709	3,396	2,764	2,111	2,764	2,111
Noncurrent loans and leases	26,310	17,852	17,595	17,223	17,795	17,223	17,795
Total deposits	1,576,725	1,630,171	1,695,817	1,801,043	2,004,855	1,801,043	2,004,855
Domestic deposits	1,364,048	1,350,658	1,406,312	1,525,565	1,685,304	1,525,565	1,685,304
Equity capital	164,660	172,655	189,714	207,167	244,992	207,167	244,992
Off-balance-sheet derivatives	5,434,701	7,570,283	7,914,818	7,488,663	8,704,481	7,488,663	8,704,481
Performance Ratios (annualized %)							
Return on equity	16.41	15.99	15.76	15.28	15.01	15.55	15.20
Return on assets	1.26	1.24	1.24	1.25	1.29	1.29	1.31
Net interest income to assets	3.95	3.87	3.78	3.88	3.83	3.90	3.78
Loss provision to assets	0.45	0.25	0.27	0.39	0.47	0.43	0.50
Net operating income to assets	1.12	1.25	1.24	1.24	1.26	1.27	1.25
Noninterest income to assets	2.23	2.12	2.22	2.30	2.35	2.47	2.42
Noninterest expense to assets	4.05	3.87	3.80	3.85	3.76	3.96	3.83
Loss provision to loans and leases	0.75	0.42	0.44	0.61	0.73	0.67	0.79
Net charge-offs to loans and leases	0.82	0.46	0.45	0.63	0.70	0.69	0.76
Loss provision to net charge-offs	91.10	91.75	98.09	96.29	103.03	95.94	104.00
Performance Ratios (%)							
Percent of institutions unprofitable	5.08	4.13	3.32	4.77	4.58	7.85	7.66
Percent of institutions with earnings gains	67.86	52.59	66.83	67.87	68.54	57.78	60.76
Nonint. income to net operating revenue	36.13	35.35	36.97	37.24	38.02	38.75	39.01
Nonint. expense to net operating revenue	65.51	64.64	63.40	62.18	60.83	62.10	61.78
Condition Ratios (%)							
Nonperforming assets to assets	1.76	1.05	0.88	0.80	0.69	0.80	0.69
Noncurrent loans to loans	2.07	1.29	1.16	1.05	0.97	1.05	0.97
Loss reserve to noncurrent loans	119.80	173.59	176.99	185.75	195.76	185.75	195.76
Loss reserve to loans	2.48	2.24	2.05	1.95	1.89	1.95	1.89
Equity capital to assets	7.84	7.65	7.90	8.19	8.47	8.19	8.47
Leverage ratio	7.37	7.39	7.31	7.40	7.43	7.40	7.43
Risk-based capital ratio	12.48	12.47	12.09	11.97	11.88	11.97	11.88
Net loans and leases to assets	58.93	59.92	62.12	63.66	62.40	63.66	62.40
Securities to assets	20.79	18.36	16.27	15.06	15.62	15.06	15.62
Appreciation in securities (% of par)	1.38	–3.84	0.86	0.50	1.11	0.50	1.11
Residential mortgage assets to assets	21.41	20.43	20.13	19.81	20.11	19.81	20.11
Total deposits to assets	75.06	72.26	70.63	71.24	69.28	71.24	69.28
Core deposits to assets	59.87	55.16	53.28	54.08	51.59	54.08	51.59
Volatile liabilities to assets	28.12	29.90	30.29	29.83	31.41	29.83	31.41

Loan performance, FDIC-insured national banks
Annual 1993–1996, year-to-date through December 31, 1997, fourth quarter 1996, and fourth quarter 1997
(Dollar figures in millions)

	1993	1994	1995	1996	Preliminary 1997 YTD	1996Q4	Preliminary 1997Q4
Percent of Loans Past Due 30–89 Days							
Total loans and leases	1.30	1.14	1.26	1.39	1.32	1.39	1.32
Loans secured by real estate (RE)	1.56	1.28	1.38	1.45	1.39	1.45	1.39
1–4 family residential mortgages	1.39	1.28	1.44	1.63	1.65	1.63	1.65
Home equity loans	0.86	0.87	1.19	1.04	0.93	1.04	0.93
Multifamily residential mortgages	1.93	1.45	1.15	1.28	1.34	1.28	1.34
Commercial RE loans	1.84	1.26	1.26	1.25	0.95	1.25	0.95
Construction RE loans	2.39	1.67	1.42	1.63	1.63	1.63	1.63
Commercial and industrial loans*	0.83	0.76	0.77	0.89	0.76	0.89	0.76
Loans to individuals	1.94	1.77	2.16	2.46	2.49	2.46	2.49
Credit cards	2.62	2.08	2.35	2.70	2.68	2.70	2.68
Installment loans	1.56	1.59	2.04	2.26	2.34	2.26	2.34
All other loans and leases	0.35	0.34	0.40	0.41	0.46	0.41	0.46
Percent of Loans Noncurrent							
Total loans and leases	2.07	1.29	1.16	1.05	0.97	1.05	0.97
Loans secured by real estate (RE)	3.01	1.83	1.46	1.27	1.07	1.27	1.07
1–4 family residential mortgages	1.32	0.96	0.90	1.10	1.01	1.10	1.01
Home equity loans	0.65	0.56	0.52	0.47	0.43	0.47	0.43
Multifamily residential mortgages	3.33	3.19	2.21	1.47	1.01	1.47	1.01
Commercial RE loans	4.53	2.81	2.18	1.71	1.27	1.71	1.27
Construction RE loans	10.49	4.93	3.17	1.31	1.00	1.31	1.00
Commercial and industrial loans*	1.77	1.04	1.06	0.87	0.78	0.87	0.78
Loans to individuals	1.15	1.01	1.18	1.34	1.47	1.34	1.47
Credit cards	1.38	1.09	1.34	1.70	1.98	1.70	1.98
Installment loans	1.02	0.97	1.06	1.04	1.04	1.04	1.04
All other loans and leases	0.97	0.47	0.32	0.25	0.27	0.25	0.27
Percent of Loans Charged-Off, Net							
Total loans and leases	0.82	0.46	0.45	0.63	0.70	0.69	0.76
Loans secured by real estate (RE)	0.69	0.29	0.13	0.09	0.06	0.06	0.07
1–4 family residential mortgages	0.19	0.14	0.10	0.08	0.08	0.09	0.08
Home equity loans	0.29	0.25	0.23	0.24	0.18	0.22	0.20
Multifamily residential mortgages	1.03	0.39	0.20	0.09	0.01	0.18	0.01
Commercial RE loans	0.91	0.47	0.18	0.02	–0.01	–0.05	0.03
Construction RE loans	3.21	0.82	–0.01	0.16	–0.10	–0.06	–0.13
Commercial and industrial loans*	0.55	0.16	0.10	0.22	0.27	0.26	0.36
Loans to individuals	1.70	1.49	1.80	2.45	2.86	2.69	3.07
Credit cards	3.58	3.06	3.40	4.25	4.95	4.52	5.28
Installment loans	0.70	0.59	0.76	1.04	1.19	1.21	1.30
All other loans and leases	0.47	–0.08	–0.07	0.09	0.07	0.15	0.06
Loans Outstanding ($)							
Total loans and leases	$1,269,271	$1,382,855	$1,522,677	$1,641,464	$1,840,662	$1,641,464	$1,840,662
Loans secured by real estate (RE)	526,941	562,005	610,405	646,570	725,463	646,570	725,463
1–4 family residential mortgages	256,739	282,000	317,521	329,031	363,608	329,031	363,608
Home equity loans	44,390	46,044	48,836	55,022	67,588	55,022	67,588
Multifamily residential mortgages	16,231	17,081	18,161	20,480	23,346	20,480	23,346
Commercial RE loans	144,827	151,514	157,638	170,359	190,050	170,359	190,050
Construction RE loans	37,063	33,571	34,736	38,839	47,388	38,839	47,388
Farmland loans	7,601	8,310	8,734	9,046	10,176	9,046	10,176
RE loans from foreign offices	20,091	23,484	24,779	23,794	23,306	23,794	23,306
Commercial and industrial loans	343,916	370,094	405,630	425,148	508,582	425,148	508,582
Loans to individuals	249,611	291,799	320,009	356,067	371,496	356,067	371,496
Credit cards	89,506	111,109	131,228	161,104	168,257	161,104	168,257
Installment loans	160,105	180,690	188,781	194,963	203,239	194,963	203,239
All other loans and leases	152,217	162,135	189,490	216,194	237,333	216,194	237,333
Less: Unearned income	3,415	3,178	2,857	2,515	2,212	2,515	2,212

* Includes “All other loans” for institutions under $1 billion in asset size.

Key indicators, FDIC-insured national banks by asset size
Fourth quarter 1996 and fourth quarter 1997
(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	1996Q4	1997Q4	1996Q4	1997Q4	1996Q4	1997Q4	1996Q4	1997Q4
Number of institutions reporting	1,457	1,377	1,061	1,030	161	147	47	43
Total employees (FTEs)	37,535	35,839	119,968	113,307	180,076	151,613	513,158	610,666
Selected Income Data ($)								
Net income	$184	$198	$887	$800	$1,935	$1,716	$5,029	$6,629
Net interest income	772	744	2,949	2,814	5,825	5,296	14,813	18,098
Provision for loan losses	51	49	299	265	1,041	1,204	1,317	2,064
Noninterest income	270	466	1,303	1,237	3,114	3,186	10,725	12,353
Noninterest expense	727	879	2,654	2,612	4,908	4,626	16,410	19,184
Net operating income	184	195	887	794	1,916	1,690	4,927	6,239
Cash dividends declared	188	203	709	748	2,141	2,849	5,168	7,460
Net charge-offs to loan and lease reserve	45	36	273	220	1,017	1,235	1,487	1,952
Selected Condition Data ($)								
Total assets	71,956	69,069	271,742	268,738	545,362	475,998	1,638,997	2,080,104
Total loans and leases	40,149	39,727	165,306	163,250	363,662	316,046	1,072,347	1,321,640
Reserve for losses	547	531	2,544	2,390	7,758	7,703	21,144	24,212
Securities	21,622	19,159	72,393	71,663	97,423	90,309	189,177	270,980
Other real estate owned	115	93	291	256	409	213	1,950	1,549
Noncurrent loans and leases	461	417	1,568	1,328	3,865	3,465	11,329	12,586
Total deposits	62,404	59,357	223,539	219,480	379,066	322,074	1,136,034	1,403,944
Domestic deposits	62,404	59,357	223,042	219,014	371,171	315,702	868,948	1,091,231
Equity capital	7,430	7,352	25,403	25,543	46,697	44,046	127,638	168,051
Off-balance-sheet derivatives	663	516	5,639	4,602	63,476	59,795	7,543,980	8,782,176
Performance Ratios (annualized %)								
Return on equity	9.99	10.81	14.13	12.65	16.54	15.44	15.79	15.71
Return on assets	1.04	1.16	1.32	1.21	1.44	1.46	1.24	1.30
Net interest income to assets	4.35	4.37	4.40	4.26	4.32	4.50	3.66	3.54
Loss provision to assets	0.29	0.29	0.45	0.40	0.77	1.02	0.33	0.40
Net operating income to assets	1.04	1.14	1.32	1.20	1.42	1.44	1.22	1.22
Noninterest income to assets	1.52	2.73	1.95	1.87	2.31	2.71	2.65	2.41
Noninterest expense to assets	4.09	5.16	3.96	3.96	3.64	3.93	4.05	3.75
Loss provision to loans and leases	0.51	0.50	0.73	0.66	1.15	1.54	0.50	0.63
Net charge-offs to loans and leases	0.46	0.37	0.67	0.55	1.13	1.58	0.56	0.60
Loss provision to net charge-offs	111.69	134.03	109.61	120.41	102.32	97.47	88.59	105.73
Performance Ratios (%)								
Percent of institutions unprofitable	10.64	10.82	4.81	4.17	4.97	4.08	0.00	2.33
Percent of institutions with earnings gains	53.67	55.99	60.70	66.89	71.43	60.54	72.34	67.44
Nonint. income to net operating revenue	25.95	38.50	30.64	30.53	34.83	37.56	42.00	40.57
Nonint. expense to net operating revenue	69.72	72.70	62.43	64.49	54.91	54.54	64.26	63.00
Condition Ratios (%)								
Nonperforming assets to assets	0.80	0.74	0.69	0.59	0.78	0.77	0.83	0.69
Noncurrent loans to loans	1.15	1.05	0.95	0.81	1.06	1.10	1.06	0.95
Loss reserve to noncurrent loans	118.62	127.32	162.19	180.01	200.71	222.31	186.64	192.38
Loss reserve to loans	1.36	1.34	1.54	1.46	2.13	2.44	1.97	1.83
Equity capital to assets	10.33	10.64	9.35	9.50	8.56	9.25	7.79	8.08
Leverage ratio	10.31	10.44	9.06	9.18	7.77	8.32	6.87	6.88
Risk-based capital ratio	18.04	17.79	15.08	14.96	12.15	12.90	11.31	11.21
Net loans and leases to assets	55.04	56.75	59.90	59.86	65.26	64.78	64.14	62.37
Securities to assets	30.05	27.74	26.64	26.67	17.86	18.97	11.54	13.03
Appreciation in securities (% of par)	0.13	0.68	0.26	0.90	0.40	1.13	0.69	1.20
Residential mortgage assets to assets	22.41	22.18	25.33	25.89	22.19	23.02	17.99	18.63
Total deposits to assets	86.73	85.94	82.26	81.67	69.51	67.66	69.31	67.49
Core deposits to assets	76.70	75.09	72.49	70.97	60.92	58.65	47.76	46.70
Volatile liabilities to assets	11.49	12.51	15.93	16.84	25.96	25.49	34.22	35.28

Loan performance, FDIC-insured national banks by asset size
Fourth quarter 1996 and fourth quarter 1997
(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	1996Q4	1997Q4	1996Q4	1997Q4	1996Q4	1997Q4	1996Q4	1997Q4
Percent of Loans Past Due 30–89 Days								
Total loans and leases	1.67	1.63	1.45	1.31	1.62	1.69	1.29	1.22
Loans secured by real estate (RE)	1.43	1.46	1.17	1.09	1.28	1.26	1.59	1.48
1–4 family residential mortgages	1.80	1.88	1.49	1.36	1.45	1.40	1.72	1.76
Home equity loans	1.18	1.15	0.84	0.80	1.03	0.85	1.07	0.96
Multifamily residential mortgages	0.66	0.87	0.65	0.88	0.70	1.01	1.75	1.55
Commercial RE loans	1.06	1.03	0.80	0.75	1.03	0.92	1.52	1.01
Construction RE loans	1.20	1.22	1.12	1.16	1.76	2.12	1.77	1.61
Commercial and industrial loans*	2.80	2.56	1.70	1.50	1.28	1.20	0.68	0.61
Loans to individuals	2.45	2.45	2.29	2.19	2.43	2.64	2.50	2.46
Credit cards	3.07	3.21	2.65	2.75	2.56	2.81	2.82	2.59
Installment loans	2.41	2.40	2.16	2.04	2.25	2.39	2.27	2.37
All other loans and leases				0.85	0.93	0.36	0.43	
Percent of Loans Noncurrent								
Total loans and leases	1.15	1.05	0.95	0.81	1.06	1.10	1.06	0.95
Loans secured by real estate (RE)	1.00	0.96	0.87	0.68	1.15	0.97	1.44	1.17
1–4 family residential mortgages	0.83	0.82	0.75	0.62	1.33	1.05	1.11	1.09
Home equity loans	0.58	0.38	0.45	0.30	0.44	0.46	0.48	0.44
Multifamily residential mortgages	0.54	0.98	1.12	0.68	0.63	0.66	1.98	1.20
Commercial RE loans	1.22	1.08	1.08	0.77	1.18	1.05	2.22	1.49
Construction RE loans	1.09	1.11	0.77	0.82	0.91	0.82	1.72	1.09
Commercial and industrial loans*	2.75	2.31	1.51	1.41	0.79	0.75	0.79	0.71
Loans to individuals	0.73	0.76	0.85	0.83	1.26	1.57	1.49	1.52
Credit cards	1.12	1.54	1.82	2.00	1.71	2.14	1.69	1.88
Installment loans	0.71	0.71	0.51	0.50	0.66	0.74	1.34	1.25
All other loans and leases					0.44	0.42	0.22	0.26
Percent of Loans Charged-Off, Net								
Total loans and leases	0.46	0.37	0.67	0.55	1.13	1.58	0.56	0.60
Loans secured by real estate (RE)	0.09	0.06	0.08	0.06	0.04	0.08	0.07	0.07
1–4 family residential mortgages	0.08	0.06	0.07	0.05	0.07	0.07	0.11	0.09
Home equity loans	0.31	–0.21	0.09	0.13	0.21	0.31	0.24	0.18
Multifamily residential mortgages	0.05	0.30	0.30	0.08	–0.07	0.13	0.27	–0.05
Commercial RE loans	0.09	0.10	0.09	0.06	0.03	0.04	–0.14	0.01
Construction RE loans	0.17	–0.03	0.07	0.03	–0.26	–0.01	–0.01	–0.22
Commercial and industrial loans*	1.44	0.92	0.85	0.81	0.36	0.22	0.15	0.34
Loans to individuals	1.06	1.15	2.28	2.06	3.15	4.41	2.53	2.62
Credit cards	3.43	3.50	5.91	6.26	4.82	6.67	4.14	4.32
Installment loans	0.94	0.98	0.99	0.96	0.98	1.16	1.37	1.42
All other loans and leases					0.22	0.34	0.14	0.03
Loans Outstanding ($)								
Total loans and leases	$40,149	$39,727	$165,306	$163,250	$363,662	$316,046	$1,072,347	$1,321,640
Loans secured by real estate (RE)	22,541	22,281	94,868	97,275	144,855	127,370	384,306	478,536
1–4 family residential mortgages	11,358	11,184	46,878	47,421	69,893	62,720	200,903	242,283
Home equity loans	536	519	5,078	5,004	12,031	10,843	37,377	51,222
Multifamily residential mortgages	503	545	3,044	3,107	5,290	4,752	11,642	14,943
Commercial RE loans	6,249	6,147	30,162	31,131	45,058	37,355	88,891	115,416
Construction RE loans	1,570	1,525	6,497	7,058	10,710	9,795	20,062	29,010
Farmland loans	2,325	2,361	3,203	3,538	1,751	1,759	1,768	2,519
RE loans from foreign offices	0	0	6	16	123	146	23,664	23,144
Commercial and industrial loans	6,812	6,690	28,315	28,405	76,035	63,206	313,985	410,281
Loans to individuals	6,322	6,049	33,549	28,438	117,612	106,410	198,585	230,599
Credit cards	311	426	8,616	6,211	67,486	62,988	84,692	98,632
Installment loans	6,011	5,623	24,933	22,227	50,127	43,421	113,892	131,967
All other loans and leases	4,683	4,878	9,043	9,536	25,403	19,243	177,065	203,676
Less: Unearned income	209	170	470	405	244	183	1,593	1,453

* Includes "All other loans" for institutions under $1 billion in asset size.

Key indicators, FDIC-insured national banks by region
Fourth quarter 1997
(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All Institutions
Number of institutions reporting	297	342	542	493	642	281	2,597
Total employees (FTEs)	259,773	181,033	145,584	70,575	97,153	157,307	911,425
Selected Income Data ($)							
Net income	$2,830	$1,401	$1,573	$922	$751	$1,865	$9,343
Net interest income	7,685	5,464	4,375	2,254	2,212	4,962	26,952
Provision for loan losses	1,243	762	438	378	148	613	3,581
Noninterest income	6,003	2,919	2,082	1,750	1,347	3,140	17,241
Noninterest expense	8,493	5,645	3,763	2,233	2,347	4,822	27,302
Net operating income	2,643	1,366	1,548	906	734	1,722	8,918
Cash dividends declared	1,899	2,975	2,711	728	872	2,076	11,261
Net charge-offs to loan and lease reserve	1,397	468	444	356	162	618	3,444
Selected Condition Data ($)							
Total assets	850,966	622,652	470,417	209,024	251,428	489,423	2,893,910
Total loans and leases	531,484	388,905	308,928	143,669	135,445	332,231	1,840,662
Reserve for losses	11,994	5,962	5,081	2,730	1,886	7,185	34,836
Securities	127,821	110,081	80,272	33,034	53,487	47,416	452,111
Other real estate owned	822	405	214	90	123	458	2,111
Noncurrent loans and leases	6,895	3,151	2,644	1,438	1,048	2,619	17,795
Total deposits	573,735	406,523	328,847	148,271	202,059	345,420	2,004,855
Domestic deposits	379,704	372,557	300,004	143,640	195,829	293,570	1,685,304
Equity capital	66,750	53,634	37,844	18,007	20,724	48,033	244,992
Off-balance-sheet derivatives	3,648,713	1,871,732	1,385,070	33,990	50,862	1,714,113	8,704,481
Performance Ratios (annualized %)							
Return on equity	16.99	10.37	16.29	20.53	14.64	15.52	15.20
Return on assets	1.35	0.92	1.35	1.79	1.23	1.53	1.31
Net interest income to assets	3.66	3.60	3.76	4.36	3.61	4.07	3.78
Loss provision to assets	0.59	0.50	0.38	0.73	0.24	0.50	0.50
Net operating income to assets	1.26	0.90	1.33	1.75	1.20	1.41	1.25
Noninterest income to assets	2.86	1.92	1.79	3.39	2.20	2.58	2.42
Noninterest expense to assets	4.05	3.72	3.23	4.32	3.83	3.96	3.83
Loss provision to loans and leases	0.95	0.79	0.57	1.06	0.45	0.74	0.79
Net charge-offs to loans and leases	1.06	0.49	0.58	1.00	0.49	0.75	0.76
Loss provision to net charge-offs	88.98	162.83	98.53	106.45	91.39	99.24	104.00
Performance Ratios (%)							
Percent of institutions unprofitable	5.39	11.70	4.61	6.90	9.03	9.25	7.66
Percent of institutions with earnings gains	63.30	62.57	61.81	59.63	57.17	64.06	60.76
Nonint. income to net operating revenue	43.85	34.82	32.25	43.71	37.84	38.76	39.01
Nonint. expense to net operating revenue	62.05	67.33	58.27	55.77	65.93	59.52	61.78
Condition Ratios (%)							
Nonperforming assets to assets	0.93	0.57	0.61	0.73	0.47	0.63	0.69
Noncurrent loans to loans	1.30	0.81	0.86	1.00	0.77	0.79	0.97
Loss reserve to noncurrent loans	173.94	189.17	192.19	189.86	179.92	274.33	195.76
Loss reserve to loans	2.26	1.53	1.64	1.90	1.39	2.16	1.89
Equity capital to assets	7.84	8.61	8.04	8.61	8.24	9.81	8.47
Leverage ratio	7.35	7.01	7.51	8.03	7.40	7.74	7.43
Risk-based capital ratio	11.95	11.47	11.61	12.38	12.65	11.94	11.88
Net loans and leases to assets	61.05	61.50	64.59	67.43	53.12	66.41	62.40
Securities to assets	15.02	17.68	17.06	15.80	21.27	9.69	15.62
Appreciation in securities (% of par)	1.06	1.27	1.12	1.14	0.83	1.18	1.11
Residential mortgage assets to assets	16.14	27.07	21.31	19.41	20.22	17.24	20.11
Total deposits to assets	67.42	65.29	69.91	70.94	80.36	70.58	69.28
Core deposits to assets	39.19	53.90	56.58	62.86	64.02	54.24	51.59
Volatile liabilities to assets	42.00	31.36	27.55	19.67	24.25	25.49	31.41

Loan performance, FDIC-insured national banks by region
Fourth quarter 1997
(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All Institutions
Percent of Loans Past Due 30–89 Days							
Total loans and leases	1.35	1.24	1.50	1.48	1.40	1.08	1.32
Loans secured by real estate (RE)	1.53	1.32	1.43	1.18	1.67	1.23	1.39
1–4 family residential mortgages	1.71	1.60	1.68	1.24	2.07	1.63	1.65
Home equity loans	1.13	0.92	0.88	0.62	0.88	0.88	0.93
Multifamily residential mortgages	1.24	1.09	1.32	1.31	1.78	1.66	1.34
Commercial RE loans	1.14	0.86	1.15	0.85	1.05	0.63	0.95
Construction RE loans	1.03	1.27	2.15	2.22	1.97	1.53	1.63
Commercial and industrial loans*	0.59	0.63	1.14	1.24	0.97	0.56	0.76
Loans to individuals	2.65	2.36	2.56	2.50	2.15	2.36	2.49
Credit cards	2.54	3.27	3.20	2.38	2.76	2.65	2.68
Installment loans	2.84	1.94	2.39	2.68	2.08	2.03	2.34
All other loans and leases	0.41	0.48	0.80	0.60	0.39	0.28	0.46
Percent of Loans Noncurrent							
Total loans and leases	1.30	0.81	0.86	1.00	0.77	0.79	0.97
Loans secured by real estate (RE)	1.61	0.94	0.84	0.62	1.05	0.98	1.07
1–4 family residential mortgages	1.22	1.09	0.84	0.60	0.98	0.95	1.01
Home equity loans	0.60	0.39	0.33	0.17	0.28	0.47	0.43
Multifamily residential mortgages	1.42	0.71	0.87	0.49	0.40	1.46	1.01
Commercial RE loans	2.46	0.90	0.97	0.64	1.14	1.20	1.27
Construction RE loans	2.19	0.54	1.05	0.77	1.21	0.96	1.00
Commercial and industrial loans*	0.88	0.58	0.93	0.99	0.76	0.59	0.78
Loans to individuals	2.03	1.09	1.08	1.80	0.63	1.22	1.47
Credit cards	1.74	2.20	2.26	2.59	2.05	1.90	1.98
Installment loans	2.52	0.57	0.75	0.68	0.48	0.41	1.04
All other loans and leases	0.24	0.25	0.33	0.45	0.19	0.26	0.27
Percent of Loans Charged-Off, Net							
Total loans and leases	1.06	0.49	0.58	1.00	0.49	0.75	0.76
Loans secured by real estate (RE)	0.13	0.05	0.10	0.03	–0.04	0.05	0.07
1–4 family residential mortgages	0.13	0.07	0.06	0.08	0.04	0.06	0.08
Home equity loans	0.23	0.13	0.22	–0.03	1.25	0.21	0.20
Multifamily residential mortgages	–0.02	0.04	0.07	0.00	–0.01	–0.04	0.01
Commercial RE loans	0.09	–0.09	0.16	–0.06	–0.07	0.06	0.03
Construction RE loans	–0.17	0.04	–0.06	0.05	–0.48	–0.36	–0.13
Commercial and industrial loans*	0.26	0.27	0.37	0.41	0.40	0.58	0.36
Loans to individuals	3.96	2.28	2.03	3.17	1.80	3.61	3.07
Credit cards	5.53	4.72	6.27	4.53	4.81	5.20	5.28
Installment loans	1.51	1.16	0.88	1.25	1.47	1.78	1.30
All other loans and leases	0.09	0.15	0.43	0.35	0.14	–0.34	0.06
Loans Outstanding ($)							
Total loans and leases	$531,484	$388,905	$308,928	$143,669	$135,445	$332,231	$1,840,662
Loans secured by real estate (RE)	168,609	192,976	133,625	55,123	49,595	125,536	725,463
1–4 family residential mortgages	83,830	108,230	61,570	26,512	24,238	59,228	363,608
Home equity loans	15,246	15,943	15,745	3,594	624	16,437	67,588
Multifamily residential mortgages	5,902	5,087	4,648	2,111	1,478	4,121	23,346
Commercial RE loans	37,165	47,296	39,886	15,740	16,209	33,753	190,050
Construction RE loans	5,243	14,526	9,316	4,536	5,543	8,223	47,388
Farmland loans	720	1,734	2,439	2,630	1,502	1,150	10,176
RE loans from foreign offices	20,503	159	20	0	0	2,625	23,306
Commercial and industrial loans	164,099	93,571	83,256	33,567	42,858	91,232	508,582
Loans to individuals	126,066	63,857	58,247	38,229	27,166	57,932	371,496
Credit cards	78,603	20,285	12,691	22,427	2,698	31,553	168,257
Installment loans	47,463	43,572	45,556	15,802	24,468	26,379	203,239
All other loans and leases	73,900	38,749	34,053	16,776	16,092	57,763	237,333
Less: Unearned income	1,189	248	252	25	265	231	2,212

* Includes "All other loans" for institutions under $1 billion in asset size.

Glossary

Data Sources

Data are from the Federal Financial Institutions Examination Council (FFIEC) Reports of Condition and Income (call reports) submitted by all FDIC-insured, national-chartered and state-chartered commercial banks and trust companies in the United States and its territories. Uninsured banks, savings banks, savings associations, and U.S. branches and agencies of foreign banks are excluded from these tables. All data are collected and presented based on the location of each reporting institution's main office. Reported data may include assets and liabilities located outside of the reporting institution's home state.

The data are stored on and retrieved from the OCC's Integrated Banking Information System (IBIS), which is obtained from the FDIC's Research Information System (RIS) database.

Computation Methodology

For performance ratios constructed by dividing an income statement (flow) item by a balance sheet (stock) item, the income item for the period was annualized (multiplied by the number of periods in a year) and divided by the average balance sheet item for the period (beginning-of-period amount plus end-of-period amount plus any interim periods, divided by the total number of periods). For "pooling-of-interest" mergers, prior period(s) balance sheet items of "acquired" institution(s) are included in balance sheet averages because the year-to-date income reported by the "acquirer" includes the year-to-date results of "acquired" institutions. No adjustments are made for "purchase accounting" mergers because the year-to-date income reported by the "acquirer" does not include the prior-to-merger results of "acquired" institutions.

Definitions

Commercial real estate loans—loans secured by nonfarm nonresidential properties.

Construction real estate loans—includes loans for all property types under construction, as well as loans for land acquisition and development.

Core deposits—the sum of transaction deposits plus savings deposits plus small time deposits (under $100,000).

IBIS—OCC's Integrated Banking Information System

Leverage ratio—Tier 1 capital divided by adjusted tangible total assets.

Loans to individuals—includes outstanding credit card balances and other secured and unsecured installment loans.

Net charge-offs to loan and lease reserve—total loans and leases charged off (removed from balance sheet because of uncollectibility), less amounts recovered on loans and leases previously charged off.

Net loans and leases to assets—total loans and leases net of the reserve for losses.

Net operating income—income excluding discretionary transactions such as gains (or losses) on the sale of investment securities and extraordinary items. Income taxes subtracted from operating income have been adjusted to exclude the portion applicable to securities gains (or losses).

Net operating revenue—the sum of net interest income plus noninterest income.

Noncurrent loans and leases—the sum of loans and leases 90 days or more past due plus loans and leases in nonaccrual status.

Nonperforming assets—the sum of noncurrent loans and leases plus noncurrent debt securities and other assets plus other real estate owned.

Number of institutions reporting—the number of institutions that actually filed a financial report.

Off-balance-sheet derivatives—the notional value of futures and forwards, swaps, and options contracts; beginning March 31, 1995, new reporting detail permits the exclusion of spot foreign exchange contracts. For March 31, 1984 through December 31, 1985, only foreign exchange futures and forwards contracts were reported; beginning March 31, 1986, interest rate swaps contracts were reported; beginning March 31, 1990, banks began to report interest rate and other futures and forwards contracts, foreign exchange and other swaps contracts, and all types of option contracts.

Other real estate owned—primarily foreclosed property. Direct and indirect investments in real estate ventures are excluded. The amount is reflected net of valuation allowances.

Percent of institutions unprofitable—the percent of institutions with negative net income for the respective period.

Percent of institutions with earnings gains—the percent of institutions that increased their net income (or decreased their losses) compared to the same period a year earlier.

Reserve for losses—the sum of the allowance for loan and lease losses plus the allocated transfer risk reserve.

Residential mortgage assets—the sum of 1–4 family residential mortgages plus mortgage-backed securities.

Return on assets (ROA)—net income (including gains or losses on securities and extraordinary items) as a percentage of average total assets.

Return on equity (ROE)—net income (including gains or losses on securities and extraordinary items) as a percentage of average total equity capital.

Risk-based capital ratio—total capital divided by risk weighted assets.

Risk-weighted assets—assets adjusted for risk-based capital definitions which include on-balance-sheet as well as off-balance-sheet items multiplied by risk weights that range from zero to 100 percent.

Securities—excludes securities held in trading accounts. Effective March 31, 1994 with the full implementation of Financial Accounting Standard (FAS) 115, securities classified by banks as "held-to-maturity" are reported at their amortized cost, and securities classified as "available-for-sale" are reported at their current fair (market) values.

Securities gains (losses)—net pre-tax realized gains (losses) on held-to-maturity and available-for-sale securities.

Total capital—the sum of Tier 1 and Tier 2 capital. Tier 1 capital consists of common equity capital plus noncumulative perpetual preferred stock plus minority interest in consolidated subsidiaries less goodwill and other ineligible intangible assets. Tier 2 capital consists of subordinated debt plus intermediate-term preferred stock plus cumulative long-term preferred stock plus a portion of a bank's allowance for loan and lease losses. The amount of eligible intangibles (including mortgage servicing rights) included in Tier 1 capital and the amount of the allowance included in Tier 2 capital are limited in accordance with supervisory capital regulations.

Volatile liabilities—the sum of large-denomination time deposits plus foreign-office deposits plus federal funds purchased plus securities sold under agreements to repurchase plus other borrowings. Beginning March 31, 1994, new reporting detail permits the exclusion of other borrowed money with original maturity of more than one year; previously, all other borrowed money was included. Also beginning March 31, 1994, the newly reported "trading liabilities less revaluation losses on assets held in trading accounts" is included.

Comptroller's Report of Operations—1997

Comptroller's Report of Operations—1997

Comptroller

The Comptroller's office manages a nationwide staff of bank examiners and other professional and support personnel who examine and supervise federally chartered national banks and federally licensed branches and agencies of foreign banks. As of December 31, 1997, there were about 2,600 national banks, representing about 28 percent of all insured commercial banks in the United States and 58 percent of the total assets of the banking system. During the year, national banks generated about 60 percent of the industry's earnings.

The Comptroller continued in 1997 to serve as a member of the board of the Federal Deposit Insurance Corporation (FDIC), the chairman of the Federal Financial Institutions Examination Council (FFIEC), and a member of the board of the Neighborhood Reinvestment Corporation (NRC).

Throughout the year, advice to the Comptroller was provided by the OCC's Executive Committee consisting, as of December 31, 1997, of the chief counsel, the ombudsman, the chief of staff, and six senior deputy comptrollers representing Bank Supervision Operations, Bank Supervision Policy, Economic and Policy Analysis, Public Affairs, Administration, and International Affairs.

The Comptroller's personal staff continued to direct, coordinate, and manage the day-to-day operations of the office; oversee projects of special interest to the Comptroller; and serve as liaison with OCC staff and the staffs of other regulatory agencies.

Senior Deputy Comptroller for Bank Supervision Operations

The senior deputy comptroller for Bank Supervision Operations was responsible for examinations and other supervision activities in the OCC's six districts; the Large Bank Supervision Department, which supervises the largest national banks and oversees operations in the OCC's London office; and OCC's Continuing Education and Supervision Support departments. Specific responsibilities of the senior deputy comptroller for Bank Supervision Operations included directing programs for the examination and regulation of national banks to promote the continuing existence of a solvent and competitive national banking system. The senior deputy comptroller for Bank Supervision Operations was responsible during 1997 for directing the examination, supervision, and analysis of almost 2,600 national banks and 70 federal branches and agencies of foreign banks in the United States. Supervision of national trust companies, and the international activities of national banks with global operations, was also the responsibility of the senior deputy comptroller for Bank Supervision Operations.

Chief Counsel

In 1997, the chief counsel continued the function of advising the Comptroller on legal matters arising from the administration of laws, rulings, and regulations governing national banks. The chief counsel was responsible for directing the legal functions in and for the OCC, including writing and interpreting legislation; responding to requests for interpretations of statutes, regulations, and rulings; defending the Comptroller's actions challenged in administrative and judicial proceedings; supporting the bank supervisory efforts of the office; and representing the OCC in all legal matters. These duties were carried out through two deputy chief counsels. One deputy counsel was responsible for overseeing Bank Activities and Structure, Enforcement and Compliance, Litigation, Securities and Corporate Practices, and the six district counsels; and the other was responsible for Administrative and Internal Law, Community and Consumer Law, the Counselor for International Activities, and Legislative and Regulatory Activities.

The chief counsel in 1997 also advised the Comptroller on policy matters involving corporate activities. The Comptroller delegated authority for deciding all corporate applications, including charters, mergers and acquisitions, conversions, and operating subsidiaries of national banks, to the chief counsel. The responsibilities under this authority were carried out by the deputy comptroller for Bank Organization and Structure, and through three divisions renamed in late 1997—Washington-Directed Licensing, Licensing Policy and Systems, and District/Large Bank Licensing—and the licensing units in each of the OCC's six district offices.

In addition, in 1997, the chief counsel advised the Comptroller on policy matters involving community development. The Comptroller delegated authority for deciding national bank community development investment proposals to the chief counsel that are carried out through the director for Community Development. In addition, the chief counsel oversaw Community Development's other activities, including policy development and research, banker and community development partner education initiatives, community development training for examiners and others, provision of advice and counsel to the Comptroller in his capacity as a statutory member of the Neighborhood Reinvestment Corporation's board of directors, and publication of the newsletter *Community Developments*.

Senior Deputy Comptroller for Bank Supervision Policy

The senior deputy comptroller for Bank Supervision Policy is responsible for formulating and disseminating the OCC's supervision policies to promote national banks' safety and soundness and compliance with laws and regulations. The department issues policy, guidance, and examination procedures related to national banks' commercial, consumer, asset management, capital markets, and community compliance activities. The department also assists in providing specialized training and examination support to OCC examiners. The senior deputy comptroller for Bank Supervision Policy is responsible for coordinating OCC participation in FFIEC activities and its task forces.

In 1997, the responsibilities and structure of Bank Supervision Policy were realigned as part of the OCC's overall restructuring effort. These changes were implemented to make Bank Supervision Policy more streamlined, efficient, and responsive in meeting the needs of the OCC and banking community. The Core Policy Division was created to focus on the OCC's supervision by risk process and those policies and activities that cut across bank size, functions, activities, and products such as accounting, capital, and management. This division is complemented by specialized risk divisions that focus on developing, maintaining, and disseminating policies and specialized expertise in the areas of community and consumer policy, asset management, credit, and capital markets. Responsibilities for international activities and the OCC's information systems that previously resided with the senior deputy comptroller for Bank Supervision Policy were transferred to other departments.

Senior Deputy Comptroller for Economic and Policy Analysis

The senior deputy comptroller for Economic and Policy Analysis was responsible for managing the agency's economic research and analysis program, providing policy advice on issues relating to the condition of the banking industry and trends in the provision of financial services, and overseeing preparation of congressional testimony for the Comptroller. The senior deputy comptroller for Economic and Policy Analysis also assisted the Comptroller in his responsibilities to coordinate the Treasury Department's efforts in electronic money and banking. These activities were carried out through the following divisions: Economics and Evaluation, Financial and Statistical Analysis, Bank Research, and Risk Analysis.

Senior Deputy Comptroller for International Affairs

In 1997, the senior deputy comptroller for International Affairs was responsible for OCC's international activities, including providing policy advice and technical expertise and analyses to OCC and the Treasury Department on international banking and financial matters, including G–7 summit issues; formulating policies and procedures for the supervision and examination of federal branches and agencies of foreign banks; liaison with foreign bank supervisors and various multilateral groups; and the analysis of country risk and other internationally related issues. These responsibilities were conducted in the International Banking and Finance Department. The senior deputy comptroller represents the OCC on the Basle Committee on Banking Supervision and the Joint Forum on Financial Conglomerates.

Senior Deputy Comptroller for Public Affairs

The senior deputy comptroller for Public Affairs advises the Comptroller on external relations with the news media, the banking industry, Congress, consumer and community organizations, other government agencies, and the public.

Specific responsibilities include the following: overseeing regular outreach efforts to foster and develop relationships with the constituencies involved in banking; tracking legislative developments and responding to congressional inquiries and requests for support; directing the preparation and dissemination of information to help bankers, examiners, community organizations, and the general public understand the national banking system, the OCC's supervisory activities, and related issues; ensuring fair and easy access to the agency's public information; coordinating internal communications; and managing news media relations for the agency.

The senior deputy comptroller for Public Affairs carries out these responsibilities through the deputy comptroller for Public Affairs, the special advisor for External Relations, the executive assistant to the Executive Committee, and the Congressional Liaison, Banking Relations, Community Relations, Minority and Urban Affairs, Communications, and Press Relations divisions.

Senior Deputy Comptroller for Administration

In 1997, the senior deputy comptroller for Administration was responsible for the efficient and effective administrative functioning of the OCC. Through the deputy comptroller for Resource Management, the senior deputy comptroller for Administration supervised the Human Resources, Administrative Services, and Minority and Urban Affairs divisions. Through the chief financial officer, the senior deputy supervised Financial Services. The Management Improvement Division and Organizational Effectiveness Division, including the Office of Diversity, were supervised directly by the senior deputy. Washington office units provided staff assistance and guidance to district administrative functions.

The senior deputy comptroller for Administration was also designated by the Comptroller to administer the OCC's equal employment programs.

Ombudsman

In 1997, the ombudsman was responsible for overseeing the national bank appeals process. The primary ongoing activities of the national bank appeals process included resolution of individual appeals from national banks, administration of the examination questionnaire process, and outreach activities. With the consent of the Comptroller, the ombudsman has the discretion to supersede any agency decision or action during the resolution of an appealable matter. The ombudsman often acted as a catalyst to spawn reviews of agency policies, processes, and procedures as a result of issues identified through his activities. The ombudsman also acted as liaison between the OCC and anyone with unresolved problems in dealing with the OCC regarding its regulatory activities. The ombudsman functions independently, outside of the bank supervision and examination area, and reports directly to the Comptroller. In addition, responsibility for the Customer Assistance Group was transferred to the ombudsman on June 30, 1997 after the Executive Committee approved enhancements to the previous process, including the centralization of the Customer Assistance Group. The new process includes a significantly improved telephone system, which is consistent with best-in-class call centers, along with a state-of-the-art case management system designed to provide assistance at the point of contact. The group will relocate to Houston, Texas, by the end of the first quarter of 1998.

Information Technology Services Department

In 1997, Information Resources Management underwent a major reorganization. The reorganization included a name change for the department and the divisions within the department. The department is now known as Information Technology Services (ITS).

The mission of ITS is to become a leader in providing information technology solutions. Information Technology Services is led by the chief information officer (CIO) who has deputy comptroller status and reports directly to the Comptroller's chief of staff. As the senior information technology official, the CIO works closely with executive management to determine the OCC's information technology direction and implement systems that support the agency's strategic objectives. In addition, the CIO represents OCC at Treasury on all information technology issues and plays a key role in ensuring closer technical cooperation with other federal financial regulators.

The CIO supervises an administrative staff and three divisions. The divisions—Customer Services, Information Services, and Network Services—have been organized in a team environment that enables greater flexibility of assignments and allocation of staff expertise. The divisions' key responsibility is to provide technical support to all OCC personnel.

The reorganization allowed ITS to refocus its efforts to provide more timely, quality-oriented customer service. During the last year, these efforts have included upgrading the technology tools available to OCC personnel, including providing a full Pentium platform of computers, upgrading the OCC's operating system to Windows 95, and fully implementing local area networks throughout the agency.

Currently, consultants are working with ITS staff to develop a standard information technology architecture and an updated data architecture that will support technology efforts into the twenty-first century. To support these efforts, an Investment Review Board (IRB) has been established to ensure that all major technology investments align with OCC business objectives.

Chief Information Officer

The Chief Information Officer (CIO) staff provides administrative support to the CIO and the ITS divisions. It is managed by the special assistant to the CIO. There are three teams—Security; Resource Management; and Policy, Planning, and Quality Assurance.

During 1997, these teams supported the implementation of federal guidelines and effectively coordinated CIO responsibilities. Their key roles include providing support for the Investment Review Board; planning the information technology budget; performing strategic planning and security functions; and developing policies, procedures, and programs that result in quality technology application and superior customer service. In addition, the staff has Treasury liaison responsibilities.

Customer Services

The Customer Services staff consists of information technology specialists with responsibilities for Washington and district information technology services, the help desk, and depot maintenance functions. The staff provides front-line customer support including troubleshooting, fulfilling equipment requests, planning, budgeting, and making initial contacts on new systems needed to support the business function.

Major accomplishments in 1997 included the implementation of the local area networks (LAN) and wide area network (WAN). The agency's voice and data telecommunications capabilities were upgraded and resulted in better connectivity for all OCC personnel, regardless of whether they were in headquarters, the district offices, duty stations, banks, or hotels.

Customer Services also developed and implemented an ITS outreach program. The program's success gained ITS a reputation for responsiveness and quality customer service.

Information Services

The Information Services staff is responsible for providing automated solutions to customer needs and improving technical support for business processes for more than 100 existing technology applications. To achieve these goals, the staff is made up of teams for analysis, application development and maintenance, research and desktop configuration, Lotus Notes development, communication delivery, data architecture, year-2000, and Examiner View activities.

Major accomplishments in 1997 included making significant progress on the year-2000 renovation of systems, implementing a new desktop configuration, implementing Lotus Notes databases, and providing technology recommendations for implementing Examiner View.

Network Services Division

The Network Services Division is responsible for database operations, LAN/WAN, mainframe support, and telecommunications services. The teams within the division include Global Server Operations, Network Operations, and Database Administration. The division is located at OCC's Centre Point facility in Landover, Maryland.

The division provides support 7 days a week, 24 hours a day. They support and maintain the disaster recovery plan that allows for complete restoration of computer services within 24 hours if a major disruption or disaster strikes.

During 1997, the division's efforts supported the implementation the local area networks (LAN) in each duty station and in most large banks. Agency communication capabilities were expanded by the implementation of FTS2000 and OCCnet, the new OCC Intranet. In addition, dial-in capability for the mobile workforce was significantly improved and video teleconferencing capabilities were implemented at the Washington office, the district offices, and the Houston duty station for the ombudsman's office.

Bank Supervision Policy

Core Policy Division

The Core Policy Division is the focal point for the OCC's core policy platforms that govern how the OCC supervises banks. These core policies and activities include the OCC's supervision by risk philosophy and its supporting systems and core examination procedures for large and community banks; policies related to general bank management and boards of directors; policies and interpretations on capital, dividends, earnings, and related bank structure issues; and accounting, reporting, and disclosure requirements for national banks. The deputy comptroller for Core Policy chairs the Supervision Policy and Capital Steering committees—forums for obtaining input on supervision policy and capital issues across functional areas of the OCC.

The division consists of three units: Core Policy Development, Capital Policy, and the Office of the Chief Accountant.

Core Policy Development

Core Policy Development establishes risk-focused policies and standards for the supervision of national banks. The unit administers the supervision by risk process, develops and coordinates OCC supervision policy issuances and publications, and develops and distributes automated tools and models used in the examination process.

A major initiative of this unit has been the development of risk-based examination procedures. During 1997, Core Policy Development began redesigning the community and large bank supervision examination structure and standards. This structure consists of a three-component template that consistently integrates risk-based supervision into all aspects of the supervisory process. The three components are:

- *Core knowledge*—a database of information that describes a bank's culture, risk tolerance, and other internal and external factors.
- *Core assessment*—standards or procedures designed to guide examiners in reaching the minimum conclusions regarding risks and CAMELS ratings.
- *Optional procedures*—detailed guidance that explains how to examine specific activities or products that warrant extra attention.

The benefits of this structure include the following: the enhancement of bank safety and soundness through greater integration of supervision by risk into the examination process; a more efficient deployment of OCC resources, while continuing to minimize burden on the banking industry; and increased efficiency and consistency through use of a risk-based examination approach. The introduction of the new structure and standards is scheduled for 1998.

In response to recent insurance sales authority granted to banks, Core Policy Development began developing the guidance on the examination of bank insurance sales. The agency is scheduled to publish the first handbook on bank insurance sales in 1998. Other significant issues addressed by Core Policy Development include the continuing development and enhancement of computerized models used by examiners in their daily examination activities, the evolution of the quality assurance process, and participation in the development of automated examination software.

Capital Policy

Capital Policy identifies issues and develops policy to address emerging risks to bank capital. This includes developing and maintaining capital regulations and interpretations as well as dividend, income, and expense policies, often in collaboration with other units of the OCC as well as other U.S. and international regulatory agencies. This unit ensures that capital policies are effectively communicated and implemented and provides technical assistance to examiners, bankers, and advisors on risk-based capital issues. It also represents the OCC on the Capital Subgroup of the Basle Committee on Banking Supervision and participates in the Basle Committee's Models Task Force. The Capital Policy unit coordinates the work of the OCC's Capital Steering Committee.

In 1997, the unit was instrumental in advancing a number of proposed interagency changes in the risk-based capital regulations. A proposed and interim rule eased the burden of the market risk amendment contained in 12 CFR Part 3, Appendix B. The capital regulation now permits banks to use their internally modeled measure of the specific risk inherent in trading activities when calculating the regulatory capital allocation. Another proposal would significantly alter the risk-based capital treatment of recourse and direct credit substitutes in securitization transactions.

Other proposed changes in capital regulations published in 1997 included a proposal to lessen the current limitation—expressed as a percentage of capital—on mortgage servicing assets. Another proposal would allow banks to include unrealized gains on certain equity securities in Tier 2 capital. Finally, a proposed amendment to the OCC's risk-based and leverage capital regulations would achieve greater uniformity with the regulations of the other U.S. bank regulatory agencies.

This interagency proposal would alter the treatment of second liens on one- to four-family residential properties, construction loans on pre-sold residential properties, and investments in mutual funds. This interagency proposal would also eliminate differences in the regulatory language setting the minimum leverage ratio.

In December, Capital Policy coordinated a conference hosted by the FFIEC on the future of bank capital regulation, "Examining Financial Institutions' Regulatory Capital Framework."

Office of the Chief Accountant

The Office of the Chief Accountant coordinates accounting and financial reporting issues, interprets and develops guidance on generally accepted accounting principles related to banks, and identifies emerging accounting issues. This office's objectives are accomplished through a headquarters and newly structured district accountant staff. Through representation on the FFIEC's Task Force on Reports, the office coordinates all changes and instructions for interagency bank reports, such as the Consolidated Report of Condition and Income (call report). In addition, the accounting staff develops and interprets instructions to the call report. The office also participates on the Basle Committee on Banking Supervision to seek harmonization of international accounting standards. Further, the financial information requirements of the Securities Exchange Act of 1933, applicable to national banks under 12 CFR 11 and 12 CFR 16, is administered by the office.

In 1997, the Office of the Chief Accountant completed its auditor/examiner cooperation pilot project providing a foundation for improving communications between bank auditors and OCC examination staffs. The office also worked with other FFIEC member agencies to develop and issue interagency policy guidance on internal audit and outsourcing of the audit function. In addition, staff continued to lead the interagency efforts to revise the call report in a manner consistent with a bank's public reporting to reduce burden and, substantially revised the Bank Accounting Advisory Series. During the year, this office also provided guidance and training on emerging accounting and reporting issues and coordinated the OCC response to proposed new accounting standards of the FASB. Principal areas of activity included the FASB's derivatives proposal, accounting for transfers and servicing of financial assets and extinguishments of liabilities (FASB 125), and unique asset securitization transactions involving complex recourse issues. Additionally, staff members provided responses to numerous questions from examiners, bankers, and other OCC divisions regarding accounting, capital, and call report preparation.

Credit Risk Division

The Credit Risk Division supports field examiners and provides policy direction on bank lending activities. The division sponsors the Retail Credit Committee and the National Credit Committee which have representatives from the OCC's districts, large banks, economics, and community development unit. The committees are responsible for identifying and analyzing emerging issues and trends that affect bank lending activities and developing policies to address these issues. The National Credit Committee completed its third annual national underwriting survey in 1997.

The division is also the OCC's principal representative in various areas of credit expertise when interacting with internal or external OCC customers such as elected officials, industry, community groups, examiners, or when collaborating with the FFIEC and other interagency parties. In 1997, the unit provided guidance to bankers and examiners through revised *Comptroller's Handbook* sections and other issuances on lease financing, credit scoring, classification of life insurance policies, and allowance for loan and lease losses. Division staff led or actively participated in several important initiatives related to risk analysis, identification, and response. These initiatives involved subprime lending, portfolio credit risk management, retail credit classification, small business lending, and lending in Indian country.

Division staff has also participated in several outreach meetings with district offices and the industry. These included presentations to groups such as Women in Housing and Finance, Robert Morris Associates, and American Banker and Strategic Research. One staff member continues to provide assistance to the National Bank of Poland in developing an off-site surveillance system.

Additionally, Credit Risk is responsible for identifying training needs for field staff and formulating the appropriate training. The division conducted two educational seminars in 1997 and also established a retail credit training program.

Treasury and Market Risk Division

The Treasury and Market Risk (T&MR) Division is the focal point for the OCC's supervisory efforts relating to asset/liability management, trading and dealing activities, securitization, mortgage banking, financial derivatives, and emerging market products. The division identifies and addresses supervisory issues regarding national bank capital markets activities and provides policy direction as well as examination guidance through the issuance of banking bulletins and handbook sections. The

Treasury and Market Risk Division also publishes a quarterly report that highlights trends and risk levels regarding derivatives activities in the U.S. banking system.

Treasury and Market Risk completed several significant projects during 1997. The division published the following three sections of the *Comptroller's Handbook:*

- "Risk Management of Financial Derivatives" (January 1997) was revised and updated to reflect the evolution of the derivative markets and risk management practices in recent years.
- "Interest Rate Risk" (June 1997) is a new section that provides guidance on effective interest rate risk management practices. This booklet includes examination procedures to be used in large banks and in community banks with high or moderate interest rate risk with increasing exposure. The booklet also serves as a reference source on interest rate risk.
- "Asset Securitization" (November 1997) represents the OCC's inaugural handbook section on the subject. The booklet provides a comprehensive review of securitization benefits, risks, and prudential risk management techniques. The booklet serves as an introductory guide for banks embarking on securitization activities and an overview for institutions expanding on them. It provides thorough examination guidance for examiners and bankers.

Another major project was the proposal to revise the FFIEC Policy on Securities Activities issued for comment in October 1997. This proposal is designed to modernize the policy describing how bankers and examiners should assess mortgage derivative products. It would also make the policy statement consistent with the risk-based supervision approaches in place at each of the bank regulatory agencies.

In 1997, T&MR administered the Capital Markets Training Program for 150 examiners who primarily perform capital markets supervision work. The division sponsored training seminars covering topics such as fixed income securities, advanced trading, securitization, managing risks with derivatives, advanced financial products and risk management practices, portfolio risk measurement techniques, and credit derivatives. Treasury and Market Risk also continued its efforts to revise and restructure the OCC's capital markets training curriculum for OCC examiners at all levels.

Other major 1997 T&MR initiatives included upgrading OCC-wide understanding of asset securitization, developing advanced understanding of credit derivatives and how they can be used to manage credit concentrations, refining management information capabilities, and ensuring that both banks and OCC staff are aware of structural changes in bank funding.

Asset Management Division

The Asset Management Division was restructured in 1997. The division is now responsible for the development and coordination of supervisory policies for national banks' asset management activities including traditional fiduciary activities, investment advisory services, and the retail sale of nondeposit products. National banks are in the asset management business when they manage or sell investment products for a fee.

The Asset Management Division initiated projects in 1997 to improve the supervision of asset management activities in national banks. Some of these projects include developing supervisory guidance for private banking services; fiduciary risk management systems; fiduciary risk-based audit, systems and operations; and trust company supervision. In addition, the division is working to develop a supervisory monitoring system and database to support the examination of asset management services in national banks. The division made numerous presentations and issued guidance on the impact of the revised 12 CFR Part 9—Fiduciary Activities of National Banks; Rules of Practice and Procedure. The division also actively participated in an interagency effort to revise and modernize the Uniform Interagency Trust Rating System.

The Asset Management staff participated in numerous industry meetings throughout the year. In addition, the division organized and sponsored the OCC's first annual Asset Management Seminar with a focus on risk management. The monthly "Asset Management Digest" continues to communicate industry news to asset management examiners. The staff also assisted in examinations of national banks, resolved consumer complaints, and responded to inquiries from bankers.

Community and Consumer Policy Division

The Community and Consumer Policy Division (CCP) is responsible for establishing and maintaining supervision and examination policies and procedures governing community reinvestment and development, fair lending, Bank Secrecy Act (BSA) reporting and record keeping, anti-money-laundering, and consumer protection.

Community Reinvestment Act

Under the Community Reinvestment Act (CRA), the OCC must assess a national bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation and to consider the bank's record in its evaluation of an application for a deposit facility.

In 1997, the OCC, along with the other federal financial institution regulators, completed the implementation of the revised CRA regulation that focused on a bank's actual CRA performance. The OCC began examining large banks using the lending test, investment test, and service test. Also, in 1997, the OCC, together with other federal financial institution regulators, supplemented and amended its "Interagency Questions and Answers on Community Reinvestment" to provide further guidance and clarification on the CRA regulation to the banking industry and the public.

Community Reinvestment and Development Specialists (CRDS)

In 1997, two individuals were assigned to each of the OCC's six districts as community reinvestment and development specialists (CRDS). They were available to assist banks and nonbank community development partners in pursuing the development goals of local communities. This program also has a coordinator who is the primary liaison to the large bank program and Bank Supervision Operations.

On an ongoing basis, the CRDS were involved in the following activities in 1997:

- Establishing working relationships and facilitating partnerships among bank, community development (CD) corporations, other CD intermediaries, and the OCC.
- Encouraging bank investment, lending, and services for low- and moderate-income persons and small businesses.
- Advising national banks; community development organizations; local, state, and federal governments; and bank examiners on bank compliance with the Community Reinvestment Act and the expansion of access to credit and capital.
- Providing training and technical assistance in the areas of economic and community development lending and investment, finance of affordable housing development, and small business finance.

Fair Lending

As a result of fair lending examinations conducted in 1997, the OCC made two referrals to the Department of Justice of pattern or practice violations of the Equal Credit Opportunity Act. In addition, in accordance with the OCC's memorandum of understanding with the U.S. Department of Housing and Urban Development (HUD), 43 complaints involving potential Fair Housing Act violations were referred to HUD for administrative processing and, if appropriate, investigation.

The OCC took several steps to improve its supervision of fair lending matters. It issued internal procedures for conducting pre-application, matched-pair testing to look for possible discrimination at the inquiry stage of the credit process. It also issued new fair lending examination procedures to replace the interim procedures that had been in effect since 1993.

Bank Secrecy Act and Anti-Money-Laundering

The Currency and Foreign Transaction Reporting Act, also known as the Bank Secrecy Act (BSA), requires financial institutions to file certain currency and monetary instrument reports, file suspicious activity reports, and maintain records for possible use in criminal, tax, and regulatory proceedings.

The "Bank Secrecy Act" *Comptroller's Handbook* section (large bank) was published in September 1996. The procedures reflect a shift of emphasis from technical compliance with the record-keeping requirements to evaluation of bank money-laundering prevention and suspicious activity reporting (SAR) practices. In addition, work began in 1997 to update the OCC's "Community Bank Consumer Compliance" (August 1995) examination procedures handbook section to reflect the change in emphasis.

During 1997, the National Anti-Money-Laundering Group was formed to serve as the agency's focal point for BSA/anti-money laundering supervision. The group worked on developing interagency "Know Your Customer" (KYC) rules, conducted interagency training programs, and discussed methods to identify banks that may be targeted by money launderers.

Consumer Protection

The OCC's annual percentage rate computer program, a tool used to verify the accuracy of annual percentage rates and finance charges, was revised in 1997 to reflect changes in legal tolerances. The revised program was issued in beta (final testing) form on the OCC's Internet site (http://www.occ.treas.gov). The final version of the program is expected to be released in the first half of 1998.

In 1997, the Community and Consumer Policy Division participated in an interagency group that developed flood insurance guidance to help financial institutions meet their responsibilities under federal flood insurance legislation. The interagency guidance, provided in the form of questions and answers, was published in the *Federal Register,* on July 23, 1997, by the FFIEC.

Bank Supervision Operations

Supervision Support Department

The Supervision Support Department was created during 1997 as part of the reorganization of Bank Supervision Operations. The primary role of the unit is to support other Bank Supervision Operations divisions, including field examiners. The Supervision Support Department includes four distinct divisions: Special Supervision and Fraud, Supervisory Data, Special Projects and Programs, and Quality Assurance. The Supervision Support Department supervises troubled banks, coordinates the OCC's Shared National Credit Program, administers the uniform commission examination, and produces information about banks supervised by OCC and information about OCC's internal processes.

Special Supervision/Fraud Division

The Special Supervision/Fraud Division supervises national banks in the most critical condition, monitors failing banks, coordinates bank closings, and helps determine OCC policy for the examination and enforcement of problem banks. Special Supervision also participates in various projects such as the creation of the National Management Information System reports, the Economic Downturn task team, and the National Anti-Money-Laundering group. Special Supervision/Fraud also participated in the development of the new Problem Bank School, which will be offered starting in 1998.

Special Supervision/Fraud is the focal point for managing most critical bank situations in which the potential for failure is high. An anticipatory approach is used in resolving these critical bank situations. The division deals with each bank individually, employing enforcement and administrative tools best suited to that bank's problems. Special Supervision/Fraud approves the scope of examination activities, holds meetings with management and boards of directors, reviews corporate applications, and processes reports of examination and correspondence for these banks. The division also helps problems banks identify all possible sources of outside capital.

The Special Supervision/Fraud Division also provides general advice and guidance on problem bank issues to district offices and other OCC units, and develops examination strategies to enhance OCC's relationship with problem banks. It also provides information on problem banks and bank failures to various publications. The division participates in District Supervision Review Committee meetings to discuss plans of action for delegated problem banks.

Special Supervision/Fraud also consists of fraud specialists located in each district and at headquarters. They serve as liaisons for field staff and management on fraud related issues. They may participate in examinations in order to provide expertise in complex investigations. They advise district staff and may conduct outreach meetings on various fraud topics. The specialists also develop contacts with law enforcement organizations and other agencies on matters relating to fraud.

Large Bank Supervision Department

The Large Bank Supervision Department supervises all national bank subsidiaries of the following 33 companies: ANB Ambro North America; BancOne Corporation; BankAmerica Corporation; Bank of Boston Corporation; Barclays Global Investors, N.A.; Barnett Banks, Inc.; Chase Manhattan Corporation; Citicorp; CoreStates Financial Corporation; First America Bank Corp.; Firstar Corporation; First Chicago NBD Corporation; First Security Corporation; First Tennessee National Corp.; First Union Corporation; Fleet Financial Group; Huntington Bancshares; KeyCorp; MBNA Corp.; Mellon Bank Corporation; Mercantile Bancorporation; National City Corp.; NationsBank Corporation; Norwest Corporation; PNC Bank Corp.; Republic New York Corporation; SouthTrust Corporation; Suntrust Banks, Inc.; Union Bancal Corporation; Union Planters Corporation; U.S. Bancorp; Wachovia Corp.; and Wells Fargo Corporation. As of September 30, 1997, these 33 holding companies held assets of $2.8 trillion. Under these companies, there are 192 national banks with total assets of $2.2 trillion, representing 79 percent of the total assets of the national banking system, but only 7.3 percent of the charters.

The department is headed by three deputy comptrollers, each managing a portfolio of banks and directly supervising examiners-in-charge of the respective institutions. The field examining staff is divided into eight geographically based teams. These teams consist of field examiners who support the continuous supervision efforts in each bank. The department also maintains a team in London. This team provides examination and supervision support for European affiliates and branches of national banks. It plays a major role in monitoring developments in the European financial markets.

The department's philosophy is one of continuous supervision to assess the condition and risk profile of the bank and to take appropriate supervisory and regulatory action when necessary. To implement this philosophy, supervisory strategies are developed annually for each large bank company and are updated quarterly. Strategies are continuous and relate closely to each company's condition, risk profile, economic factors, and marketplace developments. A major component of each strategy is the communication plan. This plan must maintain a strong, consistent, and frequent two-way dialogue with bank management and its board of directors.

To effect these strategies, a program of both onsite and office examinations and reviews are employed. Examinations are conducted to meet the requirements of the Federal Deposit Insurance Corporation Improvement Act of 1991 and subsequent amendments. Areas of special supervisory emphasis in 1997 included supervisory initiatives in retail credit (credit cards), credit underwriting, asset-based lending, and year-2000 compliance.

Continuing Education

Continuing Education (formerly Training and Performance Development) is responsible for all agency course development, maintenance, and delivery. It also manages a cadre of reserve examiners and provides customized services throughout the agency regarding organizational and management development. During 1997, Continuing Education developed a Problem Bank School and an External Training Program, which allows employees greater flexibility in selecting outside training.

Office of the Chief Counsel

Administrative and Internal Law Division

The Administrative and Internal Law Division (AIL) continued to have responsibility for providing legal advice and service on issues and matters relating to the OCC's management and operations as a federal agency. The division also continued to be responsible for assisting the chief counsel in various aspects of the Law Department's internal operations.

Most of the division's personnel have specialized experience in one of four major areas associated with the OCC's administrative functions: personnel, procurement, ethics, and information law. In addition to these areas, service and assistance have also been provided on matters relating to the OCC's fiscal operations as well as a broad range of more general administrative law issues.

During 1997, AIL provided service and assistance on matters and issues arising from the agency's internal restructuring. It also provided advice and service associated with significant changes made to certain of the agency's administrative policies. As in previous years, the division also continued to administer the OCC's ethics program in conjunction with the district legal staffs.

Bank Activities and Structure Division

The Bank Activities and Structure Division (BAS) provides legal advice on corporate structure matters such as chartering national banks, branching, main office relocations and designations, operating subsidiaries and investments in other entities, mergers and acquisitions, interstate operations, management interlocks, and changes in bank control. The division also advises on issues relating to general bank powers, special purpose banks, lending limits, leasing activities, loans to insiders, affiliate transactions, bank premises, other real estate owned, and failing banks. These questions arise under such laws as the National Bank Act, Riegle–Neal Interstate Banking and Branching Efficiency Act, Federal Reserve Act, Federal Deposit Insurance Act, Bank Holding Company Act, Bank Merger Act, Change in Bank Control Act, Depository Institution Management Interlocks Act, and the Financial Institutions Reform, Recovery, and Enforcement Act.

The division provides legal advice and service to other units within the OCC, such as Bank Organization and Structure, Multinational Banking, the Chief National Bank Examiner's Office, Capital Markets, International Banking and Finance, and Special Supervision. In addition, BAS provides advisory services to national banks, the banking bar, and the public. In developing its legal positions, the division works closely with other Law Department units, including the OCC's district legal staffs.

Significant BAS legal opinions and activities during 1996 are summarized below:

- *Automated loan machines.* BAS provided the first legal analysis of automated loan machines following passage of the Economic Growth and Regulatory Paperwork Reduction Act of 1996. This legislation removed automated teller machines (ATMs) and remote service units (RSUs) from the definition of "branch" under the McFadden Act. The analysis concluded that automated loan machines are ATMs or RSUs, and therefore such machines that are owned or rented by national banks are not subject to geographic branching restrictions. This interpretation will enhance the ability of national banks to provide service to the public.
- *Corporate manual.* BAS provided legal advice and consultation during the year to the Bank Organization and Structure Division for its revision of the *Comptroller's Manual for Corporate Activities*. This manual contains detailed information on the OCC's licensing procedures.
- *Expanded activities.* BAS provided legal support for several matters relating to real property. The division prepared legal analysis for an interpretation concluding that national banks can, pursuant to 12 USC 24(7) and 12 CFR 23, lease real property that is incidental to a permissible lease financing of personal property. BAS also provided the legal analysis for the OCC's first approval of a national bank operating subsidiary that provides flood certification for real estate loans, that is, the subsidiary performs research and certifies to real estate lenders whether or not property securing real estate loans is located in a flood plain, making flood insurance necessary. BAS also provided legal analysis for an interpretive letter concluding that shared appreciation mortgages are "adjustable-rate mortgages" under OCC regulations at 12 CFR 34. This decision also affected state-chartered banks, under a federal statute giving them parity with national banks in this area.
- *Interstate operations.* The division was significantly involved in implementing provisions of the Riegle–Neal Interstate Banking and Branching Efficiency Act that took effect in 1997. Certain types of interstate mergers between national banks became permissible on June 1, prompting many bank holding companies to merge together their subsidiary banks in different states. Some of these "interstate rollups" involved as many as 23 banks, and BAS performed the legal analysis for these transactions.

BAS provided the legal analysis for the OCC's approval of the merger, through intermediate steps, of insured and uninsured national trust banks in different states, resulting in the first interstate national trust bank approved under the Riegle–Neal Act. The decision also concluded that the resulting bank could exercise fiduciary powers in both states in which it operated. BAS also provided legal support for the first approvals of *de novo* interstate branches in a number of states, pursuant to authority under the Riegle–Neal Act that took effect on June 1.

- *Investments in subsidiaries.* As in prior years, BAS provided legal advice and support for corporate applications and opinion requests relating to investments in subsidiaries. For example, BAS provided legal analysis for the approval of a national bank's 50-percent investment in a credit card merchant processing subsidiary. The decision was of interest because it concluded that a non-controlling, 50-percent equity interest should be subject to the four-part test for minority investments rather than the OCC's operating subsidiary regulation, 12 CFR 5.34. BAS also provided legal analysis for the approval of a national bank's minority investment in a limited liability company that produces home banking and financial management software.

  BAS also provided the legal analysis for an interpretive letter concluding that a number of fees charged in connection with loans constitute interest for purposes of 12 USC 85. This was part of a series of BAS opinions clarifying the interest rate authority of national banks under that statute.

- *Thrift institutions.* BAS provided legal analysis for a number of corporate applications involving national banks and thrift institutions. One such application involved the conversion of four federal savings banks to national banks, and addressed a variety of issues that can arise in such a transaction, including legal authority, retention of branches, and treatment of nonconforming assets and liabilities. BAS also provided legal analysis for several transactions in which thrift institutions were acquired by and merged into national banks. In addition, the division provided the legal analysis to permit the conversion of a state-chartered, mutual savings bank into a national bank, while still retaining the mutual form of ownership. This was the first transaction of this kind.

Community and Consumer Law Division

The Community and Consumer Law Division (CCL) provides legal interpretation and advice on consumer protection, fair lending, and community reinvestment issues. The division is also responsible for providing legal advice on issues related to bank community development powers and activities, including activities conducted within the bank, investments in community development corporations and projects, and participation in community development financial institutions. In addition, the division provides advice regarding community protests of mergers and acquisitions by national banks.

In 1997, CCL worked with the other federal regulatory agencies on a number of significant projects which included issuance of "Revised Questions and Answers concerning the Community Reinvestment Act (CRA) Regulations;" implementing limitations placed on interstate deposit offices by the Interstate Banking and Branching Efficiency; and developing a consumer education brochure on mortgages, mortgage lenders, credit problems, loan pricing, and negotiations. The division is also participating in an intra-agency working group that is focusing on electronic banking and payments, including smart cards and EFT '99.

Within the OCC, CCL is the primary source of legal assistance and service to the agency's supervisory personnel and community development specialists as well as national banks, the banking bar, and the public with respect to consumer protection, fair lending, and community reinvestment issues. In this capacity, the division's staff provided the legal analysis for a significant number of opinions issued in 1997 that addressed the CRA. These opinions are summarized below.

Application of Lending, Investment, and Service Tests to Bank Products and Investments

The CCL division addressed issues pertaining to banks' loans and grants supporting a social service agency's programs, including its Family Loan Program, which provides small loans to low-income parents to pay for unexpected expenses that might interfere with their ability to keep a job or stay in school. In a letter the division stated that banks may receive positive consideration under the Community Reinvestment Act (CRA) regulations for grants and loans supporting the social service agency's programs. It also opined for the first time that, if a bank services Family Loan Program loans for the social service agency, the bank may receive positive consideration for that activity as a community development service under the regulations' service test.

The CCL division also clarified, for the first time, that banks may receive positive consideration for qualified investments under the CRA regulations regardless of whether the investments are made directly in a community development project or indirectly through an equity fund that finances community development projects.

Also CCL issued a letter which provides, for the first time, guidance to examiners about how to determine whether an activity has a "primary purpose" of community development when it is not readily apparent that a majority of the individuals or the area benefitted by the project are low- or moderate-income. The letter explains that, in such instances, examiners would evaluate whether the express, bona fide intent of the project is community development, as defined in the CRA regulations; whether the project is structured to achieve the expressed community development purpose; and whether the project is reasonably certain to accomplish the community development purpose.

The CCL division also opined, for the first time, that a security backed by home mortgage loans to low- and moderate-income individuals may be favorably considered in a bank's CRA evaluation as a qualified investment if the loans backing the security are located in the bank's assessment area(s) or a broader statewide or regional area that includes the bank's assessment area(s).

The division also stated in a letter that, in evaluating a bank's qualified investments, examiners will consider the dollar amount of all qualified investments that are recorded on a bank's books according to generally accepted accounting principles (GAAP). The letter clarifies, for the first time, that examiners will include both new and outstanding investments, as well as the dollar amount of legally binding commitments recorded by the institution according to GAAP. The letter notes that, although institutions may exercise a range of investment strategies, institutions making the same dollar amount of investments over the same number of years, all else being equal, would receive the same level of consideration under the CRA.

Finally, CCL also opined in a letter that if a bank's activities in connection with a financial services education program are targeted to low- and moderate-income individuals, examiners may give them favorable consideration when evaluating the bank's CRA performance. The letter states, for the first time, that student wages, paid in connection with the financial services education program, for short-term, compensated, on-the-job training for low- and moderate-income students may be evaluated as a qualified investment.

Other Matters

In 1997, CCL also played an active role on the OCC's National Fair Access Committee, and in the development of the brochure, *A Guide to Mortgage Lending in Indian Country.* The division also provided advice and legal expertise in the development of large bank CRA and fair lending examination procedures, examination procedures for consumer compliance exams of community banks, and examination procedures to implement the changes to the Fair Credit Reporting Act.

Additionally, CCL staff also provided legal guidance regarding CRA protests on several bank mergers and acquisitions during 1997.

Counselor for International Activities

The Counselor for International Activities (IA) serves as the Law Department's focal point for international banking issues relating to foreign banks' operations in the United States, as well as foreign operations of domestic banks. On such issues, IA provides legal advice to OCC supervisory offices and other divisions of the Law Department.

In 1997, IA provided advice on a number of issues relating to cooperation and exchange of information among bank supervisors of various countries. For instance, it has:

- Provided counsel on matters arising in the Basle Committee for Bank Supervision and the Joint Forum on Financial Conglomerates as these groups studied exchange of information and cooperation by supervisors of financial institutions;
- Worked closely with Treasury Department and other regulators in addressing these issues in the G-7 context; and
- Worked closely with the Federal Reserve Board on issues relating to bilateral arrangements with other bank supervisors to exchange supervisory information.

The IA also continued to work on other issues considered by the Basle Committee for Bank Supervision, and has continued to work closely with the Treasury Department on regulatory and supervisory matters regarding international banking and trade.

In 1997, IA also provided advice on legal issues regarding the authority of foreign banks to establish federal branches and agencies, intra- or interstate, in the United States. For example, it clarified the ability of a foreign bank to establish an initial branch in Florida, or to establish an additional interstate branch in Florida. Similarly, IA worked on a number of legal issues arising from mergers of foreign banking institutions and the impact of those mergers on the US operations of the involved institutions. It has also provided counsel to other departments of the Law Department in the preparation of proposed or final regulations involving foreign banks.

Enforcement and Compliance Division

The Enforcement and Compliance Division (E&C), in conjunction with the districts, recommends administrative actions and litigates these actions on behalf of the OCC in administrative proceedings. E&C may defend actions if they are challenged in United States courts of appeals. E&C defends challenges to temporary cease-and-desist orders and suspensions which have been filed in district court. The division supports criminal law enforcement agencies and provides advice on enforcement and compliance issues to senior OCC officials.

Administrative Actions

Enforcement and Compliance is responsible for nondelegated actions, while the OCC's districts are responsible for delegated actions. In adjudicating its administrative cases, E&C held numerous pre-hearing conferences and represented the OCC in two administrative hearings in 1997.

During 1997, the OCC issued 20 cease-and-desist orders against individuals, including 14 restitution orders. Restitution ordered and/or paid in 1997 totaled $1.8 million. The OCC imposed 18 civil money penalties (CMPs) on individuals. CMPs ordered and/or paid in 1997 totaled $706,400. The OCC issued 38 removal orders, 12 letters of reprimand, and 39 supervisory letters to individuals. Five cease-and-desist orders, and two CMPs were issued against banks. The OCC also negotiated 15 formal agreements, 9 memoranda of understanding, and 6 commitment letters with banks. A comprehensive listing and description of enforcement actions taken by the OCC in the first half of 1997 can be found in the September issue of the *Quarterly Journal* and elsewhere in this issue for the last half of 1997. In addition, E&C continued its Fast Track Enforcement Program (initiated in 1996), which helps ensure that bank insiders and employees who have committed criminal acts involving banks, but who are not being criminally prosecuted, are prohibited from working in the banking system.

Law Enforcement Support

In the past year, E&C continued to provide information and expert testimony to local, national, and international law enforcement authorities. The national bank examiner in E&C who is responsible for monitoring offshore shell bank and other forms of external fraud testified in 18 criminal trials, all of which resulted in convictions. E&C continued to alert the banking industry to fraudulent or questionable offshore shell banks and other fraudulent practices, issuing a total of 33 OCC Alerts.

E&C worked closely with the interagency Bank Fraud Working Group (BFWG), which is chaired by the Department of Justice (DOJ). The BFWG continues to improve coordination and cooperation between the federal financial regulatory agencies, DOJ, and the other law enforcement and regulatory agencies. In 1997, through the BFWG, the OCC issued guidance on the reporting of computer crimes. With E&C input, the BFWG also revised its interagency Bank Fraud Directory. E&C also chaired the BFWG's subgroup on check fraud, which focuses on the nature and extent of check fraud in the country and hosts quarterly meetings on an interagency basis.

As part of the OCC's anti-money laundering efforts, E&C participated in the Money Laundering Working Group, an interagency group chaired by the Financial Crimes Enforcement Network. E&C is also a member of the OCC's National Anti-Money Laundering Group, which acts as OCC's main contact for all Bank Secrecy Act (BSA) compliance issues and anti-money laundering efforts, such as development of "know-your-customer" guidelines, examiner training, and enhanced BSA and anti-money laundering examination procedures.

In addition, in 1997, E&C worked closely with the other banking agencies which are part of the Federal Financial Institutions Examination Council to develop a policy for interagency notification and coordination of all of the federal agencies' enforcement actions.

Legislative and Regulatory Activities Division

The Legislative and Regulatory Activities Division (LRA) drafts the OCC's regulations, provides legal support for the OCC's legislative work, provides legal advice on issues relating to national banks' regulatory capital requirements, and works on a variety of other projects as directed by the Chief Counsel or the Deputy Chief Counsel.

Regulations

In December 1996, the OCC completed its Regulation Review Program (program). The program, which Comptroller Ludwig initiated in 1993 shortly after he took office, was a comprehensive review and revision of all of the OCC's regulations in order to eliminate unnecessary regulatory burden, promote national bank competitiveness, and makes the rules simpler and easier to understand. In 1997, LRA, which had lead drafting responsibility for the revisions to the OCC's rules pursuant to the program, participated in the OCC's effort to evaluate the program's effectiveness. Called the Regulation Review Effectiveness Measures Project, this evaluation was conducted to ascertain what effect the program had on those who use the OCC's rules, including banks, the communities they serve, and the OCC's supervisory and examination staff. Staff working on the Measures Project prepared a final report concluding that, on balance, the program succeeded in accomplishing its objectives. In addition, the Report indicated areas for further improvements to the OCC's rules identified by bankers, banking lawyers, community group representatives, and OCC staff who participated in the evaluation of the program.

In addition, in 1997 LRA attorneys worked with staff in other divisions of the Law Department and throughout the OCC to prepare several final rules, which covered a wide range of legal and supervisory issues. Revisions to the following rules were among the most significant regulatory actions that the OCC took in 1997:

- *Part 4—Expanded Examination Cycle for Certain Small Insured Institutions*. The interim rule makes eligible for an 18-month exam cycle a national or state bank that (1) has total assets of $250 million or less; (2) is well capitalized; (3) is well managed; (4) received a CAMELS 1 or 2 at its most recent exam; (5) is not subject to a formal enforcement order; and (6) has not had a change in control during the previous 12-month period. The OCC adopted this rule jointly with the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision.
- *Part 8—Assessments*. The OCC published two final rules amending Part 8 in 1997. Together, these two rules modified the OCC's assessment regulation in ways that link the OCC's assessment revenue to the resources required to supervise an institution. The first rule authorized the OCC to reduce assessments of national banks that are not the largest national bank in a bank holding company. The second rule imposed a 25 percent surcharge on banks that received a CAMELS rating of 3, 4, or 5 in the most recent Report of Examination. This rule, which reflects OCC cost data showing a significant increase in supervision costs once an institution's rating moves from a 2 to a 3, shifts the costs of supervising banks requiring additional OCC resources to those banks.
- *Part 13—Government Securities Sales Practices*. The rule, which was adopted jointly by the OCC, the Federal Reserve Board, and the Federal Deposit Insurance Corporation (FDIC), includes provisions that are substantively identical to the Business Conduct and Suitability Rules of the National Association of Securities Dealers (NASD) and an interpretation substantively identical to the NASD Suitability Interpretation.
- *Part 25—Deposit Production Offices*. The rule, which was adopted jointly by the OCC, the Federal Reserve Board, and the FDIC, implements section 109 of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, 12 USC 1835a (the Interstate Act). Section 109 requires the agencies to determine whether a bank with covered interstate branches in a particular state has a loan-to-deposit ratio in that state equal to at least 50 percent of the aggregate loan-to-deposit ratio of host state banks (loan-to-deposit ratio screen).

For regulatory projects, LRA also serves as the OCC's liaison with staff at the Department of the Treasury, at OMB, and at the Federal Register. LRA provides advice and assistance on compliance with a variety of statutes affecting rulemakings, including the Administrative Procedure Act, the Paperwork Reduction Act, the Regulatory Flexibility Act, the Unfunded Mandates Act, and the statute providing for Congressional review of final agency rules and with various executive orders that may apply when the OCC issues regulations.

Legislation

LRA's legislative responsibilities include summarizing and analyzing pending and enacted legislation affecting national banks and the OCC; drafting legislative materials for the OCC and, upon request, providing drafting support to the Department of the Treasury and technical assistance to Congressional committees and members of Congress; advising in the development of the OCC's positions on legislative issues; assisting in the preparation of the Comptroller's Congressional testimony; and providing information responding to written or telephone inquiries from members of Congress or Congressional staff for information about the effect a legislative proposal may have on national banks or their supervision.

Legislative activity in 1997 focused principally on efforts to modernize the financial institutions industry. Although no financial modernization legislation passed the first session of the 105th Congress, LRA analyzed, monitored, and provided comments on a variety of financial modernization proposals and bills.

Capital

LRA provides drafting assistance and legal counsel with respect to the OCC's risk- based capital regulations. Most of the OCC's capital rules are issued jointly with the other three Federal banking agencies—the Federal Reserve Board, the FDIC, and the Office of Thrift Supervision. In 1997, among other actions, the agencies issued the following four joint notices of proposed rulemaking: (1) a proposal on the treatment of recourse arrangements and direct credit substitutes for risk-based capital purposes; (2) a proposal to modify the agencies' treatment of servicing assets for risk-based capital purposes consistent with accounting guidance recently adopted by the Financial Accounting Standards Board; (3) a proposal to permit insured depository institutions to include, for purposes of risk-based capital and consistent with the Basle Accord, unrealized holding gains on certain equity securities; and (4) a proposal to eliminate several of the remaining differences among the agencies' respective risk-based capital rules.

National Banks' Insurance Activities

LRA assists the Chief Counsel in matters affecting the interplay of state insurance regulation and permissible insurance activities authorized for national banks. In 1997, LRA undertook a 50 state survey of legislative and regulatory developments affecting national bank insurance sales to identify state initiatives since the Supreme Court's 1996 decision in *Barnett Bank of Marion County, N.A.* v. *Nelson*. LRA also participates in the insurance implementation working group, which is an OCC-wide task force addressing supervisory issues relating to national banks' insurance activities, and serves as liaison with state insurance commissions, groups of bankers engaged in insurance activities, and others.

Litigation Division

The Litigation Division (LIT) represents the OCC in court under a grant of independent litigating authority. The division also works closely with the U.S. Department of Justice and with U.S. Attorneys on matters of mutual interest. During 1997, the courts issued several significant decisions in the following cases in which the OCC was involved:

- *Texas Bankers Ass'n., Broadway Nat'l. Bank, and OCC* v. *Bomer:* This decision of the U.S. District Court for the Western District of Texas held that 12 USC 24(Seventh), which authorizes national banks to sell variable and fixed annuities as agent, preempts provisions of the Texas Insurance Code that prohibit banks from selling annuities. The Texas Insurance Commissioner chose not to appeal the decision.

- *Shawmut Bank, Connecticut, N.A.* v. *Googins:* This decision of the U.S. District Court for the District of Connecticut upheld the OCC's interpretation of Section 92 as authorizing a national bank located in a place of under 5,000 in population to sell insurance to customers outside that place. That interpretation of Section 92 has been upheld by both U.S. Courts of Appeals that have addressed the issue. The decision is significant for two reasons. First, it enables a national bank to sell insurance to a broader customer base. Second, it serves as additional precedent for the deference owed the OCC's reasonable interpretations of the National Bank Act.

- *Ghiglieri* v. *Sun World, N.A. and Ludwig:* This unanimous decision of the U.S. Court of Appeals for the Fifth Circuit, reversing the court below, upheld the Comptroller's approval of a national bank's applications to: (1) relocate its main office across state lines pursuant to section 30(b) while retaining preexisting branches in the state from which the main office was relocated, and (2) establish a branch, pursuant to section 36(c), at the former main office site. On June 1, 1997, after the Comptroller's approval of these applications, provisions of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 which restrict a national bank's ability to establish an interstate presence in this manner became operative. Nonetheless, this decision remains significant because it serves as additional precedent for the deference owed the OCC's reasonable interpretation of the National Bank Act.

- *Ghiglieri* v. *Ludwig and Commercial Nat'l. Bank:* This subsequent unanimous decision of the U.S. Court of Appeals for the Fifth Circuit, reversing the court below, upheld the Comptroller's approval of a set of applications virtually identical to those involved in *Ghiglieri* v. *Sun World, N.A. and Ludwig*. In light of its earlier decision, the Fifth Circuit vacated the decision of the U.S. District Court for the Northern District of Texas and remanded for entry of a judgment in favor of the OCC and the bank.

- *McQueen* v. *Ludwig:* This decision of the U.S. District Court for the Western District of Michigan upheld the Comptroller's approval of an application by Society Bank, Michigan, Ann Arbor, Michigan, to convert to a national bank with its main office in a location more than 30 miles away, then relocate that main office to Indiana, and merge with Society National Bank of Indiana while retaining the branches of both banks in Michigan and Indiana. This decision is significant for three reasons. First, the court rejected the state's argument that a converting bank must designate its principal office under state law as the location of the national bank's main office. Second, relying heavily on the Fifth Circuit's decision in *Ghiglieri* v. *Sun World, N.A. and Ludwig,* the court rejected the state's argument that a national bank relocating its main office across state lines must divest its branches in the former main office state. Finally, the court held that the Comptroller need not consider the length of time a bank intends to locate its main office in the place designated, only whether the designation complies with the requirements in section 30.

- *Matthew Lee, et al.* v. *FDIC and OCC:* The U.S. District Court for the Southern District of New York dismissed plaintiffs' challenge to, among other things, OCC's approval of the merger of U.S. Trust Co. of New York with and into Chase Manhattan Bank. Plaintiffs alleged that the agencies approved mergers without considering the applicants' record of compliance with the Community Reinvestment Act and other consumer protection laws. The court, adopting the reasoning of the Second Circuit in its recent dismissal of a closely related suit by plaintiffs against the Federal Reserve Board and the Office of Thrift Supervision, dismissed the instant suit on the grounds that plaintiffs lacked standing. In other words, plaintiffs failed to allege any concrete particularized injury caused them by the approvals that could be remedied by a favorable court decision. This decision is significant because it makes it more difficult for litigants to use the CRA to challenge mergers in court.

- *Reverend Joseph L. Jones* v. *OCC:* The U.S. District Court for the District of Columbia dismissed and granted summary judgment in favor of the OCC on pro se plaintiff's claims that the OCC improperly approved a national bank's application to acquire a mortgage operating subsidiary without considering the record of the bank's holding company in complying with the Fair Housing Act. Plaintiff, founder of the Plaisance Development Corporation in Louisiana, also alleged a general failure by the OCC to remedy discriminatory housing practices. The court summarily dismissed most of the allegations, holding that they did not raise issues subject to judicial review. As for the allegation the court did review, concerning OCC's own compliance with the statutory mandate to affirmatively further the purposes of fair housing, the court found that the record demonstrated compliance. This decision is significant because it makes it more difficult for litigants to use the Fair Housing Act to challenge operating subsidiary acquisitions in court.

The Litigation Division also drafts administrative decisions for the Comptroller and represents the OCC before the Equal Employment Opportunity Commission, the Merit Systems Protection Board, and the General Services Administration Board of Contract Appeals. In 1997, the courts affirmed the following two significant administrative actions involving the OCC:

- *William C. Sarsfield* v. *OCC:* This decision by the U.S. Court of Appeals for the Ninth Circuit upheld, as based on substantial evidence, the Comptroller's decision imposing a $10,000 civil money penalty against Sarsfield for noncompliance with seven articles of a consent cease-and-desist order. This decision is significant because it makes clear that as an institution-affiliated party (an executive and director), Sarsfield was responsible for compliance with the order even though others may share blame for the noncompliance.

- *James L. Leuthe* v. *OFIA, FDIC, OCC, et al.:* The U.S. District Court for the Eastern District of Pennsylvania dismissed a suit, brought by a respondent in two Federal Deposit Insurance Corporation (FDIC) enforcement proceedings, in which he sought a declaration that the enforcement procedures under the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) are unconstitutional because the Office of Financial Adjudication (OFIA), which employs the Administrative Judges, was not properly created as a federal agency. The court held that this type of claim does not fall within the limited jurisdiction district courts have over controversies arising under 12 USC 1818. This decision is significant as additional precedent for the proposition that district courts lack jurisdiction to interfere with ongoing section 1818 enforcement actions.

Securities and Corporate Practices Division

The Securities and Corporate Practices Division (SCP) provides legal counsel to the OCC and advises the public on federal securities laws and banking laws related to bank securities activities; bank sales of mutual funds, annuities and insurance; bank derivative activities; bank fiduciary matters; bank corporate practices; and bank investments.

SCP administers and enforces the federal securities laws affecting national banks with publicly traded securities, including the Securities Exchange Act of 1934, and the OCC's related disclosure regulations at 12 CFR 11. The division also enforces the OCC's securities offering disclosure rules (12 CFR 16), which govern national banks' public and private offers and sales of their securities, as well as national bank activities conducted under the Investment Company Act of 1940, the Investment Advisers Act of 1940, and the Trust Indenture Act of 1939.

The division is responsible for the OCC's enforcement program to assure national bank compliance with federal securities laws applicable to bank municipal and government securities dealers, bank transfer agents, and other bank securities activities. SCP is the OCC's liaison to federal and state securities regulatory agencies, including the Securities and Exchange Commission (SEC).

In carrying out these responsibilities, as in past years, the division reviewed offering circulars, abbreviated information statements, notices of nonpublic offerings, annual and special meeting proxy materials, periodic reports, and other reports filed with the OCC under the Comptroller's securities disclosure rules and merger application procedures. SCP also continued to contribute to the SEC's enforcement and disclosure review responsibilities by, for example, arranging for the SEC to review bank examination reports and work papers in SEC enforcement cases.

SCP also provides the SEC with information on national bank subsidiaries of bank holding companies filing securities disclosures with the SEC. In 1997, the division also referred potential violations of securities laws under the SEC's jurisdiction to the SEC.

Additionally, in 1997, SCP prepared or participated in the issuance of several significant opinions. These opinions are summarized below:

Authority of Bank Subsidiary to Underwrite Municipal Revenue Bonds

SCP provided the legal analysis underlying an approval with conditions enforceable, authorizing the first operating subsidiary to engage in activities other than those permitted for a parent national bank under the OCC's revised Part 5. In the approval, the OCC addressed whether a bank operating subsidiary may underwrite, deal and invest in municipal revenue bonds. The decision found that the proposed activities are legally permissible for a subsidiary of a national bank, because they are part of or incidental to the business of banking, and allowed under the plain language of the Glass–Steagall Act. The decision noted that the proposed activities are expected to have substantial benefits for the communities the bank serves, and for taxpayers. The subsidiary and bank will be subject to functional regulation by the securities regulators, and supervision by the OCC. The OCC concluded that the proposed expansion of activities in the subsidiary is consistent with safe and sound banking practices.

Insurance Activities

SCP provided the legal analysis for several precedential opinions and approvals in the insurance area in 1997. In one letter, the OCC concluded that a national bank may sell crop insurance, as agent, to farmer borrowers as part of, or incidental to, the business of banking. Banks make loans to farmers to cover the operational expenses of producing crops, and expect to be repaid out of the proceeds of those crops. Crop failure can prevent farmers from repaying those loans. Crop insurance enhances and facilitates a bank's lending activity by protecting its loans, and thus is part of or a logical outgrowth of banking operations.

Another insurance-related opinion addressed the authority of a bank to acquire an operating subsidiary to underwrite and reinsure credit disability and involuntary unemployment insurance, in connection with credit card loans made by a bank affiliate. The subsidiary would also underwrite safe deposit box liability insurance for the bank and its affiliates. The proposed credit-related insurance activities are part of or incidental to the business of banking, because the proposed activities limit the affiliate's risk of loss on the credit card loans that it makes. This is functionally equivalent to or a logical outgrowth of the bank's existing authority to conduct these activities on loans that the bank itself extends. Additionally, underwriting safe deposit insurance is a functional equivalent or a logical outgrowth of a bank's subsidiary's authority to engage in the safe deposit business.

SCP prepared several opinions in 1997 involving mortgage reinsurance subsidiaries. In these opinions, the OCC concluded that a national bank subsidiary may enter into reinsurance agreements with a number of unaffiliated insurance carriers that issue mortgage insurance on mortgage loans originated or purchased by the bank or its affiliates. The subsidiary will accept a portion of the default risk on the mortgage loans, in exchange for a share of the insurance premiums paid. The subsidiary's activities are functionally equivalent to or a logical outgrowth of the bank's business of underwriting mortgage loans.

Mutual Fund Activities

SCP prepared a letter concluding that a national bank or its subsidiary may directly provide retail commissions to selling brokers, and receive 12b-1 and contingent deferred sales charge fees. Prior to the approval, the bank had been doing so indirectly, through the additional step of making a loan to a distributor, who then paid the commissions.

Investment Securities

In the investment securities area, SCP drafted a letter providing that national banks may invest in money market preferred stock as Type III investment securities. Money market preferred stock pays a variable dividend rate based on the results of periodic auctions. The letter concludes that money market preferred stock can be properly characterized in substance as debt. Bank eligible money market preferred stock must meet applicable rating and marketability requirements of 12 CFR Part 1.

SCP clarified the meaning of an indirect general obligation under the OCC's recently revised investment securities regulation at 12 CFR Part 1, by concluding in another letter that New Jersey pension funding bonds qualified as Type I securities and would be subject to a 20 percent risk weight.

Another SCP letter in the investment securities area provided that national banks may invest in trust preferred securities as Type III investment securities. To create trust preferred securities, a corporation organizes a business trust and funds it with debt of the corporation. The trust sells preferred stock in the trust to investors. The letter concludes that an investment in trust preferred securities is functionally equivalent to an investment in the underlying debt that funds the trust. Bank eligible trust preferred securities must meet applicable rating and marketability requirements of 12 CFR Part 1.

Additionally, SCP drafted a letter that expanded OCC precedent on permissible investments by allowing national banks to invest in a privately offered investment fund that would invest in high-yield loans, subject to a 5 percent aggregate investment limit. This letter provided banks with additional flexibility in choosing whether to treat an investment as a security under Part 1 or as a loan participation.

Reverse Stock Split

SCP drafted a decision letter approving a national bank's application to conduct a reverse stock split under the corporate governance provisions of Colorado law. The bank proposed the reverse split to enable its holding company to increase its ownership to 100 percent of the bank's shares and convert to a Subchapter S corporation to decrease corporate expenses. The letter concluded that the National Bank Act does not prohibit reverse stock splits where a bank elects the corporate governance procedures of its home state, and completes the split in accordance with those provisions, as long as state law provides reasonable dissenters' rights and the bank demonstrates a legitimate business purpose for the reverse split.

Regulatory Matters

As part of the OCC's Regulatory Review Program, SCP staff participated in the amendment of 12 CFR 9, governing the fiduciary activities of national banks, and the proposed amendments to 12 CFR 10, governing the activities of municipal securities dealers.

Bank Organization and Structure

National banks must, by law and regulation, seek OCC approval for certain classes of corporate changes. These changes include new bank charters, conversions to national banks, corporate reorganizations, mergers, branches, bank relocations, operating subsidiaries, capital and subordinated debt issues, and bank acquisitions. Most licensing requests are reviewed and decided in the licensing units located in the six district offices and in Washington, DC (Federal branches and agencies file with International Banking and Finance). Complex issues are forwarded to Bank Organization and Structure (BOS) in Washington, DC, for analysis and decision by senior management. BOS establishes policies and procedures for the OCC's processing of corporate applications from national banks, reviews and makes recommendations on applications that raise significant legal and policy issues, and strives to maintain effective quality control and information systems that support decentralized licensing operations. BOS has three divisions, which were restructured and/or renamed late in 1997: Washington-Directed Licensing, Licensing Policy and Systems, and District/Large Bank Licensing.

Application Volume and Decision Results

Table 1 summarizes corporate application activity for 1997. The total number of applications filed with the OCC decreased from 3,928 in 1996 to 2,886 in 1997. Much of the difference reflects statutory, regulatory and processing changes. During the first nine months of 1996, 866 automated teller machine (ATM) applications were filed with the OCC, which is included in the total applications for 1996. However, the Economic Growth and Regulatory Paperwork Reduction Act, which became effective September 30, 1996, eliminated the requirement for national banks to file ATM applications. The 1997 count was also reduced because 92 operating subsidiary filings were effected through after-the-fact notices under OCC's revised regulation; in 1996, before the regulatory change, full applications, and OCC approval, would have been required. In 1997, net of ATM applications, the OCC experienced a decrease in the number of branch, operating subsidiary, fiduciary powers, capital and conversion filings, and an increase in reorganization, change-in-control and merger filings.

From 1996 to 1997 new charter applications decreased one to 80, after a 45 percent increase from 56 applications in 1995. The OCC received 43 charter applications from independent groups during 1997. Of these, 34 were for full service banks, 3 for trust banks, and 6 for credit card banks. The other 37 charter applications received in 1997 were sponsored by existing holding companies. Of this group, 21 were for full service banks, 15 for trust banks and 1 credit card bank.

The OCC denied two applications in 1997, compared to none in 1996 and two denials in 1995. Of the 2,910 decisions, 42 were conditional approvals. Conditional approvals decreased over 1996, when 83 of 2,911 decisions were conditionally approved.

Summaries of important corporate decisions for the previous quarter are published in each issue of the *Quarterly Journal*.

Processing Timeliness

One measure of our effectiveness in processing corporate applications is the percentage of applications processed within target time frames. To ensure applications are processed in a timely manner, BOS measures processing time using benchmark time frames for routine applications and for more complex applications. Processing timeliness varies with the volume and complexity of applications. These, in turn, vary with economic conditions and changes in banking law. Table 2 shows the time frame performance for the applications processed by the OCC in 1996 and 1997 (without including ATMs which didn't require an application after September 30, 1996, and after-the-fact notices for subsidiaries in 1996 and 1997). The OCC generally meets target time frames for all application types. Deviations from these targets are primarily the result of application complexity, the need to acquire additional information or unusual workload strain.

Changes to 12 CFR 5, OCC's regulation governing all corporate applications, became effective December 31, 1996. The revised regulation established an "expedited review" process for certain applications from banks that are well capitalized, have a CAMELS rating of 1 or 2, have a CRA rating of "satisfactory" or better, and are not subject to an OCC formal enforcement action. Overall, target time frames were shortened. In addition, for some routine transactions, OCC approval is no longer required.

The time frames performance for application processing have significantly improved from 1995 to 1997. In 1995, the OCC met target time frames on 88 percent of the applications it decided. To provide consistent comparisons with prior years results, the statistics have been adjusted for regulatory and processing changes. In 1996 on an adjusted basis, the OCC met target time frames on 90 percent of the applications it decided. In 1997, under the revised regulation performance continued to improve; even with shorter target time frames the OCC met its targets 96 percent of the time.

Community Reinvestment Act Activities

In January 1997, in connection with the implementation of the revised Part 5, OCC released new procedures for handling Community Reinvestment Act (CRA) issues in applications, including how adverse comments from the public would be handled. Those procedures provide, for example, that applications will be removed from the new expedited review procedures when adverse comments are received so that the applications are not approved merely through the passage of time. They also provide that prior to acting on a CRA-covered application, OCC will investigate issues raised, and will use examiners who were independent of the most recent examination of the bank. Further, they provide that OCC will describe the adverse comments and the results of the OCC investigation in public decision documents on the applications.

Table 1—Corporate application activity in 1997

	Applications received		1997 District decisions			1997 Washington decisions			Total 1997 decisions
	1996	1997	Approved	Conditionally approved	Denied	Approved	Conditionally approved	Denied	
ATMs[1]	866	0	0	0	0	0	0	0	0
Branches	1,838	1,771	1,735	0	0	35	2	0	1,772
Capital/sub debt	127	93	73	2	0	7	0	0	82
Change in control	17	23	21	0	0	3	0	0	24
Charters	81	80	56	5	0	4	12	2	79
Conversions[2]	75	58	69	6	0	16	1	0	92
Federal branches	0	1	0	0	0	0	0	0	0
Fiduciary powers	47	24	33	0	0	6	0	0	39
Mergers	111	115	114	1	0	12	0	0	127
Relocations	260	243	232	0	0	9	0	0	241
Reorganizations	238	322	221	0	0	98	1	0	320
Stock appraisals	3	5	0	0	0	3	0	0	3
Subsidiaries[3]	265	151	104	3	0	15	9	0	131
Total	3,928	2,886	2,658	17	0	208	25	2	2,910

Note: Approved decisions include conditional approvals. Mergers include failure transactions where the national bank is the resulting institution.

[1] The Economic Growth and Regulatory Paperwork Reduction Act, effective September 30, 1996, eliminated the requirement to file ATM applications.

[2] Conversions are conversions to national bank charters.

[3] Subsidiaries do not include 16 after-the-fact notices received in 1996 and 92 after-the-fact notices received in 1997.

Source: Bank Organization and Structure, Comptroller of the Currency.

Table 2—OCC Licensing actions and timeliness, 1996–1997

Application type	Target time frame in days[1]	1996*			1997			Annual change		
		Number of decisions	Within target		Number of decisions	Within target		Number of decisions	Within target	
			Number	Percent		Number	Percent		Number	Percent
Branches	45/60	1,848	1,773	95.9	1,772	1,762	99.4	–76	–11	3.5
Capital/sub debt	30/45	94	86	91.5	82	71	86.6	–12	–15	–4.9
Change in control	NA/60	13	13	100.0	24	21	87.5	11	8	–12.5
Charters[2]		69	41	59.4	79	63	79.7	10	22	20.3
Conversions	30/90	44	37	84.1	92	90	97.8	48	53	13.7
Federal branches & agencies	NA/120	0	0	0.0	0	0	0.0	0	0	0.0
Fiduciary powers	30/45	31	25	80.6	39	38	97.4	8	13	16.8
Mergers	45/60	100	95	95.0	127	110	86.6	27	15	–8.4
Relocations	45/60	262	235	89.7	241	236	97.9	–21	1	8.2
Reorganizations	45/60	223	173	77.6	320	292	91.3	97	119	13.7
Stock appraisals	NA/90	5	0	0.0	3	1	33.3	–2	1	33.3
Subsidiaries	30/60	222	147	66.2	131	112	85.5	–91	–35	19.3
Total		2,911	2,625	90.2	2,910	2,797	96.1	–1	172	5.9

Note: Most decisions (93 percent in 1997) were decided in the district offices, International Banking and Finance, and Large Bank Licensing under delegated authority. Decisions include approvals, conditional approvals, and denials.

* Adjustments for regulatory and processing changes include the addition of decisions made in Washington, as well as those made in the district offices for both years; these were not included last year. The adjusted 1996 totals also exclude 843 ATM decisions and 16 subsidiary filings that qualified for "after-the-fact" notices during the Part 5 testing phase. The 1997 subsidiary totals do not include 92 after-the-fact notices and the 1997 capital/debt totals do not include 95 dividend approval requests made under 12 USC 60 filings nor decisions on 93 of those filings.

[1] Those filings that qualify for the "expedited review" process are subject to the shorter of the time frames listed. The longer time frame is the standard benchmark for more complex applications. New time frames commenced in 1997 with the adoption of the revised Part 5. The target time frame may be extended if the OCC needs additional information to reach a decision, permits additional time for public comment, or processes a group of related filings as one transaction.

[2] For independent charter applications, the target time frame is 120 days. For holding company sponsored applications, the target time frame is 45 days for applications eligible for expedited review and 90 days for all others.

Source: Bank Organization and Structure, Comptroller of the Currency.

The procedures provide for OCC meetings with commenters to assure that OCC understands their concerns, and provide that OCC will accept comments at any time, even after the close of public comment periods, if to do so will not unnecessarily delay action on the application. OCC followed these policies on all CRA-covered applications received during 1997.

During the year, OCC received 26 adverse CRA comments from the public on 12 pending applications. OCC received adverse CRA comments on three additional occasions that were not submitted as protests on specific applications, but where applications were nevertheless pending. In all these cases that initially qualified for expedited review, we removed them from the expedited review procedures. In two additional cases, we removed applications from expedited review procedures even though we received no public comments, because internal reviews identified CRA issues. We investigated and responded publicly to the issues raised in each case. Two applications were approved with conditions, enforceable under 12 USC 1818, requiring the banks to take specific actions to address CRA weaknesses. The others were approved without special conditions.

The decisions on the applications presenting CRA issues, listed below, were published in the OCC's monthly *Interpretations and Actions* and are also available on the OCC's home page.

Conditional Approvals Related to the Community Reinvestment Act

The OCC conditionally approved a branch for a bank subject to the bank submitting an acceptable CRA plan that specifically detailed actions the bank would take to serve the credit needs of residents and businesses in low- and moderate-income census tracts in the town in which the bank branch would be located. At the most recent CRA performance evaluation of the bank in mid-1996, the OCC rated the bank's performance "Satisfactory." The branch application was protested, and a subsequent targeted review by OCC examiners of the issues raised in the protest revealed the need for the enforceable conditions to be attached to the approval. [Conditional Approval No. 240, dated April 30, 1997]

The OCC conditionally approved a branch for a bank subject to the bank submitting an acceptable CRA plan that specifically detailed actions the bank will take to

Bank and city	*Interpretations and Actions* date	Document number
Associates National Bank, Wilmington, DE	April 1997	Corporate Decision No. 97–23
City National Bank of Kilgore, TX	May 1997	Conditional Approval No. 240
Wells Fargo Bank, NA, San Francisco, CA	May 1997	Corporate Decision No. 97–26
Mercantile Bank, NA, St. Louis, MO	July 1997	Corporate Decision No. 97–51
Bank of America NT&SA, San Francisco, CA	July 1997	Corporate Decision No. 97–53
Wells Fargo Bank, NA, San Francisco, CA	July 1997	Corporate Decision No. 97–57
First Bank, NA , Minneapolis, MN	August 1997	Corporate Decision No. 97–74
Delta National Bank, Manteca, CA	September 1997	Corporate Decision No. 97–83
Wells Fargo Bank, NA, San Francisco, CA	October 1997	Corporate Decision No. 97–85
Huntington National Bank, Columbus, OH	October 1997	Corporate Decision No. 97–88
BankBoston, NA, Boston, MA	November 1997	Corporate Decision No. 97–91
Chase Manhattan Bank USA, NA, Wilmington, DE	November 1997	Corporate Decision No. 97–94
First Union National Bank, Charlotte, NC	November 1997	Corporate Decision No. 97–96
SunTrust Bank, South Georgia, NA, Albany, GA	December 1997	Corporate Decision No. 97–100
First National Bank of Huntsville, TX	December 1997	Corporate Decision No. 97–101
Intercontinental National Bank, San Antonio, TX	December 1997	Conditional Approval No. 260
Bank One, NA, Columbus, OH	December 1997	Corporate Decision No. 97–111

improve the geographic distribution of loans in low- and moderate-income census tracts in its assessment area. At the most recent CRA performance evaluation of the bank earlier in 1997, the OCC rated the bank's performance "Satisfactory" overall, but also concluded that the geographic distribution of its lending did not meet the standard for satisfactory performance. No protests were filed on the application. [Conditional Approval No. 260, dated December 3, 1997]

District/Large Bank Licensing Division

District/Large Bank Licensing (D/LBL, formerly Licensing Operations) oversees all district and large bank licensing operations with a goal of enhancing effectiveness. The division, through Licensing Managers in each district office and large bank licensing, has decision authority for all licensing applications not requiring decision through the Washington-Directed Licensing in headquarters. D/LBL's responsibilities include monitoring actual operating performance for the six district and large bank and international licensing units, ensuring the effectiveness and efficiency of existing operations, and exploring new programs for improving licensing operations.

Significant developments during 1997 included the following:

- The licensing quality assurance program identifies and monitors critical areas where potential exposure to risks is higher than normal. In 1997, D/LBL identified and conducted quality assurance activities in three critical areas; timely internal communications of significant licensing issues, CRA protests and their impact on corporate processes, and adherence to 12 CFR 5. Overall, the quality assurance program did not disclose any systemic problem with licensing systems, policies or procedures. Only isolated exceptions were noted throughout the year. Those exceptions were resolved on a case-by-case basis.
- The licensing customer service survey checks the quality of service provided to banks filing corporate applications. A customer service survey was sent to each bank that filed a corporate application, except for large banks and a few mid-size banks which, due to application volume, were surveyed on a quarterly basis. Applicants were asked to rate the OCC's quality of service on a scale of 1 to 5, with 1 being outstanding, 3 neutral, and 5 significantly deficient.

The survey results for 1997 show that 94 percent of applicants responding gave the OCC excellent marks (ratings of 1 or 2) for the way their applications were processed.

The average rating for each of five service categories follows:

Service category	Rating
Timeliness of decision	1.26
Appropriateness of filing location/contact person	1.22
Knowledge of OCC contact	1.24
Professionalism of OCC staff	1.12
Overall rating of service	1.21

- Timeliness is an important determinant of efficiency in licensing operations and is one of several measures D/LBL used to monitor performance. Time frame performance overall was excellent with 97 percent of all licensing applications decided within established time frames. Exceptions (cases that were not decided within established time frames) were generally those with substantive legal or policy issues, such as the sale of insurance, CRA protests, interstate banking, electronic banking, Year 2000 problems, or other significant, unique, or precedent setting activities.

- 12 CFR 5, which made major changes to the way corporate filings are processed, was implemented successfully in district and large bank licensing operations. All expedited, delegated applications were decided within Part 5 requirements.

- Effective June 1997, the licensing staff of the six district and large bank licensing units were integrated into D/LBL.

For 1998, D/LBL will be conducting a study of applications processing designed to determine "best practices" and opportunities to further streamline efficiency and consistency in licensing operations. Once best practices are identified, they will be implemented as appropriate.

Licensing Policy and Systems

Licensing Policy and Systems (LP&S) develops and implements general policies and procedures for the corporate activities of the OCC. The division also implements the OCC's licensing quality assurance program and maintains databases, such as the Corporate Activities Information System, and the Institution Database, and develops systems and reporting capabilities for the department.

Significant projects during calendar 1997 included the following:

- LP&S contributed significant resources towards the successful implementation of the revised 12 CFR 5, the OCC's regulation on corporate applications, which became effective on December 31, 1996. The revised regulation eliminated unnecessary burdens and constraints on prompt review of and action on corporate filings.

- LP&S devoted substantial resources to the final drafting of the *Comptroller's Corporate Manual*, which explains the OCC's policies to form a new national bank, enter the national banking system, and effect structural changes and corporate expansion. The manual standardizes OCC procedures for processing corporate filings to bring consistency to decision-making and record keeping. The comprehensive revision incorporates numerous statutory, regulatory and policy and procedural changes. It will replace the three-volume version issued in January 1992.

- Using the Corporate Activities Information System and Institution Database, LP&S continued to provide the OCC's Communications Division with licensing and structure information to respond to requests made under the Freedom of Information Act. Many of those requests involved providing information concerning: branches located in specific geographic locations a (e.g., by zip code or county); branches opened or closed within a specific geographical location during a specific time period; de novo charters within a state for a specific time period; and mergers within a certain state for a specific time period. Additionally, LP&S provided licensing and structure information used to respond to Congressional and press inquiries.

- LP&S prepared and the Chief Counsel issued new delegations to reflect application processing changes in 12 CFR 5. The delegations were revised to reflect the OCC's reorganization and to increase efficiency by placing the authority to act on corporate requests at the lowest appropriate official level.

- OCC Advisory Letter 98–1, issued on January 16, 1998, was drafted in 1997. The Advisory Letter outlines how the OCC will consider a bank's Year 2000 preparedness and systems integration issues when evaluating certain covered corporate applications, namely charters, conversions, mergers, and technology-intensive operating subsidiary filings. Any covered application where the applicant bank is not in compliance with the OCC's Year 2000 guidelines or any business combination where significant systems integration concerns are identified will be subject to additional review. If after careful evaluation, the problem represents a significant supervisory concern, the OCC may impose appropriate conditions to address the concern. The OCC may deny a filing under 12 CFR 5.13 if the problems represent a significant supervisory concern or if approval would be inconsistent with applicable law, regulation, or OCC policy.

- Throughout 1997, LP&S participated in an interdepartmental group that explored capital issues associated with uninsured national trust banks. This group began drafting an OCC advisory letter to enhance licensing and supervisory efforts for this group of banks. LP&S also participated in interdepartmental teams established to process certain complex charter and operating subsidiary applications.

- LP&S participated in a panel on Acquiring/Chartering Tribally Owned Institutions panel at the July 1997 Banking in Indian Country Conference that was co-sponsored by the OCC and the Department of Justice Office of Tribal Justice. Throughout the year, we provided information and materials about chartering national banks to several tribes.

- LP&S worked closely with the Federal Deposit Insurance Corporation (FDIC) to resolve differences that arose in connection with charter and deposit insurance applications. In addition, we provided advice to FDIC staff as they drafted revisions to their corporate regulations and the deposit insurance policy statement to minimize differences in the two application processes and, thereby, reduce burden to the public.
- During 1997, LP&S led the Federal Financial Institutions Examination Council (FFIEC) Interagency Working Group's effort that produced the final draft of a single Bank Merger Act application form for uniform use among the four banking agencies. As the Group's leader, LP&S presented the form to the FFIEC Task Force on Supervision for approval and solicitation of public comments. It was agreed that the OCC and Office of Thrift Supervision will collect supplemental information regarding the CRA commitments made by a target institution to its community.

Washington-Directed Licensing

Washington-Directed Licensing (W-DL, formerly Corporate Activity) coordinates the processing of corporate applications that are considered to be novel, complex or controversial. The division provides recommendations to OCC senior management with respect to the disposition of applications not delegated to the district, large bank or international processing units. Upon request from shareholders dissenting to a merger, consolidation or conversion involving national banks, the division also conducts bank stock appraisals.

W-DL contributes summaries of selected corporate decisions to every issue of the *Quarterly Journal*. In addition, decisions that represent new or changed policy or present issues of general interest to the public or the banking industry are published monthly in the OCC publication, *Interpretations and Actions*. In 1997, the following corporate decisions were of particular importance because they were precedent setting or otherwise represented issues of importance. The decision documents for these approvals were published in *Interpretations and Actions*.

Interstate Decisions

The Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994 ("Riegle–Neal Act") became effective June 1, 1997, allowing banks to establish interstate branching operations in states that did not pass legislation opting-out of interstate banking. Only the states of Texas (until 9/1999) and Montana (until 9/2000) opted-out. In 1997, the OCC approved 52 Riegle–Neal mergers for 40 banking companies. In addition, the OCC approved a number of interstate branch applications, and four interstate relocations under the authority of 12 USC 30. As of December 31, 1997, there were approximately 90 national banks with interstate branching networks. Some of the more significant precedential decisions are discussed below.

A. Riegle–Neal Transactions

The OCC approved the merger, through intermediate steps, of insured and uninsured national trust banks in different states, resulting in the first interstate national trust bank approval under Riegle–Neal. Further, the decision concluded that the resulting bank could exercise fiduciary powers in its branch state pursuant to both the Riegle–Neal Act and 12 USC 92a, notwithstanding state law that prohibited out-of-state national banks from exercising trust powers in the state. This was one of the first interstate mergers consummated under the general authority of the Riegle–Neal Act, 12 USC 1831u(a)(1), as opposed to an early "opt-in" by a state pursuant to 12 USC 1831u(a)(3). [Corporate Decision No. 97–33, dated June 1, 1997]

The OCC approved the merger of 23 different banks in Missouri, Illinois, and Oklahoma into an acquiring bank located in North Carolina. The decision presented a good overview of the post-Riegle–Neal merger and branching process, since it combined both interstate mergers under 12 USC 215a-1 and 1831u with retention of interstate branches under 12 USC 36(d), and in-state mergers under 12 USC 215a with retention of in-state branches under 12 USC 36(b). [Corporate Decision No. 97–47, dated June 6, 1997]

In addition to an interstate merger pursuant to the Riegle–Neal Act, the OCC approved for the first time the establishment of a *de novo* interstate branch followed by the establishment of another branch in the same state. The establishment of the first branch was governed by 12 USC 36(g) (added by the Riegle–Neal Act), while establishment of the second branch was governed by the usual McFadden Act provision on intrastate branching, 12 USC 36(c). [Corporate Decision No. 97–55, dated June 26, 1997]

The OCC approved an interstate merger in which it demonstrated that, even after Riegle–Neal, the merger of an interstate national bank and another bank with the same home state is governed by the traditional merger authority of 12 USC 215a and branch retention authority of 12 USC 36(b). This decision contained an extensive analysis of where the resulting interstate bank is "situated" for purposes of determining its branch retention rights. [Corporate Decision No. 97–68, dated July 10, 1997]

The OCC approved an application from the holding company of a national bank with its main offices and branches located in Wisconsin to: (1) establish a *de novo* national bank in Michigan, and (2) merge the two institutions pursuant to 12 USC 215a-1, 1828(c) and 1831u(a), and retain the main office of the target bank (Michigan) as a branch of the acquiring bank. Michigan permits *de novo* branches by out-of-state banks on a reciprocal basis. Wisconsin does not permit *de novo* branching by out-of-state banks. [Corporate Decision No. 97–90, dated October 3, 1997]

The OCC approved the first whole bank interstate purchase and assumption transaction under the authority of the Riegle–Neal Act. [Corporate Decision No. 98–03, dated October 24, 1997]

The OCC approved the establishment of a branch in Puerto Rico. This was the first decision determining that Puerto Rico permits *de novo* branches by out-of-state banks. [Corporate Decision No. 97–95, dated October 31, 1997]

B. Interstate Main Office Relocation

The OCC approved the first interstate main office relocation with branch retention under the new provisions in the Riegle–Neal Act that apply to relocations occurring after May 31, 1997. The OCC approved the bank's application to relocate its main office from New York to New Jersey while retaining its branch in New York. The bank did not propose to establish a new branch at the old main office site. The bank was allowed to retain the branch in New York because it met the conditions in 12 USC 36(e)(2), in particular because a bank in New Jersey can acquire a branch in New York under Riegle–Neal. [Corporate Decision No. 97–105, dated December 6, 1997]

Structure Decisions

A. Charters

The OCC granted the first charter approval under the Competitive Equality Banking Act of 1987 (CEBA) for a credit card bank that would acquire a real estate investment trust as an operating subsidiary. [Conditional Approval No. 245, dated May 13, 1997]

The OCC granted the first approval of a trust company charter for a religious nonprofit entity. [Conditional Approval 249, dated June 30, 1997]

The OCC granted the first approval of a credit card bank charter for a banking trade group to provide credit card services to its member banks. [Conditional Approval No. 257, dated October 7, 1997]

The OCC granted the first approval for a CEBA credit card bank to issue credit cards secured by second liens on its customers' homes. In addition to the standard CEBA credit card bank conditions, seven special consumer protection conditions were imposed due to the unique issues raised by this proposal. [Conditional Approval No. 266, dated November 3, 1997]

The OCC granted the first approval of a *de novo* monoline credit card bank. The applicant ran an existing credit card business through a finance company and transferred that operation to the new bank. [Corporate Decision No. 98–04, dated November 21, 1997]

B. Conversion

The OCC approved a state bank conversion involving several unique aspects, including treating existing low income housing tax credit investments as "nonconforming" assets until the converted bank filed self-certification or obtained OCC approval for such investments under 12 CFR 24, and granted the converted bank a two-year period in which to: (1) divest of its nonconforming insurance activities, or (2) conform the activities of those subsidiaries with applicable national banking law. [Corporate Decision No. 97–14, dated March 4, 1997]

C. Community Development Proposals

The OCC authorized the first national community development bank to open for business. The bank opened on September 22, 1997, and immediately acquired a branch from an existing bank. The bank received direct equity investments from other national banks under Part 24 and opened with approximately $9 million in assets and net capital of $5.3 million. Subsequently, the Community Development Financial Institution (CDFI) Program awarded the bank $1.5 million in equity capital, which will bring the its net capital to approximately $6.8 million. [Corporate Decision, No. 98–02, dated September 18, 1997]

The OCC chartered a bank with two subsidiary Community Development Corporations (CDCs) (one for-profit and one not-for-profit), to open for business. This was the first time that a CDC proposal was submitted to the OCC along with a charter application. The for-profit CDC will support the bank providing small business financing and the not-for-profit CDC will provide services and technical assistance for the bank's small business customers. [Corporate Decision No. 98–01, dated December 17, 1997]

D. Minority Investments

The OCC for the first time used the four-part test for national bank ownership of a noncontrolling interest in a corporation to approve a national bank operating subsidiary acquiring a 50 percent interest in an insurance agency that was located in a "place of 5,000." [Conditional Approval No. 236, dated April 3, 1997]

The OCC granted approval for a national bank to acquire and hold, through an operating subsidiary, a 50 percent interest in a limited liability company engaged in providing credit and debit card transaction processing services to merchant businesses. The OCC concluded that a non-controlling 50 percent interest is treated as a minority interest and not as a subsidiary; therefore, the four-part minority investment test is applicable, rather than the operating subsidiary application procedures of 12 CFR 5.34. [Conditional Approval No. 248, dated June 26, 1997]

The OCC approved a bank's acquisition of an 80 percent interest in a corporation engaged in originating and administering leases of equipment to commercial entities. That corporation owned minority interests in various entities (corporations and limited partnerships) which engaged in leasing activities. This decision clarified that the act of acquiring a minority interest in a business entity through an operating subsidiary is, in and of itself, an activity of an operating subsidiary that may require OCC approval. [Corporate Decision No. 97–54, dated June 26, 1997]

E. Transactions Involving Thrift Institutions

The OCC approved a transaction involving conversion of four federal savings banks, addressing a variety of issues including legal authority, branch retention in states with limited intrastate branching, other branching issues, and treatment of nonconforming assets and liabilities. [Corporate Decision No. 97–13, dated February 24, 1997]

The OCC approved an interstate merger transaction which provides models for analyzing in-state mergers that are subject to the Oakar Amendment where the acquiring Bank Insurance Fund member bank is owned by an out-of-state holding company. [Corporate Decision No. 97–70, dated July 14, 1997]

The OCC approved a national bank's acquisition of an affiliated interstate federal savings association and operate its offices in two states as branch offices of the national bank. The decision elaborated on the analysis in Corporate Decision No. 97–32 to be used in connection with branch acquisitions that are subject to the Oakar Amendment. [Corporate Decision No. 97–84, dated September 5, 1997]

The OCC authorized a conversion, the first of its kind, of a state-chartered mutual savings bank into a national bank, while still retaining the mutual interests of the account-holders of the savings bank via a mutual holding company. This was accomplished through a multi-tiered structure consisting of a mutual bank holding company owning a stock bank holding company owning an interim national bank. The mutual savings bank was then merged into the interim national bank. Ownership interests in the mutually held bank holding company will be in proportion to deposits held in the subsidiary national bank. [Corporate Decision No. 97–112, dated December 30, 1997]

Expanded Activities Decisions

A. Insurance

he OCC approved the first operating subsidiary to reinsure a portion of the mortgage insurance on loans originated or purchased by the bank or the bank's lending affiliates. The approval relied on Interpretive Letter 743 (October 17, 1996), which concluded that the activity is generally permissible under the National Bank Act because the activity is part of, or incidental to, the business of banking. Similar approvals were granted to five other banks during the year. [Corporate Decision No. 97–06, dated January 22, 1997, and Corporate Decisions 97–15, 97–27, 97–89, 97–93, and 97–97]

The OCC approved an operating subsidiary to underwrite and reinsure credit disability and involuntary unemployment insurance in connection with credit card loans made by the bank's affiliated credit card bank and to underwrite safe deposit box liability insurance for the bank and its affiliates. The proposed credit-related insurance activities were found to be part of or incidental to the business of banking because the proposed activities limit the affiliate bank's risk of loss on the credit card loans that it makes and are a logical outgrowth of the parent bank's existing authority to conduct these activities on loans that the bank itself extends. Additionally, the OCC found that underwriting safe deposit insurance is a functional equivalent or a logical outgrowth of a bank subsidiary's authority to engage in and manage its own risk in connection with its safe deposit operations. [Corporate Decision No. 97–92, dated October 17, 1997]

B. Securities

The OCC granted the first approval of an expanded activity under the new authority of 2 CFR 5.34(f), whereby an operating subsidiary may engage in an activity different from that permitted for its parent national bank. This decision granted conditional approval for a bank operating subsidiary to underwrite, deal and invest in municipal revenue bonds. The decision found that the proposed activities are legally permissible for a subsidiary of a national bank because they are part of the business of banking and allowed under the plain language of the Glass–Steagall Act. The decision noted that the proposed activities are expected to have substantial benefits for the communities the bank serves and may also benefit the taxpayers of those localities. The subsidiary and bank will be subject to functional regulation by the securities regulators and supervision by the OCC. The OCC concluded that the proposed expansion of activities in the subsidiary is consistent with safe and sound banking practices. [Conditional Approval No. 262, dated December 11, 1997]

C. Technology

The OCC granted the first approval based on a "finder" activity rationale for a bank operating subsidiary to use its Internet web site to list used cars available through its parent bank as well as unaffiliated parties. The bank had been using the site to market its own off-lease auto inventory. Acting as finder, it will now also market the vehicles of unaffiliated parties. The bank's activities also included referring buyers to various affiliated and unaffiliated companies offering loans, insurance, extended warranties, and other related products. [Corporate Decision No. 97–60, dated July 1, 1997]

The OCC approved the first *de novo* electronic national bank that will deliver products and services to customers primarily through electronic means—telephone and personal computer. While it will not initially offer banking transactions via the Internet, the bank plans to add that delivery option in the near future. The bank will only offer checking and savings accounts and electronic bill payment services; it will not offer loans. The approval contained several pre-opening requirements and supervisory conditions appropriate to the bank's electronic operating plan. [Conditional Approval No. 253, dated August 20, 1997]

D. Other

The OCC granted the first approval for a national bank to acquire an operating subsidiary that provides flood certifications for real estate loans, i.e., certifies to real estate lenders whether property securing real estate loans is located in a flood plain, making flood insurance necessary. [Corporate Decision No. 97–79, dated July 11, 1997]

Change in Bank Control Act

The Change in Bank Control Act of 1978 (CBCA) requires that parties who wish to acquire control of a national bank through purchase, assignment, transfer or pledge, or other disposition of voting stock notify the OCC in writing 60 days prior to the proposed acquisition (unless a filing is required under the Bank Merger Act or the Bank Holding Company Act).

Any party acquiring 25 percent or more of a class of voting securities of a national bank must file a change-in-bank-control notice. In addition, if any party acquires 10 percent or more (but less than 25 percent), that party must file a change-in-bank-control notice under certain conditions. The acquiring party must also publish an announcement of the proposed change in control to allow for public comment.

The CBCA gives the OCC the authority to disapprove changes in control of national banks. The OCC's objective in its administration of the CBCA is to enhance and maintain public confidence in the national banking system by preventing identifiable, serious, adverse effects resulting from anti-competitive combinations or inadequate financial support and unsuitable management in national banks. The OCC reviews each notice to acquire control of a national bank and disapproves transactions that could have serious harmful effects. If the notice is disapproved, the disapproval letter contains a statement of the basis for disapproval. The OCC's actions for 1997 are reflected in Table 2. As reflected in the table, the OCC received 24 change-in-bank-control notices in 1997, up from 17 in 1996. Two change of bank control notices received in 1996 were acted on in 1997. Of the 24 notices received in 1997, 22 were acted upon, with no disapprovals.

Community Development Division

In 1997, the Community Development Division (CDD) provided community and economic development policy guidance and procedures for national banks to facilitate their participation in the emerging domestic market; policy guidance and expertise on Community Development Financial Institutions (CDFIs), including community development banks; educational initiatives for national banks on emerging community development issues; expertise and resource development for related OCC units and policy makers; training for examiners and the Community Reinvestment Development Specialists who provide direct community development technical assistance to banks and their community partners; expertise advice and assistance to the Comptroller in his role as Chairman and a member of the board of directors of the Neighborhood Reinvestment Corporation (NRC); and, represented the agency and division on internal and external task forces and committees.

During 1997, CDD completed a broad range of community and economic development initiatives to provide guidance to national banks and examiners. This initiative covered community development lending and investing, banker education, examiner training and enhanced communication of information both internally and externally.

The Community Development Division (CDD) planned and organized a historic national symposium on "The Single Family Affordable Housing Market: Trends and Innovations" that permitted opinion leaders to address the issues and opportunities for banks as this market continues to mature. The symposium was attended by almost 200 bankers, mortgage insurers, secondary market participants, regulators, and other interested participants. The symposium was held in Philadelphia,

Table 3—Change-in-Bank-Control-Act Notices Processed, and their Disposition, 1988–1997

Year	Received	Acted on	Not disapproved	Disapproved	Withdrawn
1997	24	24	24	0	0
1996	17	15	13	0	2
1995	15	16	16	0	0
1994	15	16	15	1	0
1993	28	30	21	5	4
1992	30	29	21	4	4
1991	20	15	6	6	3
1990	31	42	32	5	5
1989	55	55	48	3	4
1988	45	42	34	4	4

Source: Bank Organization and Structure, Comptroller of the Currency.

Pennsylvania in July. This market is still relatively new within banking thus the symposium presented an opportunity for the OCC to bring together a diverse group of participants to discuss issues, innovations and bank lending performance in the single family affordable mortgage market that are essential to maintaining a healthy and growing market.

Guidance on enhanced affordable mortgage portfolio management strategies was provided in Advisory Letter 97–7 that also described techniques that had proved to be effective in controlling risk in affordable mortgage portfolios (AMPs). The guidance resulted from an OCC review that found a correlation between the level of delinquencies and the number of years a bank had offered affordable mortgage loans. The advisory letter states that banks with more than three years experience in the affordable mortgage market generally had a higher loan volume, but more effective risk management and lower delinquency levels in their AMPs. The banks with lower delinquency rates had three common characteristics that are described in detail in the advisory along with suggestions on how banks can strengthen their existing portfolios.

The division also developed policy guidance in issuing Advisory Letter 97–2, which provided clarification that national banks can use the reliable estimates category of 12 CFR 1 for unrated community development securities and defined securities. This action opened another option for banks to purchase these securities that meet the standards under the authority of the Investment Securities regulation (Part 1) that are in addition to the Part 24 option. The advisory also explains the treatment of these investments under CRA.

In November, the OCC co-hosted with the American Bankers Association (ABA) the ninth Annual Community Development Lending Conference in New Orleans, LA. Entitled "Community and Economic Development: Expanding Market Opportunities" the conference established a historic milestone with almost 300 attendees and enhanced program content. It provided the participants an opportunity to explore emerging issues in community development lending, economic development, neighborhood revitalization, urban and rural affordable housing and small business development, and CD securitization. Comptroller Eugene A. Ludwig, gave the dinner keynote address. Scott Jones, ABA president-elect and sponsor of the conference provided a luncheon keynote address. It was attended by bankers, mortgage insurers, community development lending practitioners, not-for-profit and for-profit representatives, secondary market experts, private CD securities providers, and federal, state and local government officials. Tours of affordable housing projects and the city's Enterprise Community were well attended by the conference participants. The tours highlighted the benefits of partnerships between local government, the private sector, and community development partners.

The division developed and published the 1996 Supplement to the Community Development Investments Program for National Banks Directory. The directory includes information about the measurable results of national banks' CD investments made under the authority of CDCs, CD Projects and Other Public Welfare Investments regulation (12 CFR 24). Each entry includes the name of a contact person who can provide more information about the investment.

The CDD redesigned its quarterly newsletter, *Community Developments*. It provides national banks and other interested persons with highlights of innovative bank community development programs, regulatory updates on community and economic development issues, and related national news on federal and state programs. The newsletter was redesigned to respond to bankers and other requests for more detailed articles about community economic development initiatives. The newsletter now offers bylined articles written by external bank and other experts and OCC employees. Additionally, it includes photos, graphics and continues the "OCC News" and "Capitol Views" sections. Subscription to the newsletter is free.

CDD developed and published *Community Development: A Profitable Market Opportunity,* in September 1997. The publication consists of papers from major thinkers in the community and economic development arena, including the Comptroller, that help to advance the body of knowledge regarding this emerging domestic market within banking. Many bankers, secondary market experts, insurers, researchers, and others are featured.

In September 1997, the OCC participated in the annual SEC Government Small Business Capital formation annual forum and chaired the credit round table. Approximately 200 attendees participated in this forum that reviews issues related to small business capital formation and makes an annual report to Congress based on recommendation from the forum attendees.

CDD Continued to provide leadership for the Native American Working Group that released two publications during the year: *Providing Financial Services to Native Americans in Indian Country* is a study about what financial products and services are currently provided by financial institutions in Indian country, and *A Guide to Mortgage Lending in Indian Country* provides essential information for those lenders and others who plan to provide mortgage financing in Indian country. Both were released in July 1997.

The division represented the OCC on the "Brownfields National Federal Agency Partnership Action Agenda" steering committee that involves a collaboration of 30 federal agencies that are working to help place brownfields sites back into productive use. The federal agencies are working together to exchange information on brownfields and brownfields-related activities in a more integrated fashion toward sustainable redevelopment. The OCC participated in the *Brownfields '97 Conference*, coordinating and chairing a panel titled: "Over the Rainbow—Making Brownfields into Gold," requested and received approval for the FFIEC to undertake a review of legal issues and conduct educational initiatives that will assist all financial institutions in the brownfields area, and participated in the phase I selection process of the brownfields showcase selection process that will be concluded in early 1998.

CDD approved several precedent setting national bank investments this year. The first, Citibank, N.A., received OCC approval to make a special debt investment in the National Association of Community Development Loan Funds which provides an option for banks to make "equity-like" investments in not-for profit corporations. The investment is being used by the national entity to make loans to its estimated 2,000 member community development financial institutions (CDFIs). The CDFIs are using the funds for their community and economic development projects in the bank's communities. The second, Mission Community Bank, N.A., a community development bank, was chartered by the OCC in 1997 with two subsidiary CDCs (one for-profit and the other a not-for-profit). The for-profit CDC will support the bank providing small business financing and the not-for-profit will provide services and technical assistance for the bank's small business customers. CDD also reviewed and approved Key Bank's CDC request to increase its geographic coverage from 38 to 50 states, the District of Columbia, and Puerto Rico as the first subsidiary CDC to be permitted to operate nationwide. And, lastly, the Neighborhood National Bank opened in San Diego, California, as the first *de novo* chartered national bank with a community development focus. The division provided technical assistance to the organizers prior to and throughout the chartering process. National banks were permitted to make direct equity investments under part 24 and a 1997 CDFI Fund equity investment.

CDD approved 144 national bank community development corporation and community development project investments. Since the inception of the OCC's Community Development Corporations (CDCs) and Community Development Project Program (CD projects) in 1965, the OCC has approved 1,469 national banks to invest in over 1,000 community development corporations and community development projects. Many of those investments were in one-time projects which have been completed, or were in single-purpose CDCs whose missions have been accomplished. National banks and their community partners have invested $5.3 billion in all CDCs and CD projects.

In April 1997, the OCC provided a videotape and work book on "Federal Low-Income Housing Tax Credits: A Profitable Affordable Housing Opportunity for Banks." The videotape and work book show how banks can use Federal Low Income Housing Tax Credits through the Part 24 investment authority to provide affordable rental housing in their communities. The videotape provides "How To" guidance for banks on another option for using the Part 24 authority to support providing affordable rental housing on a profitable basis. The package includes a discussion and written materials on the major aspects of how banks can participate as a developer, limited partner, and through syndications, and how to compute internal rates of return, IRS compliance rules, and opportunities for community and large bank participation.

The CDD supports the Comptroller in his capacity as a statutory member of the board of directors and chairman of the Neighborhood Reinvestment Corporation, and chairman of the NeighborWorks Campaign for Homeownership. The division also served as OCC liaison for the Department of the Treasury Consumers Affairs Council; served on the executive committee for the SEC Government Small Business Capital Formation annual forum; and as a member of the National Brownfields Partnership steering committee, a member of the OCC's National Credit Committee, and as chair of the Native American Working Group.

CDD provided community development lending and investments training to examiners in five sessions of the Bank Supervision School. The division director and other staff members were presenters at more than 12 conferences and seminars.

CDD is planning and organizing a national small business banking issues forum for bankers, small business owners, public sector officials, and service providers from across the United States. The forum will address major issues that impact small business lending and investing, including how banks can better use new approaches to financing small businesses and partnerships with national intermediaries and federal, state, and local government. The forum complements the Comptroller's 1997 "Banking on Minority Business" outreach program by exploring a broader range of small business finance and investment issues, and helps to build mutually profitable relationships between national banks and small businesses—relationships that are critical to bringing economic opportunities to local communities. The conference is planned for February 5, 1998 in Washington, D.C.

Economic and Policy Analysis

The Economic and Policy Analysis group includes the Economics Department and two new units—the Bank Technology Unit and the Special Studies Unit. The Economics Department consists of four divisions: Economics and Evaluation, Financial and Statistical Analysis, Bank Research, and Risk Analysis. The department is responsible for conducting policy analysis on many issues facing the OCC; monitoring the financial health of the banking system to identify sources of risk; analyzing the determinants of bank competitiveness and risk-taking; evaluating the effects on OCC operations of changes in the regulatory environment; providing technical support to examiners in the assessment of banks' risk measurement methods and the use of statistical tools to assess fair lending compliance; and drafting congressional testimony for the Comptroller. The Economics Department staff members participated in the production of 13 economics working papers in 1997, the most productive year thus far. The 1997 working papers explored a variety of topics important to the mission of the OCC, including mutual fund activities; deposit insurance; derivatives markets; interstate banking; bank risk-taking and returns; international bank regulations; newly chartered banks; bank organizational form; and CAMELS ratings. Several papers provided timely support for OCC policy initiatives and approximately half of the papers have been accepted, or are under consideration, for publication in academic journals.

In March 1997, the two new units—Bank Technology and Special Studies—were established in Economic and Policy Analysis to formalize management of staff and resources already dedicated to addressing broad policy issues arising from emerging electronic money and banking technologies and to bring increased focus on OCC's supervision of technology within the banking industry. The Bank Technology Unit formulates policy and examination tools for the OCC to supervise bank technology-related activities and assist examiners in staying abreast of developments in bank technology. The Special Studies Unit identifies, analyzes, and advises OCC executives on public policy issues relating to matters affecting the financial services industry, including electronic money and banking, and their effects on the financial services industry.

Economics Department

Economics and Evaluation Division

The Economics and Evaluation Division prepared nine written statements and packages of briefing materials for the Comptroller's congressional appearances in 1997. Four of the hearings focused on financial modernization issues, two addressed the OCC's efforts to ensure that national banks are year-2000 compliant, one had the Comptroller discuss the OCC's supervisory philosophy and practices, one was focused on oversight of the OCC's overall operations, and the final hearing addressed the OCC's strategic planning process in response to the Government Performance and Results Act. The unit also provided direct support for 14 fair lending examinations in 1997 through data collection and analysis and the application of statistical sampling and modeling techniques to the OCC's assessment of the banks' fair lending performance.

Financial and Statistical Analysis Division

In 1997, the Financial and Statistical Analysis Division completed four reports on the condition and performance of the banking industry; three reports on consumer credit issues, trends, and concerns; two reports using the shared credit data on the risks associated with the companies in the retail markets; and several special reports on technology risks, subprime lending concerns, and international analyses of country risks. The division completed the core development of the Integrated Bank Information System and provided training in multiple locations. Staff completed a prototype model that calculates the probability of significant deterioration in the condition of a bank as a function of economic conditions in a bank's lending area, macroeconomic trends, supervisory actions, capital levels, and possible contagion effects. The division and the Bank Research Division also completed a prototype risk estimator that provides a measure of whole bank risk.

Bank Research Division

In 1997, the Bank Research Division undertook several long-term research projects. These included works on the consolidation of the banking industry; identification of the corporate structure of commercial banks and their holding companies; credit card banks; recent increases in personal bankruptcy; bank failures in G–10 countries; single, overall measures of bank risk; behavior of newly chartered banks; and the effectiveness of CAMELS ratings in identifying prudent risk management abilities of national banks. The work undertaken in 1997 and earlier contributed to the completion of 14 papers for scholarly and trade journal publications and 36 presentations of research to academic, government agency, and foreign audiences.

Risk Analysis Division

Economists from the Risk Analysis Division participated in 45 on-site examinations in 1997. The group applies a sophisticated knowledge of quantitative methods for measuring risks in bank portfolios and of the analysis of supervisory policies addressing those risks. The division engaged in examination support in seven subject areas during 1997, the latter three of which are new support functions: interest rate risk; credit scoring; derivatives trading and pricing; mortgage banking; credit portfolio management; asset management; and internal models to comply with the new market risk regulation (currently being applied to seven internationally active banks).

Bank Technology Unit

The Bank Technology Unit is managing the OCC's efforts to supervise the year-2000 issue, outlining a comprehensive supervision strategy, implementing a reporting system to track industry year-2000 progress—beginning with an initial bank-by-bank assessment in June 1997—and developing with the FFIEC uniform year-2000 examination guidance. The unit also worked aggressively to develop guidance and examination procedures for new technology-based products and services. The unit made significant progress in 1997 on several key banking bulletins, including Technology Risk Management, PC Banking, and Digital Signatures. The bulletins will be issued in early 1998.

Special Studies Unit

The Special Studies Unit supported the Comptroller's Treasury-wide role as coordinator on electronic money issues, preparing three major policy papers for the Secretary on issues of significance to the Department of the Treasury. The unit reinforced OCC's lead role by sponsoring a series of briefings for the Treasury-wide community by outside technology and banking industry participants and by giving numerous speeches—resulting in high visibility—at industry meetings. The unit's policy agenda included significant participation in major international efforts to examine the issues presented by the emerging technologies. Finally, staff members made major contributions to the "Report of the Working Party on E-Money," which looked at consumer, law enforcement, supervisory, and cross-border issues and was presented by the G–10 finance ministers and governors to the heads of state at the June 1997 Denver summit.

International Affairs

International Banking and Finance Department

The International Banking and Finance Department (IB&F) oversees OCC supervision of the federal branches and agencies of foreign banks in the United States and maintains OCC's relationships with the international financial community and foreign supervisory organizations. The department provides policy advice and technical expertise and analysis to OCC on international banking and financial matters, including foreign regulatory trends, country risk evaluation, and the evolution of foreign financial systems, institutions, and supervisory and regulatory processes.

The IB&F department represents the OCC on interagency projects and activities affecting international banking supervision policy and regulation. These activities include cooperation with federal and state bank supervisors on specific initiatives in the supervision, licensing, and regulation of foreign banks operating in the United States, particularly the Interagency Foreign Banking Organization Supervision Program.

The department oversees the OCC's Federal Branch Program, which supervises, licenses, and regulates federal branches and agencies of foreign banks in the United States. In that regard, IB&F provides supervisory policy and procedural support and guidance to the OCC districts supervising federal branches and agencies. The department also serves as the focal point for information on foreign banks that operate federal branches and agencies and coordinates communications with those banks' home country supervisory authorities and their senior management.

In its role as staff coordinator of OCC's participation in the Basle Committee on Banking Supervision, and the Joint Forum on Financial Conglomerates, IB&F works with other OCC groups in support of U.S. efforts to achieve international harmonization of financial services supervision. The department coordinated and provided technical support to the Treasury Department on the G-7 summit process. The department also conducts research and analysis on international economic and bank supervision and regulatory matters and supports OCC examiners and other staff engaged in domestic and international supervisory activities as well as assisting in the development and implementation of OCC banking supervisory and regulatory policies and procedures.

The IB&F department also develops, analyzes, and distributes information on the global banking and financial environment in which national banks operate; the banking, financial, and financial services supervisory systems in the major countries of the world; and foreign banks that operate federal branches and agencies in the United States. As the OCC representative on the Interagency Country Exposure Review Committee (ICERC) of U.S. bank regulatory agencies, IB&F develops and analyzes information on and assesses risk in international lending, including the evaluation of transfer risk associated with exposures to countries experiencing difficulty servicing their external debt. Through IB&F, the OCC provides the permanent ICERC secretariat and rotates as chair of the ICERC every third year. In 1997, the IB&F department initiated a project to revise the ICERC process.

Staff members from IB&F meet and communicate with foreign supervisory authorities to exchange information, resolve issues, and coordinate requests for data, background materials, training, and other technical advice. In this capacity, IB&F staff members also coordinated or hosted 49 visits from examiners from other countries and coordinated or provided 17 technical assistance missions to 13 countries. The IB&F department serves as the liaison with the Treasury Department, the International Monetary Fund, the International Bank for Reconstruction and Development (World Bank), the InterAmerican Development Bank, and other external sources on a variety of issues related to global financial services supervision. It also is involved in formal programs to provide technical bank supervisory assistance to foreign bank supervisory authorities. The IB&F department provided an examiner on staff to the Treasury Department to provide assistance on G–7 matters.

Public Affairs

Public Affairs, headed by the senior deputy comptroller for Public Affairs, is composed of the special advisor to the senior deputy comptroller; the Congressional Liaison and Banking Relations divisions; the special advisor for External Relations, which includes the Community Relations and the Minority and Urban Affairs divisions; and the Public Affairs Department, headed by the deputy comptroller for Public Affairs and composed of the Communications and Press Relations divisions.

Congressional Liaison Division

The Congressional Liaison Division is responsible for the OCC's relations with members of Congress, congressional committees, subcommittees, and staff.

The division provides analysis and advice to the Comptroller and senior OCC policymakers on congressional activities that affect or could affect the OCC, the national banking system, or the financial services marketplace. It also offers guidance on potential congressional reaction to OCC actions.

As part of its responsibilities, the division maintains regular contact with congressional members, committees, subcommittees, and staff to promote effective communication and ensure that OCC's interests are represented.

The division is the focal point of congressional inquiries, including requests for testimony, staff studies, or other support. It assists in the preparation of testimony, comments, briefings, and staff studies relating to congressional actions, as well as responses to constituent inquiries. The division provides any other necessary liaison and information services relating to congressional and legislative matters.

Banking Relations Division

The Banking Relations Division acts as liaison with bankers, state bankers associations, banking trade groups, and state bank supervisors.

The division provides advice to the Comptroller and senior policymakers and is responsible for identifying proposed regulatory and industry actions that relate to OCC activities. It formulates specific approaches for ensuring that OCC's position is presented and that information is disseminated.

The division recommends new policies, concepts, and procedures to guide the OCC in its relationship with the banking industry. It prepares and directs the preparation of briefing materials for use in meetings with OCC officials and banking industry groups and assists with preparation of testimony or presentations for the Comptroller and senior officials. The division maintains state-by-state in-depth analyses of banking legislation and major issues including existing, proposed, and potential legislation.

Banking Relations also helps district offices develop effective outreach programs with bankers and state banking trade associations. The division coordinates and hosts in-house meetings with state banking trade associations and is responsible for planning and organizing off-site "Meet the Comptroller" seminars attended by chief bank executives and OCC's Executive Committee to discuss changes in the banking industry.

In 1997, the division coordinated four "Meet the Comptroller" seminars with approximately 500 bankers and directors in attendance. In addition, the division hosted 45 bank trade association delegations at the OCC and coordinated over 100 OCC speakers and panelists for industry-sponsored events.

Community Relations Division

The Community Relations Division is responsible for the OCC's outreach and external relations with consumer and community organizations, particularly national nonprofit public interest organizations that are concerned with community reinvestment and community development issues.

The division provides analysis and advice to the Comptroller and OCC's senior management on consumer and community organization interests and activities that affect or could affect the OCC, the national banking system, or the relationship of national banks to their communities. It also offers guidance on potential consumer and community reaction to OCC actions, monitors the overall direction of public interest advocacy directed at the financial services marketplace, and formulates strategies for ensuring that OCC positions are clearly and appropriately communicated to these sectors.

In addition, the division recommends new policies and procedures to guide the OCC in its relationship with the public interest sector. It assists in the preparation of speeches, testimony, or other presentations for the Comptroller and senior OCC officials before consumer and community organizations. Finally, the division is responsible for organizing and coordinating the Comptroller's formal and informal outreach with community and consumer organizations at "Meet the Comptroller" meetings and similar forums.

In 1997, the Community Relations Division:

- Organized four district "Meet the Comptroller" meetings with community leaders in Charlotte, Cleveland, St. Louis, and New Orleans;
- Organized four outreach luncheons for the Comptroller with Washington-based national organizations on issues such as fair lending, the Community Reinvestment Act, access to financial services, and home buyer counseling and affordable mortgage performance;
- Served as a representative on the OCC's National Access Committee;
- Provided assistance and information for Comptroller Ludwig's keynote addresses at five community or consumer conferences or awards dinners;
- Represented the OCC at various national conferences sponsored by community and consumer organizations which promote partnerships with national banks;
- Furnished information requested by the OCC's Community Reinvestment and Development Specialists (CRDs) about key community organizations in various cities; and
- Maintained a database of nonprofit community and consumer organizations accessible to the public via the Internet through the OCC's Web page, at http://www.occ.treas.gov/community/CCDBINFO.htm.

Minority and Urban Affairs Division

The Minority and Urban Affairs (MUA) Division is currently responsible for overseeing the OCC's external relations with national and regional civil rights and minority-based organizations, particularly those that are concerned with access to financial services. The division provides counsel to the Comptroller and senior OCC management on the banking and financial service interests of these organizations and offers guidance to management on the concerns that these organizations have relating to the OCC's supervision of the national banking system.

During 1997, the mission of the MUA division shifted from an internal focus on issues involving minorities and women employees at the OCC to an external affairs focus on the financial service concerns of minority-based organizations. In conjunction with its new responsibilities, the division was transferred to Public Affairs from the Administration Department.

Beginning in the spring of 1997, the division inaugurated an aggressive outreach program to improve the OCC's relations with national and regional civil rights and minority-based organizations. At the Comptroller's request, the division implemented a national Banking on Minority Business program that brought together bankers, representatives of the minority small business community, and leaders of minority business and community organizations to discuss how to overcome barriers to small business lending and build mutually profitable relationships. The first forum, was held in Washington, DC, on June 5, and was followed by others in Cleveland, San Francisco, St. Louis, Boston, Houston, Los Angeles, and New Orleans. More than 300 people participated in the eight forums.

On behalf of OCC, MUA participated as an exhibitor in 1997 at minority organization conferences held by the National Association for the Advancement of Colored People, the National Urban League, League of United Latin American Citizens, National Council of La Raza, the Congressional Black Caucus, and the National American Indian Housing Council. This outreach program helped to increase the OCC's visibility among the membership of these organizations and allowed the office to share information on the agency's mission and purpose. To support these and other OCC outreach programs, MUA produced informational brochures on the Community Reinvestment Act, the OCC's community reinvestment and development specialist program, and basic consumer laws and regulations.

Minority and Urban Affairs also sponsored a summer internship program with the Hispanic Association of Colleges and Universities. Several divisions at OCC headquarters participated in this program by providing summer internship opportunities for six college and graduate level students.

Public Affairs Department

The Deputy Comptroller for Public Affairs heads the Public Affairs Department, oversees the operations of the Communications and Press Relations divisions, and is responsible for managing internal and external communications activities. The deputy comptroller is charged with bringing an external perspective to all agency issues and works closely with executives to identify issues and activities that need to be communicated inside and outside the agency. In addition, the deputy comptroller provides advice and counsel to the Comptroller and Executive Committee on media relations and communications activities and policies.

The divisions overseen by the deputy comptroller for Public Affairs serve as the agency's main external contact and communicate the OCC's mission and activities to the public. The deputy comptroller is responsible for providing public affairs advice to OCC senior management, as well as coordinating internal and external communication policies and activities. Department activities include identifying and developing communication strategies for major OCC initiatives and proposals and implementing those strategies.

Communications Division

The Communications Division provides publications support and information services for the agency. Specifically, the division:

- Provides writing, editorial, and production support for all agency publications, including the *Quarterly Journal,* the *Comptroller's Handbook,* the *Comptroller's Manual for Corporate Activities,* and the *Comptroller's Handbook for Compliance,* as well as OCC policy issuances such as advisory letters, alerts, and bulletins.
- Plans approaches to disseminating information and designs appropriate vehicles for specific messages.
- Responds to inquiries from the public about the agency's mission and activities.
- Oversees the agency's electronic news systems.
- Develops and maintains the agency's Internet presence (http://www.occ.treas.gov), which offers quick access to agency materials.
- Uses appropriate technological means to improve and maintain internal and external communication for the OCC.
- Processes all initial requests filed under the Freedom of Information and Privacy acts.
- Operates and oversees the Public Information Room, which offers easy access to the agency's public documents.
- Certifies copies of bank corporate documents.

The Communications Division's 1997 accomplishments reflect a continued emphasis on public access to information. The Public Information Room offers the public quick access to agency documents, including press releases, issuances, CRA evaluations, comment letters on proposed regulations, securities filings, enforcement actions, and similar information. In January, the Public Information Room moved to its permanent location on the first floor. The room is open to walk-in visitors from 9:00 a.m. to 12:00 p.m. and 1:00 p.m. to 3:30 p.m. During 1997, the public information staff handled 5,531 requests for information within 24 hours.

Throughout 1997, the OCC's Internet site continued to gain in popularity. The site (at http://www.occ.treas.gov) managed by the new Automated Information unit, gives the public quick access to a full range of OCC documents, including many that are posted to the site as soon as they are released to the public. The site provides access to actual CRA evaluations as well as a searchable database of the CRA ratings; a database of community groups, with an opportunity for groups to register; proposed regulations; issuances and press releases, including major speeches and congressional testimony; and a variety of publications, including consumer assistance materials, the *Weekly Bulletin* (a report of agency corporate applications and actions), and the monthly *Interpretations and Actions*. During 1997, about 1.75 million pages of information were made available through this medium.

The Publications and Editorial Services personnel provide editorial and writing assistance to other OCC units and publish OCC publications. New external publications for 1997 included five new booklets in the *Comptroller's Handbook*; two booklets in the *Comptroller's Handbook for Compliance; Banking Laws for Examiners,* and the four-book set of *Banking Regulations for Examiners*. In addition, the Communications Division continued to produce many periodicals and series including the *Quarterly Journal* and *Interpretations and Actions.* Other important special publications include *The Director's Book; 1997 Survey of Credit Underwriting Practices; New Opportunities to Excel; A Guide to Mortgage Lending in Indian Country; Providing Financial Services to Native Americans in Indian Country;* and *Financial Access in the 21st Century.*

In 1997, the Publications and Editorial Services unit continued to produce a monthly employee newsletter and to distribute OCC issuances and other policy papers to national bank examiners and national banks.

Under the authority delegated by the Comptroller, the department is responsible for making initial determinations on requests for records of the OCC under the Freedom of Information Act and the Privacy Act of 1974. In 1997, the Public Disclosure unit received almost 21,000 such requests, 18,000 of which were handled through the OCC Information Line, a fax-on-demand system (releasing 144,000 pages of information).

The division is also responsible for providing certified copies of national bank corporate documents. By the end of 1997, the Public Disclosure unit issued almost 9,000 certificates for the following seven types of certificates: of corporate existence; of charter; of corporate title change; of articles of association; of merger; of fiduciary powers; and of declaration of insolvency.

Press Relations Division

The Press Relations Division works to increase public understanding and awareness of the OCC's mission by providing news media relations support to the agency and senior management. Specifically, the division:

- Prepares and issues press announcements on agency actions or policies, including new regulations, supervision guidance, new publications, statistical information (such as the quarterly report on banks derivatives activities), major conferences, and speeches by senior OCC officials.

- Develops briefing materials and support information, such as questions and answers, for agency initiatives in which there is press interest, such as the OCC's bank supervision activities to ensure that national banks will be prepared for the year-2000 date change.

- Supports agency staff in dealing with news media inquiries, by providing advice, counsel, and training.

- Responds to press inquiries on all the OCC's activities, policies, and initiatives.

Administration

Resource Management

The Resource Management area encompasses two divisions: Administrative Services and Human Resources.

Administrative Services Division

The Administrative Services Division (ASD) provided significant support to OCC's cost cutting efforts. Through negotiation and competition of contracts which saved several million dollars, management of postage costs resulting in a reduction of over $400,000 from 1996, and continued reduction of supply expenditures, the ASD staff members have led the agency's cost cutting activity.

Acquisition Services managed nearly 300 contracting actions and many hundreds of Visa IMPAC Purchase Card transactions. Purchase Card expansion is a major initiative to make procurement more customer friendly. Procurement competition was emphasized to achieve best value products. The unit made major adjustments to policy and procedures to improve its efficiency and customer service.

Administrative Operations staff played a major role in planning and carrying out meetings to promote OCC's mission, including increasing access to banking services. These meetings included "Meet the Comptroller" meetings nationwide; a Financial Access in the 21st Century forum for bankers, consumer representatives, social scientists, and government officials; and the Banking in Indian Country conference, attended by Indian community leaders, top ranking government officials, banking industry heads and featuring Comptroller of the Currency Gene Ludwig and Attorney General Janet Reno.

The emphasis on service continued, as the library answered over 7,300 reference requests and Records Management staff responded to over 4,000 requests for records or information. The library's home page became popular immediately, with the catalog, an interactive reference desk, and connections to useful Internet sites available to OCC employees over the Intranet.

The division continued to promote educational outreach in Washington and the districts. Over 90 volunteers from the Washington office took part in OCC's Partnership-in-Education with a Washington, D.C. elementary school. ASD also helped launch a new program to support high school Academies of Finance, "schools within schools," in Washington and each district.

The Real Estate and Design Services group realigned two floors of the headquarters building, and the planning and design for the expanded Customer Assistance Unit was completed.

Realignment of support space at headquarters continued with the addition of a Visiting Employees' Center, a Computer Training facility, an upgraded lighting and conference facility on the third floor, and expanded conference facilities on the first floor.

The staffing level of the Security Office was increased to accommodate both the addition of the personnel security function as well as expanded security requirements directed by the Department of Treasury.

In support of the Administrative Restructure Team, ASD employees served as team members and provided extensive support leading to recommendations for improvements. Revised customer service standards and measures were developed by all ASD activities; all measures were met for the second half of 1997.

The division continued to provide OCC liaison with the National Performance Review and the Treasury Office of Reinvention. The OCC's contribution included revised, easier to use telephone Blue Pages for over 100 directories throughout the United States; input for NPR's Annual Report and Customer Service Report; and support for the Plain English project.

Human Resources Division

During 1997, the Human Resources Division (HR) executed several highly visible initiatives in an effort to improve customer service and maintain client satisfaction. Among the more significant projects were the 1997 OCC Restructure, which involved evaluating, posting, and filling more than 300 positions; implementation of an automated self-service benefits phone line, (1-888-Ben-0-fits); administration of two buyout/early out programs designed to target overstaffed positions and offices; and negotiation and implementation of an enhanced dental/vision care program.

In keeping with HR's continuing effort to provide superior customer service, HR implemented 12 HR Customer Service Initiatives developed by an independent employee task group in 1997. These customer service standards enhanced HR's many employee oriented services. Among these were the development of new work-life initiatives, and streamlined, automated, and improved internal operations. A new Internet web site was developed and is currently being used for the purpose of advertising vacant examiner positions. Additionally, a self-service benefits information line, 1-888-Ben-0-fits, was developed. With this service, OCC employees can receive up-to-date information about their personal OCC and federal benefits simply by using interactive voice response (IVR) technology over their touch tone phone. This service supports HR's overall automation strategy to shift ownership of employee data to employees.

In 1997, Human Resources assisted in executing a major Bank Supervisions Operations reorganization. HR staff members centrally posted and orchestrated the selection of more than 300 placements. Over 50 new positions were evaluated, more than 200 employees were relocated, and new automation tracking systems were designed to facilitate the frequent impact analysis needed during the selection process. Relocation town meetings were held to ease difficulties and expedite the move of employees relocating as a result of the Bank Supervisions Operations restructuring.

Lastly, the Human Resources division embarked on a new recruitment initiative which utilized a centralized approach with a decentralized decision process. The program, now implemented, will facilitate the recruiting of more than 200 new bank examiners.

Financial Services (Chief Financial Officer)

The Chief Financial Officer's (CFO) mission is to maintain and manage OCC's financial resources, provide high quality financial services, and provide advice to senior management and managers throughout OCC to ensure that financial issues are considered in OCC decision-making. The CFO performs this through several key activities:

- Maintaining day-to-day operations of the accounting system, control of OCC's receipts and payments, management of cash and investments, and financial reporting;
- Managing design, development, enhancement, and implementation of financial systems;
- Monitoring, updating, and reviewing OCC's revenues to ensure they recover OCC's operating costs and are not burdensome to the national banking system;
- Facilitating the strategic plan process;
- Formulating and executing OCC's operating plan and budget to ensure that resource usage and staffing reflect the OCC's four pillars and operating objectives and foster the efficient allocation of resources;
- Managing OCC's efforts related to the Government Performance and Results Act;
- Reporting internally and externally on OCC's resource usage, staffing, and available resources including forecasts of revenues and expenses that reflect changes in the national banking system;
- Developing models and systems to provide estimates of future resource usage for OCC's management processes;
- Preparing the CFO Annual Report as required by the Chief Financial Officers Act;
- Developing revenue, accounting, and expenditure (including travel) policies to ensure the efficient use and effective control of resources; and
- Conducting internal quality assurance reviews to ensure the effectiveness of internal controls and the adherence to internal and external financial policies.

During 1997, Financial Services continued efforts to improve its use of technology, institutionalize customer service, and improve communication concerning planning and financial matters throughout the OCC. At the same time, Financial Services continued to ensure maintenance of internal management controls on OCC's resources and effective management of OCC's financial resources. During 1997, Financial Services:

- Issued financial statements and met requirements for the Department of the Treasury's Accountability Report. These efforts including coordinating the development and issuance of the Annual CFO Financial Statements.
- Coordinated the 1996 annual audit with the external auditors and received an unqualified opinion, without management points, for the third year in a row.
- Analyzed the full impact of Federal Accounting Standards Advisory Board (FASAB) standards and the Brown Bill and developed a plan to convert OCC's financial processes.
- Provided effective revenue management and issued the 1998 Notice of Fees. Developed and implemented a new revenue policy that eliminated a separate fee for fiduciary activities, the fee for bank securities dealers, and imposed an assessment surcharge for lower rated institutions that cost more to supervise.
- Assumed an increased level of responsibility for the Federal Manager's Financial Integrity Act (FMFIA) review process. Continued to coordinate the use of OCC's external auditors to assist in meeting annual conformance reviews.
- Conducted quality assurance reviews of financial operations in the districts and Financial Services in Washington.

- Updated and revised OCC's financial systems to allow for project accounting and changed the reporting structure and the underlying data in the financial system to incorporate changes from OCC's restructuring.
- Revised the field staff planning process to reflect the revised OCC organizational structure, better incorporate risk into the model, and shorten the process from six to three weeks, and established and enhanced the Washington/district office staffing plan.
- Integrated fully the planning, staffing, and budgeting processes. The OCC issued a strategic plan to Congress and the public. The strategic plan was fully compliant with the requirements of the Government Performance and Results Act (GPRA). The strategic plan was followed with a preliminary performance plan, which outlined the objectives and projects for 1998 which support the goals stated in the strategic plan. The strategic plan was posted to the Internet and was the first published plan in over a decade.
- Developed the 1998 budget using the strategic plan and the GPRA performance plan along with revenue estimates, which was approved by the Comptroller. The 1998 budget process represented the continued transition from traditional functional budgeting to program budgeting.
- Enhanced the budget execution process, which provides a monthly report to senior management and addresses specific budget and staffing issues each time the management report is issued.
- Continued efforts to enhance Financial Services and chaired a cross-functional team to determine OCC management's resource information needs to assure that those needs are met.

Management Improvement

Management Improvement serves as the OCC's liaison with the U.S. General Accounting Office (GAO) and the Department of the Treasury's Office of Inspector General (OIG). Management Improvement facilitates audits, evaluations, and investigations and assures that appropriate corrective action is taken by the OCC.

During 1997, the GAO completed 13 audits that reported on OCC activities. Subjects included interstate banking, tying, derivatives, private banking, and user fees. None of the reports made recommendations for the OCC to implement. The OIG completed its review of the OCC's conflict of interest controls over examiners who resign for employment with banks. The OIG's recommendation is being implemented.

The OIG also performed an evaluation of the OCC's truth in lending examination process, the first such review to be conducted at the OCC. Unlike an audit, an evaluation does not include testing and its outcomes are suggestions rather than recommendations. The OIG made several suggestions that are being considered as the OCC changes and enhances its automated systems.

Organizational Effectiveness

In 1997 the Organizational Effectiveness unit worked closely with senior management to implement OCC's new organizational structure. Consulting services included providing information on institutionalizing desired behaviors, strategic alignment issues, management selection options, customer service focus, effective management tools, and training. The unit also facilitated transition meetings for new managers and their staffs to ease the shift to the new structure.

The OCC's cultural audit provided the platform for initiating an organizational dialogue regarding behavioral and performance expectations. That dialogue continued throughout the year in employee focus groups and trust-building sessions designed to further refine and clarify those expectations and norms. The resulting list of expected employee and managerial behaviors clarifies expectations and will provide the foundation for ongoing work in performance management, employee development, and management succession.

Organizational Effectiveness has also worked with management to create a workforce that fosters cross-functional teamwork and diversity through a wide variety of processes. The unit provides facilitation assistance, team-effectiveness training, and team-building sessions on request to a wide variety of teams, both intact work groups and special project groups. The unit provides research assistance, particularly in the area of best practices, to groups that are exploring options for OCC implementation. During 1997, Organizational Effectiveness assisted cross-functional work teams in the development of recommendations for both training and performance management, incorporating best practices.

In 1997 the unit was renamed Organizational Effectiveness, in lieu of Quality Improvement/Diversity Management. The new name better demonstrates the unit's goal of enabling the OCC to operate in the most effective manner possible, employing both quality and diversity, as well as other techniques, enabling OCC to accomplish its priority objectives.

Equal Employment Programs Division

The Equal Employment Programs (EEP) Division is responsible for promoting equal opportunity in employment for all OCC employees. In addition, the EEP division is charged with identifying and eliminating the barriers to employment and advancement in the OCC. The EEP covers the areas of equal employment opportunity (EEO), affirmative employment (AE), and EEO complaint processing. In doing so, the EEP division works closely with senior managers in Washington and the districts to ensure compliance with EEO and AE policies and procedures.

In 1997, the EEP division increased employees' and managers' awareness of and participation in OCC's EEO programs by continuing to provide EEO and AE training to all employees, communicating information about new legislation and recent events in EEO to all employees, and meeting with senior management periodically to discuss and assess OCC's progress in addressing EEO and AE issues, trends, concerns, and opportunities for improvement. Also, the division revitalized OCC's Special Emphasis Program and EEO Advisory System and reinstated the EEO awards program, recognizing seven individuals and six groups with Special Act Awards for their outstanding contributions in the areas of EEO and AE.

In addition, the EEP division sought to strengthen OCC's EEO complaints process by proposing the establishment of an Alternative Dispute Resolution (ADR) program in OCC. The proposal recommended that the ADR program work in unison with the EEO complaints process. The division guided OCC as it implements the recommendations of the Treasury's Advisory Panel on Sexual Harassment Prevention and EEO, by helping OCC develop an action plan to increase the quantity and quality of communications to employees, measure the effectiveness of OCC's training efforts, assess employees' perception of the agency, and increase management's accountability in EEO by establishing a mandatory EEO performance element and standards for managers.

During 1997, the EEP division also made significant progress in identifying and eliminating the barriers to employment and advancement in the OCC. The division focused on two primary areas in this regard: analysis of the adverse impact of major organizational changes and the under-representation of Hispanics. In conjunction with other OCC departments, the EEP staff reviewed, evaluated, and analyzed the impact of OCC's "rightsizing" process, proposed selection processes and procedures, including the selection of management officials resulting from the restructuring process, and the distribution of high-visibility assignments. In addition, EEP worked with OCC's senior management to establish a Hispanic Employment Working Group to address the employment, promotion, and retention of Hispanic employees at the OCC.

Table 1—Comptrollers of the Currency, 1863 to the present

No.	Name	Dates of tenure		State
1	McCulloch, Hugh	May 9, 1863	Mar. 8, 1865	Indiana
2	Clarke, Freeman	Mar. 21, 1865	July 24, 1866	New York
3	Hulburd, Hiland R.	Feb. 1, 1865	Apr. 3, 1872	Ohio
4	Knox, John Jay	Apr. 25, 1872	Apr. 30, 1884	Minnesota
5	Cannon, Henry W.	May 12, 1884	Mar. 1, 1886	Minnesota
6	Trenholm, William L.	Apr. 20, 1886	Apr. 30, 1889	South Carolina
7	Lacey, Edward S.	May 1, 1889	June 30, 1892	Michigan
8	Hepburn, A. Barton	Aug. 2, 1892	Apr. 25, 1893	New York
9	Eckels, James H.	Apr. 26, 1893	Dec. 31, 1897	Illinois
10	Dawes, Charles G.	Jan. 1, 1898	Sept. 30, 1901	Illinois
11	Ridgely, William Barret	Oct. 1, 1901	Mar. 28, 1908	Illinois
12	Murray, Lawrence O.	Apr. 27, 1908	Apr. 27, 1913	New York
13	Williams, John Skelton	Feb. 2, 1914	Mar. 2, 1921	Virginia
14	Crissinger, D.R.	Mar. 17, 1921	Mar. 30, 1923	Ohio
15	Dawes, Henry M.	May 1, 1923	Dec. 17, 1924	Illinois
16	McIntosh, Joseph W.	Dec. 20, 1924	Nov. 20, 1928	Illinois
17	Pole, John W.	Nov. 21, 1928	Sept. 20, 1932	Ohio
18	O'Connor, J.F.T.	May 11, 1933	Apr. 16, 1938	California
19	Delano, Preston	Oct. 24, 1938	Feb. 15, 1953	Massachusetts
20	Gidney, Ray M.	Apr. 16, 1953	Nov. 15, 1961	Ohio
21	Saxon, James J.	Nov. 16, 1961	Nov. 15, 1966	Illinois
22	Camp, William B.	Nov. 16, 1966	Mar. 23, 1973	Texas
23	Smith, James E.	July 5, 1973	July 31, 1976	South Dakota
24	Heimann, John G.	July 21, 1977	May 15, 1981	New York
25	Conover, C.T.	Dec. 16, 1981	May 4, 1985	California
26	Clarke, Robert L.	Dec. 2, 1985	Feb. 29, 1992	Texas
27	Ludwig, Eugene A.	Apr. 5, 1993	———	Pennsylvania

Table 2—Senior Deputy and Deputy Comptrollers of the Currency, 1863 to the present

No.	Name	Dates of tenure		State
1	Howard, Samuel T.	May 9, 1863	Aug. 1, 1865	New York
2	Hulburd, Hiland R.	Aug. 1, 1865	Jan. 31, 1867	Ohio
3	Knox, John Jay	Mar. 12, 1867	Apr. 24, 1872	Minnesota
4	Langworthy, John S.	Aug. 8, 1872	Jan. 3, 1886	New York
5	Snyder, V.P.	Jan. 5, 1886	Jan. 3, 1887	New York
6	Abrahams, J.D.	Jan. 27, 1887	May 25, 1890	Virginia
7	Nixon, R.M.	Aug. 11, 1890	Mar. 16, 1893	Indiana
8	Tucker, Oliver P.	Apr. 7, 1893	Mar. 11, 1896	Kentucky
9	Coffin, George M.	Mar. 12, 1896	Aug. 31, 1898	South Carolina
10	Murray, Lawrence O.	Sept. 1, 1898	June 29, 1899	New York
11	Kane, Thomas P.	June 29, 1899	Mar. 2, 1923	District of Columbia
12	Fowler, Willis J.	July 1, 1908	Feb. 14, 1927	Indiana
13	McIntosh, Joseph W.	May 21, 1923	Dec. 19, 1924	Illinois
14	Collins, Charles W.	July 1, 1923	June 30, 1927	Illinois
15	Steams, E.W.	Jan. 6, 1925	Nov. 30, 1928	Virginia
16	Awalt, F.G.	July 1, 1927	Feb. 15, 1936	Maryland
17	Gough, E.H.	July 6, 1927	Oct. 16, 1941	Indiana
18	Proctor, John L.	Dec. 1, 1928	Jan. 23, 1933	Washington
19	Lyons, Gibbs	Jan. 24, 1933	Jan. 15, 1938	Georgia
20	Prentiss, William, Jr.	Feb. 24, 1936	Jan. 15, 1938	Georgia
21	Diggs, Marshall R.	Jan. 16, 1938	Sept. 30, 1938	Texas
22	Oppegard, G.J.	Jan. 16, 1938	Sept. 30, 1938	California
23	Upham, C.B.	Oct. 1, 1938	Dec. 31, 1948	Iowa
24	Mulroney, A.J.	May 1, 1939	Aug. 31, 1941	Iowa
25	McCandless, R.B.	July 7, 1941	Mar. 1, 1951	Iowa
26	Sedlacek, L.H.	Sept. 1, 1941	Sept. 30, 1944	Nebraska
27	Robertson, J.L.	Oct. 1, 1944	Feb. 17, 1952	Nebraska
28	Hudspeth, J.W.	Jan. 1, 1949	Aug. 31, 1950	Texas
29	Jennings, L.A.	Sept. 1, 1950	May 16, 1960	New York
30	Taylor, W.M.	Mar. 1, 1951	Apr. 1, 1962	Virginia
31	Garwood, G.W.	Feb. 18, 1952	Dec. 31, 1962	Colorado
32	Fleming, Chapman C.	Sept. 15, 1959	Aug. 31, 1962	Ohio
33	Haggard, Holis S.	May 16, 1960	Aug. 3, 1962	Missouri
34	Camp, William B.	Apr. 2, 1962	Nov. 15, 1966	Texas
35	Redman, Clarence B.	Aug. 4, 1962	Oct. 26, 1963	Connecticut
36	Watson, Justin T.	Sept. 3, 1962	July 18, 1975	Ohio
37	Miller, Dean E.	Dec. 23, 1962	Oct. 22, 1990	Iowa
38	DeShazo, Thomas G.	Jan. 1, 1963	Mar. 3, 1978	Virginia
39	Egerston, R. Coleman	July 13, 1964	June 30, 1966	Iowa
40	Blanchard, Richard J.	Sept. 1, 1964	Sept. 26, 1975	Massachusetts
41	Park, Radcliffe	Sept. 1, 1964	June 1, 1967	Wisconsin
42	Faulstich, Albert J.	July 19, 1965	Oct. 26, 1974	Louisiana
43	Motter, David C.	July 1, 1966	Sept. 20, 1981	Ohio
44	Gwin, John D.	Feb. 21, 1967	Dec. 31, 1974	Mississippi
45	Howland, W.A., Jr.	July 5, 1973	Mar. 27, 1978	Georgia
46	Mullin, Robert A.	July 5, 1973	Sept. 8, 1978	Kansas
47	Ream, Joseph M.	Feb. 2, 1975	June 30, 1978	Pennsylvania
48	Bloom, Robert	Aug. 31, 1975	Feb. 28, 1978	New York
49	Chotard, Richard D.	Aug. 31, 1975	Nov. 25, 1977	Missouri
50	Hall, Charles B.	Aug. 31, 1975	Sept. 14, 1979	Pennsylvania
51	Jones, David H.	Aug. 31, 1975	Sept. 20, 1976	Texas
52	Murphy, C. Westbrook	Aug. 31, 1975	Dec. 30, 1977	Maryland
53	Selby, H. Joe	Aug. 31, 1975	Mar. 15, 1986	Texas
54	Homan, Paul W.	Mar. 27, 1978	Jan. 21, 1983	Nebraska
55	Keefe, James T.	Mar. 27, 1978	Sept. 18, 1981	Massachusetts
56	Muckenfuss, Cantwell F., III	Mar. 27, 1978	Oct. 1, 1981	Alabama
57	Wood, Billy C.	Nov. 7, 1978	Jan. 16, 1988	Texas
58	Longbrake, William A.	Nov. 8, 1978	July 9, 1982	Wisconsin

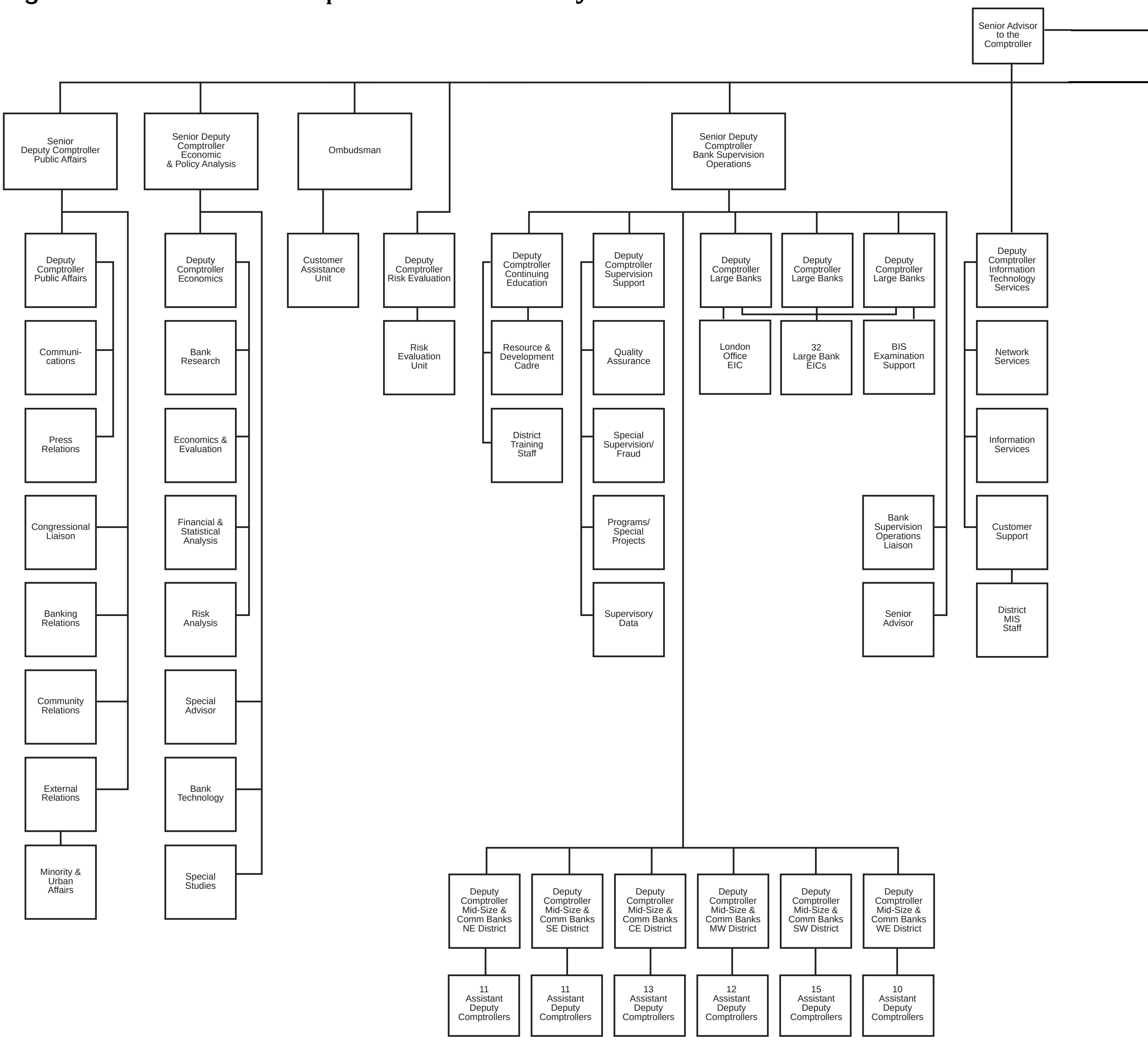
Table 2—Senior Deputy and Deputy Comptrollers of the Currency, 1863 to the present (continued)

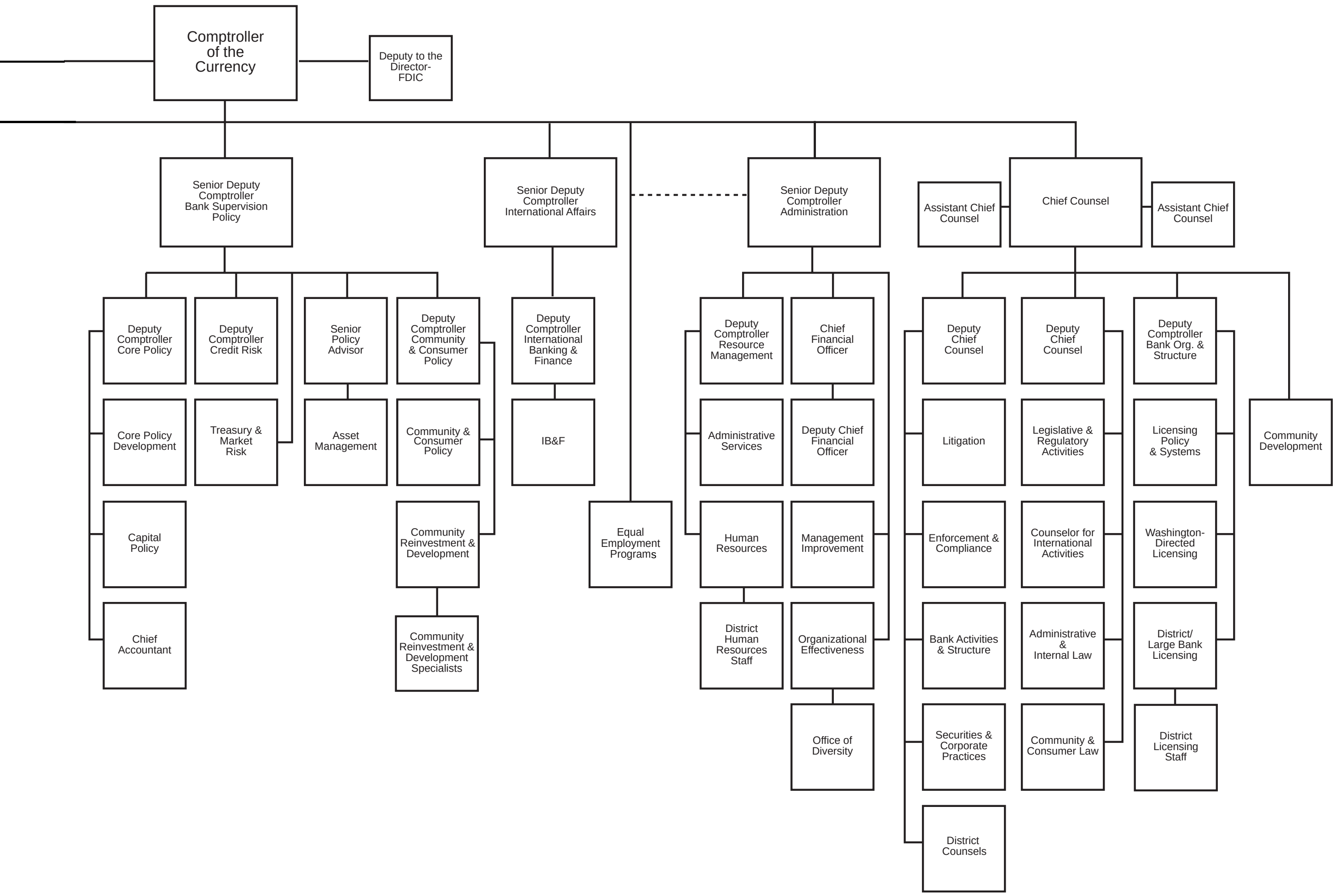
No.	Name	Dates of tenure		State
59	Odom, Lewis G., Jr.	Mar. 21, 1979	Nov. 16, 1980	Alabama
60	Martin, William E.	May 22, 1979	Apr. 4, 1983	Texas
61	Barefoot, Jo Ann	July 13, 1979	Sept. 5, 1982	Connecticut
62	Downey, John	Aug. 10, 1980	Aug. 2, 1986	Massachusetts
63	Lord, Charles E.	Apr. 13, 1981	Mar. 31, 1982	Connecticut
64	Bench, Robert R.	Mar. 21, 1982	Sept. 25, 1987	Massachusetts
65	Klinzing, Robert R.	Mar. 21, 1982	Aug. 21, 1983	Connecticut
66	Robertson, William L.	Mar. 21, 1982	Sept. 26, 1986	Texas
67	Arnold, Doyle L.	May 2, 1982	May 12, 1984	California
68	Weiss, Steven J.	May 2, 1982	———	Pennsylvania
69	Stephens, Martha B.	June 1, 1982	Jan. 19, 1985	Georgia
70	Stirnweis, Craig M.	Sept. 19, 1982	May 1, 1986	Idaho
71	Hermann, Robert J.	Jan. 1, 1983	May 3, 1995	Illinois
72	Mancusi, Michael A.	Jan. 1, 1983	Feb. 17, 1986	Maryland
73	Marriott, Dean S.	Jan. 1, 1983	Jan. 3, 1997	Missouri
74	Poole, Clifton A., Jr.	Jan. 1, 1983	Oct. 3, 1994	North Carolina
75	Taylor, Thomas W.	Jan. 1, 1983	Jan. 16, 1990	Ohio
76	Boland, James E., Jr.	Feb. 7, 1983	Feb. 15, 1985	Pennsylvania
77	Fisher, Jerry	Apr. 17, 1983	Apr. 4, 1992	Delaware
78	Patriarca, Michael	July 10, 1983	Aug. 15, 1986	California
79	Wilson, Karen J.	July 17, 1983	July 3, 1997	New Jersey
80	Winstead, Bobby B.	Mar. 18, 1984	June 11, 1991	Texas
81	Chew, David L.	May 2, 1984	Feb. 2, 1985	District of Columbia
82	Walter, Judith A.	Apr. 24, 1985	Jan. 3, 1998	Indiana
83	Maguire, Francis E., Jr.	Jan. 9, 1986	Aug. 6, 1996	Virginia
84	Kraft, Peter C.	July 20, 1986	Sept. 15, 1991	California
85	Klinzing, Robert R.	Aug. 11, 1986	July 3, 1997	Connecticut
86	Hechinger, Deborah S.	Aug. 31, 1986	Sept. 14, 1987	District of Columbia
87	Norton, Gary W.	Sept. 3, 1986	Mar. 9, 1998	Missouri
88	Shepherd, J. Michael	Jan. 9, 1987	May 3, 1991	California
89	Rushton, Emory Wayne	Jan. 21, 1987	Sept. 20, 1989	Georgia
90	Fiechter, Jonathan	Mar. 4, 1987	Oct. 30, 1987	Pennsylvania
91	Stolte, William J.	Mar. 11, 1987	Mar. 21, 1992	New Jersey
92	Clock, Edwin H.	Feb. 29, 1988	Jan. 3, 1990	California
93	Krause, Susan F.	Mar. 30, 1988	———	California
94	Coonley, Donald G.	June 29, 1988	May 31, 1996	Virginia
95	Blakely, Kevin M.	Oct. 12, 1988	Sept. 27, 1990	Illinois
96	Steinbrink, Stephen R.	Apr. 8, 1990	May 3, 1996	Nebraska
97	Lindhart, Ronald	Apr. 22, 1990	July 27, 1991	Florida
98	Hartzell, Jon K.	July 29, 1990	Dec. 5, 1995	California
99	Cross, Leonora S.	Nov. 4, 1990	———	Utah
100	Finke, Fred D.	Nov. 4, 1990	———	Nebraska
101	Kamihachi, James D.	Nov. 6, 1990	———	Washington
102	Barton, Jimmy F.	July 14, 1991	May 1, 1994	Texas
103	Cross, Stephen M.	July 28, 1991	———	Virginia
104	Guerrina, Allan B.	Apr. 19, 1992	June 23, 1996	Virginia
105	Powers, John R.	Aug. 9, 1992	July 2, 1994	Illinois
106	Alt, Konrad S.	Sept. 5, 1993	Oct. 4, 1996	California
107	Harris, Douglas E.	May 20, 1994	June 21, 1996	New York
108	Sharpe, Ralph	Oct. 30, 1994	July 6, 1997	Virginia
109	Jee, Delora Ng	May 28, 1995	———	California
110	Britton, Leann G.	Jan. 7, 1996	———	Minnesota
111	Abbott, John M.	Apr. 1, 1996	———	Texas
112	Healey, Barbara C.	June 9, 1996	Jan. 3, 1998	New Jersey
113	Calhoun, Scott G.	Sept. 29, 1996	Aug. 30, 1997	New York
114	Roberts, Matthew	Oct. 7, 1996	Oct. 18, 1997	District of Columbia
115	Nebhut, David H.	Oct. 27, 1996	———	Pennsylvania
116	Rushton, Emory Wayne	May 5, 1997	———	Georgia

Table 2—Senior Deputy and Deputy Comptrollers of the Currency, 1863 to the present (continued)

No.	Name	Dates of tenure		State
117	Gibbons, David	July 6, 1997	———	New York
118	Gilland, Jerilyn	July 6, 1997	———	Texas
119	Jaedicke, Ann	July 6, 1997	———	Texas
120	Long, Timothy	July 6, 1997	———	North Dakota
121	Nishan, Mark	July 6, 1997	———	New York
122	Otto, Bert	July 6, 1997	———	Indiana
123	Roeder, Douglas	July 6, 1997	———	Indiana

Figure 1—Office of the Comptroller of the Currency





December 1997

Recent Corporate Decisions

Interstate Transactions

On October 3, 1997, Stephenson National Bancorp, Inc., Marinette, Wisconsin, the holding company of a national bank with its main office and branches located in Wisconsin, was granted approval to: (1) establish a *de novo* national bank in Michigan, and (2) merge the two institutions pursuant to 12 USC 215a–1, 1828(c) and 1831u(a), and retain the main office of the target bank (Michigan) as a branch of the acquiring bank. Michigan permits *de novo* branches by out-of-state banks on a reciprocal basis. Wisconsin does not permit *de novo* branching by out-of-state banks. [Corporate Decision No. 97–90]

On October 24, 1997, First National Bank of West Point, West Point, Georgia, received approval to purchase the assets and assume the liabilities of First State Bank of Uniontown, Uniontown, Alabama. This was the first approval of a whole bank interstate purchase and assumption transaction under the authority of the Riegle–Neal Act. [Corporate Decision No. 98–03]

On October 31, 1997, Hamilton Bank, National Association, Miami, Florida, received approval to establish a branch in San Juan, Puerto Rico. This was the first decision determining that Puerto Rico permits *de novo* branches by out-of-state banks. [Corporate Decision No. 97–95]

On December 6, 1997, Waterhouse National Bank, White Plains, New York, received approval to relocate its main office to Jersey City, New Jersey. This was the first OCC approval of an interstate main office relocation with branch retention under the new provisions in the Riegle–Neal Act that apply to relocations occurring after May 31, 1997. The OCC approved the bank's application to relocate its main office from New York to New Jersey while retaining its branch in New York. The bank did not propose to establish a new branch at the old main office site. The bank was allowed to retain the branch in New York because it met the conditions in 12 USC 36(e)(2), in particular because a bank in New Jersey can acquire a branch in New York under Riegle–Neal. [Corporate Decision No. 97–105]

Charters

On October 7, 1997, the OCC granted conditional approval for the Independent Bankers Association of America to charter a national CEBA credit card bank to provide credit card services to member banks. The bank is to be titled "TCM Bank, National Association" and is to be located in Tampa, Florida. This was the first approval of a credit card bank charter for a banking trade group. [Conditional Approval No. 257]

On November 3, 1997, the OCC granted conditional approval for United Credit Card, Inc., Baton Rouge, Louisiana, to establish a national CEBA credit card bank to issue credit cards secured by second liens on its customers' homes. This was the first approval of a *de novo* credit card bank proposing to take such a security interest. In addition to the standard CEBA credit card bank conditions, seven special consumer protection conditions were imposed due to the unique issues raised by this proposal. [Conditional Approval No. 266]

On November 21, 1997, the OCC granted approval for Mr. Stewart J. Armstrong to establish a national CEBA credit card bank in San Antonio, Texas, with the title "CrediCard National Bank." This was the first approval of a *de novo* monoline credit card bank. The applicant ran an existing credit card business through a finance company and transferred that operation to the new bank. [Corporate Decision No. 98–04]

On December 17, 1997, the OCC granted final authorization for Mission Community Bank, National Association, San Luis Obispo, California, to open for business. The bank was chartered with two subsidiary community development corporations ("CDC") (one for-profit and one not-for-profit). This is the first time that CDC proposals were submitted to the OCC along with a charter application. The for-profit CDC will support the bank providing small business financing and the not-for-profit CDC will provide services and technical assistance for the bank's small business customers. [Corporate Decision No. 98–01]

Conversion

On December 30, 1997, in the first such approval, the OCC granted approval for First Bank Richmond, S.B., Richmond, Indiana, to convert from a state-chartered mutual savings bank to a national bank, while still retaining the mutual interests of the account-holders of the savings bank via a mutual holding company. The conversion was accomplished through a multi-tiered structure consisting of a mutual bank holding company owning a stock bank holding company owning an interim national bank. The mutual savings bank was then merged into the interim national bank. Ownership interests in the mutually held bank holding company will be in proportion to deposits held in the subsidiary national bank. [Corporate Decision No. 97–112]

Operating Subsidiaries

On October 17, 1997, the OCC granted approval for Bank of America, NT&SA, San Francisco, California, to acquire an operating subsidiary to underwrite and reinsure credit disability and involuntary unemployment insurance in connection with credit card loans made by the bank's affiliated credit card bank and to underwrite safe deposit box liability insurance for the bank and its affiliates. The proposed credit-related insurance activities were found to be part of or incidental to the business of banking because the proposed activities limit the affiliate bank's risk of loss on the credit card loans that it makes and are a logical outgrowth of the parent bank's existing authority to conduct these activities on loans that the bank itself extends. Additionally, the OCC found that underwriting safe deposit insurance is a functional equivalent or a logical outgrowth of a bank subsidiary's authority to engage in and manage its own risk in connection with its safe deposit operations. [Corporate Decision No. 97–92]

On December 11, 1997, in the first such approval, the OCC granted approval for Zions First National Bank, Salt Lake City, Utah, to expand the activities of an operating subsidiary under the authority of 12 CFR 5.34(f), to engage in an activity different from that permitted for the bank. This decision granted conditional approval for the operating subsidiary to underwrite, deal and invest in municipal revenue bonds. The decision found that the proposed activities are legally permissible for a subsidiary of a national bank because they are part of the business of banking and allowed under the plain language of the Glass–Steagall Act. The decision noted that the proposed activities are expected to have substantial benefits for the communities the bank serves and may also benefit the taxpayers of those localities. The subsidiary and bank will be subject to functional regulation by the securities regulators and supervision by the OCC. The OCC concluded that the proposed expansion of activities in the subsidiary is consistent with safe and sound banking practices. [Conditional Approval No. 262]

Decision Related to the Community Reinvestment Act

On December 3, 1997, the OCC conditionally approved an application by Intercontinental National Bank, San Antonio, Texas, to establish a branch subject to the bank submitting an acceptable CRA plan that specifically detailed actions the bank will take to improve the geographic distribution of loans in low- and moderate-income census tracts in its assessment area. At the most recent CRA performance evaluation of the bank earlier in 1997, the OCC rated the bank's performance "Satisfactory" overall, but also concluded that the geographic distribution of its lending did not meet the standard for satisfactory performance. No protests were filed on the application. [Conditional Approval No. 260]

Special Supervision/Fraud and Enforcement Activities

The Special Supervision/Fraud Division of the Bank Supervision Operations Department supervises the resolution of critical problem banks through rehabilitation or orderly failure management, monitors the supervision of delegated problem banks, coordinates fraud/white collar crime examinations, training and information dissemination activities, and supports OCC supervisory objectives as an advisor and liaison to OCC management and field staff on emerging problem bank and fraud/white collar crime related issues.

This section includes information on problem national banks, national bank failures, and enforcement actions. Data on problem banks and bank failures is provided by OCC's Special Supervision/Fraud Division in Washington. Information on enforcement actions is provided by the Enforcement and Compliance Division of the Law Department. This department is principally responsible for presenting and litigating administrative actions on the OCC's behalf against banks requiring special supervision.

Problem National Banks and National Bank Failures

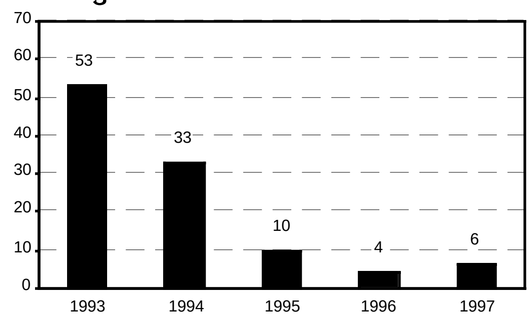
Problem banks represented less than 1 percent of the national bank population at year-end 1997. After reaching a high of 373 at the end of 1990, the number of problem national banks significantly declined to 19 as of December 31, 1997. The decline is a direct result of the improvement in the condition of the banking system brought about by an extended period of low interest rates and other favorable economic conditions. There were no national bank failures during 1997 and only one commercial bank failure.

Enforcement Actions

The OCC has a number of remedies with which to carry out its supervisory responsibilities. When it identifies safety and soundness or compliance problems, these remedies range from informal advice and moral suasion to informal and formal enforcement actions. These mechanisms are designed to achieve expeditious corrective and remedial action to return the bank to a safe and sound condition.

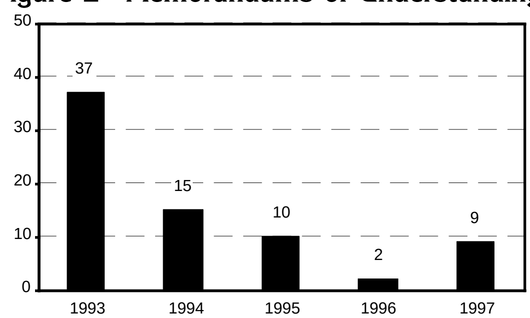
The OCC takes enforcement actions against both banks and individuals associated with banks. The OCC's informal enforcement actions against banks include commitment letters and memorandums of understanding (MOUs). Informal enforcement actions are meant to handle less serious supervisory problems identified by the OCC in its supervision of national banks. Failure to honor informal enforcement actions will provide strong evidence of the need for the OCC to take formal enforcement action.

Figure 1—Commitment Letters



Source: OCC Supervisory Monitoring System (SMS) data*

Figure 2—Memorandums of Understanding

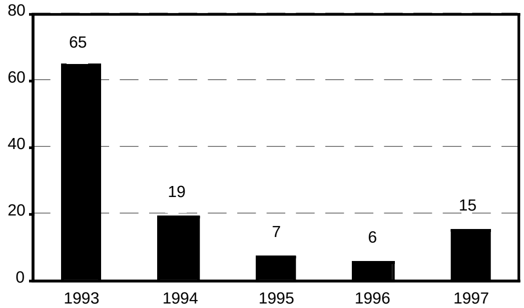


Source: SMS*

The most common types of formal enforcement actions issued by the OCC against banks over the past several years have been formal agreements and cease-and-desist orders. Formal agreements are documents signed by a national bank's board of directors and the OCC in which specific corrective and remedial measures are enumerated as necessary to return the bank to a safe and sound condition. Cease-and-desist orders (C&Ds), sometimes issued as consent orders, are similar in content to formal agreements but are public documents that may be enforced either through assessment of civil money penalties (CMPs) or by an action for injunctive relief in federal district court.

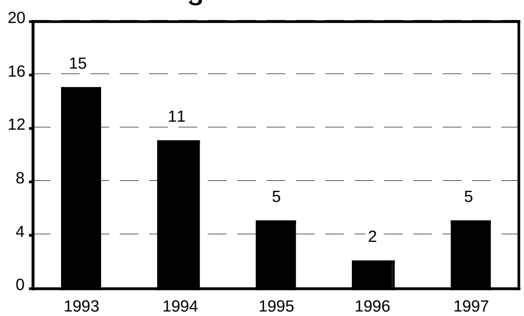
* Note that SMS totals for previous years' enforcement actions may be adjusted to reflect revised aggregates.

Figure 3—Formal Agreements



Source: SMS*

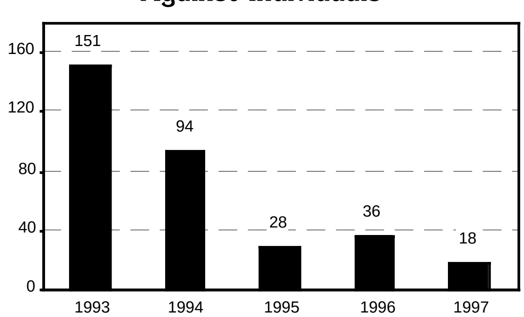
Figure 4—Cease-and-Desist Orders Against Banks



Source: SMS*

The most common enforcement actions against individuals are CMPs, personal C&Ds, and removal and prohibition orders. Civil money penalties are authorized for violations of laws, rules, regulations, formal written agreements, final orders, conditions imposed in writing, and under certain circumstances, unsafe or unsound banking practices, and breaches of fiduciary duty. Personal C&Ds may be used to restrict individuals' activities and to order payment of restitution. Removal and prohibition actions, which are used in the most serious cases, result in lifetime bans from the banking industry.

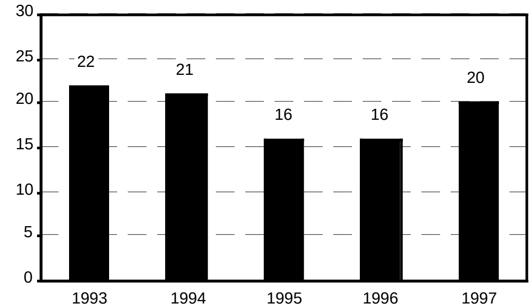
Figure 5—Civil Money Penalties Against Individuals



Source: SMS*

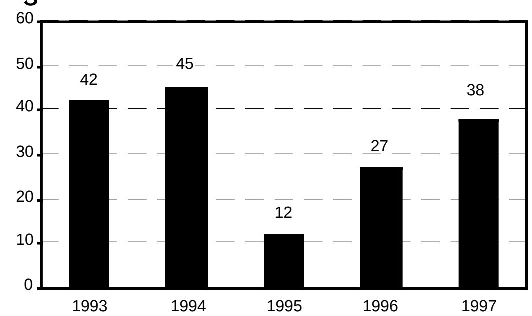
* Note that SMS totals for previous years' enforcement actions may be adjusted to reflect revised aggregates.

Figure 6—Cease-and-Desist Orders Against Individuals



Source: SMS*

Figure 7—Removal and Prohibition Orders



Source: SMS*

In addition, the OCC was given authority under the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), to issue "prompt corrective action" (PCA) directives against undercapitalized banks and to issue safety and soundness orders against banks that fail to meet the Interagency Guidelines Establishing Standards for Safety and Soundness, codified at Appendix A to 12 CFR 30. Both PCA directives and safety and soundness orders are public documents that are enforceable in the same manner as a C&D. In 1997, the OCC became the first federal banking agency to issue a safety and soundness order under FDICIA.

Recent Enforcement Cases

Appellate Decisions

In *Sarsfield* v. *OCC*, in October 1997, the Supreme Court denied William C. Sarsfield's petition for certiorari, thus letting stand a decision of the U.S. Court of Appeals for the Ninth Circuit. The Ninth Circuit had affirmed a Comptroller's Decision in which the former chairman of the board of the Sequoia National Bank, San Francisco, California, was determined to have violated half a dozen articles in a C&D order, and was ordered to pay a civil money penalty of $10,000.

* Note that SMS totals for previous years' enforcement actions may be adjusted to reflect revised aggregates.

Comptroller and Federal Reserve Board Decisions

On August 9, 1997, the Comptroller upheld a recommended decision suspending a vice president and regional manager of a $900 million national bank from further participation in the conduct of the affairs of the institution, pursuant to 12 USC 1818(g). The suspension was based upon the vice president's indictment on 10 counts of bank fraud and conspiracy for making nominee loans to a troubled borrower, during his previous employment as president of a state, non-member bank. The vice president had argued that he had a successful professional history in the banking industry, both before and after the indictment, that a bank audit found no improprieties in his current job, and that the bank's internal controls would prevent possible future improprieties. The Comptroller concluded that the vice president failed to show that his continued participation in the conduct of the affairs of the bank does not, or is not likely to, pose a threat to the interests of depositors or threaten to impair public confidence. The Comptroller also concurred with the hearing officer that the extent of the publicity of the indictment made relevant the bank's perception of his job performance, the adequacy of internal controls, and the findings of a bank auditor. The hearing officer and the Comptroller found that the public did not have access to this information, and therefore, the efforts of the bank and the vice president do not outweigh the potential negative effects on the public confidence in the bank arising from the upcoming criminal trial and the vice president's continued association with the bank.

On July 25, 1997, the Comptroller upheld a recommended decision ordering the imposition of a $25,000 civil money penalty against Thomas Towe, the former chairman of the board and legal counsel for the First National Bank & Trust, Wibaux, Montana, and a penalty of $10,000 against Edward Towe, a director and the president of the bank. On August 18, 1997, the Federal Reserve Board ordered the Towes banned from the banking industry, following the recommendation of the administrative law judge (ALJ). The ALJ found, and the Comptroller and the Federal Reserve Board agreed, that the Towes had violated restrictions on transactions with bank affiliates under 12 USC 371c and 371c–1, the restriction on bank investment in real property, 12 USC 29, the requirement that banks file accurate call reports, 12 USC 161, violated a cease-and-desist order, engaged in numerous breaches of their fiduciary duty to the bank, and committed reckless unsafe and unsound banking practices, including the manipulation and falsification of bank records to avoid honoring IRS levies that had been imposed upon Edward Towe and his wife.

On December 12, 1997, the Federal Reserve Board upheld a recommended decision of the administrative law judge and issued a prohibition order against a former employee of a federal branch. The prohibition was based on the employee's failure to disclose information regarding the branch's open option positions. A recommended restitution order and civil money penalty was pending before the Comptroller at year's end.

Administrative Hearings

The Enforcement and Compliance Division recently conducted an administrative hearing in which the OCC charged a national bank vice president and loan administrator with running a loan kiting scheme (involving a total of 24 loans). As a result of his actions, the bank lost $813,000. The OCC is seeking a prohibition, restitution, and imposition of a CMP. A recommended decision is expected by April.

Consent Orders

On December 16, 1997, the OCC executed a stipulation and consent order for prohibition, restitution in the amount of $432,695, and civil money penalties in the amount of $250,000 against the former vice president, investment banking group, capital markets division of a national bank. The former officer directed the bank's actions as placement agent for certain tax-exempt municipal bonds. The programs required the participation of other lending institutions which paid an up-front fee for the right to participate. The OCC charged the officer with misrepresenting to the participating lending institutions that an affiliate of the bank where he worked would guarantee the lenders against loss of their participation costs. In fact, the affiliate had made no such offer. Consequently, the bank incurred loss of $432,695 in the form of payments to lenders seeking reimbursement.

The OCC issued a safety and soundness order against a national bank that had a six-member board that was divided into two factions of three directors each. The dispute had reached the point where the board refused to hold meetings or otherwise meet with each other, and the bank's financial performance began to suffer. The order required the board, by a majority vote, to appoint a new director and a new, independent chief executive officer, which they did. The order is the first safety and soundness order issued by the OCC or by any other federal financial institution's supervisory agency.

Fast Track Enforcement Cases

The OCC continued its Fast Track Enforcement Program, initiated in 1996, which ensures that bank insiders who have engaged in criminal acts in banks, but who are not being criminally prosecuted, are prohibited from working in the banking industry. As part of the Fast Track Enforcement Program in 1997, the Enforcement and Compliance Division completed 26 consent prohibition orders against institution-affiliated parties, some of which also incorporated restitution payments to the appropriate banks for losses incurred. The following are representative Fast Track cases:

On July 17, 1997, the OCC entered into a consent prohibition order with a former bank teller/supervisor at a national bank. The former employee admitted to conspiring with a person or persons not affiliated with the bank to open a deposit account under a fictitious name. The former employee transferred bank funds to the account which were withdrawn by an outside party. Bank loss was $17,500.

On September 15, 1997, the OCC executed a consent prohibition and restitution order in the amount of $16,200 against a former loan collateral specialist at a national bank. The institution-affiliated party used his access to the bank's official check register to issue unauthorized checks to fictitious payees that the employee converted to his own benefit. Total bank loss before recoveries was $44,000.

Appeals Process

Case One: Appeal of Composite CAMELS Rating and CRA Rating

Background

A formal appeal was received concerning a bank's composite CAMELS rating of "5" and the bank's Community Reinvestment Act (CRA) rating of "Needs to Improve Record of Meeting Community Credit Needs" ("Needs to Improve"). The composite rating is based on capital, asset quality, management, earnings, liquidity, and sensitivity to market risk (CAMELS). The bank is chartered under the Competitive Equality Banking Act (CEBA) and engages solely in consumer credit card operations. For CRA purposes the bank is considered a limited purpose bank and is evaluated under the Community Development Test.

Composite CAMELS Rating of "5"

In the appeal letter, management explains that the current examination was conducted six months after the previous report of examination (ROE) had been issued, when the bank's composite CAMELS rating was downgraded to a "5." Management and the board of directors did not disagree with the previous examination conclusions; however, they believe their accomplishments since that examination are impressive and that the condition of the bank has greatly improved. In the appeal letter, management stated that the board perceives that regardless of the bank's accomplishments and improved condition, there was no intention by the supervisory office to fairly consider upgrading the bank's rating. In an effort to support the "5" rating, management believes the supervisory office viewed every "recommendation" as a severe problem. Management gives the following factors as their basis for appealing the "5" rating:

- The bank returned to profitability while the examiners were still conducting their on-site examination.
- Capital levels were not a threat to the bank's solvency.
- Alternative sources of capital have continually provided capital augmentation as needed.
- Vintage data and delinquency trends prove the condition of the portfolio has improved as anticipated.
- Management and the board have taken quick and decisive action to control the risks in the portfolio.
- Operational issues at the bank's affiliate have been resolved.
- Compliance systems at both the bank and the affiliate have greatly improved resulting in a satisfactory rating.
- The board and management have made good faith efforts to comply with the enforcement action.

Based on the aforementioned facts, the board believes that the bank is neither a threat to the insurance fund nor is failure of the bank highly probable.

The ROE provides the following verbiage to support the composite CAMELS "5" rating:

> The bank's condition remains weak and financial performance is unstable. Management and board supervision do not provide for effective management and control of risks within the bank. The credit card product, offered as the primary source of revenue, has not been adequately evaluated. Large capital injections were needed during 1996 to provide for continued operations.
>
> Despite better staffing levels, increased control over the bank's affiliate, and improved loan supervision, the credit card portfolio still generates excessive delinquencies and loan losses. To reduce risk, your management team must develop credit risk controls targeted at underwriting, to supplement the improved collection strategies. You must still address serious weaknesses in planning, risk management, and management information systems.

CRA Rating of Needs to Improve

In reference to the CRA rating of "Needs to Improve," the appeal letter states the board of directors cannot comprehend the position of the OCC, as the bank operated under severe financial constraints during the two-year CRA review period. According to the letter the bank has been working diligently to improve the condition of the bank by returning it to profitability, ensuring capital adequacy, complying with two regulatory enforcement actions, and improving risk management systems. Despite these obstacles, members of the bank were able to participate in community development organizations in the assessment area during the review period. Management concludes by stating the board believes that the CRA activities of the bank more adequately support a "Satisfactory" rating.

The ROE states the bank has a minimal level of qualifying community development services, and has made no

CRA loans. The ROE continues by stating that little has been done since the bank was designated a limited purpose institution. The ROE does acknowledge that management and the board's time and effort during the past year has been focused on implementing and strengthening controls over credit card assets; nonetheless, the bank's demonstrated performance under CRA falls substantially short of the criteria for a "Satisfactory" rating. Board and management were encouraged to develop a plan to strengthen the bank's performance under CRA, consistent with the spirit and intent of the act.

Discussion

Composite CAMELS Rating of "5"

Composite ratings are based on a careful evaluation of an institution's managerial, operational, financial, and compliance performance. The six key components used to assess an institution's financial condition and operations are: capital, asset quality, management, earnings, liquidity, and sensitivity to market risk (CAMELS). Composite 4 and composite 5 ratings are each defined below:

> Composite 4—Financial institutions in this group generally exhibit unsafe and unsound practices or conditions. There are serious financial or managerial deficiencies that result in unsatisfactory performance. The problems range from severe to critically deficient. The weaknesses and problems are not being satisfactorily addressed or resolved by the board of directors and management. Financial institutions in this group generally are not capable of withstanding business fluctuations. There may be significant noncompliance with laws and regulations. Risk management practices are generally unacceptable relative to the institution's size, complexity, and risk profile. Close supervisory attention is required, which means, in most cases, formal enforcement action is necessary to address the problems. Institutions in this group pose a risk to the deposit insurance fund. Failure is a distinct possibility if the problems and weaknesses are not satisfactorily addressed and resolved.
>
> Composite 5—Financial institutions in this group exhibit extremely unsafe and unsound practices or conditions; exhibit a critically deficient performance; often contain inadequate risk management practices relative to the institution's size, complexity, and risk profile; and are of the greatest supervisory concern. The volume and severity of problems are beyond management's ability or willingness to control or correct. Immediate outside financial or other assistance is needed in order for the financial institution to be viable. Ongoing supervisory attention is necessary. Institutions in this group pose a significant risk to the deposit insurance fund and failure is highly probable. [OCC Bulletin 97–1, January 7, 1997.]

CRA Rating of "Needs to Improve"

For purposes of this discussion, the following definitions from 12 CFR 25 apply:

> (o) *Limited purpose bank* means a bank that offers only a narrow product line (such as credit card or motor vehicle loans) to a regional or broader market and for which a designation as a limited purpose bank is in effect, in accordance with 25.25(b). ["Definitions," 12 CFR 25.12(o).]
>
> (b) *Designation as a wholesale or limited purpose bank.* In order to receive a designation as a wholesale or limited purpose bank, a bank shall file a request, in writing, with the OCC, at least three months prior to the proposed effective date of the designation. If the OCC approves the designation, it remains in effect until the bank requests revocation of the designation or until one year after the OCC notifies the bank that the OCC has revoked the designation on its own initiative.
>
> (c) *Performance criteria.* The OCC evaluates the community development performance of a wholesale or limited purpose bank pursuant to the following criteria:
>
> (1) The number and amount of community development loans (including originations and purchases of loans and other community development loan data provided by the bank, such as data on loans outstanding, commitments, and letters of credit), qualified investments or community development services;
>
> (2) The use of innovative or complex qualified investments, community development loans, or community development services and the extent to which the investments are not routinely provided by private investors; and
>
> (3) The bank's responsiveness to credit and community development needs. ["Community development test for wholesale or limited purpose banks," 12 CFR 25.25(b)–(c).]

The preamble to the 1995 revision to the CRA regulations lists what information the examiners will consider, as appropriate by stating the following:

> *Performance context.* An institution's performance under the tests and standards in the rule is judged in the context of information about the institution, its

community, its competitors, and its peers. Examiners will consider the following information, as appropriate, in order to assist in understanding the context in which the institution performance should be evaluated:

(1) The economic and demographic characteristics of the assessment area(s);

(2) Lending, investment, and service opportunities in the assessment area(s);

(3) The institution's product offerings and business strategy;

(4) The institution's capacity and constraints;

(5) The prior performance of the institution and, in appropriate circumstances, the performance of similarly situated institutions; and,

(6) Other relevant information. [*Federal Register,* vol. 60, no. 86, May 4, 1995, pp. 22162–22163.]

Conclusion

Composite CAMELS Rating of "5"

While the condition of the bank remained serious as of the examination date, it was concluded a composite CAMELS rating of "4" better reflects the condition of the bank at that time, rather than the "5" rating that was assigned. Consistent with the ROE, the supervisory office appropriately evaluated and rated the bank's asset quality, management, earnings, liquidity, and sensitivity to market risk as of the examination date. However, for the reasons stated below, the bank's capital position as of the examination date justified a rating of "4" and supported an upgrading of the overall CAMELS rating to a "4" as well.

OCC Bulletin 97–1 specifies that a financial institution is expected to maintain capital commensurate with the nature and extent of risk to the institution and the ability of management to identify, measure, monitor, and control these risks. A rating of "4" indicates a deficient level of capital. In light of the institution's risk profile, viability of the institution may be threatened, and assistance from shareholders or other external sources of financial support may be required. A rating of "5" indicates a critically deficient level of capital such that the institution's viability is threatened and immediate assistance from shareholders or other external sources of financial support is required. While the bank's capital level was definitely deficient and below the requirements of the enforcement action, capital injections made prior to the examination put the bank's leverage ratio at 4.21 percent as of the examination date. Accordingly, the capital component rating was changed to a "4."

CRA Rating of "Needs to Improve"

During the time since the bank's last CRA examination, the management team and the bank's board of directors focused their primary attention on the financial condition of the bank. The bank's condition did not allow the bank's management and board to expend significant resources on the bank's compliance with CRA. The bank's election to be designated as a limited purpose institution limited the bank's CRA performance to an evaluation under the Community Development Test. After reassessing the bank's performance under the Community Development Test, the ombudsman concluded that the institution's capacity and constraints were considered, and the bank's CRA performance was appropriately assigned a "Needs to Improve" CRA rating.

Case Two: Classification of a Credit

Background

A bank filed an appeal requesting the ombudsman's office to reassess two findings listed in its most recent report of examination (ROE). The bank disagreed with the following conclusions:

- The loss portion of a loan with a split classification of substandard/loss, along with the request for an additional 15 percent reserve requirement on the same loan; and,
- Comments relating to the deficiencies in the bank's process to maintain an adequate allowance for loan and lease losses (ALLL).

In the appeal letter, management acknowledges that the borrower is troubled, and that the credit is a collateral-dependent, classified loan. The disagreement comes with the valuation of the collateral. The credit is collateralized by several oil and gas leases. The bank values the leases by taking the average gross monthly revenue times the working interest percentage, less the borrower's share of average lease operating expenses, times 36 months. The supervisory office used the same method; however, the accounting for the expenses associated with the leases differed. In addition, the supervisory office did not give the bank any credit for the related equipment because the bank's last inspection did not list the equipment individually. Bank management stated that the equipment had not changed significantly from the previous valuation and that inspection did list each piece of equipment with values. The bank's value of the collateral was twice the amount of the supervisory office's valuation. The amount of loss identified during the examination was the difference between the supervisory office's valuation and the amount of outstanding debt. Bank management had a specific allocation equal to

25 percent of the outstanding debt earmarked in the ALLL. After the charge-off of approximately one third of the credit, the supervisory office requested management to reserve an additional 15 percent of the remaining debt in the ALLL. Bank management agreed to provide an additional 1 percent, but did not feel anything above that amount was necessary, since from their perspective there was adequate collateral coverage.

In reference to the comments relating to the deficiencies in the bank's process to maintain an adequate ALLL, bank management stated the bank's process follows the guidance provided in the OCC *Comptroller's Handbook* booklet, "Allowance for Loan and Lease Losses" (June 1996). The bank does not use the stated percentages incorporated into the interagency policy statement for classified credits, as they provide a specific allocation for each classified credit. During the examination, two scenarios were presented to management that slightly increased the bank percentages applied in two ranges for "pass" credits. Management agreed to increase those levels.

Discussion

If a bank takes producing, oil-and-gas properties as collateral on a credit, the bank must have the capacity to accurately assess the present value of the pledged reserves. A current reserve-based engineering report is the most appropriate and commonly accepted industry practice to value such reserves. Typically, the discounted present value of future net income of the oil-or-gas reserve is based primarily on proven, developed, producing properties. Dedicated revenues generated from the sales of oil-and-gas reserves should facilitate the orderly amortization of the production loan in a timely manner. The subject loan has been on the bank's books for over 10 years, and while there have been some pay downs, additional advances have left the balance stagnant. Although the monthly income from the properties gives some indication of past performance from these properties, the future cash flow of the properties can only be determined through the discounted present value of future net income established by current independent engineering reports.

Every national bank must have a program to establish and regularly review the adequacy of its ALLL . The ALLL must be maintained at a level that is adequate to absorb all estimated inherent losses in the loan and lease portfolio as of its evaluation date. A bank that fails to maintain an adequate allowance is operating in an unsafe and unsound manner.

To establish and maintain an adequate allowance, a bank must:

- Understand the purpose of the allowance.
- Be able to recognize its problem loans.
- Have a sound analytical process for estimating the amount of inherent loss in its loan portfolio.

The ALLL is a valuation reserve maintained to cover losses that are probable and estimable on the date of the evaluation. The ALLL is not a cushion against possible future losses; that protection is provided by capital.

Conclusion

Bank management requested a current engineering report during the course of the ombudsman review. The ombudsman concluded that until the engineering report is completed, which will establish a supported value for the assigned collateral, the bank can recapitalize the charged off portion of the credit. The ombudsman directed the debt to be classified as a substandard asset and placed on nonaccrual. At the time the engineering report is completed, management agreed to make any appropriate adjustments (charge-offs). Also, once the value of the collateral is established through the engineering report, an orderly plan of amortization should be established consistent with the dedicated revenue stream arising from the producing reserves.

With the rebooking of the charged-off loan, the balance in the ALLL is considered adequate. Since the examination, the bank has enhanced its analysis of the ALLL to address the necessary factors.

Case Three: Classification of a Credit

Background

A formal appeal was received concerning a loss classification of a bank's asset. The bank has a certificate of deposit placement in a foreign financial institution. The foreign central bank intervened and closed the financial institution.

The report of examination explains that the asset classification was based on the following factors:

- Two years have elapsed since intervention by the central bank of this financial institution,

- The prospects and time for recovery of this unsecured placement are still unknown,
- The protracted nature and uncertainty of this recovery effort have rendered the full collection of principal and interest unlikely, and
- Classification as a bankable asset is unwarranted.

The bank appealed, indicating management is confident that the liquidation process will continue and a sale or liquidation will occur. Also, management does not believe the asset is worthless and that the bank should be allowed to continue to carry the entire amount of the asset in the allowance for credit losses until the magnitude of loss can be determined.

Discussion

Generally, a bank must promptly charge off the amount of any confirmed loss. For unsecured credit, bankruptcy or protracted delinquency may confirm the fact of loss and require a charge off. This bank's asset is internally rated doubtful, on nonaccrual, and 100 percent reserved in the allowance for credit losses. The outlook for when and how much it expects to collect is vague and largely dependent on circumstances beyond the bank's control.

During the appeal process, the bank received and forwarded to this office correspondence from its legal counsel regarding the future prospects for collection of the foreign asset. The letter reports that the bank should be confirmed by the foreign court, as a privileged creditor for 50 percent of its verified credits within the next 120 days.

Conclusion

In view of the new information, this office concluded that the bank should recognize one-half of the asset as loss in the current fiscal quarter. Further, in the event the bank is not confirmed by the foreign court as a privileged creditor for 50 percent of the asset by the end of the following fiscal quarter, the remaining book balance should be charged off. The residual balance, after recognition of the 50 percent charge-off, should remain fully reserved for allowance for loan and lease losses purposes.

Speeches and Congressional Testimony

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Annual Convention of the American Bankers Association, on slippage of credit standards, Boston, Massachusetts, October 5, 1997

This will be the fifth time I have had the pleasure of talking with you as Comptroller of the Currency. So, in thinking about what I wanted say today, I went back and dusted off the speech I gave at my first ABA convention, back in November 1993. Rereading that speech helped me put into perspective some of the changes that have taken place in the past four years. Now, four years is not very long in the larger scheme of things, but for bankers and bank regulators the world of today is certainly a different place than the world as it was when I appeared before you in 1993.

Recall those days with me, if you will. Although the economy was in the early phases of recovery, the recriminations were still flying fast and furious, with bankers and regulators both being blamed and blaming each other for the credit crunch that had aggravated the recession. Bankers groaned under an onerous, outdated, and—worse—apparently ineffectual regulatory burden, hampering their efforts to adapt to the rapid-fire changes in the financial marketplace. It was a time when many pundits were prophesying the end of the banking system as we knew it. You would almost have had to conduct an all-points search to find a banker, regulator, or community activist with anything positive to say about the Community Reinvestment Act. It was a time of bank failures, of worries about the liquidity of the bank insurance fund, and of acute demoralization in the industry and the regulatory community.

What a long way we've come together! When I spoke to you in the fall of 1993, despite the incipient economic recovery, the industry's fundamentals still seemed distinctly unfavorable. At that time I referred to this state of affairs as "a temporary cyclical upturn amidst a powerful secular decline." Today I am much more optimistic about the industry's long-term future. The strength of the industry's recovery and its strategic decisions over the past four years suggest something more promising than a mere transitory uptick in a long-term downward spiral. Capital is at record levels, and so are profits. We have not had a single bank failure in the past year. Bank stocks continue to be in heavy demand on Wall Street.

Perhaps even more significant, banks have used this window of opportunity to reposition and restructure themselves to meet the challenges of the future. There is no doubt that a big part of the industry's problems in the 1980s and early 90s stemmed from over-concentration. Many banks were tied to regional economies, and when those economies ran into trouble, so did the banks. Other banks simply placed too many eggs in a single basket—energy lending, highly leveraged transactions, commercial real estate, loans to developing countries, or what have you. When the market for those products declined—or, in some cases, collapsed—some banks suffered ruinous losses. In many cases, mismanagement was to blame. But, to some degree, management's hands were tied by law and regulation, which foreclosed many profitable alternate outlets for their products and services. Banks were also stymied by structural prohibitions and disincentives that prevented them from taking advantage of efficiencies of scale, from operating across state lines, and from organizing their activities in the way that best served their own corporate objectives. And these restrictions all took their toll.

Since then, banks have made impressive strides toward diversification. In the last four years, banks have become vigorous competitors in the market for annuities, mutual funds, brokerage services, and more. New products and services are being steadily rolled out. Innovation and diversification should mean that fewer banks will be susceptible to the sectoral downturns of the future.

Diversification has also had a geographic dimension that should help some banks weather the next downturn. The last recession highlighted the significance of regional differences in national growth patterns. Even as the northeast was floundering back then, other parts of the country were experiencing growth. The formation of truly national banking organizations, a process made possible in large part by changes in federal law, should help cushion those banks when the ride starts getting bumpy—as it surely will.

Just as important as these more measurable changes, I sense a change in attitude among bankers: a new confidence that they can hold their own in head-to-head competition against nonbank providers. And, in light of all the changes that have taken place over the past four years, I believe this confidence is generally warranted.

In all modesty, I do not believe that one can tell the whole story of the industry's rebound over the past four years without mentioning the role of regulatory reform. When I addressed this group four years ago, regulatory burden was the central theme of my remarks. Today, the OCC has gone a long way in fulfilling the promise I made to you at that time: to reduce regulatory burden to the maximum extent possible, consistent with safety and soundness. We have simplified examination procedures for noncomplex community banks. We led the way among financial regulators in creating an office of the ombudsman to resolve disputes and improve bank-to-agency communications. We have cut fees and assessments. We have given our examiners the technological tools they needed to conduct examinations more efficiently. We spearheaded the drive for CRA reform, to focus on results rather than on paperwork and process. We adopted a new supervisory strategy based on the banks' underlying risk characteristics, so that we could focus more OCC resources on the banks or activities within banks that exhibited the greatest risk.

We also completed a top-to-bottom review of our regulations, and weeded out those that no longer made sense in the modern banking environment. In the process, we have been able to authorize well-managed, well-capitalized national banks to engage in a variety of new activities closely related to banking. OCC legal decisions have interpreted the national bank charter as a broad grant of authority intended by Congress to evolve with changes in the marketplace, and those decisions have been ratified by the United States Supreme Court in a series of landmark unanimous rulings. These rulings confirm that national banks have the flexibility to meet the demands of a changing market for financial services and new opportunities to achieve the kind of product diversification that is essential to the long-term safety and soundness of the banking system.

Certainly this is all good news. It should be a time for celebration and patting each other on the back. So let me ask you this: if, as I believe, the industry's long-term prospects seem so much brighter than they did to me four years ago, why am I so uneasy about the near future of the banking system? I ask myself that question quite a lot these days. Of course, anxiety is an occupational hazard for anyone who holds my job. I sometimes describe the bank regulator as a professional worrier. But the fact remains that we today face objective perils that would disconcert even an inveterate optimist.

One thing that keeps me awake at night is the strategic risk for banks inherent in the current legislative debate about financial modernization. As some of you have heard me say before, I believe strategic risk—the risk of not being able to offer the products and services that the market demands—is, in the long term, the greatest risk facing the banking industry.

Advances in technology have, over the last several decades, fundamentally changed how information is created, processed, and delivered—the heart of what banks do. The information needed to make prudent and profitable loans is now more easily available, and less costly to access, than ever before. These advances have allowed new participants to compete in the banking arena and have blurred differences among existing financial products.

In addition, economic globalization has made the financial services markets increasingly competitive. A 1997 OCC study of foreign banks operating in the United States reported that foreign banks' share of the assets of U.S. commercial banks, savings institutions, and credit unions nearly tripled between 1980 and 1995, from 4.6 percent to 12.7 percent.

Finally, the mix of products and services that consumers want and need has changed and is continuing to change. An older, more sophisticated population is demanding a broader variety of investment options for its savings. So we have witnessed a remarkable migration of savings from insured deposits to mutual funds that offer a wider range of risks and rewards. Last year, for the first time in U.S. history, assets held in mutual funds exceeded assets held in insured deposits. At the end of the second quarter of 1997, mutual fund assets exceeded commercial bank deposits by almost 25 percent.

In this increasingly competitive and constantly changing marketplace, if banks are not able to offer new products and to evolve as the markets evolve, they will not survive. That is why I have championed the flexible view of the national bank charter that the Supreme Court has ratified.

Regulatory innovation is but one route to needed change. I have also been a strong supporter of efforts to enact legislation to modernize the financial system. But I have been equally vocal in urging that financial modernization legislation move the financial services industry forward, not hold it back. Above all, no bank should be forced to sacrifice the flexibility that current law already provides in exchange for a cosmetic reshuffling of existing activity restrictions. Such a sacrifice would compromise the long-term health of our financial services industry and its ability to serve the American economy. It is a sacrifice you don't have to make.

I believe we can craft legislation that provides greater safety and soundness, increased competition, more choices for consumers, and improved access to financial services. That is the essence of genuine reform. We should take the time necessary to achieve it.

But it is not just a legislative misstep that worries me. I am also concerned about a slippage in credit standards throughout the banking industry. Back in 1995, I formed a National Credit Committee, composed of some of our most experienced examiners, to monitor underwriting standards and credit risk factors throughout the national banking system. From time to time, I have expressed my views to the industry and have issued advisories and taken supervisory steps based on our findings. In an April 1995 speech, I admonished the industry not to compromise on asset quality goals. Thereafter, the slippage in credit standards slowed. Similarly, in a speech delivered last December, I called attention to the emerging warning signals of excessive relaxation of lending standards, especially in the syndicated loan market. Just two months ago, in August, we issued another advisory, alerting national banks to the dangers of declining loan loss reserves, which we were seeing at some banks throughout the country.

I recently discussed with members of our National Credit Committee the group's assessment of credit underwriting standards at the largest national banks. Unfortunately, there is every indication these standards have slipped further. Our examiners tell me that, over the past year, underwriting standards have continued to loosen in most lending categories. The trend is particularly pronounced in commercial lending, but there has also been some loosening in segments of the retail market.

This assessment is confirmed by outside sources. According to data from the Loan Pricing Corporation, since 1993, non-rated and non-investment grade syndicated credits have risen from 35 percent to 54 percent—more than half of the total market. Pricing has declined at the same time that leveraging has increased. Since the first half of 1991, the spread in pricing between BB-rated credits and AA-rated credits has dropped from 77 basis points to 48 basis points. In other words, the spread has narrowed by almost 40 percent. And tenors have lengthened as well.

The same trends are in evidence on the retail side. By almost any measure, consumer debt is high. Today, consumer debt service payments as a share of disposable personal income are approaching levels reached in the 1980s. Our examiners have found that banks have tightened credit card lending standards in response to increasing delinquencies and losses. But this tightening is offset by an easing in terms for home equity and residential real estate loans. And, increasingly, consumers are turning away from secured retail loans to unsecured credit cards to finance purchases of durable goods, such as automobiles.

Although more and more banks are securitizing loans, in the banking industry as a whole, loan-to-deposit ratios are high by the standards of recent history. This ratio is increasing at the same time that our examiners are reporting that credit risk over the past year has increased in almost every category of loans we analyzed, with the single exception of agricultural loans.

What are we to make of these findings? And, more to the point, what are we to do about them?

Overwhelmingly, bankers tell us that—more than any other factor—competition from both banks and nonbanks is driving them to make loans that might or might not make sense on their merits. They tell us that if they don't make these loans, a competitor will. In the process, a good potential customer might be lost forever. Besides, the argument goes, similar loans are paying out now, so that if such loans add little to the bank's bottom line, neither are they doing it any damage.

Without getting into the pros and cons of these arguments, let me say this: true or not, such arguments will be small consolation when the economy becomes more volatile and the loans turn sour. We have learned before that imprudent loans made in the heady atmosphere of good times come back to haunt you when the good times fade. No one wants to learn that lesson one more time.

Accordingly, in addition to alerting the industry today about these disturbing trends, I am announcing initial steps we will be taking designed to help banks identify and address any weaknesses in their loan portfolios, so they can safely weather the inevitable vicissitudes of the national economy.

First, when we finalize our report on bank credit underwriting standards, I will ask all OCC examiners-in-charge (EICs) to discuss with senior bank management what the report means for banking generally and for that bank particularly.

Second, I will ask all EICs to bring to the personal attention of the bank chief executive officer (CEO) a sample of the bank's new loans, if any, that seem particularly deserving of the CEO's attention.

Third, over the past several years, we have seen cutbacks in bank staff experienced in dealing with troubled loans and borrowers. I will, therefore, ask OCC examiners, in the course of their regular examinations, to evaluate the bank's capacity to deal with a potential increase in its workload of problem loans. When examiners identify weaknesses in banks' systems for working through problem loans, they will draw these weaknesses to the attention of senior management and follow up to make sure the bank takes appropriate corrective action.

Fourth, the Federal Financial Institutions Examination Council (FFIEC) has just released for comment new guidance governing classification and charge-off policies on retail credit. We will carefully review the comments on this proposed guidance and work with the other regulators through the FFIEC to provide final guidance in this area as quickly as possible.

Finally, as I previously announced, the OCC is in the process of completing definitive guidance on loan portfolio management techniques.

If we take measured steps now, we can avoid serious problems later. The maintenance of sound credit standards and supervisory vigilance today will have little or no noticeable impact on economic growth now and will avoid more serious consequences later.

The past four years have been exhilarating ones in many respects. If we can steer clear of the potholes in the road that I have just marked out, I believe the next four years can be even more exciting ones for the banking industry.

This is an industry that is uncommonly blessed. It is an industry peopled by men and women rich in talent, integrity, and dedication. By working in partnership to break down barriers to innovation and to uphold safe and sound standards, we can ensure a bright future—for the banking industry, for the banking public, and for the American economy as a whole.

Statement of Eugene A. Ludwig, Comptroller of the Currency, before the Subcommittee on Financial Institutions and Consumer Credit of the U.S. House Committee on Banking and Financial Services, on bank examination and supervision systems at the Office of the Comptroller of the Currency, Washington, D.C., October 8, 1997

Statement required by 12 USC 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.

Madam Chairwoman and members of the Subcommittee, I appreciate this opportunity to testify on bank examination and supervision systems at the Office of the Comptroller of the Currency (OCC). As you are aware, direct supervision is a regulator's primary method for ensuring bank safety and soundness, which is crucial to maintaining stability in our nation's financial markets. In turn, a healthy banking industry is critical to the accomplishment of important public policy objectives established by Congress.

In your letter of invitation, you noted that the hearing would focus on how regulatory agencies are assessing the risks depository institutions take in today's financial marketplace, whether staffing is sufficient to assess safety and soundness concerns, and whether supervisory practices would need to be modified if Congress passes a financial services modernization bill. Specifically, you asked that I address a number of questions about the OCC's supervisory process. I will address your questions in the course of my statement today within the context of changes in the banking industry, how the OCC has addressed concerns resulting from these changes, my assessment of the future of the industry, and my thoughts on how the OCC will adapt to carry out its supervisory mission.

Introduction

The banking industry has changed significantly since the OCC was founded in 1863. Over the past 130 years, the industry has evolved in response to advances in technology, enhanced competition, and changes in consumer preferences. New risks have arisen, and traditional risks have emerged in new forms. Even with all of these changes, the mission of the OCC remains constant: to charter, regulate, and supervise national banks to ensure a safe, sound, and competitive national banking system that supports the citizens, communities, and economy of the United States.

In Question 1 of your letter of invitation, you asked about the factors that contributed to bank failures in the 1980s. During that time, regulators learned some hard lessons about traditional credit risks, particularly in agricultural and commercial real estate lending. Sometimes traditional risks are exacerbated by unanticipated economic shocks that disrupt even the best risk management plans. In the 1980s, several significant economic events, including the collapse of energy prices and the precipitous decline in the value of farmland, contributed to difficult times. The OCC and other bank regulatory agencies faced three main supervisory problems in addressing the consequences of these economic shocks to the banking system.

First, the agency faced competition for its seasoned employees, and attempts to hire new examiners were frustrated by our inability to offer competitive salaries—a problem that has since been rectified with a much-needed change in federal law. Second, with the improvement in our off-site monitoring capabilities, we initially reduced our emphasis on maintaining a regular cycle of on-site examinations at all banks. But perhaps most important, our supervision was still largely retrospective, analyzing how the risks of a bank had been mishandled, rather than a forward-looking assessment of what problems were on the rise and what should be done to manage them. Put simply, we were treating the disease instead of practicing preventive medicine.

The industry was feeling the aftershocks of the 1980s and still going through challenging times when I took office four and one-half years ago. There had been numerous bank failures, complaints from small businesses and consumers about a credit crunch, and concerns in the banking industry and Congress about excessive regulatory burden. Community organizations were concerned about fair lending compliance, and both community organizations and banks agreed that the Community Reinvestment Act (CRA) regulations were not as effective as they should be.

We have worked hard over the past few years to refocus and retool the OCC's supervisory process. History has taught us the importance of on-site, hands-on bank examinations. We recognize now that there is no substitute for regular on-site examinations, and we have increased the number of banks in which we maintain a full-time, on-site dedicated examiner staff. At the same time, history also taught us that our supervisory policies and practices must enable us to respond to industry changes. In response, the OCC developed a program of risk-based supervision that is forward-looking and aimed at improving our ability to identify and address potential problems before they become crises, and is sufficiently adaptable so that we can analyze risks across different products and activities. The OCC has also been able to hire talented people from a variety of disciplines and has trained examiners effectively to ensure that we can address industry changes in a timely manner.

The combination of the strong economy, the legislative changes mandated by the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), and the results of the modifications and innovations we made to our approach to supervision are evident today in the performance of the national banking system. Today, we find a banking system that is not only highly profitable, but also far better capitalized. From the passage of FDICIA through June 1997, the aggregate commercial bank equity-to-total asset ratio increased from 6.75 percent to 8.44 percent—its highest level since the 1960s—while the risk-based capital ratio increased from 10.67 percent to 12.46 percent. Bank failures in 1996 were at a 20-year low. Credit is flowing smoothly—total commercial bank loans have increased nearly 39 percent over the four years ending June 1997.

We also find a national banking system that has expanded access to financial services for all Americans, in part in response to increased efforts to enforce fair lending and community reinvestment laws. Before my arrival at the OCC, the OCC had referred only one fair lending case to the Department of Justice (Justice). Since 1993, we have held numerous informal discussions and formally referred 24 cases to Justice and the Department of Housing and Urban Development (HUD). We revised the CRA regulations, and there has been a dramatic increase in mortgage lending to low- to moderate-income individuals. Since CRA became law in 1977, we have witnessed over $215 billion in loan commitments for community development. Remarkably, $175 billion—more than 80 percent of the total—was made in the past three and one-half years alone.

Although we are pleased with the overall health of the industry and proud of our contributions to enhancing the safety and soundness of banks and enhancing access to financial services, we cannot be complacent. Now, while the industry is healthy, we must remain vigilant to address emerging risks. As I will discuss later, that is why I just announced a series of steps designed to help banks address any problems in their loan portfolios while capital and earnings are strong. It is also an appropriate time to reflect on the purpose of the banking industry, how it is changing, and what we as regulators must do to maintain its long-term safety and soundness.

The remainder of my statement today will describe our supervisory process and summarize significant actions taken over the course of my tenure. Throughout the statement, I specifically indicate when I have addressed one of the questions or issues raised in the invitation letter for this hearing. I will begin by discussing the changes affecting the banking industry, and offer some thoughts on future challenges facing the industry. Next, I will describe some of the measures taken by the OCC over the past four and one-half years to ensure that our supervision remains relevant to changes in the financial marketplace in order to safeguard the safety and soundness of the industry. Finally, I will summarize the initiatives the OCC is taking to ensure that our staff has the skills necessary to supervise the banking industry of the 21st century.

Changes in Banking and Bank Supervision

Banking Industry Changes

As I noted above, over the years, the banking industry has changed in ways that could not have been anticipated when the OCC was founded. For example, at the time of the creation of the national bank charter in 1863, the law restricted national banks to loans that could be readily turned into cash. In that era, public confidence in banking was synonymous with liquidity. Accordingly, most home mortgages were forbidden by law, and OCC examiners, consistent with the intent of Congress, were quick to criticize commercial loans that extended for more than the customary 30 or 60 days.

Today, no one would deny that sound mortgage lending, medium-term business lending, farm lending, and many other activities that would once have been frowned upon are necessary and proper activities for commercial banks. Had national banks been unable to respond to businesses' and consumers' demands and to the competitive challenges of other financial providers, they would not exist as they do today, and American businesses and consumers would be disadvantaged by that result. But because the laws, regulations, and supervision have been amenable to change, national banks have been able to continue making important contributions to the growth of our communities and our nation.

The banking industry of the 21st century is being shaped by an unprecedented combination of pressures. Today's information-driven economy is decreasing banks' traditional, core, competitive advantage in certain key areas. The information needed to make prudent and profitable loans often is more easily available, and less costly to access, than ever before. As technological changes alter the production, packaging, and delivery of financial services, banks face competition not only from finance companies, mortgage bankers, and investment houses, but also from non-traditional competitors, such as telecommunications companies and software development firms. Moreover, many of banks' traditional, core customers—commercial and industrial firms—can now bypass insured depositories and access the capital markets directly.

Similarly, distinctions among different types of financial products have blurred. Although core lines of business within the financial services industry remain distinct, firms in different sectors of the financial services industry offer products to their customers that are close substitutes, but bear different labels. There is no longer a sharp distinction between a syndicated loan and privately placed commercial paper, between an interest-bearing NOW (negotiable order of withdrawal) account and a money market mutual fund, or between a mutual fund and a variable annuity. In short, technological and financial innovation, together with market pressures to offer consumers a wider array of services, have eroded the traditional segmentation of the financial marketplace. This change is manifesting itself through a recent wave of acquisitions and mergers. Banks are acquiring brokerage and securities firms. Several insurance companies and brokerage firms have acquired, and others have announced that they are contemplating establishing or acquiring, insured depository institutions. Recently, one of America's largest insurance companies announced its intention to acquire one of the country's largest wholesale securities firms.

Driven by technological change, economic globalization also has made financial services markets increasingly competitive. Within the United States, commercial bank assets held by foreign banks increased from 10 percent in June 1990 to 14 percent in June 1997. Foreign banks' share of total U.S. commercial banks' commercial and industrial loans increased from 19 percent to 27 percent over that same time.[1]

In addition, the mix of products and services that consumers demand has changed and will continue to change with increasing consumer sophistication and demographic shifts. The aging baby boomer population understands it has a variety of investment options and opportunities for its retirement savings. Correspondingly, there has been a migration of savings from insured deposits to mutual funds that offer an array of investment and risk/reward profiles. In 1995, for the first time in the history of the United States, assets held in mutual funds exceeded assets held in deposits. Net assets of mutual funds were $4.2 trillion at the end of August 1997,[2] while total domestic deposits at commercial banks and savings institutions were $3.5 trillion at the end of June 1997.[3]

Amid these changes, the organizational structure of the banking industry is being altered as well. Some banks have responded to this increased competition by seeking to merge with other banks to obtain the benefits of economies of scale or scope, or geographic diversification. The continuing trend toward bank consolidation has seen the number of commercial banks fall to 9,308 as of June 1997 from 11,462 when I took office in April 1993. Consolidation also seems to be leading to a bifurcation among banks into community banks and larger institutions, with relatively fewer medium-sized banks as a result.

The OCC's Supervisory Response

The rapid pace of change in the financial services business presents new challenges to bank supervision. As the banking industry adapts to a dynamic economy, so too must bank supervision evolve. Just as a failure to change would make banking less relevant to the needs of the economy, a failure by the OCC to adapt to changing circumstances would make bank supervision less effective. In my term as Comptroller, we have taken and continue to take many steps to modernize our supervisory policies and practices. Let me highlight the most significant actions we have taken over the past four and one-half years.

I strongly believe the key for bank supervisors to carry out their responsibilities effectively is to identify the risks incurred by banks, to assess their systems for managing those risks, and to ensure that the banks' risk management systems are, in fact, identifying, measuring, monitoring and controlling risks. At the OCC, we are doing this through a forward-looking program called supervision by risk. We have also issued guidance or advisories on a number of current issues and followed up to ensure that our guidance is being implemented by the banking industry. We have established specialized committees to monitor emerging risks and communicate relevant findings to the banks.

In addition, we have improved our direct communications with the banking community. Shortly after I became Comptroller, we initiated annual meetings between myself and the largest national banks in an effort to improve communication between the agency and the industry. I also encouraged OCC senior management to increase their meetings with bankers, and I revived nationwide "Meet the Comptroller" sessions throughout the country.

[1] "Assets and Liabilities of Commercial Banks in the United States," H.8, Federal Reserve Board.

[2] Investment Company Institute data.

[3] Call report data, Federal Financial Institutions Examination Council.

Supervision by Risk

In January 1994, we initiated the bank supervision review program to focus relatively more of our supervisory resources on those banking activities and those banks that pose the most likely threats to the safety and soundness of the banking system. Our review resulted in supervisory policies and processes that tailor our oversight to the key characteristics of a bank, including size, products offered, markets in which it competes, and management's tolerance for risk.[4] Supervision by risk is a dynamic process that not only allows us to tailor our oversight to the risks of a particular bank, but also to change the way we supervise that bank in light of its risk profile. This process also provides an effective means for the OCC to communicate to senior bank management the areas where they may need to correct problems before they become severe and how we intend to allocate our supervisory resources. The OCC's current, risk-based approach to supervision therefore has adapted the fundamental elements of on-site, hands-on examination of banks to incorporate lessons learned from supervision of the past.

Supervision by risk does not replace the interagency framework the agencies use to rate banks' capital adequacy, asset quality, management, earnings performance, liquidity, and sensitivity to market risk (CAMELS). Rather, the two systems work in tandem, yielding an assessment of the bank's current condition and a forward-looking analysis of its risk. Under the CAMELS system, examiners assess a bank's performance to draw conclusions about its current condition. Supervision by risk focuses our attention on areas of current and emerging risk, and focuses our examination resources on areas of prospective higher risk.

Although the centerpiece of supervision remains on-site bank examinations, OCC supervision is a complex cycle of planning, examining, and follow-up that involves cooperation and communication among the supervisor, other regulators, and the institution being supervised. In other words, supervision is much more than the actual time spent on-site in the bank. For example, a supervisory team spends significant time determining what the examination will focus on prior to entering the bank. While on-site, examiners sample, test, and verify policies, procedures, and systems. At the conclusion of an examination, matters requiring board and management attention are included in the report of examination, and examiners are responsible for following-up with bank management to ensure that the bank addresses these weaknesses and concerns. Furthermore, national bank examiners are responsible for continued, year-round monitoring of each national bank.

The risk assessment system. Under supervision by risk, the OCC uses a risk assessment system to measure and assess the risks at each bank we supervise. The first step in our supervision of an individual bank or in evaluating a new product or activity is to identify the key associated risks.[5] Having identified the risks for an individual bank, we evaluate and measure the quantity of risk and the quality of risk management to form an overall conclusion about the bank's risk profile. Because market conditions and company structures vary, there is no single risk management system that works best for all banks. However, we do expect each bank to have a system that is commensurate with the risks it assumes and that addresses each of the four aspects of effective risk management: to properly identify, measure, monitor, and control risks.

The OCC's large bank and community bank risk assessment systems are different. During a large bank examination, an OCC examiner rates each risk category by the quantity of the risk and the quality of risk management. Next, the examiner assigns an aggregate or composite risk rating based on his or her judgment of the level of supervisory concern considering both the quantity of risk and the quality of risk management. Finally, we assign a rating of the expected 12-month direction of the quantity of the risk.

Community banks, however, receive only an aggregate or composite risk rating and a rating on the expected direction of the risk. The community bank risk assessment is meant to focus attention on areas that historically have posed the greatest risks to banks. Examiners use a core set of procedures that cover all major areas of safety and soundness for low-risk and moderate-risk/stable-expected direction areas of the bank. Even in the areas of lowest risk, we sample, verify, and test the bank's policies, procedures, and systems. Examiners may expand the procedures if supervisory concerns emerge while using the core procedures. For areas of higher risk, examiners use customized procedures that focus on the risk and the bank's risk management processes. We are fully committed to ensuring the safety and soundness of community banks. In fact, when the

[4] The OCC's supervision by risk examination procedures differentiate between large banks and community banks. The OCC defines a large bank as a national bank with total assets of $1 billion or more or a national bank that is part of a multibank holding company that has a national bank with over $1 billion in assets. We define a community bank to be a national bank with total assets of less than $1 billion or one that is part of a holding company where none of the national banks' assets exceed $1 billion.

[5] The OCC has defined risks as credit, liquidity, interest rate, price, foreign exchange, transaction, compliance, strategic, and reputation risks. Most bank activities contain one or more of these risks.

OCC conducts a full-scope, on-site examination in 1997, it spends on average 60 percent more workdays per bank than it did for a comparable on-site review in 1985.

Because of the greater systemic risk posed by the largest banks, we have assigned examiners full-time to each of the 32 largest national banks. We recently increased the number of national banks in which we maintain examiners permanently on-site in recognition of the supervisory benefits we receive by having a constant presence in the bank. We now have about 250 examiners in these 32 banks, and we expect to have an additional 50 examiners on-site by early next year. This program allows the examiners to develop a more thorough knowledge of the bank, including its activities and risks, than is possible through the traditional regime of periodic examinations. As a result, our examiners are better able to identify increases in risk or deterioration in risk management so that we can act quickly to ensure that weaknesses are corrected.

Benefits of the supervision by risk program. Many of the questions you raise in your letter of invitation deal with the benefits of our supervision by risk program. Let me address them in this section of my statement.

In Question 5 in the invitation letter, you asked whether prompt corrective action (PCA) policies complement the supervision by risk approach. We believe that the two are complementary, because the knowledge that reductions in capital will trigger the prompt corrective actions required by the Federal Deposit Insurance Corporation Improvement Act (FDICIA) creates a healthy caution within the industry and appears to have resulted in many banks increasing their capital levels to avoid the supervisory consequences of PCA.

Question 3 of the letter requested information about the extent to which our national banks have come under supervision by risk, and whether there were adequate guidelines and training for our examiners. Supervision by risk is currently being used in examining all national banks for safety and soundness. We will expand the supervision by risk approach to include several specialty areas through the rest of 1997 and into 1998, including bank information systems and fiduciary activities. The examination procedures implementing supervision by risk are documented in the *Comptroller's Handbook,* and we have provided targeted training to all of the examiners in the field. We have also revised certain in-house training courses to incorporate the principles of risk-based supervision.

Questions 2 and 4 asked about the measures that we have initiated to ensure that examiners effectively assess the financial condition of a bank, and how, overall, we measure the effectiveness of our examinations. First, I would note that the OCC has organized its activities in such a way as to promote the ongoing review of examination effectiveness. For example, we have periodic meetings involving the examiners-in-charge of our large banks, and senior management at headquarters holds weekly discussions with the deputy comptrollers in the district offices to discuss examination issues. Second, we will soon complete an overhaul of our quality assurance program for bank supervision. For the past two years we have reviewed a sample of work papers from each field office completed during community bank examinations as part of our community bank quality assurance program. This quality assurance review will be extended to our large bank examinations by the end of the first quarter of 1998. These two functions now report to our newly established Director for Quality Assurance within our bank supervision operations area. His job is to ensure that the goals and objectives of our bank supervisory process are applied in a consistent and cost effective manner throughout the OCC, all in the interest of ensuring that our examiners effectively assess the financial condition of a national bank.

Third, as part of our supervision by risk program, we are in the process of refining our large bank supervision program, including examining the effectiveness of our risk assessment system. We continue to strive to improve the process. Senior management will review staff recommendations by year-end, and then will implement procedural changes as warranted. Finally, we are in the midst of implementing a pilot program of effectiveness measures for ensuring safety and soundness. Based on the results of the pilot, we expect to implement several effectiveness measures of examinations as part of our ongoing quality assurance efforts.

In Question 7, you asked how we have improved examination procedures to provide regulatory effectiveness and protect the deposit insurance funds. I strongly believe that supervision by risk is the best way to supervise banks in the current rapidly changing environment. Our supervision by risk program allows us to apply a consistent supervisory methodology across an increasingly diverse group of banks that engage in an increasingly diverse set of activities. Because the design of this approach requires that we customize an examination based on a bank's underlying risk characteristics, it allows us to direct OCC resources to the banks or activities within banks exhibiting the greatest risk. The supervision by risk framework allows us to be more efficient in our examination planning, yet it is still sufficiently flexible to allow us to verify and test our assessments and devote additional time to following up with the bank after an examination to ensure compliance with our requirements. We believe that our supervision by risk program would be readily adaptable to changes Congress may decide to make in the financial services industry in the context of a financial modernization bill, but we cannot answer definitively without knowing the bill's final requirements.

You inquired in Question 6 whether our risk assessment examinations were adequate when operations are on an interstate or global basis. We believe that supervision by risk is an effective method for supervising interstate and multinational banks, given their size, reach, and complexity. The focus of supervision by risk is forward-looking and strategically oriented. We feel prepared to address issues raised by the increasingly global focus of national banks. We have an OCC office in London with examiners devoted to supervising the overseas branches of national banks. Technological advances have enhanced our information on a bank's consolidated operations and geographic exposures, and our examiners regularly travel to a bank's international sites when appropriate. The determination to go on-site is based on factors such as whether an adequate assessment can be made from the head office, the examiners' knowledge of the bank's risk in a particular location, the relation of the overseas operation to the overall risk of the company, and the length of time between exams in an area/operation of high risk. Since the OCC formally adopted its supervision by risk program, other U.S. regulators have embraced the concept, and the United Kingdom's Bank Supervisory Service and other international regulators are developing similar systems.

Guidance and Advisories Issued

Our supervision by risk philosophy, implemented through individual bank examinations, is reinforced and supplemented by our public statements and formally issued policy guidance and advice to the industry to address emerging risks. Our policy guidance focuses on the risks posed by activities and the critical elements of prudent risk management, and typically contains a series of follow-up actions that the OCC will take to ensure that national banks are heeding our warnings. For example, our groundbreaking issuance and examination procedures on derivatives activities stressed the need for board and senior management oversight, timely and accurate market and credit risk measurement systems, and effective operational and risk controls. We issued guidance on stored value card systems that described emerging electronic cash systems and the associated risks to banks investing or participating in those payment systems. We revised *The Director's Book: The Role of a National Bank Director*. The revised book provides guidance to bank directors on how to meet their responsibilities in the increasingly complex financial services industry. Furthermore, we revised a number of sections of the *Comptroller's Handbook*, including sections on mortgage banking, credit card lending, risk management in derivatives, and, most recently, on interest rate risk. These revisions provide guidance to examiners and help keep them informed about new procedures.

As I have noted, we are constantly on the alert for emerging problems, and we issue advisories to national banks when we identify issues of concern. This year, we have issued advisories on a range of topics, including credit underwriting, credit scoring models, affordable mortgage portfolios, and loan loss reserves. Our advisory letter on credit underwriting and credit portfolio risk management reminded national banks of the effects that changes in loan underwriting standards may have on portfolio credit risk and highlighted the major elements of an effective portfolio credit risk management process. At the same time we issued this advisory letter, I urged banks to focus on three potential problem areas: cuts in banks' internal controls to boost earnings, consumer credit quality, including credit card losses, and managing the overall credit risk in bank loan portfolios. We alerted national banks to the potential benefits and risks of credit scoring models, and advised banks to carefully develop, implement, evaluate, and maintain their models to ensure their proper use. We issued an advisory letter offering information about effective techniques and strategies banks may want to consider to improve the quality of their affordable mortgage portfolios. We issued an advisory letter asking national banks to perform a quarterly review of loan loss reserves after we became concerned that the amount of loss allowance coverage was beginning to decline at the same time certain credit quality indicators appeared to be deteriorating. All of these issuances keep national banks informed of emerging risks and highlight the steps we intend to take to ensure that banks heed these warnings.

Interagency Policies and Guidance

In Question 8, you asked about the coordination of our efforts with the other bank regulators. The effectiveness of the OCC's examination program is enhanced by our ongoing coordination with the Federal Reserve Board (FRB) and the Federal Deposit Insurance Corporation (FDIC) (collectively, with the OCC, the bank regulatory agencies). As mandated by statute, the OCC has worked with the other bank regulatory agencies to make our regulations and policies uniform. With the Office of Thrift Supervision (OTS), the bank regulatory agencies issued an Interagency Statement on Examination Coordination, in which we set forth procedures to be followed in planning and conducting joint interagency examinations, as well as sharing information and coordinating enforcement actions. In 1996, the bank regulatory agencies issued a uniform interest rate risk policy. In the fall of 1996, we issued our final market risk rule. Last December, the Federal Financial Institutions Examination Council (FFIEC), which I currently chair, revised the uniform bank rating system, putting additional emphasis on the quality of risk management practices and adding a new component on sensitivity to market risk.[6] In April 1997, the OTS and the bank regulatory agencies issued joint guidance on the sales of 100 percent loan participations.

The bank regulatory agencies and the OTS issued a joint Notice of Proposed Rulemaking on the treatment of servicing assets for regulatory reporting and capital purposes in August 1997. Most recently, in September 1997, the FFIEC issued a request for comments on changes to the 1980 Uniform Policy for Classification of Consumer Installment Credit Based on Delinquency Status (1980 policy). The 1980 policy is used by the agencies for classifying retail credit loans of financial institutions on a uniform basis. The FFIEC is currently reviewing and soliciting comments on the 1980 policy to determine where revisions may be necessary to reflect more accurately the changing nature of risk in today's retail credit environment.

We are working aggressively with the other banking agencies to make the year-2000 computer conversion problem a priority with bankers and their vendors and service providers. The banking agencies first alerted the financial services industry to our concern over the year-2000 problem in a June 1996 FFIEC statement. In that statement, we strongly encouraged depository institutions to complete an inventory of core computer functions and to set priorities for compliance changes, keeping in mind that testing should be under way for mission-critical systems by no later than December 31, 1998. In May of this year, the OCC and other agencies issued a second statement through the FFIEC, together with interagency guidance for banks and examiners, on year-2000 project management. In that statement, we listed steps that OCC examiners would take in their initial assessment of banks' year-2000 preparations prior to the conduct of actual examinations, which will be completed by mid-1998. Furthermore, the FFIEC will issue guidance on year-2000 testing this fall.

In addition, the banking agencies are coordinating a number of capital-related initiatives. We recently issued a joint notice of proposed rulemaking (NPR) on recourse and direct credit substitutes, small business loan recourse, servicing rights, collateralized transactions, and unrealized gains. We are also preparing to issue a joint NPR proposing various unifying capital amendments to implement section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994, which requires the banking agencies to work jointly to develop uniform regulations that implement common statutory or supervisory policy. Finally, the FFIEC is sponsoring a one-day conference in December 1997 to examine the current regulatory capital framework in today's evolving financial services environment.

Securities Activities

National banks are engaging increasingly in the sales of mutual funds and other securities-related activities. In Question 10, you asked whether our examiners were trained effectively to evaluate new activities and emerging products and financial instruments. As an example of how we are addressing that issue, I cite our issuance of new compliance examination procedures concerning mutual fund sales and the series of guidance we have issued to our examiners, consumers, and the industry. In the fall of 1993, we issued guidance for consumers about the differences between mutual funds and insured accounts. We followed up on that effort by issuing an interagency statement offering uniform guidance on the sales of mutual funds. In 1994, the OCC tested compliance with the guidance by undertaking a review of bank mutual fund advertisements and marketing materials. Over 700 national banks engaged in the retail sale of mutual funds voluntarily submitted materials for this effort. I initiated meetings based on the results of our findings with bank trade associations to address our concerns and establish disclosure standards.

Coordination with the SEC. You asked in Question 9 how we coordinate our examination activities with the Securities and Exchange Commission (SEC). The OCC and the SEC share supervisory responsibility for the oversight of mutual fund sales by national banks and operating subsidiaries. In 1995, the OCC and SEC agreed to coordinate efforts related to oversight of investment advisory activities. As a result, the OCC and SEC have conducted several joint examinations of banks and operating subsidiaries involved in investment advisory activities. Also, we share a variety of supervisory and examination information with the SEC, and the SEC with us.

In 1995, the economics staffs of the OCC and the SEC jointly conducted a survey of 2,000 investors to assess their understanding of the risks and expenses associated with mutual funds. The survey found that there was virtually no difference in the understanding of the risks and expenses involved in mutual funds between investors who purchased mutual funds from banks and those who purchased from nonbanks.

National Association of Securities Dealers (NASD) agreement. The bank regulatory agencies and the National Association of Securities Dealers (NASD) share a common interest in the supervision of broker/dealers selling nondeposit investment products on depository institution

[6] The Federal Financial Institutions Examination Council is composed of the OCC, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA).

premises and, in particular, the supervision of broker/dealers affiliated with a banking organization or thrift institution. To promote regulatory consistency and reduce unnecessary burdens, the four federal financial institutions regulators and the NASD signed an agreement in January 1995 to share information from examinations. The agreement also states that the OCC and the NASD may request that an examiner be present during the other's examination of a banking organization. The OCC will refer apparent violations of securities laws to the NASD, and the NASD will refer apparent violations of banking laws to the OCC. Our district offices continue to work with the NASD according to the terms of this agreement.

International Cooperation

The effectiveness of our examination program is further enhanced by our ongoing coordination with international bank regulators. In this era of increased globalization, it is imperative that U.S. banking regulators work with their counterparts abroad. The OCC's primary mechanism of cooperation is through the Basle Committee on Banking Supervision (Basle Committee), which pursues its goal to improve supervisory coordination and the quality of supervision by exchanging information and expertise; developing and sharing improved supervisory approaches, guidance, and technology; and setting minimum standards where needed. Currently, in addition to participating in all subgroups and task forces, including the Working Group on Electronic Money, the OCC chairs the Basle Committee's Information Subgroup, whose purpose is to identify and analyze the information needed by supervisors, to supervise effectively, and by market participants, to improve market transparency and promote market discipline.

In June 1996, the G–7 heads of state called for a cooperative study to investigate the implications of recent technological advances that make possible the creation of sophisticated methods for making retail electronic payments. A Working Party, of which the OCC was a member, produced a report in April 1997 that identified the policy issues facing G–10 governments as a result of electronic money and highlighted issues that could benefit from additional international cooperation.

Recently, the Basle Committee has furthered the development of international capital adequacy standards, completing standards for market risk. In adopting "sound practices" guidelines for the supervision of derivatives, the Basle Committee also adopted in large part the derivatives guidance issued by the OCC. The Basle Committee released its Core Principles for Effective Banking Supervision—25 basic principles for ensuring the effectiveness of a banking supervisory system—in September 1997. They were developed over the last 15 months to respond to the Lyon G–7 Summit communiqué of June 1996 calling for actions to improve the strength of financial systems caused by weaknesses in the banking system.

We are also extending our international coordination efforts to include foreign securities and insurance supervisors. The OCC is a member of the Joint Forum on Financial Conglomerates (Joint Forum). The Joint Forum is a high-level panel consisting of members of the Basle Committee on Banking Supervision, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors. Its objectives are to promote cooperation between bank, securities, and insurance supervisors and to develop "sound practice" standards for the prudential supervision of financial conglomerates. This past year, a major initiative of the Joint Forum has been a careful review of several global financial conglomerates to determine how they manage risks and how those risks are supervised.

Organizational Changes

As indicated by the summary of activities above, the OCC has demonstrated significant supervisory and examination flexibility to meet the current needs of supervising the banking industry. Since I became Comptroller, the OCC has also made a number of internal organizational changes to improve our ability to monitor and effectively supervise emerging risks. We added expertise and restructured the organization to respond to changes in the banking industry, particularly consolidation and the decreased relevance of geographic location in supervising large banks. These banking industry changes also increased our need for specialists.

Creating new units to address emerging risks. Soon after I became Comptroller, I recruited an individual with substantial expertise in the derivatives activities of major Wall Street securities firms and commercial banking organizations to lead the OCC's Derivatives Task Force. That task force issued guidance to bank management on managing the risks of financial derivatives. The unit has been formalized as the OCC's Treasury and Market Risk Division.

In 1995, I formed the National Credit Committee because of growing concerns about erosion in credit underwriting standards. The committee continues to help the OCC identify and respond to changes in credit risk that could affect the safety and soundness of the national banking system. In each of the past three years, the committee surveyed loan standards at the 40 largest national banks, identified areas that needed improvement, and communicated its findings to bank management.

I recently discussed with members of our National Credit Committee the group's assessment of credit underwriting standards at the largest national banks. There is every indication these standards have slipped further. Our examiners tell me that, over the past year, underwriting standards have continued to loosen in most lending categories. The trend is particularly pronounced in commercial lending, but there has also been some loosening in segments of the retail market. Accordingly, in a speech to the American Bankers Association last Sunday, I announced a series of steps involving the banks, our examiners, and the FFIEC that are designed to help banks identify and address any weaknesses in their loan portfolios, so they can safely weather the inevitable vicissitudes of the national economy. If we take measured steps now, we can avoid serious problems later. The National Credit Committee's recent findings and the initiatives we are taking to address these findings are a good example of how our new organizational structures are working together with supervision by risk to enhance our safety and soundness efforts.

Another organizational innovation is the National Risk Committee, formed in 1996 to identify and analyze potential significant risks to the banking system and make recommendations to senior management as to appropriate supervisory responses. Composed of an interdisciplinary group of deputy comptrollers, the committee views potential risks from a range of perspectives. Recommendations from the National Risk Committee have led to various OCC actions, such as the recent credit scoring bulletin and advisory letter on the allowance for loan and lease losses. This committee will continue to help the OCC prioritize its supervisory resources and alert national banks to new potential risks as they are identified.

In our Economics Department we created the Risk Analysis Division, which is devoted to the delivery of expertise in quantitative modeling of financial risks. Economists from that division have provided top-quality assistance to our examiners in evaluating large banks' use of quantitative models to measure, monitor, and control market risk, interest-rate risk, and credit risk. The economists, who work on-site as part of the examination team, offer assessments of whether the risk models are logically and empirically well-founded and whether they are applied appropriately by the bank.

Early this year, we established a Bank Technology Unit to focus on the impact of changing technology on national bank activities. This group is responsible for determining how the use of technology by national banks can be best supervised and for providing training and support to OCC examiners who specialize in banks' use of technology, to ensure national banks are managing this risk appropriately. They have been particularly focused on the year-2000 issue.

Restructuring supervision policy and operations. To make certain that the OCC could respond to continuing changes in the banking industry quickly, we began a fundamental restructuring of our supervision policy and operations units in January of this year. This restructuring, which is nearing completion, has involved the entire supervision work force. We believe these changes will create a more flexible and efficient organizational structure that will allow the OCC to provide higher quality supervision to an industry that has and will continue to change dramatically. At the same time, we believe these changes will provide more career opportunities than would otherwise have been the case for our employees.

On the policy side, we have created risk specialty units for asset management, core policy, credit risk, capital markets, and community and consumer policy. These units are charged with ensuring that we keep abreast of emerging risks and that we have appropriate supervisory policies and examination expertise in these key areas.

On the operations side, we have restructured our supervision units to better reflect the differing risks and supervisory challenges posed by large and community banks. Today, for example, we have examiner specialists for different types of risk, including bank information systems, CRA/compliance, fiduciary activities, fraud, capital markets, and credit. As part of this restructuring, we have reassessed our staffing requirements. Our banks are now supervised by far more experienced examiners than in 1985, possessing an average of 13.9 years of experience today versus 8.1 years in 1985.

Our restructuring also reflects the changes that have taken place in the banking industry's organizational structure. When I took office in April 1993, there were 3,593 national banks. Today there are 2,656 national banks. Major cities, such as Los Angeles, Denver, Dallas, and Houston, are no longer the headquarters of major banks. With fewer banks to supervise, we need fewer employees, and with fewer major banking centers, it has been necessary for many employees to relocate. In 1993, we had 3,873 employees, while today we have 2,820. The number of OCC offices has declined from 89 in 1993 to 84 today, and the distribution of employees among these offices has changed significantly. Our staff levels allowed us to perform 2,318 full-scope safety and soundness examinations on 2,726 national banks in 1996, a coverage ratio of nearly 85 percent. This compares with a coverage ratio of only about 40 percent in 1985.

We realize that we will have to adjust our staffing in the future given the changing industry structure. To facilitate this adjustment, in addition to OCC's traditional hiring programs, the agency has also established a mechanism that would allow us to tap an experienced "reserve pool" of examiners so that we can quickly and easily do contract hires to respond to crises or other sudden increases in workload. This approach is preferable to, and far more cost-effective than, maintaining too large a staff in good times so that we are not caught short-handed in down-times, or continually trying to catch up with the current economic and banking environment through permanent hiring. This procedure also eliminates the need for a prolonged hiring and training period for new examiners.

Fair Lending Compliance

As I noted earlier, over the past four years, the OCC has also undertaken a number of measures to enhance access to financial services for all Americans, including improvement of our enforcement of fair lending laws. We issued new fair lending examination procedures in 1993, and the OCC has conducted over 3,000 examinations using these new procedures. We recently further revised our fair lending examination procedures to cover all credit products and stages of the lending process. These revised procedures make greater use of statistical analysis and mandate the use of modeling when activity is sufficient to produce reliable results. These procedures also include information about examining banks that use credit scoring and self-evaluation techniques, and how the OCC will evaluate disparate impact. Along with new examination procedures, we have used mystery shoppers to test for the presence of discriminatory lending behavior, and we have encouraged banks to self-test to ensure the integrity of their processes and procedures. As I mentioned earlier, since April 1993, the OCC has held numerous informal discussions and formally referred 24 cases to Justice and HUD identifying national banks that we believed were in violation of fair lending laws.

Economists from the Economics and Evaluation Division participate in fair lending examinations, employing statistical models to supplement judgmental evaluations in checking for the presence of discriminatory behavior. The use of statistical analysis, including models, helps the OCC focus and thus increase the efficiency of its examination effort by pre-screening banks to find possible discriminatory behavior and by guiding us in completing our actual examinations in a highly productive, objective manner.

Along with the Secretary of HUD and the Attorney General, in 1993, I initiated an Interagency Task Force on Fair Lending to deter lending discrimination.[7] This Task Force undertook a comprehensive review of fair lending enforcement and issued a joint policy statement on lending discrimination. In addition, starting this past January, a separate interagency group of economists and statisticians has commenced meeting to exchange ideas regarding the approaches and statistical techniques they employ in fair lending exams.[8] Most important, these task forces have provided the agencies that are responsible for fair lending enforcement with a means to exchange information and enhanced their ability to work together toward a common goal. Currently, the OCC and other FFIEC-member agencies are working to develop interagency fair lending examination procedures that will ensure a consistent interagency approach to fair lending supervision.

During this time period, we have seen a corresponding increase in lending to minorities. Conventional mortgage loans by all mortgage lenders to all minorities increased 46 percent from 1993 to 1996, twice the increase in overall mortgage lending.[9] While recent data show impressive gains in lending to minorities, I am troubled that loans to African-Americans rose more slowly in 1996. Accordingly, I have directed my staff to begin an immediate in-depth effort to get to the bottom of the weaknesses in last year's numbers. I also asked all the relevant agencies and departments to join us in this effort, and have requested that a report be delivered this month so that we can immediately take whatever corrective action may be necessary.

Community Reinvestment Act (CRA)

Congress reaffirmed the important responsibility that banks have to serve their local communities when it passed the CRA in 1977. However, as I noted earlier, the regulations to implement CRA that were in place when I became Comptroller were not as effective as they could have been, primarily because they focused on a bank's compliance process rather than its actual lending performance. To revise the CRA regulations so they would focus on performance and therefore be more effective and accepted, we held seven public hearings with the other bank and thrift regulatory agencies in 1993 across the country, and we put our proposed solution out twice for public comment. We issued revised regulations in 1995, and all national banks are subject to the revised regulations as of July 1997, when the OCC unveiled its revised CRA examination procedures for large banks. I remain committed to our efforts to ensure consistent application of the CRA regulations across the bank and thrift regulatory agencies.

Our efforts are being rewarded by the creation of effective partnerships between banks and community development groups—partnerships that are, today, growing in strength and helping to rebuild communities. The in-

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[7] In addition to the OCC, this group includes the FRB, the FDIC, the OTS, the NCUA, the Office of Federal Housing Enterprise Oversight, the Federal Housing Finance Board, the Departments of Justice, Treasury, and HUD, and the Federal Trade Commission.

[8] This interagency group includes representatives of the OCC, the FRB, the FDIC, the OTS, and the Federal Trade Commission.

[9] Home Mortgage Disclosure Act (HMDA) data.

creased attention given to this area has had concrete results: home mortgage loans in low- to moderate-income census tracts increased 30 percent from 1993 to 1996, compared with an increase of 23 percent across all census tracts.[10] Also, as I mentioned earlier, in the past three years, banks' CRA loan commitments have totaled $175 billion, representing over 80 percent of all reinvestment commitments since enactment of the CRA.

Planning for Future Supervisory Needs

You expressed an interest in Question 10 about the measures we are taking to train our examiners to evaluate new activities and emerging products. I discussed this briefly earlier in this statement, but I would like to elaborate here. Because of continuous changes in bank activities, the demands placed on our employees to develop expertise in new and rapidly evolving financial products and services is greater than ever before. The importance of training and selective hiring to address these dynamic changes cannot be overstated. There are a number of initiatives being undertaken by the OCC to ensure that our staff has the skills necessary to supervise the banking industry of the 21st century.

Training

The OCC's comprehensive Continuing Education Program consists of numerous formal training programs in a wide variety of technical, administrative, and managerial areas. A number of our staff also take courses offered through the FFIEC. Through these programs, examiners are kept up-to-date on the state of the industry and prepared for higher-level responsibilities. For example, in recent years, we have developed significant training programs in a number of technical product areas, such as capital markets and derivatives, and are currently training bank information systems examiners on topics such as Internet security. We will continue to build upon the OCC's extensive experience with training examiners in new and familiar areas. At times we will work independently, and at other times we will work with other bank regulatory agencies, using recognized experts with well-documented experience to lead the training.

We are also in the process of developing an enhanced approach to training, creating a continuous learning environment. This summer, we created a new, higher-level position in the organization, a Deputy Comptroller for Continuing Education, in recognition of the critical importance of the training function, to lead our efforts to prepare our staff for emerging supervisory challenges. Already, we are offering new courses for the coming year in such areas as cyberbanking and syndicated loans.

While today we offer a large number of training classes throughout the year, the training program of the future will not be based solely on classroom experience. We are exploring alternative methods of training delivery, such as interactive software and video conferencing technology. Such alternatives will facilitate the OCC's ability to address individual training needs, as well as decrease scheduling conflicts and lower travel costs. We have streamlined the process in order to get our staff access to expert training more quickly and easily. In addition, as the banking industry continues to change and we continue to draw on the full range of expertise of OCC employees, including economists and lawyers, we will develop a training environment that suits a wider variety of OCC specialists.

Skills and Resources

To formalize the OCC's commitment to maintain the quality of our supervision, we have made one of our primary objectives for 1997 the continued enhancement of the OCC's workforce knowledge, skills, abilities, and resources. To meet our objective, we are determining what types of skills and knowledge are necessary to meet our supervisory needs at present and in the future and taking action to ensure that we have access to the necessary skills and knowledge, either through developing training opportunities or hiring individuals with specific expertise. For example, earlier this year we contracted with a security expert to assist us with electronic money issues and supervising remote banking activities. This assessment will be an ongoing process.

Another of our primary objectives for 1997 and 1998 is to install new technology to support the workforce so that OCC employees have timely and reliable access to the OCC's information technology systems and automated data sources. The OCC recognizes the importance of using technology to improve the efficiency and quality of bank supervision. Appropriate use of technology can produce several important benefits. Technology can help improve intra-agency communications, enable us to use more sophisticated analytical methods where appropriate, and focus our resources on the most significant risk areas once examiners enter a bank. The result can be less burden on banks and improvement in the quality of our examinations.

Already we have switched from using only a mainframe environment into connecting all employees with a local area network (LAN). This change enables improved agency-wide communications, because documents can be more readily shared. Our plan also calls for agency-wide distribution of examination support systems such as the Integrated Bank Information System (IBIS) and the Industry Sector Information Service (ISIS). The IBIS system uses technology to give examiners and analysts on-line access to data, analytical tools, and models of the

[10] Source: HMDA data.

banks and their competitive and economic environment. The ISIS system delivers information on industries and individual companies for the primary purpose of supporting credit quality analysis. These systems are designed to improve our examiner's abilities to analyze data. Full implementation of these new systems will help make the examination process more efficient and effective.

Summary and Conclusions

Supervision is the principal means the OCC employs to ensure that national banks remain safe, sound, and competitive and that the industry continues to support the citizens, communities, and economy of the United States. As the industry has changed, the OCC's supervisory philosophy and practices have adapted. Throughout our history, the OCC has updated and modified its supervisory techniques and acquired new expertise. Our experience has taught us repeatedly that on-site, hands-on examination of a bank is critical. It has also taught us that supervision must be forward-looking, and that many traditional banking activities, like lending, can be as risky as non-traditional ones.

When I became Comptroller four and one-half years ago, I set as a priority the strengthening of supervision at the OCC. In doing this, I wanted us to understand fully the lessons of the past and to use what we have learned to improve our supervision. With the help of the OCC's many dedicated professionals, we have made a number of important changes to our supervision that enhance safety and soundness and increase the effectiveness of our supervision by better focusing our resources on those activities and products presenting the greatest risks. The OCC's current, risk-based supervision program integrates what we have learned from the lessons of the past with the fundamental elements of on-site, hands-on examination of banks. At the same time, we are dedicating additional resources to the training of our examiners and planning to ensure that we have the necessary expertise on-hand to supervise the national banking system of the future. We believe the changes we have made improve the safety and soundness of the national banking system as it evolves.

My goal for the remainder of my term is to assure that the national banking system remains healthy, stable, and able to serve the diverse needs of American consumers and communities. To do so, we must ensure that the national banking system is prepared to enter the new century. At the same time, I am committed to making certain that our supervision and our policies can meet new challenges that the future will bring.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the American Enterprise Institute, on the supervision of global financial entities, Washington, D.C., October 9, 1997

I am delighted to join this distinguished panel as we launch another phase of the public debate over ways to keep our financial system strong. It is not surprising that our panel should convene under the auspices of the American Enterprise Institute, which, under the leadership of Chris DeMuth, has sponsored some of the most significant work I know of on the most urgent policy questions of our day.

When financial regulators get together these days, umbrella supervision is one of the things that they are likely to talk about. One cannot avoid being struck by the apparent disconnect between a fragmented financial regulatory structure and the increasing consolidation of the financial services industry we regulate. The financial system is increasingly dominated by very large, highly diversified, global firms that do not stop at traditional sectoral boundaries, but engage in every type of financial business, from commercial lending to investment banking to insurance underwriting. These firms manage their risks globally, rather than looking at risks in individual entities within the company. Yet these companies are typically supervised by multiple functional regulators, each responsible for only a piece of the firm.

It is this juxtaposition of geographically diverse companies offering multiple new products being supervised by an array of functional regulators that leads many to call for some level of coordination or group oversight. In response to these calls, some have articulated the idea of "umbrella supervision."

The metaphor of the umbrella has obvious appeal. It evokes safety and security. But we need to move beyond imagery to specifics. What exactly do we mean by umbrella supervision? What role do we envisage for the umbrella supervisor? What entities would it oversee? And how would umbrella supervision differ from other proposals that have been put forward for improving the supervision of diversified financial firms?

I will organize my remarks by examining three basic approaches to the supervision of global financial entities—approaches that entail widely divergent costs and benefits. Each of these arguably could be what is meant by umbrella supervision. The first two of these approaches could be viewed as a species of umbrella supervision though some may see it otherwise. To my mind, however, they satisfy to a considerable degree what is most appealing about the umbrella concept.

The first approach is "supervision from a group-wide perspective." Its premise is that regulators cannot adequately supervise global, diversified financial firms unless they see all of the firm's risk exposures across all its legal entities, and unless they are in a position to assess the risk management systems of the firm as a whole.

If the current system of bank supervision did not already embody this group-wide perspective, I would certainly agree that the system needed to be changed. But group-wide supervision is, of course, one of the foundations of bank supervision in the United States, as it is in all of the G–10 countries. This goes back at least to 1979, when the Basle Committee on Banking Supervision adopted the following principle:

> It should be a basic principle of banking supervision that the authorities responsible for carrying it out cannot be fully satisfied about the soundness of individual banks unless they are in a position to examine the totality of each bank's business worldwide. . . . All parent supervisory authorities should, within the context of their own systems and present circumstances, be required to give effect to the agreed principle that the capital adequacy and the risk exposure of all their banks be examined and assessed on the basis of the totality of their international activities.

In practice, consolidated supervision of U.S. banks is typically carried out at the level of the dominant bank within the firm. There is an obvious reason for this: the dominant bank typically accounts for the vast majority of the firm's total assets. In the case of large national banking companies, non-bank assets represent only 10 percent of the consolidated total assets. Consequently, the primary bank supervisor—whoever that may be—possesses the most extensive knowledge of the bulk of the firm's activities.

But the primary supervisor does not limit its risk analysis to the bank, but instead often looks beyond the bank to the activities of non-bank subsidiaries and affiliates. It also assesses all the risks borne by the bank, including those risks that originate in non-bank subsidiaries and affiliates; and it assesses the adequacy of the firm's overall risk management systems, even when those systems extend beyond legal entity lines. I agree that we may need more of this kind of group-wide perspective to deal with increasingly complex conglomerates. But providing this broad perspective is well within the bank supervisor's reach, where the bank itself is the focal point for the company's risk management systems. Therefore, the bank supervisor can obtain necessary information from the bank and its affiliates, and also can verify transactions flowing between the bank and its affiliates. For some companies, this assessment will be complemented by information obtained from other functional supervisors.

The upshot is this: the primary supervisor seems well situated to undertake whatever may be needed in the way of supervision from a group-wide perspective. One must question what would be added by creating another layer of regulation in the form of an additional type of umbrella supervisor. For, if the primary bank supervisor is doing its job, it is already taking into account the risks that non-bank affiliates may pose to the bank.

The second "umbrella" approach to improving the supervision of diversified financial firms is the one that, until recently, had received the most international attention. It focuses on information sharing, using as its vehicle what the Joint Forum on Financial Conglomerates (of which I am a member) referred to as a "convenor." The role of the convenor would be to facilitate communication and information sharing among the various functional and national supervisors of a diversified financial firm. The convenor would gather information from functional regulators about the entities that they supervise and disseminate that information to the other functional regulators. It would also have the authority to convene meetings among functional supervisors to deal with emergencies as well as routine situations.

This approach has the considerable virtue of allowing existing functional regulators—each expert in its own area of supervision—to continue to do their jobs with a minimum of interference or disruption. Depending upon how much information the functional supervisors are asked to provide, it would involve a minimum of additional burden. And it could well help functional regulators assess risk, by providing them with additional information and a point of contact for use when troubles arise.

I am certainly in favor of developing better mechanisms for information-sharing between supervisors. But we need to be clear on the limitations of this approach, and be aware of the pitfalls that we need to avoid.

First, periodically gathering, collating, and distributing information, particularly for a multinational firm with numerous legal entities supervised by numerous supervisors in different countries, is likely to impose a great deal more cost than might initially be apparent. I remember my own surprise at learning what it would cost respondents if we added just a few additional items to the "call report," the federal government's uniform report for banks. Different entities gather information in different ways, often to match their own risk management, public disclosure, and accounting needs. Asking these entities for information often involves requiring them to undertake new information collections themselves, and this undertaking can be quite costly. Even organizing existing information in a new way can involve costs that are hardly trivial. We should be particularly cautious about imposing these costs when the benefits of collecting and disclosing the information are not clear.

And we have to wonder just how much value a convenor would add, particularly since information exchanges between supervisors can and do take place already on a bilateral basis. Indeed, it is not clear that we would make it easier for supervisors of the different parts of a banking group to share information and to communicate with each other by requiring that all these communications pass through a third party. These arrangements tend to reduce information sharing to a routine: a fixed set of information that supervisors exchange at set intervals. Routinized information sharing could well be both more costly and less useful than improving bilateral communication channels so that a supervisor facing a particular problem can more easily ask his counterpart for the precise piece of information that he needs.

The value of a convenor is even more questionable if we are talking only about public information, which supervisors ought to be able to obtain without the help of a convenor. If, on the other hand, we are talking about confidential information that will be gathered and disseminated to numerous regulators worldwide, this raises a confidentiality issue of no small proportions. A leak occasioned by a wide distribution of such information may actually increase risk, particularly in times of stress.

Let me be clear: I believe that we do need to improve information sharing among supervisors. But we must be careful to avoid setting up unwieldy formal arrangements that cost more to operate than they can deliver in benefits, or that serve to impede rather than to facilitate supervisory cooperation. My conclusion is that we might do better to concentrate our efforts on improving coordination, rather than on designating coordinators. To my mind, the first steps we take should be to strengthen bilateral communication channels, probably starting with information-sharing arrangements in emergencies, where the need is greatest and the ongoing cost is least.

In seeking the benefits of coordination, it is important that we proceed with some care. There is genuine risk that precipitous action to achieve the worthwhile goal of improved coordination would actually decrease safety and soundness. For regulators, as for doctors, the first rule should be: "First, do no harm."

So far, I have talked about two "umbrella" or top-down approaches to improving supervision of large, diversified financial firms: first, relying on the primary supervisor to employ a group-wide perspective in its supervision, and second, mechanisms for information sharing.

A third approach, which some equate with umbrella supervision, is the creation of an overseer—an authority distinct from and above the functional supervisors, including the primary supervisor. This "full-scale" umbrella supervisor would have full responsibility for the entire firm.

Unlike the first two approaches, which, if properly implemented, could improve the supervision of global financial firms, full-scale umbrella supervision of banking firms seems to me to have more costs than benefits.

My greatest objection to this formulation of umbrella supervision is that it adds an additional layer of regulation to what is already a heavily supervised sector. And what exactly does this additional layer contribute to the effectiveness of bank supervision? Not a group-wide perspective: as I mentioned earlier, the primary supervisors are ideally situated to practice supervision from a group-wide perspective. There seems little to gain from transferring responsibility for consolidated supervision to an umbrella supervisor who is farther removed from the bulk of the banking firm's activities.

Nor will an additional layer of supervision necessarily improve information sharing. And the benefits of information sharing can be gained by improving cooperation between functional supervisors, without creating an additional layer of regulation. It is unclear what else a full-scale umbrella supervisor might add to the supervision of global financial firms.

Moreover, beyond the fact that the benefits are questionable, it is likely that such umbrella supervision will carry a high price. Redundant layers of regulation increase both the direct budgetary cost of regulation and the burden that regulation imposes on the regulated entities. Multiple layers also tend to slow supervisory decision-making and—what is worse—to blur accountability for supervisory decisions. Functional supervisors may be tempted to wait for word from their umbrella supervisor before acting—or not act at all—since the umbrella supervisor is likely to share the ultimate responsibility for any problems. Full-scale umbrella supervision would also tend to be seen as extending the federal safety net to non-banks—for example, deposit insurance guarantees, access to the discount window, daylight Fedwire overdrafts, and even the concept of too-big-to-fail—with all of the accompanying moral hazard problems. As a strong believer in the free market and free market solutions, I have to wonder whether creating a new regulator—a full-scale umbrella supervisor—is the best way to improve coordination. Would the benefits of this kind of umbrella supervision outweigh its costs and risks, including the potential for a perceived extension of the federal safety net to an entire financial conglomerate? There is a growing consensus that we should be moving in the opposite direction: limiting the scope of the safety net and relying to a greater degree on transparency, disclosure, and market discipline to help ensure the strength of the financial system.

I have just outlined three types of oversight for financial conglomerates. One or all of these arguably could be called umbrella supervision. All three approaches involve both benefits and burdens. It is critically important that we study the issue carefully to ensure that the trade-off makes sense.

In this regard, let me suggest three important principles that should guide our efforts to enhance coordination in the supervision of financial conglomerates:

- First, as I mentioned earlier, we should build on the expertise of functional supervisors through bilateral information-sharing arrangements; the primary emphasis should be on coordination, not coordinators.
- Second, we should strive to maximize efficiency and to minimize duplication and burden. Duplication and burden impose severe costs not just on the financial system as a whole, but on individual consumers in terms of pricing and availability of products and services.
- Third, we should recognize that, whatever model of coordination we choose, some additional burden will result. If we decide that this burden is justified, we should make sure that we apply it as equitably as possible to all similarly situated entities so that we do not distort the playing field in a way that may itself create safety and soundness concerns.

I would like to thank AEI and Chris—and my colleagues on our panel—for helping us move the discussion forward.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Neighborhood Housing Services of New York City, on community development and affordable housing issues, New York, New York, October 21, 1997

Thank you, Bill, for that introduction. I am proud to accept this award on behalf of the 3,000 men and women of the Office of the Comptroller of the Currency. They are as fine a collection of public servants as one can hope to assemble. It has been an honor to represent them as Comptroller over the past four and a half years.

As a personal matter, this is an especially moving and meaningful moment for me because I know full well what this award and this organization stand for. Indeed, I feel as though I should be giving you an award, rather than receiving one. To me, the New York Neighborhood Housing Services (NHS) is a organization of heroes—of people dedicated in and out of season to the principles of public–private partnership that I believe are so crucial in moving us toward the kind of America we all wish to see—an America of abundance, of compassion, and of real equal opportunity for all.

The accomplishments of the New York NHS and its myriad of corporate partners are both legion and legend. In the last year alone, the New York NHS secured and helped to originate tens of millions of dollars of first-time mortgage loans, down payment and closing cost-assistance loans, home rehabilitation loans, and other affordable housing loans. You enabled homeowners to obtain property insurance when they could not do so by other means. You counseled thousands of New Yorkers about the responsibilities of home ownership and the intricacies of the home buying process, helping them to acquire the financial skills to obtain their homes and the mechanical skills to maintain them. Dreams do not materialize simply because we want them to come true. Exceptional accomplishment can only come from true commitment, hard work, and leadership. The New York NHS has been blessed with an abundance of all three, in people who give freely of themselves for the sake of a better America and a better New York.

The New York NHS has made a difference, and Fran Justa is a big part of the reason why. Fran has given of herself through long hours of labor to make NHS New York work. She is that rare combination of talents that every organization needs but few are fortunate enough to have. Fran is at home in a conference of academics, just as she is on the streets of the South Bronx. She is equally comfortable in a corporate boardroom as in a community room of first-time homeowners. Fran, I salute you.

I can bear personal witness to her accomplishments and all of yours. As a native son of this great city, I know what its neighborhoods once looked like, and what so many of them are becoming once again through your efforts. I have seen the communities once decaying, now flowering with renovated homes and thriving small businesses. I have walked with you on the streets of Bedford–Stuyvesant and the Bronx, and seen the buildings, once boarded up and abandoned, now restored to solid habitability. I have joined you in the classrooms where bankers teach would-be homeowners how to manage the mortgage application process and tutor first-time homeowners on how to manage their budgets. I have seen the look of pride in the eyes of those hard-working New Yorkers, once relegated to the ranks of renters, now owners of their own homes, with the opportunity to build equity and become full stakeholders in the American dream.

I am proud to report that your success reflects similar successes around the whole country. As chairman of the Neighborhood Reinvestment Corporation, I have traveled the length and breadth of our land, watching the commitment of people like yourselves transforming lives and communities—one neighborhood, one block, and one building at a time. Today, the NRC provides financial and technical assistance to over 175 local NeighborWorks organizations dedicated to expanding home ownership and affordable housing opportunities in 500 communities nationwide. Over the last five years, the NeighborWorks network has helped more than 70,000 families purchase or improve their homes. And, this leadership is replicated many times over in the growing partnerships between lenders and community-based organizations in cities and towns all across America.

We in the financial regulatory community have played a small but, I think, significant role in the renewal of America's neighborhoods and the expansion of credit and home ownership opportunities. Recent results in this area stem, in part, from a reform in which I take great pride. One of my first acts as Comptroller of the Currency was to commit to change the Community Reinvestment Act regulations to emphasize results—loans, investments, and services—instead of paperwork. The final phase of the new regulations only became fully effective on July 1 of this year. I think you will all agree that the new results-oriented CRA represents a significant improvement over the process-burdened approach that had produced more frustration and disappointment than benefits since the enactment of CRA in October 1977. Now, exactly 20 years later, we finally have in the revised CRA the effective tool for community investment envisioned by Senator William Proxmire and his many colleagues who worked so hard for its passage.

Already the gains under the revised CRA have been substantial. In less than four years, we have witnessed new commitments for low- and moderate-income loans totaling more than $175 billion—more than 80 percent of the total loan commitments under CRA since the law was enacted. In the past four years, national banks have invested four times as much in community development investments or "public welfare" investments as they did in the whole previous 30 years. During 1996 alone, national banks and their community partners invested almost $1.5 billion in community development corporations and community development projects—funds used to produce affordable housing, finance small business, and develop retail and commercial revitalization projects.

Home Mortgage Disclosure Act (HMDA) data from 1993 to 1996 show increases in mortgage originations for Hispanic Americans and blacks of 56 percent and 55 percent respectively, more than three times the 14 percent increase for white borrowers. Similarly, the rate of increase for low-income borrowers was more than one and a half times the rate of increase for middle- and upper-income borrowers. And, from 1993 to 1996, home loans in low- and moderate-income geographies increased 33 percent, while gaining only 21 percent in upper-income geographies. Our anti-redlining efforts have clearly begun to pay off.

During my tenure, we have also stepped up our enforcement of the fair lending laws, sending an unambiguous message that discrimination will be dealt with quickly and effectively. Less than two months after I took office, the OCC adopted new procedures for examining banks for fair lending compliance and—essentially for the first time—started referring cases to the Justice Department. Over the past four years, we have conducted more than 3,000 fair lending examinations, and referred 25 cases of violations of fair lending law to the Justice Department and the Department of Housing and Urban Development for prosecution. And we have continued to refine our supervision—including adopting updated fair lending procedures just last month—and to work with the other federal banking regulators in an effort to develop uniform approaches to fighting credit discrimination.

Certainly we have much to be proud of. I believe that many bankers are doing an excellent job of expanding credit availability to previously underserved populations and in assuring that all credit applicants are treated fairly and equitably. But for all the good news, there is still a long way to go, as suggested by the recent HMDA data for 1996. Some of that data was troubling. Although the growth in home mortgage loan originations continued to rise for all groups, originations to black borrowers increased more slowly than in the previous year. The data also showed that denial rates for black applicants, as for all applicant groups, had increased compared to 1995 data.

Someone once said that statistics is the science which uses easy words for hard ideas. Certainly, behind the numbers is always a story, and often a complicated one. In order to really make sense of our HMDA numbers, we are trying to unravel that story. So, in my capacity as chairman of the Federal Financial Institutions Examination Council, the coordinating body of federal bank regulatory agencies, I asked an interagency team of economists to conduct a thorough analysis of that data and to report back to me. I recently received some of their preliminary findings, and I would like to share them with you this evening.

- First, the economists report that the 1.5 percent decline in conventional mortgage loans to black borrowers reported in the HMDA numbers was more than offset by a 9.3 percent increase in the number of VA and FHA home purchase loans to blacks—an increase which can be attributed in part to recent changes in the FHA program which made FHA loans more attractive to borrowers. These changes included a reduction in the up-front premium, an increase in the maximum loan amount, a reduction in the FHA contract rate, and increased flexibility in a number of the qualifying ratios. Thus, total home purchase loans to blacks increased in 1996, although the increase was substantially smaller than in 1994 and 1995, and smaller than the 1996 increase in mortgage loans to whites and Hispanics.
- Second, the FFIEC economists noted a dramatic increase—34.2 percent—in the number of conventional loans for which the borrower's race was not reported—a trend that reflects the increased number of mortgage loan applications taken over the phone or on-line, situations in which race is not commonly disclosed during the application process. Certainly, lenders have encouraged such automated application procedures, which serve to cut processing time, reduce costs, and increase consumer convenience. But some have suggested that black borrowers concerned about discrimination may be more apt to avail themselves of such procedures to ensure that information on race is not available to the lender. We just don't know. What we do know is that the number of loans to blacks may have been under reported to a significant degree

because some portion of this 34 percent of borrowers is almost certainly black.

- Third, the team of economists found that variations in regional housing markets appear to explain some of the racial discrepancies in mortgage lending patterns. For the most part, states in which blacks constitute the largest share of the population overall also happened to be states experiencing relatively slow economic growth in 1996. Conversely, those states experiencing more rapid growth, largely in the southwest and mountain regions, happened to be states in which blacks constituted a smaller share of the overall population. Still, within many of those states with higher concentrations of blacks, conventional loans to whites nevertheless grew faster than conventional loans to blacks—which suggests that regional variations are unlikely to fully explain the drop in conventional loans to blacks in 1996.

The interagency team of economists also identified factors that help in understanding relative denial rates, which, as already noted, continued to be more than twice as high for blacks as for whites in 1996.

- They tell us that when the reported denial rates are adjusted for the income of the applicants, racial discrepancies diminish significantly. In this context, higher denial rates for blacks may say less about the behavior of lenders than about the pervasive problem of economic inequality in our country. Financial institutions can and must contribute to our efforts to solve that problem. But they cannot be expected to provide the solution singlehandedly.

- Another factor in racial disparities in denial rates, the economists suggest, is the growth in subprime mortgage lending. Here the evidence is both stark and startling. Subprime home lending has been growing by leaps and bounds in recent years—by anywhere from 34 to 70 percent a year. Denial rates in the subprime market are about three times higher than in the non-subprime. Indeed, subprime application denials constitute more than 57 percent of all HMDA-reportable denials of black applicants and just under 51 percent of white applicant denials—a relatively minor difference. The problem, the economists tell us, is that blacks are almost twice as likely as whites to seek a mortgage from a subprime lender. This badly skews the overall HMDA denial rate in favor of white applicants.

- Finally, the economists' analysis noted the increase in multiple applications from borrowers seeking the lowest possible interest rate or attempting to increase the likelihood of securing a loan. Their analysis suggested that low-income applicants were over-represented in the pool of loan-seekers filing multiple applications—not surprising, given the greater likelihood that their applications would be denied.

That is a summary of the preliminary conclusions of the interagency team. What do we make of these findings? And, more to the point, what are we proposing to do about them?

First, it is clear that multiple factors contributed to the slowdown in loan growth to black applicants in 1996 and the persistent disparities in denial rates among applicants of different race and ethnicity. Among those contributing factors were general economic conditions, regional population patterns, changes in government lending programs, borrower income characteristics, increases in the number of applications for which race is not reported, the growth of subprime mortgage lending, and the increase in multiple applications by a single applicant.

Our analysis shows that focusing on any one category of lending—like conventional mortgage loan originations—or a particular pattern of denial rates or a single year will likely provide an incomplete picture of lending patterns. The challenges of real equal opportunity and fairness in lending are complicated ones. A broad perspective is essential if we are to understand those problems and pursue workable solutions.

However, even when we take all these factors into account, the economists' preliminary analysis fails to provide conclusive evidence—one way or the other—that discriminatory factors underlie trends in recent HMDA data. My personal belief is that some discrimination in the mortgage lending process of some lenders probably continues to exist. How much of that may be the result of disparate impact as opposed to disparate treatment I do not know. What I do know is that the responsibility for enforcement is no less today than it was the first day I came to the OCC.

Moreover, our findings about the HMDA numbers do not tell us the extent to which worthy borrowers are not getting the loans they need to fulfill their dreams. That is, discrimination aside, can we reach more borrowers while maintaining the safety and soundness of the banking system? I am personally convinced that we can—that sound demand continues to exceed supply.

To deal with these discrepancies and to further the goal of improving access to credit, we will follow a three-part program.

First, let me make this point clear: the OCC's policy has been and always will be one of zero tolerance for illegal discrimination. In our new fair lending examination procedures issued to our examiners last month, we provided additional guidance in setting the scope of the fair lending exams, in using advanced statistical methods to conduct certain exams, and in assessing a bank's self-testing efforts. One facet of our revised procedures deals with the use of credit scores in the mortgage origination process: examiners are now directed to evaluate a lender's override practices, to ensure that they are applied consistently and in a non-discriminatory way.

Second, we are continuing to advance the CRA modernization effort, refining our examination procedures to assure that examiners identify true exemplary performance and innovation, reduce regulatory burden where possible, while crediting and encouraging real, concrete results that make a difference in the lives of our people and communities.

Third and perhaps most important, we are putting increased emphasis on building partnerships with community organizations, local governments, and other public constituencies. To give you just one example of the forms these partnerships take, the OCC recently launched an initiative called Banking on Minority Business. This cross-country dialogue brings together community leaders, minority small business entrepreneurs, and bankers to discuss how to break down barriers to small business lending and build mutually profitable relationships that will bring economic opportunities to our neglected neighborhoods. We look forward to crafting more such partnerships over the coming months.

Of course, if there is one place where it is superfluous to talk about the importance of partnerships, it is at the New York NHS. For you have made partnering a veritable art form—a national model for others to emulate. Other community development organizations around the country look to you for inspiration and for ideas on how to harness the resources of diverse sectors of our economy. They look to you for the practical solutions you have pioneered to accomplish so much. You and I both know that there is much, much more to do. Working together, one day at a time, we will reach the goals we all share.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Neighborhood National Bank opening ceremonies, on the first nationally chartered *de novo* community development bank, San Diego, California, October 27, 1997

Not long ago, in the early 1990s, California was mired in a recession, the state's worst since the Great Depression. Southern California, including San Diego, was especially hard hit. Thousands of jobs were lost as manufacturing and construction firms went out of business or migrated out of state. Population growth was stagnant. Real estate values plummeted; foreclosures skyrocketed. In fact, in 1992, half of all San Diego–based financial institutions lost money. Before long, all three of the major thrift institutions once headquartered here were gone. In the wave of banking consolidations that took place, thousands of jobs disappeared. Capital left town. Competition for corporate contributions intensified, and the city's voluntary sector felt the effects. Local borrowers, consumers, and businesses accustomed to dealing with local lenders had to adjust to new financial partners and relationships.

In the midst of all this, Robert McGill was quietly pursuing his vision of better days to come. It is a special breed of person who can keep the dream alive when little seems right with the world. But Bob is that kind of person. For him and those whom he recruited to join him in the effort, the vision was simple, yet profound: to start a community development bank—a bank that would provide basic banking services to the hardworking, underserved citizens of southeast San Diego; a bank that would funnel funds into affordable housing and small business; a bank that would serve as an economic pillar of its community. Others had done similar things before in other places. But this vision was a vision for San Diego.

For all of the experience, talent, and positive energy that the bank's organizers brought to the vision, the going was not easy. They ran into many skeptics along the way, people who told them that such a venture could never succeed. Raising the necessary start-up capital was a herculean task. There were innumerable disappointments, frustrations, and setbacks along the way. Bob, I'm sure there were days when you and your associates thought the obstacles might prove insurmountable and all the effort would be in vain. But you never gave up. And now, three years after it all began, the day so long awaited has arrived.

But you could not have done it by yourselves. There will always be a place for the rugged individualist in our society. But in this day and age, the big jobs, the really meaningful jobs, require that people work together to achieve common goals. You have. You've had the indispensable support of local government, neighborhood leaders, and the business community. You gained important assistance, both technical and financial, from out-of-town banks, and one in particular. At a critical point in the organizational process, when Neighborhood National looked as though it might remain but a glimmer in its organizers' eyes, Wells Fargo stepped up to the plate. Its sale on concessionary terms of the former Wells branch here at 35th and National not only enabled Neighborhood National to clear a major hurdle in obtaining its national bank charter. It also enabled Neighborhood National to hit the ground running, with an established base of deposits and thousands of customers. Since then, Wells's dedicated staff has worked diligently with Neighborhood National personnel to ensure that the new owners were ready to give both existing and new customers the kind of service they deserve. Wells's support of this enterprise underscores its commitment to the betterment of the people you serve, particularly in San Diego.

But Wells is by no means alone in having made a meaningful contribution to the launching of Neighborhood National. The list of banks, insurance companies, securities firms, local businesses, and nonprofit organizations with equity investments in Neighborhood National includes many of California's most outstanding corporate citizens and civic leaders. Let me also recognize the contribution of the Department of the Treasury, whose community development financial institution (CDFI) equity award at a critical time helped push Neighborhood National over the top. This day would not have been possible without all of you.

For the OCC, too, today is a red letter day. Neighborhood National is the first *de novo* community development bank we have ever chartered. It may serve as a prototype for community development national banks in the future. But the granting of Neighborhood National's charter back in February 1995 was itself the culmination of months of consultations between the bank's organizers and OCC staff, who provided them with technical assistance in advance of their formal corporate application. In connection with their application, we developed new procedures to enable other national banks, for the first time, to make qualifying equity investments directly in the new institution. These investments were crucial to Neighborhood National in meeting its capital targets. I am very proud of the OCC's contribution to the cause of community development banking generally and Neighborhood National particularly.

And I feel a deep sense of personal satisfaction in what we have come to celebrate today. Just a year ago, in October 1996, Mayor Golding and I jointly sponsored a public forum that brought bankers, public officials, and members of the local business and development community together to discuss the opportunities and challenges facing San Diego. Two dozen bankers joined us in our discussion, and even after the forum adjourned, the dialogue continued. It helped to focus attention on the banking needs of San Diego and what could be done to help. I would like to think that this focus gave Neighborhood National a boost it sorely needed at a critical time in its organization.

Each of the parties I've named—bankers, regulators, government officials, businesspeople, and private citizens—has played an important role in Neighborhood National's creation. Neighborhood National is a tribute to the power of partnerships between government, the private economy, and community organizations—partnerships to achieve common goals through cooperation. The same kinds of partnerships will be indispensable as Neighborhood National sets out to fulfill its commitment to making southeast San Diego a better and more prosperous place for its citizens.

So while this is emphatically a time for rejoicing, we must never lose sight of the realities that will face Neighborhood National when the bunting comes down and the dignitaries go home. Whatever it took in the way of determination and resourcefulness to turn Neighborhood National into a going concern, the real work has only just begun. That work will not be easy. The challenges facing this bank and many U.S. banks are great—not only in terms of meeting the pressing needs of their communities, but also in doing so in a way that maintains the bank's safety and soundness and assures it a prosperous future. Change—the same forces that altered the face of San Diego banking in the early and mid 1990s—is everywhere. The banking business is more competitive than ever before. The residential mortgage market is an increasingly difficult place for responsible lenders. Technology is transforming the nature of financial services. Your customers are older, more sophisticated, and have more options than ever before.

Yet, I am convinced that Neighborhood National, while today modest in size, will be one of the success stories of the next decade and beyond. I believe in its management, I believe in its organization and business plan, and, most of all, I believe in its mission: to promote lending to small businesses and homeowners. Bob, anyone with the persistence and good judgment that you showed in getting this bank off the ground against all odds has what it takes to make it work. I look forward to returning to San Diego to celebrate your accomplishments in the years to come. Let's roll up our sleeves and get on with the job.

Testimony of Eugene A. Ludwig, Comptroller of the Currency, before the U.S. House Committee on Banking and Financial Services, on the impact of the year-2000 problem on the banking industry and the U.S. government, Washington, D.C., November 4, 1997

Statement required by 12 USC 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, thank you for conducting this important hearing and focusing public attention on the impact the year-2000 problem may have on the banking industry and the U.S. government. Achieving awareness in business, government, and the public is the critical first step towards obtaining year-2000 compliance. Given the complexity of the task, we must move aggressively. The attention the Congress is devoting to the year-2000 challenge is timely and underscores the importance of the issue.

The year-2000 problem poses a difficult and wide-ranging challenge to the banking industry and the American economy. All users of communications, computer, or office automation technology face year-2000 risks and must prepare for the century date change. They must maintain the integrity of their internal systems and address external risks associated with connecting to other systems. The banking industry's readiness is especially important, because banks are at the center of our payments system and credit flows in the economy. Any operational and systems malfunctions caused by the century date change could have an impact on a bank's ability to meet its obligations. Of equal concern are malfunctions that bank customers may experience that could prevent them from meeting their obligations to the bank. These problems, if not addressed, could have repercussions throughout the nation's economy. Adding to the challenge is the difficulty in finding sufficient programmers who are familiar with old mainframe languages.

Larger banks, which hold the majority of the industry's assets, frequently have computer applications that were developed in-house. These banks must examine their systems carefully to determine the changes necessary to make them year-2000 compliant and effect those changes. Many smaller banks rely heavily on vendors for data-processing and software services as a more cost-effective way to manage their operations. Banks that depend on vendors to achieve year-2000 compliance must carefully manage their relationships with such vendors and service providers, making sure that these vendors commit the necessary time and resources to make their products year-2000 compliant.

Given the complex web of technologies financial institutions use, as well as the many other institutions with which they exchange information electronically, no one can guarantee that no problems will occur when the clock strikes midnight on December 31, 1999. Malfunctions may occur. But the Federal Financial Institutions Examination Council (FFIEC), which I currently chair, and the federal bank and thrift regulatory agencies individually are taking vigorous steps to protect against the possibility of serious harm to the nation's financial system.

Since last year, the regulatory agencies have undertaken a number of initiatives in preparation for the year 2000. Our supervisory strategy is aggressive and comprehensive. It involves alerting financial institutions to the nature of the problem; assessing the risk at each institution by conducting careful examinations; requiring institutions to address the problem and monitoring their progress; preparing for the unexpected by ensuring that institutions have back-up strategies in place; and developing joint contingency plans among the supervisory agencies. The success of those actions will have an important impact on the public welfare. By making these actions a top priority for depository institutions and their supervisors, we hope to minimize disruptions to bank operations and to bank customers.

As requested in your letter of invitation, my statement today will address the year-2000 problem and its implications for the safety and soundness of the nation's financial system. As part of this discussion, you asked that I discuss the associated insurance, legal, and security issues. Then, I will highlight the FFIEC's initiatives and the Office of the Comptroller of the Currency's (OCC) implementation of those actions. I will specifically address your questions regarding the importance given to year-2000 preparedness when assigning CAMELS ratings [based on capital adequacy, asset quality, management, earnings performance, liquidity, and sensitivity to market risk], the contingency planning that is necessary to prepare for problems that may arise despite the best preparation on the part of financial institutions (with a particular focus on liquidity), and the preparedness of the international banking community.

To begin, I will discuss the year-2000 problem in more detail.

The Year-2000 Problem

Information technology is an integral part of almost everything we do. Accordingly, the year-2000 problem has enormous reach, affecting almost every business, large and small. Communications systems, transportation services, and computers—mainframes, networks, and personal computers alike—are all at risk. Modern conveniences and facilities, such as elevators, escalators, vaults, and alarm systems also may be affected. Computer programs for accounting, security, and bill payment need to be tested. All of these systems and processors will require some attention to ensure that they will continue to operate at the turn of the millennium. And the greater the reliance on technology, the greater the size and complexity of the task ahead for any institution, private or public.

The year-2000 problem arises because many information technology systems currently in use will not recognize or process information with dates beyond December 31, 1999.[1] The problem results from efforts to store data efficiently in the early years of computer development, when computer memory was at a premium. In those years, computer programmers made the decision, almost universally followed, to store the year as a two-digit number (e.g., 75) instead of a four-digit number (e.g., 1975). Therefore, when the next century arrives, computers may interpret the date "00" as "1900" and thus produce inaccurate calculations when performing comparisons of dates, arithmetic operations, or sorting by date. Indeed, unless corrected by January 1, 2000, information systems worldwide may not only produce erroneous information, but in many cases may fail altogether.

Newer computer systems may be year-2000 compliant; however, many older systems and applications must be modified.[2] For larger institutions, this can mean reviewing millions of lines of code to identify those that need modification and making the necessary corrections. There are several ways to manage this recoding. Some options are permanent but costly. Others are less costly but temporary. One permanent solution is to recode all programs to read and write to a four-digit date format, but this process is also time-consuming and expensive. Another solution is to rewrite code so that low-value two-digit dates (e.g., 00, 01, 02 . . .) are recognized as being years of the 21st century. This method would not be a permanent solution, but it would buy time to put in place a permanent solution.

Addressing the year-2000 problem involves more than just selecting a solution or monitoring and testing a vendor's solution. Businesses need to think about a variety of issues, including, importantly: the cost and timing required to replace computer systems or software, as opposed to repairing or upgrading them; the cost and availability of skilled personnel; the impact any considered merger or acquisition may have on meeting compliance deadlines; the compliance efforts of remote or overseas operations; the obligations to customers who rely on services and payments; and the date and calculation changes needed to account for the fact that the year 2000 is a leap year.

Impact on the Banking Industry

Banking is one of the most information-intensive businesses in the American economy. As such, it has historically been exceedingly reliant on information processing technology and was, in fact, an early adopter of many of the systems and applications that now need to be fixed. Today, nearly every aspect of the banking industry is dependent on computer systems for processing transactions and providing information. Banks exchange data daily with their customers, correspondents, vendors, other financial institutions, clearing houses, and corporate borrowers. Thus, financial institution applications must be not only revised or replaced to become year-2000 compliant, but, as noted above, they must also be tested for interoperability with the numerous internal and external systems—foreign and domestic—with which banks interact. Many experts tell us that the testing process will be the most difficult and time-consuming challenge, because the fix adopted for one system may not be compatible with the fix adopted for another.

Solving the year-2000 problem will take significant resources and demand the attention of bank management. Banks will spend considerable sums of money to prepare, particularly larger banks, which generally do intensive in-house development of applications and databases. Smaller banks will face substantial demands on their resources because vendors' conversion efforts are often expensive and difficult to verify prior to installation.

[1] Computer systems may begin to experience problems well in advance of the year 2000, when making calculations or triggering dating mechanisms that look at or beyond the year 2000. For instance, an application that schedules events 12 months in the future, may begin to experience problems on January 1, 1999, a full year in advance of 2000.

[2] Not all hardware or software systems manufactured in the last few years are necessarily year-2000 compliant as many new products still rely on older technology. Banks should check with their vendors or software publishers to determine if their applications and hardware are year-2000 compliant. Key software and hardware that interact with mission critical applications should be included in the overall year-2000 testing program.

In your invitation letter, you asked us to discuss specific legal, insurance, and security issues related to the year-2000 problem. Many of these issues are complex and multi-faceted. We believe that, as banks move forward in addressing the year-2000 problem, more of these issues are likely to emerge.

Legal and insurance issues. There are two categories of legal and insurance issues arising from potential year-2000 problems: first, who should pay for correcting a bank's year-2000 problems; and second, if the year-2000 problems are not corrected, who should bear the liability resulting from the failure of any bank's systems?

As was previously noted, the cost of correcting a year-2000 problem can be great. A bank's legal right to correction or replacement by a supplier of computer services, software, or equipment that is not year-2000 compliant is largely controlled by the contract between the bank and the vendor. However, the terms of these contracts vary considerably and banks will need to review them to determine general warranties or express provisions that might apply to year-2000 compliance.

If any undetected or uncorrected year-2000 problems cause a bank's systems to fail, the bank could breach many legal obligations arising from its fiduciary and contractual relationships with customers. For example, the bank might no longer be able to comply with its contractual obligation to depositors to keep accurate records on account balances or to make timely payments in accordance with the instructions of demand account customers. The bank's systems might also improperly refuse debit, credit, or ATM cards. Indeed, this has already happened. Late last year, one bank discovered that credit cards it had issued with expiration dates beyond 1999 were not being honored by point of sale terminals because its credit card processing software was not year-2000 compliant.[3] As these examples illustrate, a bank's extensive contractual relations with retail and wholesale customers and the intrusive nature of the year-2000 problem could result in failure to perform on many obligations, giving rise to extensive liabilities.

Banks facing liability for year-2000 problems may have means to shift or reduce that liability. Banks need to review vendor and servicer contracts to evaluate their rights in this regard. However, banks should not assume that this route is a cure to their problems. For example, many equipment and software purchase and license contracts limit the liability of the provider to the cost of the equipment or software.

Banks and bank vendors also may have insurance policies that cover their liability caused by a year-2000 problem. Whether and the extent to which a particular bank is covered depends, of course, upon the contractual language in the relevant insurance policy. Again, banks will need to review their insurance policies to determine if coverage might extend to the costs or liabilities arising from year-2000 problems. For example, some believe that business interruption polices will not cover losses caused by year-2000 system failures, because year-2000 problems are not "fortuitous" events covered by those policies.[4]

Further, a bank selecting a firm to correct its year-2000 problems will have to consider whether the firm's insurance policy would cover liability for the bank's failure to perform. Similarly, the bank might well wish to seek contractual assurance that the selected firm will indemnify the bank for any losses arising from year-2000 problems it contracted to fix.

Some insurance companies are apparently offering policies specifically covering year-2000 risks, including unforeseen business disruptions. Generally, these policies have limitations of between $100 million and $200 million, and the companies offering such policies have indicated that they will be selective as to which firms they insure.[5] For example, some require that applicants document their year-2000 plans and require that an accounting firm review those plans before the application is accepted. The coverage is also expensive. It is reported that, in many cases, the insured party is expected to pay from 50 percent to 85 percent of the risk limit during the period of coverage. In some cases, however, 90 percent of the premium will be returned if the insured institution experiences no year-2000 problems.[6] Bank management will have to evaluate their specific situation to decide whether the purchase of such insurance is justified. In any event, the purchase of insurance is not a substitute for reasonable and prompt measures to ensure that the bank and its counterparties are year-2000 compliant.

Security. The year-2000 problem also highlights a security issue of growing concern to supervisors. Banks increasingly will rely on consultants and vendors to solve their myriad information technology problems, including the need to bring their systems into compliance for the

[3] Jeremy Quittner, "As Year 2000 Looms, Issuers Play Beat the Clock," *The American Banker,* August 5, 1997.

[4] Jeff Jinnett, "The Millennium Strikes Back," *Los Angeles Lawyer,* June 1997; and David Schaffer, "Insurance and Y2K," February 1997.

[5] Thomas Hoffman, "CIOs wary of year 2000 insurance," *Computerworld,* February 3, 1997; Jinnett, *supra.*

[6] Hoffman, *supra;* Charles Holt, "Glitch Guard," *Kansas City Business Journal,* September 29, 1997.

year 2000. It is important that banks assure themselves that they know their service providers and are confident that those parties will not compromise banks' information security. This means: a) monitoring third parties to prevent security breaches, and b) requiring vendor contracts to have a confidentiality provision. Just as bank supervisors have told bankers to "know their customer," banks must also "know their vendor."

I would now like to discuss the initiatives the Federal Financial Institutions examination Council (FFIEC) is undertaking to address these issues.

FFIEC Initiatives

The issues outlined above will have a profound impact on the banking industry if institutions do not effect timely remedial action. As the current chairman of the FFIEC, I am committed—as are the other financial institution regulatory agencies—to pursuing a forceful agenda to ensure that insured depository institutions address year-2000 issues in an aggressive manner. One part of this agenda is a series of initiatives designed to inform financial institutions of systemic issues and outline regulatory expectations as we oversee their year-2000 project efforts.

The FFIEC first alerted the financial services industry to our concern over the year-2000 problem in a June 1996 statement. In that statement, the FFIEC member agencies strongly encouraged depository institutions to complete an inventory of core computer functions and have reprogramming efforts complete by December 31, 1998. In May of this year, the FFIEC issued a second statement, which included interagency guidance for depository institutions and examiners on year-2000 project management.

The May guidance emphasized two important points that are essential to addressing the year-2000 problem. First, depository institutions need to address external sources of potential risk attributable to the year 2000, in addition to their internal sources of such risk. Second, depository institutions must implement a comprehensive project management process to address these risks, because correcting systems and software for the year 2000 involves a broad sweep of an institution's operations. I will elaborate on both of these points.

External Risks

In-house fixes to internal computer systems will not solve an institution's year-2000 problems. Most depository institutions rely on third-party vendors for some data processing needs. Moreover, their systems interact daily with other computer systems, and each of these electronic relationships poses a potential risk to the depository institution.

Reliance on vendors. Depository institutions' reliance on vendors for performing critical operational processes, such as deposit posting or check sorting, requires that the institutions closely monitor their vendors' conversion programs and determine if contract terms can be revised to include year-2000 covenants. Depository institutions must have contingency plans identifying alternative service and software providers in the event that vendors cannot correct their systems or software adequately or quickly.

The FFIEC will hold a vendor conference on November 10. It will provide a forum for vendors, depository institutions, and their supervisors to express their concerns and clarify regulatory expectations. We will be shortly issuing FFIEC guidance for depository institutions on the vendor management due diligence process. This guidance will emphasize the key components of any vendor management process: the financial institution should know whether its vendor has the financial capacity to make necessary changes; the financial institution should establish appropriate contingency plans, with trigger dates, to allow plenty of time to change course and use different service providers; the financial institution should identify its contractual rights and responsibilities, as well as those of its vendors; the financial institution should establish an ongoing system of communication with service and software providers; and the financial institution should develop a plan detailing how and when it and its vendors will test the interoperability of system or software changes.

Clearly, the reliability of vendor-provided products and services will be critical to the success of many financial institutions' efforts to address the year-2000 problem. Because a vendor's customers could include banks, thrifts, and credit unions, the regulatory agencies will conduct joint examinations of nonbank data-processing centers before June 30, 1998, using supervisory authority provided by the Bank Service Company Act. The FFIEC intends to accelerate the examinations of the largest data processing centers and companies that publish depository institution software so that this important information may be gathered as soon as possible. We are also implementing for all major vendors a quarterly monitoring program, which will track vendor progress in executing their project plan.

Data exchange. The multiple linkages banks have with other counterparties—other financial institutions, governments, borrowers, and depositors—require that financial institutions allow sufficient time to assess the effects of their year-2000 solutions on data transfers and exchanges. It is not enough for insured depository institutions just to make their systems year-2000 compliant. Should their counterparties fail to address the year-2000 problem, or adopt a method which produces data that are unrecognizable by the financial institution, electronic fund transfers might fail or financial institution systems might be contaminated with corrupt data.

To manage these challenges, financial institutions will have to institute a comprehensive process which tests the linkage with each counterparty. The number of linkages that need to be tested can grow geometrically because of the interrelationships among payment systems at the local, national, and international levels. Consequently, much of our focus as regulators in 1998 and beyond must be directed at ensuring that financial institutions' year-2000 project management plans include comprehensive testing programs. The Federal Reserve Board will play a very significant role in coordinating the year-2000 testing process, because of their payments system responsibilities. The FFIEC intends to provide further guidance outlining regulatory expectations for testing in early 1998.

Relationship with counterparties. Insured depository institutions must ascertain how well their counterparties, who also rely on computer systems, are addressing the year-2000 problem. Counterparties that do not address these problems may experience operational or financial problems that may make it difficult for them to conduct business. If loan customers or bond issuers cannot repay their debt as agreed, the financial institution faces increased credit risks. If derivative counterparties cannot settle maturing transactions, the financial institution potentially faces not only increased transactional risk, but also increased credit risk, depending on the net position of the contract. If fund providers cannot deposit or maintain funding agreements, the financial institution faces potentially increased liquidity risk. The FFIEC's May Interagency Statement outlined the due diligence process that banks should undertake in assessing the year 2000's potential impact on their credit exposure. We are developing guidance that extends the due diligence process to all the key counterparties of a financial institution.

Year-2000 Project Management Process

The second major focus of the May FFIEC guidance was to outline a comprehensive and effective year-2000 project management process. This management process begins with a written statement that focuses on the specific issues arising at each insured depository institution. But that is not enough. All financial institutions, regardless of size or complexity, will require strong leadership, effective internal and external communication processes, and clear lines of accountability to ensure that year-2000 initiatives will be successful. The FFIEC guidance enumerates the five phases or stages necessary to properly manage a computer conversion program: awareness, assessment, renovation, validation, and implementation.

Awareness phase. During this phase, management needs to become educated about the year-2000 problem at its institution and establish executive level support for the resources necessary to correct it.

Assessment stage. This stage of the process includes identifying all hardware, software, networks (including those dealing with security systems, elevators, and vaults), automated teller machines, other various processing platforms, and customer and vendor interdependencies affected by the year-2000 date change in order to assess the size and complexity of the problem. During this period, project managers must identify resource needs and establish the schedule and the sequencing of steps in the year-2000 project. Resources needed include appropriately skilled personnel, contractors, vendor support, budget allocations, and hardware capacity. As well, the financial institutions must also develop contingency plans. Most financial institutions should have completed these stages by now.

Renovation phase. This phase includes code enhancements, hardware and software upgrades, system replacements, vendor and other associated changes. Institutions relying on outside servicers or third-party software providers must hold ongoing discussions with the vendors and monitor their progress. Backup data processors should also be lined up as part of contingency planning. This phase needs to be completed, with testing fully under way for mission critical applications, by December 31, 1998.

Validation stage. Testing is critical to a year-2000 project and plays a major role in the final stages of the project management plan. Only through a comprehensive testing program can year-2000 compliance be verified. This stage includes verifying connections with other systems and verifying the acceptance of all changes by internal and external users. Management should establish controls to assure the effective and timely completion of all hardware and software testing prior to final implementation. As with the renovation phase, financial institutions must be involved in ongoing discussions with their vendors on the success of their validation efforts.

Implementation phase. During this phase, management must verify that systems are year-2000 compliant and acceptable to business users. For any system that is unacceptable, financial institutions must clearly assess the business effect of that system and implement the organization's year-2000 contingency plans.

Upcoming Activities

As they observe the work depository institutions have under way to fix their systems and programs, regulators have identified several problems shared by many of these institutions. The FFIEC member agencies are working on joint guidance that addresses and suggests some practical solutions to these common problems.

Guidance. The FFIEC has four planned issuances of guidance that will address:

1) enterprise risk;
2) counterparty issues;
3) vendor management; and
4) testing.

The issuance on year-2000 business enterprise risk will provide guidance to bank boards of directors on ensuring that senior management is addressing the effects of the year-2000 problem on their business. The counterparty guidance will set forth the minimum due diligence process we expect financial institutions to follow in assessing how the year 2000 affects their large clients. The vendor management guidance, which I discussed earlier, will outline the due diligence process that financial institutions who rely on vendors should follow in analyzing their vendors' ability to address the year-2000 problem. The testing guidance (also mentioned earlier) will review testing issues and clarify what all financial institutions, large and small, should do to ensure their systems are year-2000 compliant. The FFIEC will issue further year-2000 guidance throughout 1998 and probably into 1999, as other issues and concerns are identified.

Outreach and contingency planning. It is important for the FFIEC member agencies to have ongoing discussions of year-2000 issues with financial institution managers and industry trade associations. By working together, we can best ensure that the industry is well-positioned to solve the problems posed by the year 2000. To that end, the FFIEC member agencies have formed a working group comprised of supervisory, legal, and receivership experts to review a number of questions, including coordinating vendor examinations. In May, the working group met with six of the larger banking trade groups to discuss further steps we could be taking to increase industry awareness. It plans to hold another joint meeting later this year.

With respect to our contingency planning, we are determining what steps regulators must take to handle problems that may arise in critical systems. The Federal Reserve Board is focusing on potential disruptions to the payments system, while the Federal Deposit Insurance Corporation is looking into liquidation and resolution matters. The OCC is working to ensure its examiners are prepared to address year-2000 problem situations quickly and consistently across the national banking system.

The forthcoming FFIEC guidance will make clear that it is important that financial institutions monitor their vendors' progress. In the event that a vendor cannot meet the FFIEC's schedule, the financial institution needs to take steps to secure services elsewhere. The risks associated with noncompliance—credit risk, operational risk, reputational risk, strategic risk—will be borne by the financial institution, not the vendor.

OCC Implementation of Initiatives

Implementation of the FFIEC guidance is the responsibility of the lead supervisors and, like our fellow regulators, we are taking aggressive action to implement the FFIEC initiatives. These are demonstrative of what our sister agencies also are doing.

Assessments. In conjunction with the release of interagency guidance in May, the OCC conducted assessments of every financial institution we supervise in order to gauge the institution's readiness for the task ahead. This general assessment helps us focus our resources on the institutions that require priority attention. We also assessed the degree to which large national banks are considering the year-2000 exposure of their largest borrowers, and the banks' preparation for the new European Monetary Union currency, the Euro, which may compete for resources with year-2000 efforts.

Our finding was that some national banks and some vendors need to speed up their efforts in order to complete their year-2000 preparations in a timely manner. In order to alert institutions to the importance that both regulators and the Congress place on these preparations, and particularly the importance of setting and meeting deadlines, I recently sent a letter to all chief executive officers of national banks and bank vendor companies expressing my concerns about those who are not doing enough.

To follow up on our assessments, OCC examiners contacted the chief executive officers of each of the banks and vendors that we found to be lagging in their planning efforts. Examiners evaluated any actions taken since the first assessment. For banks that had not taken sufficient action, we scheduled an on-site examination within 90 days.

Year-2000 exposure of large corporate borrowers. The value of bank loan portfolios may be affected if borrowers are unable to meet their payment obligations to the banks because of the borrowers' own year-2000 malfunctions. For this reason, the OCC has looked at syndicated loans exceeding $25 million in which the 24 largest national banks participate. Those banks underwrote approximately $425 billion in syndicated loans in

1996, representing 80 percent of the syndicated loans originated by national banks and 36 percent of all outstanding shared national credits.

Our results show that while large national banks are aware of the credit implications of the year 2000, most need to take additional actions to address the issue with current or potential borrowers. Presently, most banks we have assessed are in the process of determining what should be done to address year-2000 credit risks. Most will review year-2000 plans with corporate borrowers, and many plan to include year-2000 analyses in their file documentation or credit review process.

European Monetary Union. The OCC has talked to a number of national banks, federal branches, and data centers active in foreign currency transactions to find out whether the scheduled 1999 introduction of the new Euro currency may place significant competing demands on scarce technical resources. None of the institutions assessed said that their EMU projects conflict with their year-2000 projects. We will continue to monitor this issue.

Bank examinations. The OCC is examining, on-site, every national bank for year-2000 compliance by mid 1998. In notifying the banks about these year-2000 examinations, the OCC emphasized that it would look for comprehensive planning and a clear commitment to meeting year-2000 goals. We informed the banks that we would focus special attention on whether senior management and the board of directors are fully engaged in the planning and monitoring of year-2000 conversion efforts.

We initiated the examination process in June, and we have completed approximately 500 examinations. Based on our initial analysis of those exams, I can tell you that we are finding both evidence of strong commitment, and areas of concern. Overall, national banks are aware of the year-2000 problem, and, where relevant, are working well with their vendors. However, some banks, particularly some community banks, still do not have well-developed management processes for dealing with their vendors.

The banks that came up short in our initial examinations are on notice that they are behind schedule and will be held accountable to demonstrate improvements as soon as the next quarter. The OCC is instituting a quarterly reporting system for year-2000 monitoring of national banks and their vendors. This will enable more timely and efficient supervisory responses to institutions that are having year-2000 difficulties.

Enforcement. Institutions must recognize that making adequate preparations for the year 2000 is more than a regulatory requirement—it is a business imperative. As part of our efforts to help make sure national banks are prepared for the date change, the OCC must consider how it will use its supervisory and enforcement authority if a bank fails to prepare adequately. Our response will, by necessity, depend on many factors. When we find that an institution is slipping behind schedule and is likely to fail to meet one or more of the key benchmark dates, we must identify the reason for that failure and assess the efficacy of enforcement action. We will not be hesitant to take action, but we must all recognize that doing so will not assure year-2000 compliance for institutions that are trying, but still failing, to solve their year-2000 problems. Thus, we are working with our fellow financial institution regulators to identify as early as possible which institutions are in serious trouble and to develop contingency plans to deal with them.

With regard to the service providers and vendors national banks use, we have successfully exercised enforcement authority in the past. In all such cases the service providers agreed to take corrective measures and it was not necessary to initiate formal proceedings. We have no reason to expect resistance from vendors with regard to our year-2000 efforts.

Outreach. I have asked senior OCC management to maintain an active role in communicating year-2000 issues and concerns to the industry. A discussion of the year 2000 is on the agenda for the “Meet the Comptroller” meetings with senior bank officers, which we hold throughout the year. Our district management teams have been very active in discussing this issue with their bankers during outreach meetings, and senior OCC managers will continue to give speeches on this subject in a variety of public and industry forums. As the year 2000 approaches, we will also identify other useful ways to inform the public about these issues, while continuing to maintain public confidence in the banking system.

CAMELS ratings. Your letter of invitation asks whether year-2000 preparedness will be reflected in an institution’s CAMELS rating [based on capital, asset quality, management, earnings, liquidity, and sensitivity to market risk]. Our examiners evaluate a bank’s ability to manage risks, including the risks posed by existing or emerging issues facing the institution or the financial services industry, such as the year-2000 problem. In that regard, bank management’s near-term, year-2000 compliance efforts—that is, how we rate their current year-2000 commitment—will be a significant factor in determining the management component of the institution’s safety and soundness CAMELS rating. Ultimately, an institution’s failure to address the problem of, and prepare for, the year 2000 could lead to undue exposure to transaction, credit, liquidity, and strategic risks. Should it become clear, based on the results of testing, that an institution faces serious problems in making its mission-critical systems year-2000 compliant, we would make appropriate adjustments to the capital and earnings components of the institution's CAMELS rating.

Contingency planning addressing liquidity. As you note in your letter of invitation, problems can arise despite the best preparation. For that reason, we are also making sure, in the course of our examinations, that national banks have adequate contingency plans. Your invitation letter asks, specifically, what planning is necessary to handle the liquidity problems that may arise. The OCC as a matter of course evaluates liquidity risk and contingency funding plans during bank examinations. Based on their risk exposure and size, banks have either formal or informal contingency funding plans incorporated into their management processes.

However, the century date change could result in problems of a greater magnitude and of a somewhat different character than we have experienced in the past. If an institution was unable to access its data processing systems for an extended period of time, it would, eventually, be unable to conduct its business. Or, even if it could conduct its business, it might not be able to access its contingency funding lines, because its information systems could not communicate externally. Early testing, so that problems can be isolated and targeted contingency plans developed, is an essential element in dealing with this problem.

International Preparedness

Your letter of invitation asks about the year-2000 preparedness of the international community. The Federal Reserve Board, the Federal Deposit Insurance Corporation, and the OCC have been closely involved in efforts to focus the international supervisory community on the issue, recognizing this is a problem of global dimensions. In particular, both the Federal Reserve and I asked that this matter be put on the agenda for the Basle Committee on Banking Supervision. I personally participated in that discussion. The Committee has just issued a paper on the year 2000 that outlines the steps that financial institutions need to take to resolve the problem, and identifies the role of bank supervisors in helping to ensure success. The Basle Committee has sent copies of this paper—which covers much of the same ground as the FFIEC's statement—to banking supervisors in more than 150 countries. A task force under the Committee is now surveying the adequacy of year-2000 efforts, both in G–10 and non-G–10 countries.[7]

[7] The G–10, or Group of Ten, includes the following eleven countries: Belgium, Canada, Germany, France, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

Conclusions

In my role as chairman of the FFIEC, I have worked with the other banking agencies to develop an aggressive program to address the year-2000 problem. We have informed the institutions we supervise about supervisory concerns and potential problems. In addition, the OCC and the other supervisory agencies have pressed for an international understanding of the need to provide similar uniformity and coordination among countries.

As Comptroller of the Currency, I have established a forceful program to ensure that national banks are prepared. A critical aspect of this program is testing. Banks must test their systems to make sure they can process dates after the year 2000, and they must make sure these systems are compatible with external systems with which they exchange data.

In conclusion, all the financial institution regulators are working hard to help the financial services industry succeed in meeting the year-2000 challenge. No banking supervisor can guarantee that no problems will occur on January 1, 2000. But we can—and must—do everything in our power to ensure that the institutions under our supervision understand what the situation demands, respond accordingly, and have contingency plans in place in case of malfunctions. As chairman of the FFIEC and the Comptroller of the Currency I am completely committed to that goal.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the 1997 National Community Development Lending Conference, on the democratization of financial services, New Orleans, Louisiana, November 5, 1997

Abraham Lincoln was a great president but sometimes a poor prophet. At Gettysburg, in what is universally viewed as the finest speech ever delivered on American soil, he predicted that "the world will little note nor long remember what we say here." How wrong he was! But Lincoln's characteristic modesty where his own gifts were concerned, I think, reflects a universal tendency to undervalue the importance of our own lives and times—to mistakenly conclude that because so much of what we do is routine and mundane, little of it will matter to future generations. It is all too easy to forget that change need not be violent or abrupt to have significant—or even revolutionary—impact.

Just such a revolution has been quietly unfolding during our time. The effects of major steps forward in what I like to refer to as the democratization of financial services have made the benefits of financial services available to entirely new segments of our society. In 1776, only the very wealthy had access to the few financial institutions available. Even a century later, there were many more banks, but law and custom still limited their ability to serve the needs or ordinary citizens. Indeed, until 1913, national banks were actually prohibited from making mortgage loans for homes and farms. Then, beginning in the 1920s, bankers began to discover business opportunities in the retail market for loans and other bank services. And since the end of World War II, meeting consumers' financial needs has become a robust part of banking business.

But it was only recently—really within the last several years—that this democratization process has come to embrace low- and moderate-income Americans. Today, for millions of our fellow citizens, particularly low- and moderate-income Americans, this democratization process—this improved access to credit and other financial services—has truly brought home the promise of the American dream for the first time. It has enabled renters to become homeowners; it has made it possible for thinkers and doers with the germ of an idea to turn that idea into a small business and build it into something even bigger. It has enabled us to work toward the renewal of our aging communities, so mean streets could be restored to main streets. It has put us on the right path—the path of economic opportunity—to resolving some of the social, racial, and ethnic differences of our past.

The financial history of the twentieth century will soon be written, and when it is, I believe it will show that these last few years have been truly noteworthy ones in advancing access to financial services. One area in which we have seen particular progress is in loans to would-be homeowners. The numbers are impressive. Between 1993 and 1996, home purchase loans to borrowers in low- and moderate-income areas have risen 33 percent, or about one and a half times as fast as home purchase loans in upper income neighborhoods. In the same period, mortgage originations to Hispanic Americans and African-Americans have risen 56 percent and 53 percent, respectively.

Of course, people are more than percentages. They are individuals, with hopes and dreams for themselves and their families. So consider this: if home purchase loans to minority groups had increased no faster than the growth in these loans to all borrowers, roughly 190,000 more conventional home purchase loans to minorities—representing more than $16 billion in loans—would *not* have been made between 1993 and 1996. That means 190,000 more American families—about 800,000 people—would not have known the security and inner satisfaction that comes from home ownership. It means that hundreds of American communities would have been deprived of the greater permanence and stability that homeowners bring to their neighborhoods.

Financial democratization is hardly limited to home mortgage lending. Working together, we have also made important strides in bringing banking services to previously underserved communities and in understanding why some populations either go elsewhere to obtain financial services or do without them. For example, on the Navajo reservation in 1994, there were 3 bank branches. Today there are 12. In 1994, the Navajos had 2 ATMs. Today they have 14. Regulatory initiative helped to highlight the Navajos' unmet financial needs, but it was a business decision—and a good one—on the bankers' part to respond aggressively to that challenge. Today, the Navajo branches are highly profitable—for the bankers as well as for the Navajos, who have benefitted from an array of new mortgage and small business loan programs and easier access to deposit and other banking services. And, importantly, such an example speaks for dozens more in communities across the nation.

Community development banks and loan consortia have been developed across the country, and new products and services are being steadily rolled out: low down-payment mortgage programs; second-look mortgage and commercial loan programs; housing counseling programs; home repair forums for first-time homeowners; small business loans based on cash flow rather than collateral; and microfinance programs for entrepreneurial endeavors. Just last week in San Diego, I attended the opening ceremonies for the first *de novo* community development bank ever chartered by the OCC—an event that would never have taken place had other national banks not stepped up to the plate and made public-welfare equity investments in the new institution. This is but one example of the exciting developments in community lending and investing that are transforming our nation's landscape. There are many others—an equity investment bank for low-income small businesses, retail branches in churches and high schools, and innovative and specialized loan funds and development banks organized by local community organizations.

We're where we are today—a step further along on our journey toward full access to financial services, but still some considerable distance from the finish line—because you and other bankers and community leaders like you—have been willing to invest and become fully committed partners in continuing efforts to reach our goal. We're where we are because community leaders like you and others who have talked with you this week—for example, Mayor Morial—recognized that through partnerships with the financial sector can come economic empowerment for the communities they serve. The language of indifference and confrontation has been replaced by the spirit of cooperation and mutual self-interest.

You are indeed the heroes of this generation's democratization of credit story. And from your efforts, we have learned important lessons. We have learned that the cause of community development and economic revitalization advances best when it advances simultaneously on many fronts. We have learned, for example, that the community development strategy that focuses solely on housing and expanded home ownership may not produce the same positive and sustainable results as the more comprehensive strategy that also targets small business growth and neighborhood employment opportunities. We have also learned that development loans, investments, and strategies that target a specific neighborhood work better than a scattershot approach to lending over a broader community.

We have come to understand the relationship between financial education and financial success. Increasingly, we are finding that the most successful loan programs in the housing and small business markets are those that include a counseling and technical assistance component. The work that goes on behind the scenes in a makeshift classroom, teaching the fundamentals of budgeting or homeowner preparedness, might not be glamorous or dramatic, but it can make the difference between a successful loan and a not-so successful one—between a dream fulfilled and a dream denied.

We have also learned that the Community Reinvestment Act can be made to work. We have learned that by focusing our CRA efforts on results and not paperwork, we can reduce burden and increase access to financial services. Our new CRA regulations are predicated on the belief that one size does not fit all; that different communities have different needs, and that creative people ought to be encouraged and rewarded for developing their own approaches to meeting those needs.

Yes, we have made remarkable progress in community development lending and investments—progress that is all the more noteworthy because it has not come easily. Moreover, this progress is almost universally acknowledged. The question now being debated in many circles is not whether this progress has occurred but rather whether this progress—this democratization of financial services—can advance further in the future. I for one believe strongly that it can advance—*if* we focus our attention on three critical factors.

First, we need to obtain the facts, face up to what they tell us, and—where we can—respond to what they tell us with creativity and innovation. For example, the fact is that a few affordable housing lending programs apparently have higher than normal delinquency rates. Some have said that these higher delinquency rates mean that aggressive lending programs for low- and moderate-income home buyers are not sustainable over any length of time. On the other hand, some have said that we should disregard these delinquencies effect, look the other way.

To me, neither approach is acceptable. The naysayers would deny progress without closely examining the entire picture. And those who would close their eyes to any problems would place at risk the very opportunities for credit we seek to expand. There is a better course. By carefully examining those programs where we do have higher than normal delinquencies, I believe we have an opportunity to learn a number of important lessons, two of which are already apparent.

Lesson number one—even in the most aggressive programs with the highest delinquency rates, more than nine out of 10 borrowers are paying in full on time. They have demonstrated they are good credit risks and, were it not for these programs, these borrowers would have been denied access to credit.

Lesson number two—from borrowers who *have* been delinquent, we have learned there are steps banks can take to lower delinquency rates. Credit counseling programs can have an impact. So can stable and early intervention servicing arrangements. It's also important to work with first-time homebuyers to secure a financial cushion through insurance or some other mechanism so that borrowers have the wherewithal to deal with unanticipated problems, such as a furnace breakdown, a leaky roof, or a fire.

Certainly there are other lessons we can learn from studying the results of affordable lending programs—even those where delinquencies appear to be higher than normal. The key point is to learn from these results—not to use them as a justification for suspending efforts to reach previously underserved populations. They must not be an excuse for throwing the baby out with the bath water.

The second critical factor in sustaining community development lending performance into the future, I believe, is gaining a greater commitment on the part of government at all levels to innovation in community development finance. The fact is our public resources are scarce. We simply cannot afford to miss opportunities to better leverage these resources and target them to support the leading edge of innovation among private sector lenders.

Further, the best efforts of private sector lenders will fall flat if local governments fail to do their best to keep the streets clean, the lights on—and to make certain that communities on the way back are reliably supported by essential public services, including safe and effective schools. Fortunately, we have a new breed of creative and strong leaders in local government who are setting an example in this area. From Mayor Morial here in New Orleans to Mayor White in Cleveland and Mayor Archer in Detroit we have learned new lessons in how to marshal local resources, energize whole cities, and set a clear revitalization course for business, banking, and for-profit and non-profit development communities.

The third important factor that will affect our ability to advance the democratization of financial services in the future involves, on the one hand, finding new ways to expand access to financial services and promoting asset building for low- and moderate-income groups and, on the other hand, doing more in financial education and counseling for those not currently served by the banking system. Both these elements have a direct impact on the ability of low- and moderate-income individuals to become full participants in the financial services system.

Finding opportunities to further asset building and expanding access to financial services will require us to be much more creative in our thinking. I believe much can be done in this area—indeed, it may be the next frontier in the democratization process. It's only common sense that, if we can create profitable branches in Navajo country where there were virtually none in 1990, we can create profitable financial service delivery systems in other low- and moderate-income communities. If these delivery systems are to succeed, they will have to be innovative, just as successful community development lending reflects innovations that are outside the box of traditional lending. For example, these delivery systems will have to be community based and reflect the linguistic and cultural needs of local communities. And they may not look like traditional bank branches or ATMs. Similarly, successful financial education and counseling will require more creative thinking about the economic background and culture of those who meet their financial needs outside the economic mainstream of our society.

You might conclude from what I have said so far that I am pretty optimistic about the future. By and large, you would be right. You might also conclude that the historical process of expanding access to financial services is by now well nigh unstoppable. After all, it was none other than Lincoln who, in 1856, assured an Indiana audience that "revolutions do not go backward." But we have already alluded to Lincoln's limitations as a prophet, and, here again, I must respectfully register my dissent. History shows that revolutions can and do slide backward if those who have a stake in defending them fail to rise to that challenge. The truth is we will not be able to continue the democratization of financial services into the future if we lack the necessary will and commitment . . . if we are unwilling to take the risks of innovation . . . if we focus on problems as an excuse rather than learning from our experiences and using that knowledge as a basis for continued efforts.

There is also the distinct possibility that some provisions in financial modernization legislation now pending in Congress could diminish the value of the bank charter and reduce the ability of bankers to continue to advance the democratization process and serve a broader array of customers and communities. That is a possibility that I would find troubling even if I were not the Comptroller of the Currency. For banks perform a special function in our society. Banks are subject to standards that often do not apply to other providers of financial services. Banks are comprehensively and frequently examined to ensure that they are a safe place to store money. Banks are subject to certain specific types of obligations, such as consumer protection requirements and CRA.

If banks are to continue to shoulder these responsibilities, they and their subsidiaries must be allowed to engage in a broader range of financial and financially related activities to the same extent as other financial providers. To do otherwise would be both unfair and imprudent. For if, in the name of "financial modernization," incentives are provided for banks to shift new and expanding activities to holding company affiliates, the bank itself will become a less stable enterprise and less able to meet its obligations to its customers and community. Banks would no longer be able to perform their special economic and social functions. Many would be unable to make the contributions to the cause of community development that we are here to discuss this week.

I strongly believe that good financial modernization legislation is critical if banks are to emerge as robust providers of financial services into the twenty-first century. But genuine financial modernization legislation must advance bank safety and soundness, further access to credit, promote competition, and lead to lower prices and more options for consumers and business. Genuine financial modernization is critical if banks are to continue advancing the development of Americans and their communities.

But net-net, despite all the problems, I *am* optimistic about the future. I am optimistic that, in the end, Congress will do the right thing and give us real financial modernization rather than modernization in name only. I am optimistic that the real progress that we have made to date in advancing the democratization of financial services will continue. And I am optimistic that, through dialogue and partnerships, we will continue to make even more impressive strides in promoting the development and redevelopment of our nation's communities.

In my four and a half years as Comptroller and chairman and vice chairman of the Neighborhood Reinvestment Corporation, I have visited scores of American cities and taken dozens of bus tours through neighborhoods and community development projects. I have talked with home loan applicants at credit counseling sessions in neighborhood churches. I have spent a day wielding a hammer and spreading spackle as part of a volunteer project to rehabilitate low-income housing. And for the past three years, OCC staff members and I have tutored elementary school children at a public school two blocks from our Washington headquarters. As a consequence, as is the case for most of you, I've seen for myself the strength and ability of Americans who have not been able to gain access to mainstream financial services—but still have the desire and zeal to become full participants in the American economy. I have seen for myself how, despite the many difficulties you have had to overcome in creating innovative programs and finding ways to meet the needs of a broader range of customers, you have stepped up to the plate and more than met this challenge. In short, I have seen the possibilities for a better future for America with my own eyes.

We have a choice—a choice of either continuing our efforts to make sure these underserved Americans achieve their piece of the American dream, or using the difficulties inherent in any innovation as an excuse for backing away from our commitment to this segment of our society. Because of their innate abilities and desire to succeed, and because of your continuing energy and commitment, I am confident we can and will continue to make significant progress in the years ahead.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Consumer Federation of America, on open competition in financial services with appropriate consumer protections, Washington, D.C., December 4, 1997

It is a pleasure to be with you once again as the Consumer Federation of America (CFA) begins its fourth decade of distinguished service to consumers and to a growing economy—interests that are truly inseparable. But it was not so long ago that a different view prevailed. Indeed, when CFA began its work back in 1967, the consumer marketplace was widely considered to be a zero sum game in which buyers and sellers could make good only at the other's expense. Consumer protections, especially in financial services, were weak. Concern about customer satisfaction was too often a matter of lip service; "take it or leave it" was the message implicit in many retail transactions back then. There is little doubt that this mentality—at once complacent and confrontational—contributed to the temporary loss of America's competitive edge in many key sectors of the consumer economy during the 1970s and early 1980s.

Today, it is much clearer that consumer satisfaction has a significant impact on our nation's general economic well being. By making informed, rational choices in the marketplace—by demanding fairness, value, and choice—consumers reward the best and most efficient providers of goods and services. In that way, we preserve and enhance our standard of living and competitiveness in the global economy.

For your important contribution to that cause, Steve, you and CFA deserve our thanks. CFA's work in promoting consumer education and meaningful disclosure—CFA's emphasis on fairness, value, and choice for consumers—have helped build a better consumer marketplace and a better American economy. Often you have sounded alarms and proposed practical solutions to the failings of our dynamic consumer marketplace, particularly in the realm of financial services. Today's financial consumer takes for granted so many of CFA's accomplishments over the years: from credit card and savings account disclosure and regulation to check hold and home equity protections—to say nothing of the initiatives that CFA has spearheaded in protecting the consumer in the insurance and real estate markets. I know of few advocacy organizations that have been as effective as CFA.

You knew—and now we all know—that a big part of our economic success as a nation during this century was the result of recognizing and satisfying the needs of consumers. This has certainly been true in banking, especially on the credit side.

One of the great secular trends of the twentieth century is what I often refer to as the democratization of financial services—a retail revolution that has transformed the whole complexion of banking and with it, our whole society. Once limited to making short-term loans to accommodate the needs of commerce, commercial banking today is just as much about households and communities as it is about business. A century ago, national banks were prohibited by law from making mortgage loans; today, banks make more home purchase loans than any other type of depository institution. Early in this century, mainstream bankers denounced the idea of lending for the purchase of an automobile as frivolous if not reckless; today, commercial banks own the biggest share by far of the market for auto loans. And, within just a few short years, we have seen the use of the credit card and other higher technology payment and credit vehicles proceed from futuristic to commonplace. Indeed, given current debt loads and default rates, some have suggested that we may have actually made access to credit *too* easy.

Despite what we have achieved, the democratization of financial services is by no means complete. There remain important areas of concern. One area that I would like to focus on today concerns the availability of quality financial products to underserved communities. For while important strides have been made within the last several years in serving some of the credit needs of low-and moderate-income Americans, the non-credit financial needs of low and moderate income Americans still are too often going unmet.

For example, roughly 12 million American households do not have deposit accounts. Millions of others lack access to effectively regulated credit and payment services. Many of these consumers are frustrated in their efforts to build wealth by the lack of a formal banking relationship. CFA and a number of its member organizations have long advocated greater participation in the financial sector as an essential element in our efforts to promote real economic opportunity and equality all across our country. Now, as our century comes to a close and as CFA enters a new decade of service, we must ask anew, how do we get there? What steps remain to be taken to bring the millions of under-banked households into the financial mainstream?

To my mind, there are three essential preconditions that must exist before any plan to increase banking services to underserved and unserved communities has a chance for success. First, we must create an atmosphere that encourages innovation. Second, we must establish a balanced regulatory framework. And third, we must promote greater competition in the financial services marketplace. Innovation, sensible regulation, and competition, in short, are what I believe to be the keys to increased access to financial services for low- and moderate-income Americans.

Let me turn first to innovation. As one reviews the long process by which credit was democratized in this country, two things stand out. The first is the extent to which traditionally held views that it was not possible to safely or profitably lend to a particular group or area turned out to be dead wrong. The second is that the development of these new credit markets required product innovation. The variable rate mortgage, securitization, the credit card, targeted community development lending, microfinance and support group lending—these were all critical innovations that propelled the development of retail credit markets in this country.

Interestingly, while innovation has long characterized the retail credit market, until recently there has been relatively little innovation in retail service delivery. The advent of the ATM, supermarket branch, and electronic banking products are exceptions. Such innovative delivery approaches are going to have to become the rule of the future.

This relative lack of innovation in the non-credit product area raises two questions. What caused it? And what can be done to encourage greater innovation and product integration that would help all segments of our population but particularly the underserved segment? For answers to these questions, I believe we have to look at the two other essential preconditions for expanding access to financial services—sensible regulation and competition.

To my mind, for much of this century, the banking industry has been locked into a regulatory straightjacket that has limited its ability to innovate. For example, until very recently, for a bank to open something as mundane as a point of sale terminal, enabling customers to make payments at a convenient location, required a branch application. And, because of state and interstate branching restrictions, permission to open this sort of an innovative branch was often denied. The same thing was true for mobile delivery of banking services. A mobile delivery vehicle was also deemed a branch, and, here again, approvals were often denied because of restrictive rules and regulations.

Moreover, rather than being encouraged to provide integrated products and services, banks have until fairly recently been actively discouraged by regulation from providing new products and services or integrating product and service offerings.

It should go without saying that, in criticizing some regulations that restrict innovation and competition, I am by no means criticizing all regulations. Many regulations on the books are absolutely necessary to provide adequate consumer protections, safe and sound operations of financial institutions, and a fair and open marketplace. For example, where banks sell multiple products, it is essential that they be required to make appropriate disclosures so that consumers know that they are purchasing what they set out to purchase.

What I am arguing for, instead, is *balanced* regulation—regulation that minimizes burden, promotes competition, but at the same time protects consumers and the economy.

In recent years, I believe we have proved that regulation does not have to be burdensome to be effective—indeed, that regulation can go hand in hand with expanded business opportunity. A good example of that—one in which I take particular pride—is the revised Community Reinvestment Act—a statute long written off as both onerous and ineffectual. By refocusing its emphasis from process and paperwork to product and concrete results, we have seen dramatic increases in community development lending and investment. In the past four years, banks have invested four times as much in community development projects as they did in the previous 30 years. During 1996 alone, national banks and their community development partners invested almost $1.5 billion in community development corporations and community development projects—funds used to produce affordable housing, finance small business, and develop retail and commercial revitalization projects.

When the Community Reinvestment Act (CRA) became law 20 years ago, few thought of it as anything more than a new imposition on the banking business. Today it has become the opening wedge for building profitable relationships between banks and previously underserved markets. It has provided bankers with information—and incentives—to assess and address these markets. In short, the recent history of CRA has seen a dramatic and promising shift in emphasis away from mere compliance to competitive opportunity for providers and consumers of financial services.

For example, consider how CRA has helped address the banking needs of native Americans. On the Navajo reservation, a land mass the size of the state of West Virginia, there were 3 bank branches in operation in 1994. Today there are 12. In 1994, the Navajos had 2

ATMs. Today they have 14. Regulatory initiative and CRA obligations certainly helped to highlight the Navajos' unmet financial needs. The OCC, for its part, sponsored the formation of partnerships between the tribal government, community organizations, and financial institutions and launched educational programs that helped break down the barriers of culture and miscommunication. But it was a business decision—and a good one—on the bankers' part to respond aggressively to that competitive challenge. Today, the Navajo branches are highly profitable—for the bankers as well as for the Navajos, who have benefitted from an array of new mortgage and small business loan programs, as well as easier access to deposit and other banking services.

The recent history of low- and moderate-income housing finance offers another good example of the new possibilities inherent in competition coupled with enlightened regulation. The "low/mod" market was one bankers had long shunned—again, in large part because they lacked both information about that market and competitive incentives to explore it. The renewed emphasis on CRA over the past five years has led many bankers to reconsider their mortgage lending policies to low- and moderate-income communities. And, lo and behold, they have discovered that most of these loans perform just as well, if not better, than home purchase loans to more traditional borrowers. That experience has drawn new lenders into the market—drawn not by the compulsion of the law but by the magnet of new opportunities for profit.

Reaching out to new markets requires new and innovative ways of doing business. The lessons we are learning from our experiences in expanding access to credit are leading to improvements in the broader service area. The OCC's own research on the needs of the nontraditional bank customer reaffirms what the experience of the marketplace tells us: that first-time homeowners sometimes need more than a mortgage to make their experiences positive ones. They need a whole range of ancillary products and services. We have found, for example, that the default rates in the affordable mortgage market are lowest where lenders work with borrowers both before and after the loan closes, to acquaint them with the intricacies of the lending process, and to develop budgeting and household management skills. We have found that early intervention programs can be effective in preventing a loan in trouble from becoming a loan in default. Of course, none of this will come as a surprise to CFA, whose efforts to promote consumer education—by means such as this conference—have long been a model for others to emulate.

In other words, to become successfully integrated into the economy, we have learned that nontraditional bank customers benefit from an integrated package of financial products and services. There is nothing new in this lesson. Back around the turn of this century, in what was heralded as one of the real financial and social reforms of the day, big employers started to pay workers their wages by check instead of by cash. This obviously made sense for employers, who no longer had to keep large sums of currency on hand. But what really commended the change in policy to its proponents was its expected beneficial effect on the standard of living of the wage earners. Having to cash their paychecks at the bank would presumably make it easier for wage earners to save and to budget, and less likely that their earnings would fall prey to theft or their own impulse spending.

But it didn't work out that way. Few factory workers had bank accounts or felt comfortable setting them up. Instead, local merchants—especially saloon keepers—got into the business of cashing paychecks for paying customers. For all the good intentions with which it was launched, this experiment wound up doing little to promote thrift—or sobriety.

This story holds lessons for us today. Certainly, loans to first-time homeowners and consumers are important. But to help these Americans become full participants in our national prosperity, it is equally important to provide information about and access to the whole interrelated menu of financial services. As we reach out to underserved markets, we need to embrace a balanced, integrated approach that includes financial education, savings and investment products, and low-cost access to the payments system, as well as credit in its various shapes and forms.

Some banks have already made important progress in this area. CFA is especially to be commended for collaborating with financial institutions in programs to provide comprehensive financial education. One of our largest banks recently unveiled a program that offers employees without bank accounts direct deposit of paychecks and a debit card, through which funds can be accessed from ATMs and point-of-sale (POS) locations nationwide. Other banks use stored-value cards for the same purpose. Still other institutions, which serve large foreign-born populations, allow people without accounts to electronically transmit funds abroad for a low flat fee—an especially important service for immigrants wishing to send cash to family members outside the United States. Such services will become increasingly important when the law requiring that government payments be transmitted electronically goes into effect in 1999.

The integrated approach to consumer finance that I am advocating today bears directly on the debate going on here in Washington and in state capitals around the country over financial modernization. From the beginning, the OCC's position has been that genuine financial modernization must advance bank safety and soundness, promote access to credit, enhance competition, and lead to lower prices and more options for consumers. We believe that all of these goals would be served by legislation that would permit banks to engage in a wide range of financial activities and to choose the organizational form that best suits their business plans, consistent with safety and soundness.

Take the question of insurance powers. Just like the turn-of-the-century worker whose paycheck was worthless without a place to cash it, today's aspiring homeowner or small business owner will get nowhere without property insurance. Period. All the budgeting and counseling, the saving and the comparison shopping, and the most accommodating lender in the world will not do the trick if affordable property insurance cannot be obtained.

It simply does not make sense to me that on the one hand we encourage bankers to reach out and make more home purchase loans to low- and moderate-income borrowers or more small business loans, and then, on the other hand, we tell these same lenders that they cannot provide the product required to close the transaction. Nor does it seem reasonable to deny the customer in need of insurance the benefits of competition for his business. Neither the banker's nor the customer's interest require that the customer be obliged to go elsewhere to get the insurance he or she needs.

You and others have expressed legitimate concerns about the cross-selling of loan and insurance products. Certainly there is potential for abuse. No one would dispute that we need effective consumer protections to prevent unfair and deceptive practices. No one would defend a lender who used pressure tactics to coerce customers into buying insurance or any other related product. And many states, in addressing the question of insurance sales by banks and other depository institutions, have adopted reasonable and effective safeguards to prevent such abuses from occurring.

For example, the recently enacted law of the state of Illinois contains a comprehensive package of consumer protections: licensing of bank insurance personnel, full disclosure of the risks associated with insurance, restrictions on the use and sharing of confidential customer information consistent with federal standards, and prohibitions against coercive practices.

But, just as important, the Illinois statute does not put banks at a critical disadvantage in competing with nonbank insurance providers for the customer's business. That adds up to real competition and more choice for consumers. In the end it will mean lower costs for everyone. And that is something we can all support.

The potential exists right now to make very great strides toward improving the financial well-being of all Americans, but particularly underserved and unserved Americans. To achieve that potential, we need to encourage innovation, a balanced and sensible regulatory environment, and an open marketplace that serves everyone through genuine competition. I am confident that we *can* take these steps forward. At the OCC, we are committed to building on our constructive partnership with CFA to make certain these steps *are* taken and taken in a way that ensures a better world for America and all America's children.

Thank you.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Federal Financial Institutions Examination Council Conference on Regulatory Capital, on regulatory capital with a risk-based component, Washington, D.C., December 12, 1997

Good morning. As the current chairman of the Federal Financial Institutions Examination Council, it is my pleasure to welcome you all to our conference on regulatory capital. The subject before us today is one whose importance and complexity are truly worthy of the outstanding representatives of the financial, academic, and government gathered here to discuss it. Let me extend a special welcome to our featured speakers, Governor Phillips and Mr. Medlin.

Almost 10 years ago, the Basle Committee on Banking Supervision adopted the accord on international convergence of capital measurement and capital standards. The Basle accord was immediately—and rightly—hailed as a landmark event. "Never before," one commentator wrote in 1988, "have regulators from so many countries reached agreement on a basic issue affecting the operation of financial institutions." Basle was the breakthrough that formed the basis for rationalizing the international crazy quilt of regulatory capital standards. It helped to assuage a building protectionist backlash against non-U.S. financial service providers, some of whom had been accused of taking advantage of unequal regulation to leapfrog their American competition. With the Basle accord, the rationale for retaliation—which had real potential for disrupting the global flow of financial products and services—lost urgency.

And that was not all. The Basle accord highlighted and ultimately helped reverse the slippage in bank capital levels worldwide. It focused attention on the whole concept of risk, as a tool both for bank managers and bank supervisors. It gave official recognition to the growing importance of off-balance sheet activities in bank operations. Finally, Basle pointed the way to the future—a future full of possibilities for continued cooperation and international harmonization of bank regulation—cooperation which has continue to bear important fruit in such important areas as the regulation of derivatives, year-2000 compliance, money laundering, and more. Unquestionably, the Basle accord has significantly advanced the effectiveness of bank supervision worldwide.

Certainly no one expected that the Basle risk-based capital formula would endure for all time. But few of us imagined that we would have cause to revisit these issues so soon. Since 1988, the financial marketplace has evolved far faster than most of us anticipated—and in new, often uncharted directions. The explosive growth of asset securitization, derivatives and other hedging instruments, and new internal risk management strategies and technologies have transformed the traditional banking business—and introduced new risks of their own. Changes in the statutory and regulatory framework have paved the way for interstate banking, new opportunities for affiliations, additions to the permissible product mix, and corporate consolidation. Globalization has proceeded apace, bringing new competitive pressures and opportunities in its train. We have become a nation of investors instead of savers, with all that implies for bank funding and liquidity. Money itself is in the process of a historic transformation from a tangible commodity to a series of electronic impulses embedded on microchips.

But even if the banking world had stood still over the past decade, the current risk-based framework would nevertheless have required attention. As it is, many outside analysts believe that the time has arrived for major modifications of our current capital framework. They point both to its technical limitations and the practical problems that have flowed from them. Certainly Basle reflected the temporal wisdom of its time, when there was less focus on risk as the fulcrum for safety and soundness supervision and our tools for measuring risk were not as refined as they are today. The original accord of 1988 primarily addressed the issue of credit risk and did not address many other kinds of risk that affect banks' need for capital. And its approach to credit risk presupposed a limited ability to distinguish between different levels of risk.

One important test of any regulatory regime is whether it promotes rational or irrational economic behavior. Does it allocate investment capital fairly and efficiently? Or does it divert resources unproductively and serve primarily to make more work for lawyers and other financial engineers whose job it is to identify and exploit loopholes?

Our implementation of the risk-based capital standard, some critics conclude, is problematic in this regard. For example, the current system, these critics point out, has given rise to a whole cottage industry of consultants and advisers, producing ream upon ream of ponderous interpretations designed to help banks calculate and manage regulatory capital. What's more, the capital accord applies only to banks and their subsidiaries. Other types of financial institutions are not held to the same level of rigor. So while the Basle accord has clearly helped level the playing field between U.S. and foreign banks, the absence of uniform international standards in other sectors of the financial marketplace continues to create competitive inequalities that can make it difficult for banks to compete effectively with nonbanks here at home and abroad.

So where do we go from here? Can we draw on the experiences of the past decade to reform the current risk-based capital framework, altering it to bring it into line with the current realities of the financial marketplace? Or is a more dramatic overhaul needed? As a member of the Basle Committee, I am certainly raising these questions with other members of the international supervisory community.

Some reforms of the risk-based framework are already under way. For example, supervisors in several Basle Committee countries are currently looking at ways to extend the capital accord framework to credit derivatives and other novel financial instruments. There are those who believe that a transaction-based form of capital adequacy could eventually capture risk of credit concentrations and other types of risk such as operational risk and settlement risk.

But there is also a school of thought which says that because the more subjective—but no less critical—risk factors can never be quantified for inclusion in any risk-based capital formula, we should throw in the towel altogether and lay the risk-based approach to rest, honoring it as a regime that accomplished much in its heyday but one that has outlived its usefulness.

Some bankers and regulators might be prepared to do just that, if we were only able to agree on a better substitute. That is where the difficulty arises—and that is why we have our work cut out for us today. Not that we can realistically expect to achieve a consensus on such a complicated subject in the space of a few hours. The options we will be discussing range across a wide gamut, and each one has distinct pluses and minuses. But we can at least expect to learn more about the possibilities from the varied perspectives of the distinguished representatives of the financial, legal, and academic communities here with us today.

As our discussion proceeds, it seems important to me that we make a special effort not to confuse means and ends in two very fundamental respects. First, there is a danger that, in dealing with the technical challenges involved in *measuring* regulatory capital, we lose sight of the *function* of capital itself. For the truth is, that even though the financial world has seen massive changes in recent years, the logic behind regulatory capital is pretty much the same as it has always been: bank owners are most likely to operate prudently when they have their own funds at risk. Capital provides a buffer against losses and thus protects the interests of depositors—and deposit insurance.

Second, it is important that we not lose sight of the fact that while capital is only one, albeit important, indicator of an institution's overall health, it is also only one, albeit important, tool in our overall supervisory arsenal. Most regulators would hesitate to say that capital, even a mountain of capital, will guarantee a bank's stability or future solvency. Indeed, excessive capital can be almost as detrimental as inadequate capital, if it compels bankers to take greater risks to earn the hurdle rate of the return that the markets require. Some have argued that no amount of capital will salvage a bank that is grossly mismanaged. Catastrophic events do occur, and when they do, all bets are off. On the eve of the Great Depression, commercial bank capital was well in excess of regulatory minimums, sometimes by a factor of two or three. But it was all swept away by a flood of unanticipated losses.

That is why some have argued that, as my friend and distinguished predecessor John Heimann once put it, capital adequacy is "situational"—just one factor to consider in the context of the caliber of the bank's management, the level of its earnings, and a host of other factors. At the OCC, we have always tried to look beyond the raw numbers to interpret what those numbers mean for a particular institution, with its own peculiar risk characteristics. As a matter of policy, capital measurements should be determined objectively, consistently, and uniformly, but the interpretation of those measures is necessarily subjective and should be an adaptable component of overall supervision.

Notwithstanding that fact, I for one firmly believe that we need solid, substantial, and tangible capital—regulatory capital with healthy, uniformly applicable minimum standards.

Historically, bank supervision has always involved compromises and tradeoffs and trying to strike the optimum balance of intervention and detachment. Over time, the pendulum has swung between those two poles. It was not that long ago that examiners conducted what amounted to intensive audits of loans and passbook accounts, and counted all the cash in the vault. But the marginal benefits of this exhaustive approach led to its abandonment in favor of a framework in which examiners made only rare and fleeting appearances inside the banks they were responsible for. Because that approach also proved unsatisfactory, for obvious reasons, the search resumed for the right middle ground. We may not yet have found the perfect system, but our risk-based approach to supervision takes us a giant step closer to supervisory prudence.

The history of regulatory capital has included similar give and take. Over the course of the last century, until the implementation of the Basle accord in the late 1980s, bank capital levels fell almost steadily. More than a hundred years ago, the first Comptroller of the Currency *discouraged* bankers from increasing capital because he worried that increased capital would lead to too-rapid asset expansion—a story which illustrates yet another way in which regulatory capital has been used to promote supervisory goals. But this view of capital as a public policy liability changed, as concern shifted to the safety of deposits in the pre-insurance era, when confidence in the banking system often hung by a thread. In 1914, the OCC adopted its first minimum capital ratios—a flat 10 percent of deposits. Banks typically posted the most current levels of capital and surplus in gold-leaf letters as a way of reassuring depositors.

With the advent of deposit insurance, however, the focus shifted away from depositor confidence to the asset side of the balance sheet, as federal regulators grew increasingly concerned over risk-taking with insured deposits. By 1948, the OCC had abandoned the capital-deposit ratio and was placing emphasis on the ratio of capital to assets. But which assets? Banks had emerged from World War II with huge quantities of government securities—essentially riskless from the credit point of view. Thus, the OCC embraced the then-novel concept of risk assets—a concept generally interpreted as meaning assets less cash, physical plant, and both direct and indirect government obligations.

This seemed simple, but it proved anything but that. After conclusion of the 1951 Treasury–Federal Reserve accord, which exposed longer term securities to market forces, these government obligations no longer looked so riskless. And, just as obviously, commercial loans varied dramatically in their risk characteristics. So the regulators tried to fine-tune their formulae. In the early 1950s, the Federal Reserve adopted a scheme based on "adjusted capital," which assigned varying percentage capital requirements according to their presumed relative riskiness. The Federal Reserve Bank of New York refined this approach to produce a formula that was even more complex.

The system soon began to buckle under its own weight, and the regulators themselves were among the first to acknowledge it. The OCC backed away from its risk-asset emphasis in the 1960s and, by the early 1970s, the Federal Reserve had followed suit. Straight leverage ratios were adopted and refined—until the 1980s, when the rise of off-balance sheet activities led risk-based formulae to come into vogue once again.

If one were to take this history literally, one might predict that flat ratios are due for a comeback. Indeed, there are those who advocate just such an approach, as a kind of regulatory backstop. For those whom history teaches that the regulators will never get it right at acceptable cost, the argument is that, in this age of transparency, the markets are fully capable of determining how much capital a given institution should hold.

The odds are, however, that neither straight leverage nor a purely laissez faire approach will hold sway at the end of the day. For one thing, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) institutionalized regulatory capital—using a hybrid of Basle-defined risk weights plus leverage—as a matter of law. Until Congress decides otherwise, regulatory capital with a risk-based component will be an integral part of our overall supervisory strategy. And secondly, as long as that strategy is genuinely harnessed to the concept of risk, it is hard to imagine that we will dispense altogether with risk-weighted capital standards.

So the issue, for all practical purposes, reverts back to the traditional one of supervisory balance—in this case, setting capital standards that accurately reflect the risk they insure against without incurring the kind of burden that is ultimately counterproductive. Some have proposed that we adopt a simplified approach for community banks, in the same way that we have modified our overall examination procedures to make them less burdensome for smaller, healthy banks. Another approach suggests that regulators should rely upon the banks' own internal risk capital allocation models—sometimes known as RAROC—or "risk-adjusted return on capital"—that tells bankers how much risk there is in a particular line of business and how much capital is needed in that business. From such calculations, they can determine how much capital is needed overall. Even so, most experts agree that these models will never capture all unanticipated risks. The problem, of course, is that if capital is to protect against what cannot be anticipated, then standards for its need are necessarily vague because it is impossible to measure them. And some regulators, with indelible memories of the bank and thrift failures of the 1980s and early 1990s, have misgivings about letting financial institutions in effect set their own capital levels. Certainly, before we embrace risk allocation models too enthusiastically, they will have to have met the test of several down cycles in the economy.

What I have tried to do in these brief remarks is to provide some perspective for our discussions today—perspective that points to the importance of maintaining a reliable, substantial and tangible capital base for all institutions, but one which also reflects the genuine risks financial institutions face. Striking the right balance is the challenge we face. With the help of the experts gathered here today, I know it is challenge we will meet.

Thank you.

Remarks by James Kamihachi, Senior Deputy Comptroller for Economic and Policy Analysis, before "Pathways to Profits: Banking in the 21st Century," Houston Baptist University Symposium, on banking and technology, Houston, Texas, October 30, 1997

Banking and Technology

Good morning, and thank you for inviting me here today. I'd like to talk to you about banking and technology. We Americans are often eager to embrace new gadgets—we like to try new things; and we like to find better ways to do chores. Sometimes, we understand our gadgets—they are as simple as pointing the remote control to change the TV channel.

Other times, things don't work as we expect or want them to. Let me give you two examples of this technology disconnect from a *Wall Street Journal* story about customer help lines at the big PC makers. One technician tells of a time he asked a caller to put a disk in the drive and close the door. The customer agreed and—a few moments later—the technician heard a door slam in the background. But the consensus favorite in my office is the person who inquired about warranty repairs on his computer's broken cup holder—which, upon questioning, turned out to be the load drawer for the CD-ROM.

In a lighthearted way, these anecdotes remind us of our ever-growing reliance on computer technology—whether we understand it or find it perplexing. And there's no going back. Somehow, we're going to have to learn how to use technology well. And we have to recognize that there are limits to what technology can do, as the hapless consumer with the defective cup holder discovered.

The same lessons are true for banks and technology. Because the banking industry was among the first to adopt computer automation, banks today may well have more applications running simultaneously than any other sector of the economy. Computer technology continues to transform the very nature of the business.

Yet, bankers and their customers often take for granted the pretty remarkable advances that allow us to do our chores faster, easier, and more cheaply. ATMs allow us to access our money from around the globe. Customers *like* to use telephone banking and it continues to grow as a cost-effective and efficient means to manage accounts. And PC banking holds the promise of a more flexible distribution channel for financial information and payments between banks and consumers.

This is just the tip of the iceberg. Bankers have an extraordinary opportunity to lever at least two prime assets by using technology—consumers' trust of banks to handle their money; and banks' own detailed customer information databases. Bankers are going to have to make sophisticated strategic decisions regarding what opportunities in the financial services business they want to pursue. And they are going to have to make very difficult tactical decisions about their use of technology in those businesses.

I'm sure you've thought about some of these things before. I know that, as community bankers, many of you face special difficulties. There are at least two reasons your job incorporating new technology is no less challenging than it is for large banks:

You have built your businesses on the basis of personal relationships that have relied on face-to-face contact with many of your customers. Increasingly, you've got to make decisions about how to use more efficient products and service delivery channels, but, at the same time, keep and even strengthen those personal relationships.

Unlike large banks, you've got to be particularly adept at making choices that fit your budget and get the job done. So, you cannot always choose the best technology and the best expertise that money can buy and that size can justify.

Right now, trying to figure out how we'd *use* technology to seize these coming opportunities might leave some of us perplexed. Trying to *operate* such systems adds a whole other category of perplexity. This lack of understanding and control—of the risks created by technology for banks—is a particularly noteworthy point for me, as a bank supervisor, but I'll get back to that in a few minutes.

The point here is that the bankers who *really* understand how to use and manage technology to their advantage will succeed where others fade, in the increasingly competitive financial services business. Fundamentally, this means that regardless of the size or complexity of your institution, banks will need to develop a clear understanding of how technology helps them achieve their strategic objectives.

One result of the competitive advantages offered by technology is banks' increasing use of outside contractors. It's the classic make-or-buy decision that confronts thousands of businesses: Should we purchase machinery and hire workers to maintain our plant, or should we contract this service out?

As I've suggested, for some banks, it's more efficient to own the equipment and hire their own system operators and managers. This decision makes sense for banks with the money and the expertise to make these capital expenditures and take on the associated risks. And it makes equal sense for other banks to shed such risks. The sheer complexity and growing sophistication of modern financial operations make it harder and harder to develop and operate the full range of potential bank products and processing systems.

Looking at the make-or-buy decision through a wide angle lens, it becomes clear that bank managers, in choosing to "in-house" or "outsource," are transforming the structure of banking. What we see is the emergence of a funnel-shaped industry structure. At one end, there are a few large, fully integrated banks. They hold the lion's share of commercial bank assets. At the other end, we see lots of small institutions that focus on retailing. They outsource most of their back-room operations, and they originate fewer of the products and services they sell.

Risk

With all this change going on, it's more important than ever before that banks manage the risks brought on by technology-based services—which brings me back to the point I started to make earlier about bankers who may not understand and have controls for their use of technology. These bankers are going to find themselves in serious trouble. And they won't be able to avoid the problem by not using technology. In that case, competitors simply will pass them by.

Whether in-house or outsourced, it is absolutely fundamental that bankers know enough about what technology can do and how it is being used at their banks. Bankers must be able to adequately measure, monitor, and control their risk exposure. Vendor relationships are an added challenge, and one that is particularly sensitive, because banks often relinquish some amount of control over the security and confidentiality of their most prized asset—their customers' personal information. Bank customers and bank supervisors will blame the bank, not the vendor, for vendor mistakes.

I want you to know that this risk management approach has not been an easy task for bank supervisors, either—our single-minded focus for many decades has been the evaluation of credit risk. It is the more intense application of computer technology to bank decision-making and operations, and the emergence of new and exotic financial instruments that has required us to rethink our supervisory strategies. It has also required that we hire new and highly specialized expertise in bank information systems and the quantitative models used by banks or their vendors.

Of course, bank supervisors do not want to second guess a bank's business judgment—or speculate about whether its research and development will prove fruitful. We know that technological advances and the emergence of sophisticated service providers are very strong, positive trends for banks and their customers. Our challenge is to stay out of the way as banks make efficiency-enhancing changes—while, at the same time, making sure that they do not make the banking system less safe and sound.

What supervisors would like is for senior management to be aware of the risks its bank is taking, to have proper controls to mitigate those risks, and to have contingency plans in place to ensure that technology failures cannot do substantial damage to capital and earnings.

A striking example of the serious risks technology can pose is the year-2000 problem. As I'm sure all of you know, the year-2000 problem is the result of our old computers reading only two fields—the "00" in the year 2000, for example. The problem is that these computers only know about the twentieth century, so they will read "00" as 1900.

The year-2000 problem poses challenges of unprecedented urgency and complexity. Some banks run thousands of applications, some superimposed on top of one another. Many applications have millions of lines of code, which all have to be read to find out which ones need modification. And then the systems have to be tested for interoperability—not only with each other, but with the numerous external systems, foreign and domestic, with which banks interact daily. Many experts tell us that the testing process will be the most difficult part of the whole conversion, because the fix adopted for one system may not be compatible with the fix adopted for another.

In addition, banks have year-2000 issues to worry about beyond getting their own houses in order. Many experts predict a rise in business bankruptcies among firms unable to complete timely year-2000 renovations. Some estimates show business failures increasing by as much as 10 percent. Most technology-dependent businesses will feel the effects of the year-2000 project costs in their cash flows—which may impair their ability to manage and service debt. Banks can and must take steps now to minimize the risk that loans extended today will turn sour.

For these reasons, the OCC and the other bank supervisors have undertaken a comprehensive and aggressive strategy for the year-2000 problem that includes supervisory guidance, on-site inspections, and follow-up examinations or reviews.

The systemic risk posed by the year-2000 problem is our concern at the large banks that have complicated computer links to other systems, very substantial corporate borrowers, and simultaneous computer projects to prepare for the Euro. Our assessment of national banks this summer showed that, for the most part, these institutions are making the necessary commitment of resources. But, we need to keep in mind that there's a lot to be done.

We also are concerned about some of the community banks. Our assessment shows that a significant percentage of national community banks—almost all of which completely depend upon outside vendors for their data processing needs—are counting upon the vendors' assurances that the problem is well in hand. In some cases, these assurances are entirely legitimate. In some others, there may be more wishful thinking than accomplished fact. This is quite serious: let a bank start missing interest payments, or miscalculating dividend or maturity dates due to a year-2000 slip up, and that bank will have real trouble—from its customers, from its government supervisors and, more than likely, from the courts.

We Americans already had a taste of what happens when central systems stop working—during the recent UPS strike. Even careful and cautious business people woke up one morning to the realization that their ability to earn income that day and in the days that followed was heavily dependent upon whether the UPS strike would end. They were so accustomed to seeing that guy in the brown shorts every day, that they took him for granted. Unfortunately, there's no labor negotiator who can fix the year-2000 problem.

But, on a more serious note, I'm here to reinforce the point that every bank—big and small—needs to take their use of technology seriously. You don't have to be a computer expert. You don't have to reinvent data processing. But you do need to know how your bank is using technology. And you need to know how to use technology going forward to achieve your strategic goals. And, to the extent that you use contractors, you need to know your vendor.

Thank you.

Interpretations—October 1 to December 31, 1997

Interpretive Letters

800—September 11, 1997

[Note: This OCC Interpretive Letter was released jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision.]

12 USC 2901

Dear [ ]:

This letter responds to your letter (supplemented by additional written material, telephone conversations and meetings with OCC staff), in which you inquired about the applicability of the Community Reinvestment Act (CRA) regulations to a financial institution's investment in a pooled national community development fund, such as the [ ], that invests in low-income housing tax credit projects. Specifically, you asked:

(1) Whether the CRA regulations treat an institution's investment differently according to whether the institution invests directly in a project or indirectly, such as through a national fund;

(2) When and how examiners consider such an investment in a national fund by an institution; and

(3) How the CRA regulations define "region" for purposes of evaluating a wholesale or limited purpose institution's performance under the community development test.

Because the agencies recently have received several inquiries regarding these general issues, we believe it is necessary to clarify how examiners will evaluate a financial institution's commitment to invest equity in community development funds.

The four federal financial institution supervisory agencies ("the agencies") have promulgated substantively identical CRA regulations. Therefore, staff from all of the agencies have considered the issues you raised and they concur in the opinions expressed in this letter.

For the reasons discussed below, the agencies conclude that:

(1) The CRA regulations do not differentiate between "direct" and "indirect" qualified investments;

(2) Examiners will consider the dollar amount of all qualified investments, including commitments to invest, that are recorded on an institution's books at the time of the examination and will evaluate these investments based on a variety of factors; and

(3) A "regional area" may be as small as a city or county or as large as a multistate area.[1] A wholesale or limited purpose institution that makes a qualified investment outside of the institution's assessment area(s) (or a broader statewide or regional area that includes the institution's assessment area(s)) will receive consideration for the investment, provided the institution has adequately addressed the community development needs of its assessment area(s).

I. Background

According to the information you supplied, the [ ] is a non-profit affiliate of the [ ], a tax-exempt public charity under section 501(c)(3) of the Internal Revenue Code. Corporations, including financial institutions, enter limited partnership agreements with the [ ] to invest capital equity in affordable rental housing developments sponsored by low-income community-based development corporations not affiliated with banks ("upper-tier investment partnerships"). In return for their investments, the corporate investors receive federal low-income housing tax credits and related federal tax deductions when the housing projects are completed.

The [ ] operates under a two-tiered limited partnership structure—(1) an "upper tier" with corporate investors as limited partners and the [ ] as a general partner, and (2) a "lower tier" with a community-based housing project sponsor as a general partner and the upper-tier investor partnership as the limited partner. The formation of an upper-tier investment partnership involves the execution of a partnership agreement and promissory note by each corporate investor. Some investors pay out their obligations immediately while other investors finance their obligations over time. You described an investor's obligations as "legally binding," "irrevocable," and "unconditional" because the delivery of an investor's note to the upper-tier partnership fully obligates the investor. Once the [ ] has received $5 million in investors' notes, it pledges the notes as security to obtain bridge loans.

At the time an "upper-tier" partnership is formed, a financial institution commits to invest in the [ ] on a "blind pool" basis because the [ ] has not yet identified the actual projects to receive the committed funds. A financial institution can, however, target its investment to a particular geographical area that correlates with its assessment area(s) or a broader statewide or regional area that includes the institution's assessment area(s).

[1] Community Reinvestment Act; Interagency Questions and Answers Regarding Community Reinvestment (hereinafter "Qs and As"), 61 Fed. Reg. 54,647, 54,651 (Oct. 21, 1996) (Q and A 6 addressing sections __.12(i) and __.563e(h)).

You indicated that the [ ] will provide its investors a written statement that it intends to invest a specified dollar amount in a geographical region(s) specified by the investor and based on the [ ] regional structure.[2] According to your letter, the [ ] generally issues a report to investors when it has issued all the binding commitments necessary to invest all of the equity in project partnerships.

Investors may thus continually evaluate the performance of the [ ] to determine if the [ ] is actually meeting the investor's geographic and qualitative goals. These targeting assurances from the [ ] allow a retail institution to meet its geographic investment needs with an investment in the [ ]. A wholesale or limited purpose institution may target its investment in the same manner as other retail institutions or, if it has adequately addressed the needs of its assessment area(s), it may invest in a nationwide fund such as the [ ] without targeting its funds.[3]

According to your letter, once the upper-tier partnership is formed, each investor records the promissory note on its books as an "asset" and amortizes the investment over the life of the tax credit benefit period. The investor thus assumes all the benefits and burdens of the investment. Further, you state that this accounting treatment also applies to investors that finance their obligations over a number of years.

You stated that a financial institution should receive consideration under the CRA regulations for a qualified investment at the time the institution makes a binding commitment to the upper-tier partnership. At that time, "an investment for CRA purposes can legitimately be demonstrated" because all other indicia of ownership exist. You also stated that the method by which institutions should receive CRA consideration over the life of the investment should match the investor's accounting treatment of the asset—i.e., in each subsequent year after the investment, the CRA consideration that an institution would receive for the dollar amount outstanding would decrease in an amount equal to the amortization taken in that year. In your view, such treatment would maximize CRA consideration in the early years when the risk is greatest and minimize CRA consideration in the later years when risk has diminished.

[2] The [ ] regional structure consists of western, midwestern, southern, and northeastern regions.

[3] *See* 12 CFR 25.25(e), 228.25(e), 345.25(e), and 563e.25(e).

II. Discussion

A. The CRA Regulations Do Not Differentiate Between "Direct" and "Indirect" Investments

You inquired whether the CRA regulations treat a direct investment differently from an indirect investment. The regulations do not differentiate between direct and indirect investments.[4]

B. How Examiners Evaluate Investments in a Community Development Fund

Examiners evaluating an institution's qualified investments will look at the following four performance criteria:

(1) the dollar amount of qualified investments;

(2) the innovativeness or complexity of qualified investments;

(3) the responsiveness of qualified investments to credit and community development needs; and

(4) the degree to which the qualified investments are not routinely provided by private investors.[5]

These criteria reflect the agencies' expectation, embodied in the CRA regulations, that examiners will consider not only the dollar amount of qualified investments, but also will exercise judgment on other factors affecting how such investments will be weighed as part of an overall CRA rating.

With respect to the first criterion, examiners will determine the dollar amount of qualified investments by relying on the figures recorded by the institution according to generally accepted accounting principles (GAAP). Examiners will include both new and outstanding investments in this determination. The dollar amount of qualified investments also will include the dollar amount of legally binding commitments recorded by the institution according to GAAP.

As a general matter, institutions may exercise a range of investment strategies, including short-term investments, long-term investments, investments that are immediately funded, and investments with a binding up-front commitment that are funded over a period of time. Under any of these investment strategies, institutions making the same dollar amount of investments over the same number of years, all else being equal, would receive the same level of consideration.

[4] The agencies answered this question in a recent interagency letter. *See* Interagency Staff CRA Opinion Letter from Michael Bylsma (June 10, 1997) (designated as OCC Interpretive Letter No. 787) (copy enclosed) [enclosure omitted—for a copy of this letter, see *Quarterly Journal,* Vol. 16, No. 4, p. 88].

[5] 12 CFR 25.23(e); 228.23(e), 345.23(e), and 563e.23(e).

However, a variety of considerations *beyond the dollar amount of the investment* will affect the level of favorable consideration that examiners will accord any qualified investments in any given examination. The extent to which qualified investments receive favorable consideration also depends on how examiners evaluate the investments under the remaining three performance criteria—innovativeness and complexity, responsiveness, and degree to which the investment is not routinely provided by private investors.

Examiners also will consider factors relevant to the institution's CRA performance context, such as the effect of outstanding long-term qualified investments, the pay-in schedule and the amount of any cash call, on the capacity of the institution to make new investments.

C. Consideration of Qualified Investments By Wholesale or Limited Purpose Institutions

You inquired how CRA examiners interpret the term "regional area" for purposes of measuring the performance of a limited purpose or wholesale financial institution under the community development test. As explained in the Qs and As issued on October 21, 1996, a "regional area" may be as large as a multistate area, such as the mid-Atlantic states.[6]

In evaluating a qualified investment by a wholesale or limited purpose institution, examiners would first consider whether the institution has adequately addressed the needs of its assessment area(s). Although a wholesale or limited purpose institution is not required to help meet the credit needs of a broader statewide or regional area, qualified investments in a broader statewide or regional area that includes the institution's assessment area are favorably considered in the evaluation of an institution's performance in its assessment area(s). Examiners that find a wholesale or limited purpose institution has adequately addressed the needs of its assessment area(s) will give favorable consideration to qualified investments, community development loans, and community development services by that institution nationwide.[7] Finally, as you requested, we confirm that the criteria applicable to qualified investments described earlier in this letter would be considered by examiners in evaluating qualified investments made inside and outside of an institution's assessment area(s).

[6] *See id.* (Q and A 6 addressing sections __.12(i) and __.563e(h) (meaning of "regional area")).

[7] *See* Interagency Staff CRA Opinion Letter from Michael Bylsma, at II.B. (Dec. 23, 1996) (designated as OCC Interpretive Letter No. 764) (copy enclosed) [enclosure omitted—for a copy of this letter, see *Quarterly Journal,* Vol. 16, No. 2, p. 83].

III. Conclusion

You asked whether the agencies' examination staff follow the guidance provided in interagency interpretive letters, such as this one. The agencies consult with one another on each interagency CRA letter to ensure that we provide consistent guidance. The agencies also work to ensure that examiners apply these rules consistently by, for example, conducting joint training, reviewing public evaluations on an interagency basis, and providing additional examiner guidance, as needed.

I trust this letter has been responsive to your inquiry. If you have any additional questions, please feel free to contact me or Julie Yang, an attorney on my staff, at 202–874–5750.

Michael Bylsma
Director
Community and Consumer Law Division

Enclosures [enclosures omitted—OCC Interpretive Letters No. 787 and 764 may be found in the *Quarterly Journal,* Vol. 16, Nos. 4 and 2, respectively; or in the monthly *Interpretations and Actions* periodical on the World Wide Web at http://www.occ.treas.gov]

801—September 11, 1997

[Note: This OCC Interpretive Letter was released jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision.]

12 USC 2901

Dear [ ]:

This responds to your letter dated January 31, 1997,[1] in which you inquired about the applicability of the Community Reinvestment Act (CRA) regulations to a financial institution's commitment to invest in a partnership that invests in low-income housing. Specifically you asked whether a wholesale or limited purpose financial institution may receive CRA consideration for its entire investment at the time the commitment is made, rather than at the time of, and only for the amount of, each cash call. Your question raises the following two issues:

[1] I apologize for the delay in responding to your letter. As I have indicated during previous telephone conversations with you, this delay resulted from the efforts of the federal financial institution supervisory agencies to coordinate this response with another response letter, described *infra*, that raised similar questions.

(1) Whether the timing of payments of a qualified investment will affect the amount of consideration received; and

(2) How examiners will evaluate an institution's qualified investment in a partnership with nationwide investments.

The four federal financial institution supervisory agencies ("the agencies") have promulgated substantively identical CRA regulations. Therefore, staff from all of the agencies have considered the issues you raised and they concur in the opinions expressed in this letter.[2]

I. Background

According to your letter, [ ] is a general partner in limited partnerships that invest in low-income housing projects and receive tax credits in return ("partnerships"). Corporations, including wholesale or limited purpose financial institutions,[3] become limited partners by entering subscription agreements to commit funds for low-income housing projects in return for federal Low Income Housing Tax Credits. The subscription agreements contain "unconditional" and "irrevocable" commitments by the investors to fund the investment over a number of years. The pay-in schedule for each investor varies according to the project's needs, as determined by [ ].

You indicated that [ ] generally requires investors to pay the committed equity over two years. The subscription agreement is the sole document that binds the investor. If an investor wants to finance an investment over a longer period of time, [ ] requires the investor to sign a promissory note, in addition to the subscription agreement, and deliver the note and agreement to the partnership. In either case, the partnership has received an "absolute and unconditional" obligation from the investor to pay its equity investment. Pursuant to the subscription agreement, the partnership is authorized to use the promissory note (or the subscription agreement itself in the case of two-year obligations) as collateral to obtain a bridge loan for the entire amount of the investment. If a limited partner fails to pay any portion of its equity obligation, the limited partner shall be in default of the subscription agreement and the partnership may demand full payment of the entire obligation immediately and initiate legal proceedings to collect the obligation.

II. Discussion

A. How Examiners Evaluate Investments in a Community Development Fund

You inquired whether an institution's pay-in schedule for an equity investment in a community development fund would affect the timing and amount of CRA consideration received by the institution. As explained more fully in section II.B of the enclosed interagency letter, the regulations do not favor investments that are immediately funded over investments with a binding up front commitment that are funded over a period of time. Under either of these investment strategies, institutions making the same dollar amount of investments over the same number of years, all other performance criteria being equal, would receive the same level of consideration. In response to your question, factors such as the pay-in schedule under a binding commitment will be considered relevant to the capacity of the institution to make new investments, as part of the context for evaluating an institution's CRA performance.

B. Qualified Investments By Wholesale or Limited Purpose Institutions Must Meet Geographical Requirements

In evaluating a qualified investment by a wholesale or limited purpose institution outside the institution's assessment area (or broader statewide or regional area that includes the assessment area), examiners would first consider whether the institution has adequately addressed the needs of its assessment area(s). As explained in section II.C of the enclosed interagency letter, a wholesale or limited purpose institution is not required to help meet the credit needs of a broader statewide or regional area; however, qualified investments in a broader statewide or regional area that includes the institution's assessment area are favorably considered in the evaluation of an institution's performance in its assessment area(s). Examiners that find a wholesale or limited purpose institution has adequately addressed the needs of its assessment area(s) will give favorable consideration to qualified investments, community development loans, and community development services by that institution nationwide.[4]

[2] The agencies have received other inquiries regarding these general issues and have responded to them in another interagency letter. *See* Interagency Staff CRA Opinion Letter from Michael Bylsma, at II.B. (Sept. 11, 1997) (designated as OCC Interpretive Letter No. 800) (copy enclosed) [enclosure omitted—for a copy of this letter, see preceding interpretive letter in this issue of the *Quarterly Journal*]. Although this letter cites to the performance criteria under the investment test, the discussion also applies to evaluations of qualified investments under the community development test, which contains the same performance criteria. *See* 12 CFR 25.25(c), 228.25(c), 345.25(c), and 563e.25(c).

[3] You indicated that [ ] does not enter any tax credit partnerships with retail financial institutions. Our response is based on that representation.

[4] *See* Interagency Staff CRA Opinion Letter from Michael Bylsma, at II.B. (Dec. 23, 1996) (designated as OCC Interpretive Letter No. 764) (copy enclosed) [enclosure omitted—for a copy of this letter, see *Quarterly Journal,* Vol. 16, No. 2, p. 83].

You indicated that investors in a partnership pool their money into a national fund for the purpose of maintaining a diversified portfolio of projects. You also indicated that [ ] does not enter limited partnerships with retail financial institutions; only wholesale or limited purpose financial institutions may become limited partners. Consequently, if a wholesale or limited purpose institution has adequately addressed the needs of its assessment area(s) as explained above, the institution may invest in a nationwide fund without targeting its investment.

III. Conclusion

I trust this letter has been responsive to your inquiry. If you have any additional questions, please feel free to contact me or Julie Yang, an attorney on my staff, at 202–874–5750.

Michael Bylsma
Director
Community and Consumer Law Division

Enclosures [enclosures omitted—OCC Interpretive Letter No. 800 is published in this issue immediately preceding this letter and OCC Interpretive Letter No. 764 may be found in the *Quarterly Journal,* Vol. 16, No. 2, or in the monthly *Interpretations and Actions* periodical on the World Wide Web at http://www.occ.treas.gov]

802—September 17, 1997

[Note: This OCC Interpretive Letter was released jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision.]

12 USC 2901

Dear [ ]:

It was a pleasure speaking to you recently. This responds to your August 25, 1997, letter requesting an interpretation and clarification of the Community Reinvestment Act (CRA). In particular, you asked whether favorable consideration would be given to financial institutions as part of their regulatory agencies' CRA review for participation in financial education and career training activities such as those offered by the [ ] ("program"). As discussed more fully below, if the activities are targeted to low- and moderate-income individuals, examiners may view them favorably during a participating financial institution's CRA examination.

As I mentioned to you during our conversation, the four federal bank and thrift regulatory agencies promulgated substantially similar CRA regulations on May 4, 1995.[1] Staff from all four agencies have considered your inquiry and concur in the opinions expressed in this letter.

The Program

The program is one of three educational programs of the [ ],[2] a nonprofit 501(c)(3) organization. The purpose of the program is to introduce high school students throughout the United States to career opportunities in the financial services industry, and, in the process, equip them to make sound choices for their future. Local program activities in high schools across the country (hereinafter, [ ]) provide students with financial industry-related courses of study. The [ ] enable and encourage students to participate in paid internships at financial services corporations and to obtain employment in the financial services industry after graduation or pursue higher education. The program's industry-validated, two- to four-year academic course work augments the students' standard educational curricula.

Financial Institutions' Program Activities

You specifically asked how financial institutions' participation in the following program activities would be considered during the institutions' CRA examinations:

- Active participation by financial institution personnel on program advisory boards and other involvement with the program, such as appearing as guest classroom speakers, providing mentors to [ ] with mentoring programs, assisting school districts with local staff development through teacher mentoring programs and by having bank staff teach financial principles to program instructors, and assisting the program with national staff development, such as by providing guest speakers to further the financial knowledge of program teachers;
- Financial contributions to the program for student enrichment activities (e.g., field trips to stock exchanges, attendance at conferences, scholarships for exemplary graduates, etc.); and
- Providing paid summer internships for students who have completed their junior year academic requirements as well as successfully prepared for their internship experience. Internships are an extension of the curriculum of the program in that they are educational activities that are monitored, structured, and evaluated as part of the student's academic

[1] *See* 12 CFR pts. 25, 228, 345, and 563e.

[2] The other two educational programs of the [ ] are the [ ] and the [ ]. This letter addresses a financial institution's activities only in connection with the [ ].

record in the program. Participating institutions, therefore, provide students with meaningful and instructive internships, rather than merely "summer jobs."

Discussion

The first step in determining whether examiners may favorably consider financial institutions' participation in the program is to determine whether the program has a primary purpose of community development. The CRA regulations define "community development" to include, among other things, "community services targeted to low- or moderate-income individuals."[3] Among the examples of "community services" that have been provided by the agencies are educational services targeted to low- and moderate-income persons.[4]

Examiners consider financial institutions' qualified investments[5] and community development services[6] when they evaluate the institutions' CRA performance.[7] "Qualified investments" are lawful investments or grants that have as their primary purpose community development.[8] "Community development services" are services that (1) have as their primary purpose community development; (2) are related to the provision of financial services; and (3) have not been considered in the evaluation of the institution's retail banking services.[9]

In general, the activities about which you inquire involve the institution either making a financial contribution to the program or providing personnel who will offer services and expertise that are related to banking and financial services. Examiners may determine that these activities have a community development purpose if they are targeted to low- and moderate-income individuals. If so, such activities could receive favorable consideration during a participating financial institution's CRA examination. Thus, for example, if a contribution is given to the program to provide financial training for program instructors and staff, examiners may consider this activity to be a qualified investment. Or, if financial institution staff directly provide training for program instructors, it would be considered a community development service. In either case, however, the instructors and staff that are trained must teach primarily low- and moderate-income students.[10]

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[3] 12 CFR 25.12(h)(2), 228.12(h)(2), 345.12(h)(2), and 563e.12(g)(2). "Low income" means "an individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent, in the case of a geography." "Moderate income" means "an individual income that is at least 50 percent and less than 80 percent of the area median income, or a median family income that is at least 50 and less than 80 percent, in the case of a geography." 12 CFR 25.12(n), 228.12(n), 345.12(n), and 563e.12(m).

[4] *See, e.g.,* Interagency Questions and Answers Regarding Community Reinvestment (hereinafter, "Qs and As"), 61 Fed. Reg. 54,647, 54,650 (Oct. 21,1996) (Q and A 1 addressing __.12(h) and 563e.12(g)).

[5] Large institutions' CRA performance is typically evaluated under the lending, investment, and service tests. Examiners consider large institutions' qualified investments under the investment test. 12 CFR 25.23(a), 228.23(a), 345.23(a), and 563e.23(a). In a small institution examination, examiners may adjust an institution's loan-to-deposit ratio, if appropriate, based on lending-related qualified investments. 12 CFR 25.26(a)(1), 228.26(a)(1), 345.26(a)(1), and 563e.26(a)(1). Qualified investments may also be considered to determine if a small institution merits an outstanding CRA rating. 12 CFR pt. 25 app. A(d)(2), pt. 228 app. A(d)(2), pt. 345 app. A(d)(2), and pt. 563e app. A(d)(2). The community development test, which is appropriate for institutions designated as wholesale and limited purpose institutions, evaluates, *inter alia*, the number and amount of qualified investments. 12 CFR 25.25(c)(1), 228.25(c)(1), 345.25(c)(1), and 563e.25(c)(1). And, finally, institutions evaluated on the basis of a strategic plan must include in their plan how they intend to meet the credit needs of their assessment area(s). They may meet credit needs through lending, *investment*, and/or services, as appropriate. 12 CFR 25.27(f)(1), 228.27(f)(1), 345.27(f)(1), and 563e.27(f)(1) (emphasis added).

[6] Examiners consider large institutions' community development services under the service test. 12 CFR 25.24(e), 228.24(e), 345.24(e), and 563e.24(e). In a small institution's CRA examination, examiners focus on lending and credit-related activities. To the extent community development services enhance credit availability, they may be considered by examiners to determine if a small institution merits an outstanding CRA rating. 12 CFR pt. 25 app. A(d)(2), pt. 228 app. A(d)(2), pt. 345 app. A(d)(2), and pt. 563e app. A(d)(2). The community development test, which is appropriate for institutions designated as wholesale and limited purpose institutions, evaluates, *inter alia*, the number and amount of community development services. 12 CFR 25.25(c)(1), 228.25(c)(1), 345.25(c)(1), and 563e.25(c)(1). And, finally, institutions evaluated on the basis of a strategic plan must include in their plan how they intend to meet the credit needs of their assessment area(s). They may meet credit needs through lending, investment, and/or *services*, as appropriate. 12 CFR 25.27(f)(1), 228.27(f)(1), 345.27(f)(1), and 563e.27(f)(1) (emphasis added).

[7] Qualified investments and community development services must benefit the institution's assessment area(s) or a broader statewide or regional area that includes the assessment area(s). *See* 12 CFR 25.23(a), 228.23(a), 345.23(a), and 563e.23(a). A wholesale or limited purpose institution can also receive consideration for qualified investments and community development services that benefit areas outside the institution's assessment area(s) (or a broader statewide or regional area that includes that institution's assessment area(s)), if the institution has adequately addressed the needs of its assessment area(s). *See* 12 CFR 25.25(e), 228.25(e), 345.25(e), and 563e.25(e).

[8] 12 CFR 25.12(s), 228.12(s), 345.12(s), and 563e.12(r). This letter assumes, but does not determine, that contributions or investments in the program are lawful. The CRA and its implementing regulations do not provide authority for institutions to make investments or contributions that are not otherwise allowed under federal laws and regulations.

[9] 12 CFR 25.12(j), 228.12(j), 345.12(j), and 563e.12(i).

[10] *See* Interagency CRA Staff Opinion Letter from Glenn E. Loney, Associate Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System (Aug. 29, 1997) (copy enclosed).

Although providing employment generally is not considered as a qualified investment under the CRA, the agencies believe that a financial institution's contribution to the program to help finance the summer intern program, and thus provide financial services education to low- and moderate-income students, could be evaluated as a qualified investment. It is our opinion, therefore, that providing the same benefit to the program by providing short-term, paid on-the-job training to low- and moderate-income summer interns as part of such a curriculum may receive the same favorable consideration.

In conclusion, financial education activities, such as those you described, if targeted to low- and moderate-income individuals, have a community development purpose. Therefore, examiners may consider them favorably during a participating financial institution's CRA examination.

I trust this letter responds to your inquiry. If you have further questions, please contact me or Margaret Hesse, an attorney on my staff, at 202–874–5750.

Michael S. Bylsma
Director
Community and Consumer Law Division

Enclosure (1)

Enclosure

[Note: This Interagency CRA Interpretive Letter was released jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision.]

August 29, 1997

Dear [ ]:

This is in response to your letter that inquires about how a grant from a financial institution to provide your organization's [ ] curriculum ("curriculum") to local school districts may be considered under the revised Community Reinvestment Act (CRA). You have also asked for clarification of the income level criteria contained in the CRA, and for an opinion on whether grants by banks or thrifts to support training teachers to learn your curriculum would be considered under the CRA. As you know, the four bank and thrift regulatory agencies have promulgated substantively identical Community Reinvestment Act regulations.[1] Therefore, staff from all of the agencies have considered your letter, and they concur in the opinions expressed herein.

[1] *See* 12 CFR parts 25, 228, 345, and 563c.

The revised CRA regulations establish a framework and criteria by which the agencies assess an institution's record of helping to meet the credit needs of the community. An institution may receive positive consideration for making "qualified investments" that have primarily a community development purpose and benefit the institution's assessment area or a broader statewide or regional area. The October 21, 1996 "Interagency Questions and Answers Regarding Community Reinvestment" provide examples of some of the types of qualified investments that would receive positive CRA consideration. One example is, "Investments, grants, deposits or shares in or to: . . . Not-for-profit organizations serving low- and moderate-income housing or other community development needs, such as counseling for credit, homeownership, home maintenance, and other financial services education . . ."

The CRA regulations contain a definition of what type of activities are considered "community development" for the purposes of the regulation. At 12 CFR 228.12(h) it states, "Community development means: (1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals; (2) *Community services targeted to low- or moderate-income individuals;* (3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of $1 million or less; or (4) Activities that revitalize or stabilize low- or moderate-income geographies" [emphasis added]. Community development activities may include direct or indirect lending; investments, grants or donations; or providing services to the community.

For the purposes of CRA, low-income is defined as less than 50 percent of the HUD adjusted median family income for the MSA in which the person lives, or, if not in an MSA, the statewide nonmetropolitan median family income. Moderate-income is at least 50 percent and less than 80 percent of the same income figures.

Your curriculum provides the types of financial services education that are described above. However, if a financial institution would like to receive positive CRA consideration, it would have to target its grant to a school that primarily serves low- and moderate-income children. If the grant is given to the school district for it to use to provide the curriculum to the entire school district or a wide variety of schools, it may not be possible for the investing bank or thrift to determine if the program is primarily serving low- and moderate-income individuals.

You have also asked whether a grant to fund training for teachers so they can in turn instruct their students in the curriculum would receive favorable CRA consideration. While there is an obvious multiplier benefit to training teachers so they can use the curriculum over several years, this type of a grant would meet the definition of a qualified investment only if the teachers being trained primarily teach low- and moderate-income students. To avoid any question in this regard it may be necessary for the investing bank or thrift to target its grant to benefit such teachers if it wishes to receive favorable CRA consideration, rather than having the school district use the grant to train teachers that work with all types of students.

I hope this has been responsive to your inquiry. If you have any questions, you may contact me at 202–452–3585 or Karen Murtagh of this division's staff at 202–452–2652.

Glenn E. Loney
Associate Director
Division of Consumer and Community Affairs
Board of Governors of the Federal Reserve System

803—October 7, 1997

12 USC 85

Dear [ ]:

This letter responds to your inquiry asking whether certain fees levied by [ ] (the bank) in connection with home equity loans constitute "interest" for purposes of 12 USC 85 (section 85) as that term is defined in 12 CFR 7.4001(a) (section 7.4001(a)). If the fees constitute "interest" and if they are permitted by the state where the national bank is located, then section 85 provides authority to the national bank to charge those fees to borrowers who reside in another state even if that other state prohibits the imposition of a particular fee in connection with home equity loans.

As more fully described below, the fees about which you inquire are (1) an account opening fee, (2) a fee for exercising a fixed rate option, (3) a fee for prepaying a fixed rate option, (4) a fee for early closure of the account, and (5) rejected item fees imposed in a variety of situations. For the reasons set forth in detail below, it is our view that the first four categories of fees constitute "interest" for purposes of section 85 and section 7.4001(a) as upheld by the U.S. Supreme Court. *See Smiley* v. *Citibank* (South Dakota) N.A., 135 L.Ed.2d 25 (1996) *(Smiley)*. Likewise, except for fees imposed on items presented following termination of a home equity account, the fees in category 5—rejected items fees—also would constitute interest. The fees constituting interest may be assessed by a national bank if similar charges may be imposed by another lender in the state where the national bank is located without reference to whether these fees are denominated as "interest" under state law. *See* 12 USC 85; 12 CFR 7.4001(c). These fees also may be charged without reference to whether they are permissible under the laws of another state where the borrower may reside. *See Marquette National Bank of Minneapolis* v. *First of Omaha Service Corp.,* 439 U.S. 299 (1978).[1] Rejected items fees imposed, based on the presentation of items following the termination of an account, are governed by 12 CFR 7.4002, which applies to noninterest charges and fees.

Background[2]

As we understand it, the bank offers home equity secured, variable rate, open-end lines of credit (the home equity account or the line of credit). Borrowers may draw on the line of credit during a 10-year period and then have an additional 15 years to repay the outstanding balance. You have advised us that terms used by the bank include an annual fee for the first 10 years, and an account closing charge if the borrower closes the line within the first three years unless the property that secures the loan is sold.[3] One feature of the home equity account is that it permits the borrower, at his or her option, to obtain fixed rate advances that are repayable in regular monthly installments over a fixed term. If this option is exercised by the borrower, the bank charges a fee for exercising the fixed rate option and also charges a fee for prepaying an advance received pursuant to the exercise of the fixed rate option. In addition, the bank charges fees for rejected items, that is, items that are presented by the customer for payment from the home equity account and which are not, for a variety of reasons, paid by the bank. You state that items might be

[1] You have asked us to assume in answering this question that the bank's main office state rate applies because no state other than the main office state has any connection with the loans other than the fact the borrowers, and the residence that secures the loan, will be located in various states. Consequently, you have not asked us to address any issues about which state's interest rate law applies to loans made by an interstate national bank which has taken action with respect to a loan in a state, other than its main office state, in which it has branches. *See, e.g.,* OCC Interpretive Letter No. 686, September 11, 1995, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–001.

[2] The facts, as set forth in this response, are based on your letter dated August 6, 1997, and telephone conversations between you and a member of my staff.

[3] You have advised us that, while fees may vary in different loan programs, a representative annual fee would be about $65 per year, which, under the terms of the home equity account agreement, could be adjusted over the 10-year period to increase by up to 5 percent per year. A representative prepayment penalty would be $500. No prepayment fee is imposed if the line is closed after three years or if the property securing the loan is sold during the first three years.

rejected if the home equity account has been suspended or terminated (either by the borrower or the bank[4]), if the advance would cause the outstanding balance to exceed the customer's credit line, or if the attempted draw was for less than the required minimum advance.

You have asked whether the fees described above are interest for purposes of section 85, as defined in section 7.4001(a) and, thus, can be charged by the bank no matter where the borrower resides.

Discussion

A. The Statute

Interest rates that national banks may charge generally are governed by 12 USC 85 which provides, in pertinent part, that "Any association may . . . charge on any loan . . . interest at the rate allowed by the laws of the State . . . where the bank is located. . . ."

You have represented that the law of the relevant state permits the fees about which you inquire. Therefore, these fees may be imposed by national banks under the authority of section 85 irrespective of the state of residence of the borrower if they are "interest" within the meaning of section 85. *See Marquette National Bank of Minneapolis* v. *First of Omaha Service Corp.,* 439 U.S. 299 (1978).

B. The Regulation

OCC regulations define "interest" for purposes of section 85 and set forth a nonexclusive list of examples of fees that constitute interest. This regulation states:

> The term "interest" as used in 12 USC 85 includes any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended. It includes, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, not sufficient funds (NSF) fees, overlimit fees, annual fees, cash advance fees, and membership fees. It does not ordinarily include appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports.

12 CFR 7.4001(a). The U.S. Supreme Court unanimously upheld this ruling last year in the context of a case in which plaintiffs argued that late fees were not properly considered to be interest for purposes of section 85 and, thus, not subject to exportation. *See Smiley.*

C. Applicability of the Regulatory Definition of "Interest" to the Fees at Issue

We note that, as recognized and upheld by the Supreme Court in *Smiley,* section 7.4001(a) draws a line between charges that fit within the definition of interest and "all other payments." Included in the regulation's list of noninterest charges are appraisal fees, premiums and commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports. The Supreme Court explicitly upheld this distinction stating:

> [I]t seems to us quite possible and rational to distinguish, as the regulation does, between those charges that are *specifically assigned* to such expenses and those that are assessed for simply making the loan, or for the borrower's default. In its logic, at least, the line is not "arbitrary [or] capricious."

Smiley at p. 32 (emphasis in original). The following discusses the applicability of section 7.4001(a) and the Supreme Court's decision in *Smiley* to the various fees about which you inquire.

1. Account opening and fixed rate option fees

It is clear that an account opening fee and a fee for exercising a fixed rate option would constitute "interest" for purposes of section 85. As you have described the account opening fee, we understand that it is imposed simply for making available a line of credit and provides compensation to the bank in addition to periodic interest charges assessed on outstanding balances. Thus, it clearly constitutes "payment compensating a creditor . . . for an extension of credit . . ." and just as clearly *does not* constitute a charge that "is specifically assigned" to cover the cost of an activity or service, such as those listed in section 7.4001(a), pertinent to making the loan.

The history of section 7.4001(a) provides further support for this conclusion. The OCC has been explicit that the examples of fees considered to be "interest" do not

[4] The circumstances under which a bank may terminate or suspend a home equity line of credit are set forth in Regulation Z at 12 CFR 226.5b(f)(2) and (3). A creditor may terminate a plan and demand repayment of the outstanding balance in advance of the original term if there is fraud or material representation by the consumer in connection with the line of credit, the consumer fails to meet the repayment terms, or any action or inaction by the consumer adversely affects the creditor's security or any right of the creditor in such security. *Id.* at (f)(2). Paragraph (f)(3) sets forth a variety of circumstances in which a creditor may suspend further draws against a home equity line including, among others, a period during which the value of the dwelling that secures the line declines significantly below its appraised value. *Id.* at (f)(3)(vi)(A). As you have described it, accounts subject to suspension remain open; if and when circumstances change, additional draws may be made.

constitute an exclusive list. As stated in the general rule set forth in section 7.4001(a), "interest" includes *"any payment"* to a creditor for an extension of credit or any default or breach of a condition by a borrower. Moreover, in adopting section 7.4001(a), the OCC stated in the preamble, "the ruling is not intended to be a comprehensive treatment of the issue, and other fees or charges may also be found to be components of interest." 61 Fed. Reg. at 4859.[5]

Moreover, the preamble explaining the proposed revisions to section 7.4001 makes it clear that the OCC intended to revise the OCC's prior ruling in Part 7 pertaining to interest rates on loans to "reflect current law and OCC interpretive letters." 60 Fed. Reg. at 11,1929.[6] As the OCC stated in that preamble:

> Although the exportation principle of section 85 is well-established in case law, the application of section 85 is still the subject of court challenges, usually over whether a particular fee or charge imposed by a bank located in a given state is properly characterized as "interest" and is thus "exportable" to a different state. . . . [Citations omitted.]
>
> The OCC has addressed, through interpretive letters, the issue of what fees or charges may be considered "interest." Most recently the OCC summarized its previous opinions and concluded that in addition to periodic percentage rates, charges consisting of late charges, annual fees and overlimit charges are included within the meaning of "interest" as used in section 85. Thus, if they are permissible for lenders to impose under the laws of the state where a bank is located, they may be charged and "exported." . . . *See* Letter from Julie L. Williams to John Douglas, dated February 17, 1995 (the 1995 letter).[7]

Id. The analysis in the 1995 letter underlies the general definition of "interest" now set forth in the first sentence of section 7.4001(a); that is, "any payment compensating a creditor or prospective creditor for an extension of credit, making available a line of credit, or any default or breach by a borrower of a condition upon which credit was extended." Application of that analysis to account opening fees and fixed payment option fees provides added support that those fees fit within the newly codified definition of "interest."

The 1995 letter analyzed whether annual fees, late charges, and overlimit charges constituted "interest" within the meaning of section 85. The analysis emphasized that each type of charge constituted compensation to the bank for the use of its money. With respect to annual fees, the 1995 letter stated that banks apply annual fees to credit card transactions:

> as an alternative to higher monthly percentage finance charges on outstanding balances, and to compensate the bank for other costs and risks associated with establishing and maintaining the account. Annual fees fit squarely within the traditional definition of "interest": "compensation . . . fixed by the parties, for the use or forbearance of money, or as damages for its detention." [Footnote and citation omitted.]

Similarly, the 1995 letter noted that late charges, imposed against borrowers who are delinquent in their payments, and overlimit fees, imposed when a customer's draws on an account exceed the amount the bank has agreed to advance, compensate the bank for risks undertaken in connection with the use of its money.

Likewise, account opening fees and fixed payment option fees are an alternative to higher monthly percentage finance charges and, like periodic interest charges, are part of the compensation that the bank receives in connection with lending its money to a borrower. In addition, we note that the fixed payment option charge helps compensate the bank for risks incurred in foregoing the variable rate feature and extending credit based on a fixed rate of interest.[8]

2. Fees for prepaying a fixed rate option and for early closure of the account

The OCC already has recognized that a prepayment fee assessed when a borrower prepays a home equity loan constitutes interest under section 7.4001(a). *See* OCC

[5] The preamble to the notice of proposed rulemaking stated the same position with regard to the nonexclusivity of the list. *See* 60 Fed. Reg. 11,924, 11929 (March 3, 1995).

[6] A similar statement also appears in the preamble to the final regulation. *See* 61 Fed. Reg. 4859. The Supreme Court in *Smiley* acknowledged this reliance by the OCC on its precedents in formulating the regulation. *Smiley* at p. 32.

[7] The 1995 letter is OCC Interpretive Letter No. 670, *reprinted in* [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,618. This letter reviews in detail the principles underlying section 85 including the most favored lender doctrine, the fact that the term "interest" as used in section 85 calls for a federal definition and is to be construed broadly, and provides for the exportability of interest. That analysis is incorporated into this letter.

[8] In addition, we note that the fixed payment option fees, levied at the time that a borrower draws against his or her line of credit and elects the fixed rate, fixed term option, instead of the usual open end, variable rate alternative can be analogized to a cash advance fee which is specifically listed in section 7.4001(a) as a fee that is considered to be "interest" for purposes of section 85. That this fee is not levied in connection with all draws against the account is not relevant—it is, in fact, a cash advance fee where the cash advance is made pursuant to certain terms of the line of credit agreement between the bank and the borrower.

Interpretive Letter No. 744, August 21, 1996, *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–109 (the 1996 letter). Based on the analysis set forth in that letter, which is fully incorporated and relied upon in this letter, we likewise conclude that prepayment fees levied upon borrowers who make early repayments of advances obtained pursuant to the fixed rate option, as you have described, constitute "interest" under section 7.4001(a) for purposes of section 85.

Similarly, we conclude that the fee for early closure of the home equity account constitutes interest. As discussed in the 1996 letter, "prepayment fees constitute compensation to the bank, in the form of an alternative to higher finance charges, for the risk that an extension of credit will be repaid prior to the maturity date on which the interest rate was predicated."[9] We conclude that a similar principal applies to the early closure fee that you describe. As discussed, when the bank extends the line of credit under the terms that you have described, it anticipates, at a minimum, that it will receive interest in the form of annual fees for at least a 10-year period. The early closure fee, like the prepayment penalty fee, compensates the bank for the risk that the borrower may choose to close the account prior to the expiration of the 10-year period and the bank will not receive the income it anticipated in extending the line of credit.

3. Rejected items fees

You also have asked whether a $10 fee imposed by the bank when it rejects an attempted draw by the borrower constitutes interest for purposes of section 85. The reasons that you cite for rejecting a draw are that the account has been suspended or terminated as described previously, the draw would cause the outstanding balance to exceed the borrower's credit line, or the attempted draw is less than the minimum draw that can be made by the borrower under the terms of the credit agreement. As stated, the definition of "interest" in section 7.4001(a) includes "any payment compensating a creditor or prospective creditor for an extension of credit, making available a line of credit, or any default or breach by a borrower of a condition upon which credit was extended."

When developing a particular loan product and setting its terms, it is reasonable for a bank to expect that the borrower, entering into that loan agreement, will comply with those terms and for the bank to base its interest charges on the expectation of compliance with those terms by the borrower. Thus, as was recognized in the 1996 letter concerning prepayment fees, a lender may base its charges on the expectation that the loan will be repaid over the term of the loan stipulated by the contract. However, as that letter determined, if earlier repayment is made, the prepayment fee levied by the lender is considered to be "interest" for purposes of section 85 and section 7.4001(a). Likewise, the OCC has recognized in section 7.4001(a) that other fees, such as late fees, overlimit fees, and nonsufficient fund fees, are considered interest for purposes of section 85. *See also* the 1995 letter. Similarly, though no money is advanced in connection with rejected items,[10] these fees compensate the lender for a borrower's actions in connection with an extension of credit, that are contrary to the terms of the credit agreement and that are not otherwise taken into account by the lender in establishing the other components of the interest applicable to the extension of credit. Consequently, we conclude that where a borrower presents for payment against the home equity account an item that is rejected because the advance would cause the balance to exceed the outstanding credit line, or the attempted draw was for less than the amount permitted under the terms of the agreement between the lender and the borrower, or the account has been suspended, as described above, the rejected item fee constitutes interest under section 7.4001(a) and section 85.[11] When, however, an item is presented against an

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[9] As at least one court has noted:

> By accepting prepayment, the bank relinquished its right to receive anticipated earnings on the money loaned, and was faced prematurely with the reinvestment of a large sum of money, with the additional expenses thereof and the vagaries of the money market at the time.

See Northway Lanes v. *Hackley Union National Bank and Trust Company,* 334 F. Supp. 723, 732 (W.D. Mich. 1971), *aff'd.,* 464 F.2d 855 (6th Cir. 1972). Because plaintiff's in this case altered their argument on appeal regarding the permissibility of prepayment fees, the appellate court did not have to, and did not, opine on the district court's analysis of this issue.

[10] In this regard, we note that the rejected items fees are similar to the nonsufficient funds charges levied by lending banks for the return of dishonored checks presented in payment of a loan. These fees were recognized as "interest" by the OCC in Interpretive Letter No. 452, August 11, 1988, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,676 and this determination was codified in section 7.4001(a).

[11] Our determination that rejected items fees constitute interest within the meaning of section 7.4001 also is consistent with the holding of the one court that considered the question of what constitutes a "breach" of a condition under which credit was granted. *See Doe* v. *Norwest,* 107 F.3d 1297 (8th Cir. 1997). That case involved a failure by the borrower to maintain insurance on the collateral for a loan which, under the terms of the loan agreement, permitted the lending bank to purchase insurance to protect its interest in the collateral and pass the premiums along to the borrower. Though section 7.4001(a) specifically excludes from the definition of interest "premiums . . . attributable to insurance guaranteeing repayment of any extension of credit," the borrower argued that, under these circumstances, the premiums were "interest" because they compensated the creditor for a breach by the borrower. *Id.* at p. 1302–1303. In upholding the OCC's exclusion of these premiums from interest, the court stated:

> It is true that Norwest charges a borrower for insurance only after the borrower breaches the covenant to maintain insurance. But there is a notable difference between a late fee,

account that has been terminated, either by the borrower or the lender, no debtor/creditor relationship exists at that point and the fee cannot be considered to be interest for purposes of section 85. As discussed, under these circumstances, the rejected item fee is governed by the principles set forth in 12 USC 7.4002.

Consequently, we conclude that each of the rejected items fees that you list, except for the fee imposed where a draw is attempted on a terminated account, constitutes interest within the meaning section 85 as defined by 12 USC 7.4001(a).[12]

> which compensates the creditor *solely for the effects of the debtor's default,* and an insurance charge, which compensates the creditor for the cost of protecting its security, a cost the debtor is supposed to bear anyway.

Id. at p. 1303 (emphasis added). Unlike the insurance premiums at issue in *Norwest,* the OCC has not excluded rejected items fees from the definition of interest, and in the language of the court, these fees do, in fact, compensate the creditor for the effect of the debtor's action in contravention of the loan agreement, that is, the expenses that the creditor incurs as a result of the breach of the loan contract by the borrower.

[12] In analyzing annual fees, the 1995 letter also addressed in detail the issue of whether "interest" in section 85 had to be expressed on a percentage basis. The Supreme Court has since made it abundantly clear that interest does not have to be expressed on a percentage basis or as functions of time and amount owing. *Smiley* at pp. 34–35. Moreover, the list of fees, set forth in section 7.4001(a), demonstrates that when the fee is due—prior to the extension of funds, after the extension of funds, or otherwise—is irrelevant in determining whether a given fee constitutes interest within the meaning of section 85.

In connection with its analysis of late charges, the 1995 letter also rejected the argument that these charges did not constitute "interest" within the meaning of section 85 because they were "contingent." Fees for exercise of the prepayment option, prepayment fees, early closure fees and rejected items fees, like late charges, also can be said to be "contingent." As the 1995 letter stated, however:

> That argument simply does not make any sense. Many charges, including the monthly percentage finance charges on a credit card account, are "contingent" on whether the customer draws on the account or on the amount or duration of the draw, but they are still recognized as "interest."

Apparently, this argument was not made before the Supreme Court in *Smiley* and the court did not address it, but as the 1995 letter noted, the Supreme Court had previously noted that *Citizens' National Bank of Kansas City* v. *Donnell,* 195 U.S. 369 (1904), clearly established that a contingent charge imposed by a national bank (based on a borrower's failure to pay on time) is governed by section 85.

The 1995 letter also rejected the argument that late charges were not "interest" because they are "penalties." The Supreme Court in *Smiley* explicitly addressed this argument and flatly rejected it. As the court stated: "In section 85, the term 'interest' is not used in contradistinction to 'penalty' and there is no reason why it cannot include interest charges imposed for that purpose." *Smiley* at p. 4402. Consequently, this argument does not preclude prepayment, early closure, and rejected items fees from being considered interest.

Moreover, as stated in the 1996 letter at n. 7 and the related text, while fees may be imposed as an alternative to higher periodic interest rates, it is not necessary for a bank to offer the alternative of accepting certain fees in exchange for a lower rate of interest. As the 1996 letter noted, just as annual fees may be levied across the board to help a bank reduce its finance charges, so might prepayment fees. The same can be said of account opening fees, fixed rate option fees, early closure fees, and rejected items fees levied by a bank across the board to reduce its finance charges.

Conclusion

Based on the foregoing, we conclude that the described account opening, fixed rate option, prepayment, and early closure fees on the home equity accounts that you have described compensate a creditor or prospective creditor for an extension of credit or making available a line of credit and, thus, constitute "interest" within the meaning of 12 USC 85, as that term is defined in section 7.4001(a) and as upheld by the Supreme Court in *Smiley*. We also conclude that, except in the situation where a draw is attempted on a terminated account, the rejected items fee constitutes a fee for a default or breach by a borrower of a condition upon which credit was granted and, therefore, also constitutes interest within the meaning of section 7.4001(a) and section 85. Thus, a national bank located in a state where another lender is permitted to assess these fees may assess these fees to customers within that state and in other states without reference to whether these fees are considered by the state in which the national bank is located to constitute "interest" or whether these fees are permissible under the laws of the other state where the customer resides. I hope that this has been responsive to your inquiry.

Julie L. Williams
Chief Counsel

804—September 30, 1997

12 USC 24(7) *[files 70, 15–80A]*

Dear [ ]:

This letter responds to your request of June 30, 1997 that the Office of the Comptroller of the Currency ("OCC") confirm the permissibility of the proposed marketing and advertising activities and arrangements of [ ] (the "bank") described below (the "proposed marketing arrangement"). The proposed marketing arrangement primarily relates to the advance of retail commissions for mutual fund shares sold under a "back-end load structure" and the receipt of 12b–1 fees and contingent deferred sales charges as compensation. Based on the information and representations provided, and for the reasons discussed below, we agree with your conclusion that the proposed activities are permissible.

1. Background

The bank has an operating subsidiary that is a broker-dealer (or *[Co. 1])* and two operating subsidiaries that are investment advisors *([Co. 2* and *Co. 3])*. The bank, itself and through its subsidiaries, is now the sixth largest bank investment advisor to mutual funds and advises registered mutual funds having in the aggregate over $30 billion in assets (the “proprietary funds”). A large part of the sales of proprietary fund shares is made through *[Co. 1],* which is one of many selling brokers for the proprietary funds. *[Co. 4],* which is completely owned by *[Co. 5]* and is unaffiliated with the bank, serves as distributor for the proprietary funds.

A. Existing Arrangements

The bank’s proprietary funds have a back-end fee structure to sell shares (typically referred to as “Class B shares”). As currently structured, the distributor pays to the selling broker (either *[Co. 1]* or an unaffiliated broker-dealer) a commission at the time of sale between 3–4 percent of the current net asset value of the Class B shares being purchased. This is known as the “retail commission.”

No sales charge is imposed on the investor at the time of purchase of the Class B shares, but there may be a sales charge imposed on the investor at the time these shares are redeemed. This charge is typically 4–6 percent of the amount redeemed in the first year after purchase and a declining percentage over time to zero after a specified number of years; the charge is based on the lesser of the net asset value at the time of purchase or redemption. This back-end fee is called the “contingent deferred sales charge” or “CDSC.” CDSCs are payable by the investor to the selling broker, who is obligated to repay it to the registered broker-dealer serving as distributor.

The proprietary funds using the back-end fee structure and offering Class B shares have adopted plans pursuant to Rule 12b–1 under the Investment Company Act. These plans are intended to provide compensation for marketing activities, including the payment of retail commissions, through the payment by the funds of an ongoing annual fee, which are referred to as 12b–1 fees.

Under this Class B share structure, a designated party advances the retail commissions to the selling brokers and incurs marketing expenses, in each case in anticipation of ultimately being compensated over time for such advances and expenses through a combination of CDSCs and annual 12b–1 fees. Currently, the designated party in the case of the proprietary funds is the distributor. The bank finances the distributor’s payment of retail commissions by means of a loan to the distributor (or special-purpose entity that provides financing services to the distributor) secured by an assignment of the 12b–1 fees and the CDSCs. The distributor also receives administrative fees from the proprietary funds and pays administrative fees to the selling brokers.

B. Proposed Marketing Arrangement

You note that the bank or its subsidiaries would continue to provide the following marketing services:[1]

- general marketing and advertising services, including the preparation and distribution of general and fund-specific marketing brochures and informational materials; the preparation and distribution of direct marketing materials; and the placement of advertising in print and broadcast media;
- marketing support for selling brokers by personnel who would provide liaison and communication services with selling brokers and who would be responsible for maintaining the ongoing relationships with selling brokers; and
- the printing and mailing of prospectuses (other than to current shareholders and other than in connection with sales) and sales literature.

[text omitted][2]

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[1] You also assert that the proposed marketing activities would not violate restrictions contained in 12 USC 371c, 371c–1 (“sections 23A and 23B of the Federal Reserve Act”). Based on the information and representations set forth in your letter, we concur with your belief that the distributor and selling brokers are not affiliates and that marketing activities do not constitute covered transactions between the bank and the proprietary funds. The selling brokers simply do not fall within the definition of affiliate. 12 USC 371c. *See also,* OCC Interpretive Letter No. 730, *reprinted in* [1995–96 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–047 (May 29, 1996). The proprietary funds are deemed to be affiliates of the bank, because they are advised by the bank. 12 USC 371c(b)(1)(D). *See also* OCC Conditional Approval Letter No. 143 (April 15, 1994), in *Interpretations and Actions,* July 1994 (hereafter cited as “Lieber Letter”); also available from the OCC Public Information Room, (send written request to the Public Information Room, Communications Division, Washington, DC 20219 or by fax at 202–874–4448 or e-mail to Kevin.Satterfield@occ.treas.gov). The transactions in question are not, however, “covered transactions” under sections 23A and 23B of the Federal Reserve Act. The bank is not extending credit to the proprietary funds; the payment of 12b–1 fees and CDSCs are for services provided by the bank and the bank has no recourse against the proprietary funds if these fees are insufficient to pay the retail commissions. Nor do the 12b–1 fees and CDSCs represent a security of the proprietary funds or a purchase of assets from them; they are merely a form of compensation. Further, the proposed transactions will be conducted to satisfy the arm’s length standard; the specific arrangements would be approved by the Board of Trustees of each proprietary fund and there are comparable arrangements involving other mutual fund complexes.

[2] *See* Lieber Letter, *supra*. As the OCC explained in connection with the marketing activities it approved in the Lieber Letter, the

Under the bank's proposal, the bank or a subsidiary would directly provide the retail commissions to the selling broker and receive the 12b–1 fees and the CDSCs, rather than accomplishing the same result by the additional steps involved with making a loan to the distributor.[3] The bank or a subsidiary would also collect administrative fees from the proprietary funds and pass them through to the selling brokers.

The bank asserts that its proposal would allow the elimination of the substantial administrative burden and expense related to the current loan structure.[4] The bank believes that its proposal will also eliminate the potential for confusion and negative impact on the proprietary funds and the bank if the distributor were unable to repay the loans. The bank further believes that the proposed structure would also eliminate the need to use an intermediary to provide retail commissions, thereby removing an additional level of administration and risk. The bank states that the proposed marketing arrangements will not change in any significant respect the ultimate cash flows arising under the current loan structure.

2. Legal Analysis

A. Permissible Activities

The National Bank Act provides that national banks shall have the power:

> To exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of title 62 of the Revised Statutes.

12 USC 24 (Seventh). The Supreme Court has held that this powers clause is a broad grant of power to engage in the business of banking, including, but not limited to, the five specifically recited powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A.* v. *Variable Life Annuity Co.,* 115 S.Ct. 810 (1995).

In the mutual fund context, the OCC has previously determined that investment advisory, brokerage, and administrative services are part of, or incidental to, the business of banking. OCC Interpretive Letter No. 648, *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,557 (May 4, 1994) (hereafter cited as "Mellon Letter"); Lieber Letter, *supra*. The OCC has stated that various administrative functions are "incidental to the related provision of investment advisory and brokerage services." Mellon and Lieber letters, *supra.*[5] Further, the OCC has previously stated "[b]ased on existing judicial and agency precedent, we find that providing advertising and marketing support relating to mutual funds is an integral part of permissible brokerage and advisory services and thus is part of, or incidental to, the business of banking."[6]

The various aspects of the bank's proposal are clearly just that—advertising and marketing activities—designed to provide customers with clearly permissible brokerage and investment advisory services. This is no less the case with respect to the payment of retail commissions than with respect to the bank's other marketing activities. The marketing of mutual funds can be divided into two basic types. The first is direct marketing to possible purchasers of the funds, such as through newspaper

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Supreme Court found that under its incidental powers, a national bank can advertise any service that the bank lawfully offers. *See id.* (citing *Franklin National Bank* v. *New York,* 347 U.S. 373, 377–78 (1954)). Further, it has been clearly recognized that the selling of securities necessarily involves soliciting buyers and that "no sensible construction of the statute [section 16 of the Glass–Steagall Act] could say that otherwise permissible selling activities cannot involve the solicitation of buyers." *Securities Industry Ass'n.* v. *Board of Governors of the Federal Reserve System,* 807 F.2d 1052, 1062 (D.C. Cir. 1986), *cert. denied,* 483 U.S. 1005 (1987) ("Bankers Trust II"). In connection with brokerage services, the OCC has also permitted national banks and their operating subsidiaries to provide a variety of administrative and shareholder services with respect to the operation of mutual funds. *See* Lieber Letter (citing various services previously approved). The Federal Reserve Board ("FRB") has also approved similar administrative services. *See Mellon Bank Corporation,* 79 Fed. Res. Bull. 626 (1993).

[3] There is no requirement that fees under a 12b–1 plan be paid only to the distributor of a mutual fund (as opposed, for example, to the advisor or some other party providing marketing services).

[4] The bank represents that, to reflect the new marketing arrangements, it will make appropriate changes in disclosures to customers in compliance with all applicable provisions of law and the Interagency Statement on Retail Sales on Nondeposit Investment Products, OCC Bulletin 94–13, *reprinted in* [Vol. 6] Fed. Banking L. Rep. (CCH) ¶ 70–113 (February 15, 1994).

[5] The FRB has also permitted nonbanking subsidiaries to provide various administrative and advisory services. These include maintaining and preserving fund records, computing net asset value and other performance information regarding the funds, preparing and filing with the SEC and state securities regulators registration statements and other required materials, preparing and filing tax returns, providing office facilities for the funds, and coordinating communications and activities between the investment advisor and other service providers. *See Mellon Bank Corporation,* 79 Fed. Res. Bull. 626 (1993) (Appendix A).

[6] *See* Lieber and Mellon letters, *supra* (citing letters on making lobby materials available, placing newspaper advertisements, sending statement stuffers, preparing and distributing explanatory materials concerning the investment portfolios, furnishing prospectuses or sales literature upon request, having advertisements and brochures listing mutual funds available through the bank, and generating and distributing advisory newsletter).

advertisements and mailings. The second is marketing to the intermediaries selling the funds (that is, the selling brokers). The payment of retail commissions is part of the latter approach to marketing.

Furthermore, it is beyond doubt that a national bank can sell, as agent, shares of mutual funds. *See* Mellon and Lieber letters. Banks certainly may pay others to assist in the provision of banking functions as part of, or incidental to, the business of banking.[7] Accordingly, the retail commissions are provided to compensate and motivate selling brokers for doing exactly what a national bank can do, and what the bank does through *[Co. 1]*—sell, as agent, shares of registered mutual funds, including proprietary funds.

The proposal also represents the functional equivalent of, or logical outgrowth of, a permissible lending or marketing activity. The OCC has previously approved the financing of retail commissions.[8] In these prior cases, the financing activity was a permissible lending function for the bank. Under the bank's proposal, the bank will continue to finance retail commissions with the expectation that it will be compensated from the same sources.[9] The bank's proposal avoids the administrative burdens previously associated with structuring the financing as loans. The proposal to advance retail commissions is simply a restructuring of existing activities and this restructuring has no substantive impact on the legal permissibility of these activities. Further, the bank has committed that the distributor would continue all of its other functions and be paid a fee commensurate with industry practice.

B. Glass–Steagall Analysis

Apart from the authorities permitting national banks to engage in the proposed activities as part of or incidental to the business of banking, we have also examined the proposal's treatment under the Glass–Steagall Act ("GSA").[10] We find that the proposed activities are not precluded under the GSA.

No Glass–Steagall Act section 16 underwriting or dealing is involved under the proposed marketing arrangement, whether these terms are defined in terms of their plain meaning or their underlying policy, because the bank will not assume any principal or underwriting risk. *See* 12 USC 24(Seventh). The GSA does not define the terms "underwriting" or "dealing." Underwriting as commonly used, however, refers to the process by which newly issued securities are purchased by another firm for its own account for distribution and sale to investors. Similarly, dealing in securities generally encompasses purchase and sale activities as principal with respect to the securities of other issuers.[11] The bank is not purchasing any shares; it will incur no principal risk; it will have no

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[7] 12 USC 24(Seventh). *See* Mellon and Lieber letters ("an integral part of full-service brokerage is the ability to attract customers by advertising and marketing the services and products available"). The bank generally characterizes the function of advancing retail commissions as a form of permissible advertising and marketing. Further support for this point may be found outside of the context of mutual funds. For example, a bank may use the services of, and compensate persons not employed by, the bank for originating loans. 12 CFR 7.1004. Banks may establish and operate a messenger service or use third-party messenger services; if a third-party service is used, a national bank may defray all or part of the costs incurred by a customer. 12 CFR 7.1012. Further, banks may pay transaction fees to supermarkets for the bank customers' use of ATMs owned by supermarkets. *Independent Bankers Ass'n. of New York State* v. *Marine Midland Bank, N.A.*, 757 F.2d 453 (2d Cir. 1985), *cert. denied,* 476 U.S. 1186 (1986).

[8] OCC Interpretive Letter No. 730, *supra*. These loans are secured by the distributor's rights under its distribution contract to receive future distribution fees and CDSCs. The 12b–1 fees and CDSCs are expected to provide funds to repay these loans. The OCC has stated that the terms of the loans could provide that the bank may receive interest, principal, and the excess of 12b–1 fees and CDSCs over the distributor's payments of interest, principal, and service charges. *Id. See also,* OCC Interpretive Letter No. 656, *reprinted in* [1994–95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,604 (March 13, 1995) (not objecting to proposed bank loans to distributor that would be repaid from CDSCs and 12b–1 fees).

[9] The bank notes that to its knowledge, for the entire mutual funds industry, the combination of 12b–1 fees and CDSCs have always been sufficient to repay the retail commissions. Further, this record enables the bank to make the credit judgment necessary to provide loans to the distributor under its present arrangements. Unlike a loan to the distributor, there is no obligation to repay retail commissions.

[10] The Glass–Steagall Act is the popular name for essentially four provisions in the Banking Act of 1933. Section 16 (12 USC 24(Seventh)) places limits on national bank underwriting and dealing in securities and stock and prohibits national banks from purchasing and selling securities except upon the order and for the account of customers. Section 20 (12 USC 377) prohibits Federal Reserve member bank affiliation with a company "engaged principally in the issue, flotation, underwriting, public sale or distribution at wholesale or retail or through syndicate participation of stocks, bonds, debentures, notes, or other securities. . . ." Section 21 (12 USC 378) prohibits organizations that are engaged in underwriting and other securities activities from simultaneously engaging in the business of receiving deposits. This restriction however does not "prohibit national banks . . . from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of [Title 12]." 12 USC 378(a)(1). Section 32 (12 USC 78) prohibits officer, director, or employee interlocks between member banks and companies that are primarily engaged in the securities activities listed in section 20.

[11] *See* OCC Interpretive Letter No. 388, *reprinted in* [1988–89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612 (June 16, 1987). The FRB has also recognized that underwriting and dealing involve the banking entity's purchase of shares for its own account thereby incurring a principal risk. *See* Board of Governors of the Federal Reserve System Letter, *reprinted in* [1985–87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 86,620 (June 1986) ("Sovran Letter"). *See also, Securities Industry Ass'n.* v. *Board of Governors of the Federal Reserve System,* 468 U.S. 207, 218 n.18 (1984) (hereafter cited as *"Schwab"*) (as underwriter and dealer, a securities firm engages in buying and selling securities on its own account, thereby assuming all the risk of loss).

potential for market gain with respect to the fund shares; and it will have no indicia of ownership of record or beneficial ownership.

The prohibitions in section 20 of the GSA on affiliations between national banks and companies engaged principally in the "issue, flotation, underwriting, public sale, or distribution" of securities do not apply to the bank's proposal. *See* 12 USC 377.[12] The mutual funds are not "affiliates" of the bank under 12 USC 221a because the common ownership and control required under the definition of an affiliate in section 221a does not arise under the proposal.[13] In fact, the proprietary funds will meet the independence requirement from the bank dictated by the Investment Company Act of 1940, requiring that the proprietary funds' boards of directors consist of a majority of persons who are not directors, officers, or employees of the banks. *See* 15 USC 80a–10(c). Because the funds must operate under the control of independent boards, the relationship with the bank cannot be viewed as prohibited by section 20.[14]

In addition, the bank would not be involved in impermissible distribution under the GSA. As the Supreme Court has noted, "it is a familiar principle of statutory construction that words grouped in a list should be given a related meaning." *Schwab,* 468 U.S. at 218 (citing *Third Nat'l. Bank* v. *Impac, Ltd.,* 432 U.S. 312, 322 (1977)). The Supreme Court concluded that the term "public sale" in section 20 refers to sales as an underwriter or dealer and not sales to the public as agent. *See Schwab,* 468 U.S. at 218. Further, the court suggested that "distribution" for GSA purposes has a meaning similar to "underwriting."[15] *Id.* at 217–18. There is no impermissible underwriting occurring under this proposal, nor any analogous, impermissible distribution.

The conclusion that the proposed marketing arrangement does not constitute impermissible "distribution" activities is confirmed by an analysis of the list of responsibilities that will be performed by the independent distributor for the proprietary funds. These include the distributor acting as a "principal underwriter" for purposes of the 1940 Act and having responsibility for:

(1) entering into distribution agreements with the proprietary funds;

(2) being named as the distributor in all prospectuses and sales literature for the proprietary funds;

(3) confirming to investors or broker dealers all sales of proprietary fund shares with a confirmation complying with Rule 10b–10;

(4) providing the required seed money for any new proprietary funds;

(5) entering into agreements with selling brokers for the proprietary funds; and

(6) collecting front-end sales charges from broker-dealers or investors.

Section 21 of the GSA restricts any person or organization "engaged in the business of issuing, underwriting, selling or distributing . . . stocks, bonds, debentures, notes, or other securities" from receiving deposits.

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[12] The FRB has stated that under section 20, "a company that owns a member bank may not control 'through stock ownership or in any other manner' a company that engages principally in distributing, underwriting, or issuing securities." *Mellon Bank Corporation,* 79 Fed. Res. Bulletin. 626 (1993) (citing 12 USC 221a, 377). The FRB has specifically found that banks may perform five of the six major services needed by a mutual fund; they may serve as investment advisors, transfer agents, custodians, registrars, and administrators. *Id.* The sixth function is acting as distributor.

[13] The term "affiliate" for GSA purposes is generally defined as any corporation, business trust, association, or similar organization: (1) of which the member bank, directly or indirectly, owns or controls a majority of voting shares or more than 50 percent of the number of shares voted for the election of its directors or trustees or controls in any manner the election of a majority of its directors; (2) of which control is held, directly or indirectly, by the shareholders of a member bank who own or control either a majority of shares of the bank or more than 50 percent of the shares voted for the election of directors of the bank or by the trustees for the benefit of the shareholders of the bank; (3) of which a majority of its directors, trustees, or other persons exercising similar functions are directors of any one member bank; or (4) which owns or controls, directly or indirectly, either a majority of the shares of capital stock of a member bank or more than 50 percent of the shares voted for the election of directors or controls in any manner the election of a majority of the directors of a member bank or for the benefit of whose shareholders or members all the capital stock of a member bank is held by the trustees. 12 USC 221a(b). None of these relationships exist between the mutual funds and the bank.

[14] *See* Mellon and Lieber letters. In its decision on Mellon Bank Corporation, the FRB noted that the policy-making function and control would rest with the board of directors of the fund, which must meet the requirements of the 1940 Act. *Mellon Bank Corporation,* 79 Fed. Res. Bulletin. 626 (1993). *See also, The Governor and Company of the Bank of Ireland,* 82 Fed. Res. Bulletin 1129 (Oct. 21, 1996) (also relying on the independence of the board of directors).

[15] The court stated that

> In the typical distribution of securities, an underwriter purchases securities from an issuer, frequently in association with other underwriters. The distribution of these securities to the public may be effected by the underwriters alone, or in conjunction with a group of dealers who also purchase and sell the securities as principals. Underwriters may also distribute securities on a "best efforts" agreement pursuant to which large blocks of specific issues of securities are offered to the public by the investment banker as agent for the issuer. A "best efforts" distribution is not technically an underwriting. 1 L. Loss, Securities Regulation 172 (2d ed. 1961).

Id. at 217. Like the brokerage activities at stake in *Schwab* which the court stated "involves none of these distribution plans," the bank's proposal does not involve distribution.

12 USC 378. Despite the different terminology, the Supreme Court has held that section 16 and section 21 seek to draw the same line.[16] Thus, a finding that the proposed activities are permissible under section 16 necessarily leads to the conclusion that they are not prohibited by section 21. For the reasons noted above, we believe that the bank's proposed activities are permissible under section 16. Further, for the reasons noted by the Court in *Schwab* (which interpreted section 20), the term "distribution" should connote an activity that has the same general attributes as "underwriting" and "dealing." And, as noted above, there is no impermissible underwriting or dealing in the bank's proposal.

Finally, the bank's proposal does not involve any changes in employee interlocks and therefore does not raise any issue of prohibited employee interlocks between the bank and the mutual funds prohibited by section 32.[17] In sum, we find that the proposed activities are permissible under the GSA.

3. Conclusion

Based on the above analysis, we find that the proposed activities are permissible banking activities and are not prohibited by the Glass–Steagall Act. Other than as noted herein, we are not expressing any opinion on compliance with other federal banking laws, regulations, or directives or compliance with federal securities laws.[18]

If you have any questions, please contact Nancy Worth, Senior Attorney, Securities and Corporate Practices Division, at 202–874–5210.

Julie L. Williams
Chief Counsel

[16] *Securities Industry Ass'n.* v. *Board of Governors of the Federal Reserve System,* 468 U.S. 137, 149 (1984). Courts have found that section 21 cannot be read to prohibit what section 16 permits. *See Bankers Trust II,* 807 F.2d at 1057; *Board of Governors of the Federal Reserve System* v. *Investment Company Institute,* 450 U.S. 46, 63 (1981).

[17] 12 USC 78. *See also,* Lieber letter, *supra* (finding no prohibited relationships).

[18] We also note that examiners will review the safety and soundness of the advances being made as part of the normal supervisory process.

805—October 9, 1997

12 USC 24(7) *[file 14]*

RE: Notice of Expanded Marketing by [ ]

Dear [ ]:

This is in response to your notice dated August 22, 1997 (the "notice") that [ ] (the "company"), in which [ ] (the "bank") holds a minority interest, plans to expand the marketing of its electronic imaging services[1] beyond medical claims processing. Specifically, the company intends to market electronic imaging services to (1) banks and other financial services companies and (2) nonfinancial services companies for use with financial data. In addition, the company plans to utilize its excess capacity in electronic imaging to provide limited services to nonfinancial entities for use with nonfinancial data. For the reasons below, we do not object to the expanded marketing as described in the notice, provided that the conditions imposed in the OCC's March 12, 1996 letter shall continue to apply to all activities conducted by the company.

On March 12, 1996, OCC issued an opinion letter to *[corporation]* concluding that, subject to certain conditions, the bank could lawfully acquire a 49 percent interest in the company, which is engaged in the use of data processing and electronic interchange facilities to assist hospitals and physicians in communicating billing and payment-related information. Among other things, the company stores, processes, and retrieves documents and information needed to substantiate submitted medical claims through proprietary software systems designed by the company for these purposes.

Subsequent to the bank's acquisition of its minority interest in the company, the company decided (based upon the bank's recommendation) to market its document storage, retrieval, and management systems using electronic imaging to banks and other financial institutions. For example, the electronic imaging services proposed to be offered to the banking industry include loan document management systems and signature verification systems using optical storage technology. The company also proposes to market its electronic imaging systems to nonbank firms, but would limit the marketing to financial information systems.

The OCC has said that national banks are legally permitted to make a minority investment in a company provided four criteria or standards are met. *See* OCC Interpretive

[1] Electronic imaging systems use digital technology to capture, index, store, and retrieve electronic images of paper documents. *See, generally,* OCC Bulletin 94–8 (January 27, 1994).

Letter No. 732, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–049 (May 10, 1996); OCC Interpretive Letter No. 692, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007 (November 1, 1995); and OCC Interpretive Letter No. 694, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009 (December 13, 1995). These standards, which have been distilled from our previous decisions on permissible minority investments for national banks and their subsidiaries, are:

(1) The activities of the enterprise in which the investment is made must be limited to activities that are part of or incidental to the business of banking.

(2) The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

(3) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

(4) The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

In the March 12, 1996 letter, the OCC concluded that the proposed investment in the company met all four criteria. The notice states that the proposed expansion of activities will not affect the second, third, and fourth criteria. We agree. We also agree that the proposed additional activities of the company are part of the "business of banking" or incidental thereto under 12 USC 24 (Seventh), and therefore satisfy the first criterion.

The provision of electronic imaging services to banks and other financial institutions is clearly part of the business of banking. Many banks and financial institutions use electronic imaging systems to process and store their documents efficiently.[2] National banks are permitted to provide data processing and other computer-related services to other financial institutions. OCC Interpretive Letter No. 754, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–118 (Nov. 6, 1996). Because they are correspondent banking services, such services are part of the business of banking. *Id.* Moreover, the OCC has found document control and record keeping to be a permissible bank correspondent service.[3] The use of electronic imaging technology to provide the same type of correspondent banking document management services does not render the services impermissible. 12 CFR 7.1019. Thus, the company may provide electronic imaging services to banks and other financial institutions.[4]

The company also proposes to market its image processing services to nonbanks for use with financial data and documents. This is permissible under the OCC's March 12, 1996 letter. The letter found the company's document and data processing for medical firms to be permissible based upon OCC's longstanding position that, as part of the business of banking, national banks may provide nonbanks with electronic data processing for financially related data. While the company proposes no longer to limit its processing to medical firms, the nature of the customer firms was not a material factor in the legal analysis of the March 12, 1996 letter or the precedent cited. Thus, this aspect of the proposed expansion is also permissible.

Finally, the company plans, on a limited basis, to market excess capacity in its imaging processing equipment to school districts and other nonfinancial entities for use in processing nonfinancial data.[5] You have represented that the company will conduct these nonfinancial activities using good faith excess capacity as required in 12 CFR 7.7019. *See, e.g.,* OCC Interpretive Letter No. 742, *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–106 (August 19, 1996). In this regard, the company does not expect revenues from the sale of its services to school districts and other nonfinancial services companies to exceed five (5) percent of its total revenues.

Thus, we have no objection to the company conducting the expanded marketing of its electronic imaging systems as described in the notice, provided that the conditions imposed in the OCC's March 12, 1996 letter shall continue to apply to all activities conducted by the company.

Julie L. Williams
Chief Counsel

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[2] *See, e.g.,* OCC Bulletin 94–8, *supra,* and Remarks of Comptroller Eugene A Ludwig Before the Women in Housing and Finance Technology Symposium (December 4, 1996), in *Quarterly Journal,* No. 16, No. 1, March 1997.

[3] *See* OCC Interpretive Letter No. 513, *reprinted in* [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,215 (June 18, 1990) (permitting national banks to provide other financial institutions with loan application and disclosure documents, mail room processing, bank communication support services, and courier services).

[4] The company should be aware that use of electronic imaging systems by banks can raise supervisory issues (see OCC Bulletin 94–8, *supra)* and that, by providing such services to depository institutions, the company will become subject to examination and regulation under the Bank Service Company Act, 12 USC 1867(c).

[5] However, the company anticipates that the school districts will use the company's services in part, if not primarily, for processing financial data.

806—October 17, 1997

12 USC 24(7)
12 USC 371

Mr. Steven T. Thomas
General Manager
United Bank of Kuwait
Tower 56
126 East 56th Street
New York, New York 10022

Dear Mr. Thomas:

This responds to your letter and subsequent telephone discussions requesting our opinion regarding whether the National Bank Act permits The United Bank of Kuwait PLC ("UBK" or "branch"), a federal branch located in New York, New York, to offer a residential net lease home finance product as part of the business of banking, pursuant to 12 USC 24(Seventh) and 12 USC 371. The branch currently has an active mortgage lending business and wishes to have the flexibility to offer net leases to meet the special needs of its customers who adhere to the principles of Islam. The religious prescriptions of Islam or other faiths prohibit home purchasers from borrowing money where the lender charges interest and, therefore, effectively prohibit such individuals from purchasing homes by executing standard mortgages. The branch proposes an alternative arrangement to help Islamic customers purchase residential real estate. The branch will finance the home purchase contingent upon the branch and the customer executing a net lease and purchase agreement. UBK argues that the economic substance of the net lease will be functionally equivalent to secured real estate lending. UBK further represents that its proposal satisfies accounting requirements so that the net lease will be characterized as financing rather than leasing. UBK anticipates that the Internal Revenue Service ("IRS") will treat its proposal as financing rather than leasing. As discussed below, we conclude that UBK may conduct the activity based upon the facts and circumstances described herein.

I. UBK's Proposal

UBK will structure the residential home financing arrangement as follows. The lessee will contract with the seller to buy a single family residence and will tender a down payment toward such purchase. Before funding the remainder of the purchase price, UBK and the lessee will simultaneously enter into a net lease agreement and a purchase agreement (collectively "the agreements"). The lessee will accept the property "as is" and UBK, as lessor, will make no representations or warranties regarding the property or its suitability. Then, UBK will supply the remainder of the funds to purchase the property from the seller under the sales contract. UBK will have "legal title" to the property. UBK will record its interest in the property in the same manner as it would record a traditional mortgage.

UBK will not purchase or maintain an inventory of properties to sell to customers. Instead, the customer will be required to find the property that he or she wishes to purchase and negotiate the terms of the purchase with the seller. The branch also will not serve as a real estate broker or agent.

The net lease will convey to the lessee occupancy rights in and to the property for a specified number of years. The net lease will require that the lessee maintain the property, and pay charges, costs, and expenses attributable to the property that an owner or purchaser would ordinarily otherwise pay. Monthly lease payments will be sufficient to cover principal and interest, and pay insurance and property taxes. The lessee will amortize the entire principal by the end of the lease term.

The lessee will automatically become the legal owner of the property upon fulfilling the terms of the lease. Once the lessee pays the final lease installment, the lessee will not have to take any additional steps to acquire title to the property. The purchase agreement will also provide that the lessee may acquire title to the property anytime before the expiration of the lease by prepaying the remainder of the purchase price.

In case of a material default under the lease, UBK will have remedies against the lessee for nonpayment similar to those available to a lender on a "traditional" nonrecourse mortgage. UBK will provide notice of default to the lessee and give the lessee an opportunity to cure the default. If the lessee cannot cure the default within a specified time, UBK will treat the property as if it had been acquired in foreclosure. UBK will not relet the property; instead, it will treat the property as other real estate owned ("OREO") and sell the property in accordance with 12 USC 29 and 12 CFR Part 34.

UBK represents that the net lease financing program satisfies the requirements of generally accepted accounting principles and the net lease will be treated as financing rather than leasing. The branch's general ledger would have accounts called residential loans and Islamic home finance lease receivables. The branch will use the accrual methodology to account for both the conventional mortgage and the net lease home finance product. Although the two products will have different documentation, the monthly lease payments will be calculated in the same manner. UBK will add its margin to its cost of funds at the beginning of the lease. The London interbank offered rate will be used to determine

UBK's cost of funds. UBK will then allocate lease payments to mirror the principal and interest breakdown of a conventional mortgage.

UBK also anticipates that the IRS will treat the net lease as financing and allow the customer to deduct the interest portion of the lease payment in the same manner as interest is deducted on traditional mortgages.

UBK initially intends to provide net lease financing for home purchases in [ ] states: [ ]. UBK estimates that loan demand could reach $[ ] during the first few years. The branch currently has approximately $68 million in assets and expects [ ] percent additional growth in 1997. UBK anticipates [ ] percent annual growth thereafter. UBK has an existing mortgage lending portfolio of approximately $[ ]. The branch anticipates that its mortgage loan portfolio will increase to approximately $[ ] by year-end 2001. If approved, it anticipates that the proposed net lease home finance product will account for approximately $[ ] (i.e., [ ] percent) of the mortgage loan portfolio. During the startup phase of the program, UBK will monitor the condition of the properties. UBK intends to have an appraiser and compliance officer as part of its staff to inspect the properties periodically. If demand for the program increases, UBK may contract with a third party to service the loans.

II. Discussion

The International Banking Act of 1978 permits federal branches to engage in the business of banking under the rules, regulations, or orders that the OCC considers appropriate. Federal branches may conduct their operations with the same rights and privileges provided to national banks under the National Bank Act. *See* 12 USC 3102(b). UBK is a federal branch of a foreign bank and may engage in activities that the Comptroller, in his discretion, considers to be part of, or incidental to, the business of banking. *See* 12 CFR 28.13(a).

A. Applicable Law

The National Bank Act provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes . . . .

12 USC 24(Seventh).

The Supreme Court has held that this clause is a broad grant of power to engage in the business of banking including, but not limited to, the five specifically recited powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A.* v. *Variable Life Annuity Co.,* 513 U.S. 251(1995), 115 S. Ct. 810 (1995) *("VALIC").* Many activities that are not included in the enumerated powers are also part of the business of banking. Judicial precedent reflects three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. *See, e.g., Merchants' Bank* v. *State Bank,* 77 U.S. 604 (1871); *M & M Leasing Corp.* v. *Seattle First Nat'l. Bank,* 563 F.2d 1377 (9th Cir. 1977), *cert. denied,* 436 U.S. 956 (1978); *American Ins. Ass'n.* v. *Clarke,* 865 F.2d 278 (2d Cir. 1988).

B. UBK's Net Lease Proposal is Within the Scope of the Business of Banking

1. UBK's proposal is functionally equivalent to or a logical outgrowth of secured lending

UBK's residential real estate financing proposal is functionally equivalent to or a logical outgrowth of secured real estate lending or mortgage lending, activities that are part of the business of banking. *See M & M Leasing Corp.* v. *Seattle First Nat'l Bank,* 563 F.2d 1377 (9th Cir. 1977), *cert. denied,* 436 U.S. 956 (1978). National banks are expressly authorized to make loans under 12 USC 24(Seventh) and underwrite mortgages under 12 USC 371. But, in the current financial marketplace, lending takes many forms. Today, banks structure leases so that they are functionally equivalent to lending secured by personal property. In the *M & M Leasing* decision, the court noted that in appropriate circumstances, a lease transaction may constitute a loan of money secured by the property leased. *Id.* at 1380. The court reasoned that because secured lending and personal property leasing are functionally interchangeable, personal property leasing was within the business of banking and was therefore permissible. *Id.* at 1382. According to the court, a lease that has the economic attributes of a loan is simply a new way of conducting an activity that is within the business of banking.

Although the Ninth Circuit was careful not to define the "outer limit of the 'business of banking,'" it rejected a narrow interpretation of national banks' leasing authority. In the *M&M Leasing* decision, appellants argued that secured lending to permit the acquisition of property could be accomplished through traditional forms, and that a loan of money on personal security should be accomplished by a loan secured by a chattel mortgage or a conditional sales contract. *Id.* The Ninth Circuit rejected this narrow view of the "business of banking" and stressed that the "functional interchangeability" of leasing and lending was the touchstone of its decision. *Id.* at 1383. The court's point, stated differently, is that when the economic characteristics of a lease are substantially similar to a loan, the lease may be considered to be functionally equivalent to the loan. Therefore, the substance of the transaction, rather than its form, should guide our analysis.

The Ninth Circuit also emphasized that its holding was not without limits. The court did not embrace the view that national banks may engage in any type of leasing activity. *Id.* at 1393. For example, a lease, which from its inception inevitably must be repeated or extended to enable the bank to recover its advances plus profit, is not a "loan of money on personal security." *Id.* at 1384. A lease of this nature would be more akin to conducting a rental business. To engage in this type of business would cause national banks to assume risks that they are not permitted to undertake. *Id.* In making this distinction, the court made it clear that only those leases which were functionally interchangeable with loans were within the "business of banking."

The principles articulated in the *M & M Leasing* decision are not unique to personal property leasing. In reaching its conclusion that 12 USC 24(Seventh) permits national banks to lease personal property, the Ninth Circuit stressed that personal property leasing did not define the "outer limit of the 'business of banking,'" and that the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking. *Id.* at 1382.[1] The court drew comfort in noting that "commentators unanimously have recognized that the National Bank Act did not freeze the practices of national banks in their nineteenth century form," and cautioned that an overly "technical reasoning [of the statute] could stop the development of a new machinery rendered necessary by the new needs of an expanding trade." *Id.* at 1382. The court recognized that the "business of banking" is in a constant state of evolution and must be given a broad and flexible interpretation to allow national banks to use modern methods and meet modern needs.

The *M&M Leasing* decision could be read to mean that the classification of the property as real or personal property should not determine whether national banks can participate in certain forms of lending transactions. Instead, the economic substance of the transaction, rather than its form, should guide our analysis of whether national banks can engage in a particular activity. The OCC has followed this line of analysis in many of our other precedents. *See* OCC Interpretive Letter No. 717, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,032 (March 22, 1996) (national bank's purchase of tax certificates deemed to be authorized under 12 USC 371 because it is functionally equivalent to the making or purchasing of real estate–secured extensions of credit); OCC Interpretive Letter No. 687, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,002 (August 5, 1995) (using transparency analysis to conclude that a national bank may participate in a limited partnership which invests in a pool of bank eligible securities); OCC Interpretive Letter No. 649, *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,556 (May 12, 1994) (retirement CD deemed to be a permissible financial product whose primary attributes are grounded in the bank's express authority to receive deposits, enter into contracts, borrow, and otherwise fund their operations); OCC Interpretive Letter No. 388, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612 (June 16, 1987) (OCC opined that the issuance of mortgage-backed pass-through certificates evidencing ownership interests in a national bank's conventional mortgage assets represents a negotiation of evidences of debt and the sale of real estate loans); OCC Investment Securities Letter No. 29, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85, 899 (August 3, 1988) (national bank's investment in separate trusts funded by one company and guaranteed by the same company should be treated as investment in the securities of "one obligor" when determining whether a bank has complied with the investment limits of 12 USC 24(Seventh) and 12 CFR Part 1).

Courts have supported the Comptroller's position. *See American Ins. Ass'n.* v. *Clarke,* 656 F.Supp. 404 (D.D.C. 1987), *aff'd.,* 865 F.2d 278 (D.C. Cir. 1988) *("AMBAC"); Securities Indus. Ass'n.* v. *Clarke,* 885 F.2d 1034 (2d Cir. 1989), *cert. denied,* 110 S.Ct. 1113 (1990) *("SIA").* In

[1] For example, UBK's proposal is similar to the bank's lease of "big ticket" items, *i.e.,* boats, airplanes, mobile homes, etc., that was discussed in the *M&M Leasing* decision. In those circumstances, the customer calls the bank directly and expresses an interest in leasing a particular item. This contact is essentially to inquire about the availability of credit. The bank performs no procurement function. The customer chooses the item that he or she wishes to lease and negotiates the terms of the lease agreement with the merchant. If the bank decides that the customer is an acceptable credit risk, it then purchases the property and leases it to the customer. Delivery by the seller is made directly to the customer-lessee who makes the lease payments to the bank. *Id.* at 1380–81. In UBK's case, the lessee locates the property and arranges the terms with the seller. The lessee will then contact UBK and, if UBK decides that the lessee is an acceptable credit risk, UBK will provide funding for the remainder of the purchase price. UBK will lease the property to the lessee for a specified lease term. These types of leases impose no more onerous economic burdens on banks than other types of leases or a mortgage. *Id.* at 1381.

the *AMBAC* decision, the D.C. Circuit emphasized that bank powers analysis should focus on the substance of the transaction and not proceed from the narrow and artificially rigid view of both the business of banking and the statute that governs that business. *See AMBAC,* 656 F. Supp. at 404. The court endorsed the OCC's position that in determining whether an activity constitutes part of the business of banking, the Comptroller may "look beyond the label given to a certain activity to determine whether or not it is permissible." *Id.* The court then upheld the Comptroller's determination that a national bank's issuance of standby letters of credit in the form of municipal bond insurance was the "functional equivalent" of the issuance of a letter of credit, which is a permissible banking activity under section 24 (Seventh). In reaching its decision, the court recognized that although neither letters of credit nor municipal bond insurance are enumerated as permissible bank products under the National Bank Act, extending credit is a fundamental banking practice that can take a variety of forms, notwithstanding the label given to the activity. *Id.*

The Second Circuit Court of Appeals used a similar approach in the *SIA* decision. In that case, the Second Circuit reviewed whether the National Bank Act permitted a national bank to sell pass-through mortgage-backed certificates. The bank had originated the loans and subsequently placed them in a pool. The loans were then transferred to a trust. In exchange for the pool, the trustee transferred pass-though certificates to the bank. The certificates were later sold publicly. The court agreed with the OCC's decision that the sale of pass-through certificates was, in substance, the use of a new mechanism to perform the "old job of selling bank assets." *See SIA,* 885 F.2d at 1044. *See also* OCC Interpretive Letter No. 388, *supra.* The court also agreed that the sale of pass-through certificates was incidental to the business of banking because it was "convenient and useful" in connection with the bank's sale of mortgage loans. *See SIA,* 885 F.2d at 1044. In reaching its decision, the Court of Appeals rejected the district court's analysis which focused on the form of the transaction rather than its substance. *Id.*

In *VALIC,* the Supreme Court considered whether national banks may serve as agents in the sale of annuities. The Comptroller considered the sale of annuities as "incidental" to "the business of banking" under the National Bank Act , 12 USC 24(Seventh), and concluded that annuities are not insurance within the meaning of 12 USC 92, which prohibits insurance sales by banks in towns with more than 5,000 people. *See VALIC,* 513 U.S. at ___. The court agreed with the Comptroller's interpretation that annuities should be classified according to their functional characteristics, *id.* at ___, and concluded that annuities are financial investment instruments, and not insurance. *Id.* at ___. The court recognized that annuities serve an important investment purpose and are functionally similar to other investments that banks typically sell. *Id.* at ___. Indeed, the court equated annuities to having a savings account, a debt instrument, or mutual fund and stated that modern annuities, though more sophisticated than standard savings bank deposits of old, answer the same needs. *Id.* at ___. In effect, the court rejected the label of insurance and looked at the substance of the instrument and determined that the bank may sell annuities as an incidental activity necessary to carry on the business of banking.

The principle of focusing on economic substance over form is also a recognized concept in generally accepted accounting principles and specifically applies to leases. A lease that transfers substantially all of the benefits and risks incident to the ownership of property should be accounted for as the acquisition of an asset by the lessee and as a financing by the lessor. In other words, in a lease that transfers substantially all of the benefits and risks of ownership to the lessee, the economic effect on the parties is similar to an installment purchase by the lessee. *See* Financial Accounting Standards No. 13 ¶ 60. A lease would generally be accounted for as a financing under generally accepted accounting principles if (1) the underlying property is transferred to lessee at the end of the lease or (2) the lease contains a bargain purchase that is reasonably assured of being exercised, and (3) it is reasonably certain that lease payments will be collected and (4) no uncertainties surround the amount of unreimbursable costs yet to be incurred by the lessor under the lease. *See* Financial Accounting Standards No. 13 ¶ 7.

Similarly, commercial law recognizes the principle of economic substance over form. For example, the Internal Revenue Service has adopted this concept and courts have affirmed IRS decisions that have relied upon this reasoning. *See e.g., Helvering* v. *Lazarus & Co.,* 308 U.S. 252, 255 (1939) (courts are concerned with substance and formal written documents are not rigidly binding); *Kirchman* v. *Comm'r,* 862 F.2d 1486, 1491 (11th Cir. 1989) (courts should look to the substance of a transaction rather than just its form); *Saller* v. *United States,* 694 F.2d Supp. 224, 226 (E.D. Tex. 1988) (generally the substance of the commercial transaction, not merely its form, is determinative of questions of economic reality); *Sun Oil Co.* v. *Comm'r,* 562 F.2d 258, 263 (3d Cir. 1977) (court should look to the economic realities of a lease transaction and not to the labels applied by the parties); *Carr Staley, Inc.* v. *United States,* 496 U.S. 1366, 1375 (legal title to property is not the decisive factor in determining whether government may tax the income accruing to that property).

Specifically, the Internal Revenue Service developed objective factors to determine when a purported purchase and lease transaction may be recharacterized as a financing. *See* Rev. Rul. 55–540, 1955 IRB (LEXIS 24). The ruling states that in the absence of "compelling factors" to the contrary, the presence of one or more of the following factors warrants recharacterizing a purported lease as an installment sale or loan transaction:

(a) Portions of the periodic payment are made specifically applicable to an equity interest that the lessee will acquire;

(b) The lessee will acquire title upon payment of a stated amount of "rentals" which the lessee is required to make under the contract;

(c) The lessee may acquire the property under a purchase option at a price which is nominal in relation to the value of the property at the time when the option may be exercised, as determined at the time of entering into the original agreement, or which is a relatively small amount when compared with the total payments that the lessee is required to make;

(d) Some portion of the periodic payment is specifically designated as interest or is otherwise readily recognizable as the equivalent of interest.

Id. See also Helvering v. *Lazarus & Co.,* 308 U.S. 252 (affirming the Circuit Court and the IRS rulings).

This substance over form approach has been followed in the bankruptcy context. *See In re Omne Partners II,* 67 Bankr. 793, 795–797 (Bankr. D.C.N.H. 1986). There, the court stated that it may consider the parties' intent and look through the form to the substance of the transaction to determine the rights of the parties. *Id.* at 795–797 (court found that the economic substance of a sale-leaseback transaction that included a "triple net lease" was not a disguised financing transaction).

Here, it is apparent that UBK's net lease proposal is functionally equivalent to a financing transaction in which the branch occupies the position of a secured lender. The transaction conveys the benefits and burdens of ownership to the lessee. Once the lessee enters into the sales contract, but before UBK funds the remainder of the purchase price, UBK and the lessee negotiate the terms and conditions of the agreements. Under the net lease, the lessee will make periodic payments, maintain the property, pay charges, costs, and incur expenses attributable to the property that the owner would otherwise pay. UBK will ensure that the lessee is capable of complying with the terms and conditions of the net lease. The branch will review the creditworthiness of each lessee to ensure that the lessee can make minimum monthly lease payments. UBK will use the same formula that it uses to set traditional mortgage payments to determine the amount of monthly lease payments. The amount of the monthly lease payments will cover principal and interest and will be sufficient to amortize the entire purchase price by the end of the lease term. The lessee will acquire title to the property at the end of the lease term or earlier if the lessee pays the remainder of the purchase price. And, as is the case in a conventional mortgage transaction, the lessee will not have to take any additional action to acquire title after the lease expires. Thus, UBK's net lease proposal, in substance, has the characteristics of a financing transaction.

Our view that UBK's net lease proposal is functionally equivalent to financing is bolstered by UBK's representations that its proposal satisfies generally accepted accounting principles for lease financing transactions. The Internal Revenue Service also accepts the principle that a lease may be functionally equivalent to financing and UBK anticipates that the IRS will allow the lessee to deduct the interest portion of the monthly lease payment from its taxes in the same manner as interest is deducted on a traditional mortgage. Moreover, the net lease proposal is not representative of the type of activity that the Ninth Circuit explained was outside of the "business of banking." The net lease proposal is not akin to conducting a real estate rental business because the branch will not purchase or maintain an inventory of real estate to sell to customers. The branch will not serve as a real estate broker or agent. Also, as will be explained more fully below, UBK's net lease proposal will not cause the branch to assume impermissible risks. The net lease proposal is functionally interchangeable with secured real estate lending or mortgage lending, activities that are part of the business of banking, and represent a "new way" of providing financing. UBK's net lease proposal shows that the "business of banking" is not a static concept; instead, it is an evolving, organic concept that responds to developments in the financial marketplace and responds to the needs of the branch's customers.

2. UBK's net lease proposal responds to customers' needs and also will benefit UBK

UBK's net lease proposal responds to the special issues regarding Islamic customers by providing an alternative method for a discrete group to get access to credit without forcing them to choose between their religion and home ownership. It allows followers of Islam to purchase homes without violating Islamic proscriptions on borrowing money on which interest is charged. Furthermore, UBK's net lease proposal is consistent with the well-established public policy of encouraging home ownership.

3. UBK's net lease proposal involves risks similar to those already assumed by the branch

The risks posed by UBK's net lease proposal would be essentially the same as those associated with underwriting traditional mortgage loans. In both secured lending generally, and mortgage lending, in particular, the branch makes a judgment concerning the borrower's creditworthiness. As with both arrangements, the branch's decision to accept the credit risks are determined by the branch's underwriting standards, which are derived from the branch's lending experience and expertise. In a typical case, the branch makes a loan to its customer secured by a lien on the property that is being purchased. The customer makes monthly mortgage payments until the loan is amortized. If the customer defaults on the loan, the bank forecloses on the property, provides notice of sale, and sells the property. The bank also has the option of holding the property as OREO in accordance with 12 CFR 34. Here, UBK will follow the same procedures. UBK will not relet the property. Instead, UBK will characterize the property as OREO and dispose of it in accordance with 12 USC 29 and 12 CFR Part 34. Therefore, UBK's risks under the net lease real estate finance program are similar to its risks on traditional mortgage loans.

UBK also proposes to pool and securitize its leases and ultimately sell them on the secondary market. UBK represents that there is an active market for securitized leases. This aspect of the net lease proposal is similar to the authority provided in 12 USC 371(a) which allows national banks to sell loans. Twelve USC 371(a) provides that:

> Any national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interest in real estate, subject to section 1828(o) of this title and such restrictions and requirements as the Comptroller of the Currency may prescribe by regulation or order.

12 USC 371(a).

Even before the creation of this express authority for banks to sell their mortgage loans, however, the Supreme Court had already determined that the sale of mortgages and other evidences of debt acquired through a national bank's exercise of its express power to lend money on the security of real estate, and to discount and negotiate other evidences of debt, was authorized as part of the business of banking under 12 USC 24(Seventh). *See First Nat'l. Bank of Hartford* v. *Hartford,* 273 U.S. 548, 560 (1927). *See also* OCC Interpretive Letter No. 388, *supra*. Because national banks may sell their mortgage assets under the express authority of 12 USC 24(Seventh) and 12 USC 371(a), that rationale should extend to UBK's net lease proposal since the branch's proposed activity is functionally equivalent to secured lending or mortgage lending. Moreover, a portfolio of prudently arranged leases would not impose greater risks on the branch than a portfolio of equally prudently arranged loans. *M&M Leasing,* 563 F.2d at 1381–1382. UBK's net lease proposal provides the branch with the ability to engage in more creative and flexible financing, and to become a stronger participant in the home finance market.

Furthermore, securitizing leases serves specific banking purposes. Securitizing leases that the branch would otherwise hold for 20 or 30 years provides needed liquidity to the branch's real estate finance program. This results in the generation of additional funds for new financing activities and other purposes. *See* OCC Interpretive Letter No. 388, *supra*. UBK anticipates that investors from the Islamic community, among others, will purchase these securities on the secondary market. Accordingly, the proposal responds to customers' needs and benefits UBK.

III. UBK's Proposal Does Not Violate the Policies of 12 USC 29

A. Language and Intent of 12 USC 29

The National Bank Act provides that national banks may:

> purchase, hold, and convey real estate for the following purposes, and for no other:
>
> **First.** Such as shall be necessary for its accommodation in the transaction of its business.
>
> **Second.** Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.
>
> **Third.** Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.
>
> **Fourth.** Such as it shall purchase at sales under judgments, decrees, or mortgages held by the association, or shall purchase to secure debts due to it.
>
> But no such association shall hold the possession of any real estate under mortgage, or the title and possession of any real estate purchased to secure any debts due to it, for a longer period than five years . . . .

12 USC 29.

At first glance it might appear that UBK's net lease proposal is contrary to 12 USC 29 because UBK will have legal title to the real estate.[2] But such a narrow view

[2] Legal title refers to "one which is complete and perfect so far as regards the apparent right of ownership and possession, but which carries no beneficial interest in the property, another person being equitably entitled thereto." *Black's Law Dictionary* 897 (6th ed., 1990).

of the statute would elevate form over substance because, in this case, having legal title is largely cosmetic and the actual indicia of ownership are borne by the lessee.

The branch does not, and will not, actually hold real estate. It will not operate the property, pay taxes, insurance, and other charges, maintain upkeep of the premises, make repairs when necessary, assume liability for injuries or other accidents on the property, or otherwise exercise dominion and control over the property. The lessee, and not the branch, will bear these responsibilities. Although the branch will have legal title to the property,[3] it will not take actual possession of the property at any point during the lease term. The branch will only take possession of the property if the lessee defaults or upon termination of the lease.[4] If the branch does take possession of the property, it will take the property as OREO within the meaning of 12 USC 29. Thus, despite the cosmetic appearance of the branch holding real estate, the substance of the transaction shows that the branch and the lessee will have an arms-length, mortgagor–mortgagee relationship.

While UBK's net lease proposal is unique, the concept is not. The OCC has supported this concept in at least three contexts in which national banks had legal title, but were not in violation of 12 USC 29 because the substance of the transactions showed that the banks were not holding real estate. They buttress our view that analysis of 12 USC 29 does not end with the form of the transaction.

The first context concerns providing financing to municipalities. *See* 12 CFR 7.1000(d). Twelve 12 CFR 7.1000 provides that:

> A national bank may purchase . . . a municipal building, school building, or other similar public facility and, as holder of legal title, lease the facility to a municipality or other public authority having resources sufficient to make all rental payments as they become due. The lease agreement must provide that the lessee will become owner of the building or facility upon the expiration of the lease.

[3] The branch may create or contract with a trust to hold title to the properties.

[4] It is unlikely that the lessee will not take possession of the property at the end of the lease term because the lessee will have made sufficient payments to acquire title to the property and no further steps will be necessary to take possession of the property. Therefore, the branch is likely to take possession of the property only if the lessee defaults on the lease.

12 CFR 7.1000(d)(1). The regulation envisions that the parties will structure the lease so that it has the characteristics of a loan. *See* Letter from Robert J. Herrmann, Domestic Operations Division (June 15, 1977) (unpublished); Letter from Kenneth Leaf, CNBE (November 28, 1972) (unpublished); Letter from Thomas DeShazo, Deputy Comptroller of the Currency (October 23, 1968) (unpublished). The purpose of the regulation is to provide financing to municipalities secured by real estate.

The OCC has also declined to object to an analogous situation involving a land sale contract,[5] and has determined that such contracts are part of the business of banking. *See* OCC No Action Letter 86–2 from James M. Kane, District Counsel, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,008 (February 25, 1986) ("Kane Letter"). In the Kane Letter, a lessee entered into a land contract with a seller to purchase a home. The lessee then paid a portion of the purchase price. The bank subsequently paid the remainder of the purchase price to the seller who, in turn, assigned its interest in the land contract to the bank and conveyed a warranty deed[6] to the bank. The lessee was legally prohibited from giving the bank a mortgage. The bank received title to the property incidental to its purchase of the land sale contract pursuant to 12 USC 371 and 12 CFR Part 34. The lessee paid monthly installments to the bank. There, the OCC did not object to the transaction. Instead, we reasoned that the seller's conveyance of title in the real estate to the bank while simultaneously assigning its interest in the land contract to the bank is incidental to the transaction because the transfer of seller's interest in the real estate alone, if properly recorded, entitles the bank to a priority interest. Therefore, a land sale contract has the same substantive effect as a traditional mortgage if it is properly recorded.

UBK's proposal is analogous to the bank's purchase of an interest in the land sale contract discussed in the Kane Letter. UBK will fund the remainder of the purchase price and will have title to the real estate. It will simultaneously purchase and lease the property to the lessee. The lessee will make monthly payments to the branch and UBK will transfer title to the lessee at the end of the

[5] A land contract (or land sale contract) is a contract for the purchase and sale of land upon execution of which title is transferred. The term commonly refers to an installment contract for the sale of land whereby lessee receives the deed from the owner upon payment of the final installment. The vendor retains legal title to the property (deed) as security for payment of the contract price. *Black's Law Dictionary* 879 (6th ed., 1990).

[6] Warranty deed refers to a deed which explicitly contains covenants concerning the quality of title it conveys. The usual covenants of title are warranties of seisin, quiet enjoyment, right to convey, freedom from encumbrances and defense of title as to all claims. *Black's Law Dictionary* 1589 (6th ed., 1990).

lease term. The net lease proposal is functionally equivalent to an extension of credit secured by a lien on, or an interest in, real estate, and is an alternative method that a branch may use for financing real estate.

Furthermore, the OCC also did not object to a national bank holding a portfolio of Maryland ground rents. *See* Letter from William Glidden (January 17, 1996) (unpublished). A ground rent is a reversionary interest in an estate in land that is subject to a perpetually renewable lease. The only covenants are the payment of rent and taxes.[7] The OCC did not object to the interpretation of Maryland statutory and common law that the ground rent arrangement was more akin to a mortgagor–mortgagee relationship than a landlord–tenant relationship. We agreed with the reasoning that the Maryland ground rent was functionally equivalent to holding a security instrument to secure payment of money due under 12 USC 371, rather than an investment in real estate within the meaning of 12 USC 29. The Internal Revenue Service's interpretation allowing a lessee's payment of ground rent to be treated as a deduction in the same manner "as interest on indebtedness secured by a mortgage" bolstered our conclusion. *See* 26 USC 163(c). Similarly, the Federal Housing Administration ("FHA") historically treated ground rents like mortgages.[8] Accordingly, we concluded that the Maryland ground rent arrangement did not violate 12 USC 29.

In each of these circumstances, we looked beyond labels to the substance of the transaction and allowed national banks to find creative ways to finance real estate even if the bank, as a technical matter, had legal title. Such financing transactions are permissible if, as here, the obligor is creditworthy, the transaction is functionally akin to a traditional mortgagor–mortgagee arrangement, rather than a landlord–tenant relationship, and the transaction would not expose the bank to undue risks.

[7] The following example demonstrates how a ground rent is created. A buyer purchases a house which cost $16,000. The bank holds the ground rent to the property which is valued at $2,000. The ground rent lessee possesses the vast majority of the "bundle of rights" traditionally associated with ownership of property. The buyer is given absolute control over property subject only to the buyer's payment of taxes and lease payment. The buyer has an absolute right to "redeem," or acquire the fee estate in, the property at the time of the buyer's choice, and for a sum certain. *See* Md. Code Ann. 8–110 (1996 Repl. Vol.).

[8] The policy of the FHA was to guarantee loans up to 80 percent to 90 percent, depending on the status of the property. In guaranteeing mortgages on leasehold estates, the FHA deducted the capitalized value of a redeemable ground rent from the value of the property. Thus the FHA did not consider the leasehold as a separate entity. Instead, it valued the property as a whole and deducted the capitalized value of the ground rent as if it were a mortgage.

UBK's net lease proposal is also similar to "riskless principal" securities transactions in which a broker executes a purchase (or sale) only if it can conduct an offsetting sale (or purchase). *See* OCC Interpretive Letter No. 371, *reprinted in* [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85, 541 (June 13, 1986) (bank's subsidiary may act as broker of securities of foreign issuers when a customer's order to purchase a security is offset by an order to sell the same security). A "riskless principal" transaction occurs when a broker, after receiving an order to buy (or sell) a security from a customer, purchases (or sells) the security to offset a contemporaneous sale to (or purchase from) the customer. *See id. See also* OCC Interpretive Letter No. 626 *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 49, 101 (July 7, 1993) (bank permitted to act as broker for the sale of preferred equity and investment grade-rated debt securities on behalf of institutional investors in secondary market transactions). The OCC approved such transactions because the bank did not assume any of the customer's risk of loss, did not assume any liability as guarantor or endorser of the value of the securities, and did not have any beneficial ownership of the securities. In looking at the substance of the transactions, we recognized that riskless principal transactions were functionally equivalent to securities brokerage, and that the bank assumed the responsibilities and obligations ordinarily assumed by a securities broker, *i.e.,* risk of customer default at settlement. *See id. See also* Bankers Trust New York Corporation, 75 Federal Reserve Bulletin 829 (October 30, 1989) (Federal Reserve Board Order which concluded that a bank would not be acting as a dealer for its own account in buying or selling securities in a riskless principal capacity because the bank would not assume the risk of ownership of the securities); The Bank of New York Company, Inc., 82 Federal Reserve Bulletin 748, *reprinted in* [1995-1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 100, 043 (June 10, 1996) (Federal Reserve Board Order that concluded that riskless principal transactions do not constitute securities underwriting or dealing and are essentially equivalent to brokerage activities). We therefore concluded that the brokerage activity did not violate the prohibition on bank underwriting and dealing in securities contained in 12 USC 24(7) since the transactions were without recourse to the bank and were on the order of and for the account of the customer.

Here, UBK's will function like a "riskless principal" because it will not purchase any real estate until the lessee requests that it do so, and the lessee enters into a net lease to occupy the property immediately and a purchase agreement to take title to the property at the end of the lease term. Once UBK purchases the real estate from the seller, it will transfer all indicia of ownership to the lessee. The lessee will be the beneficial owner of the real estate. UBK will assume no greater risks than it already assumes when it underwrites a traditional mortgage. UBK will not purchase real estate for its own portfolio. UBK will not hold itself out as a real estate broker or agent. UBK will not maintain an inventory of real estate for sale to customers. If a lessee defaults on the agreements, UBK will consider the property to be OREO and dispose of it in a manner consistent with 12 USC 29 and 12 CFR Part 34.

B. UBK's Net Lease Proposal Is Not Inconsistent With Goals of section 29

The restrictions in section 29 are intended to: (1) keep the capital of banks flowing into the daily channels of commerce; (2) deter banks from embarking on hazardous real estate speculations; and (3) prevent banks from accumulating and holding large masses of real estate in perpetuity. *See Union Nat'l. Bank* v. *Matthews,* 98 U.S. 621, 626 (1878). *See also* OCC Interpretive Letter No. 770, *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,134 (February 10, 1996); OCC Interpretive Letter No. 758, *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,122 (April 5, 1996); OCC Interpretive Letter No. 717, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,032 (March 22, 1996); OCC Interpretive Letter No. 613, *reprinted in* [1992–1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,453 (January 15, 1993).

UBK's net lease proposal does not conflict with any of the purposes underlying the restrictions of section 29. First, UBK's net lease proposal would not impede the flow of capital to commerce. To the contrary, UBK's net lease proposal creates an alternative means of providing access to credit to an unserved segment of prospective home buyers. Without the program, these individuals effectively will not have access to credit. Second, UBK's net lease proposal is neither hazardous nor speculative because the program will be limited to single family residential homes selected by its customers for their own occupancy. The branch will not purchase or maintain an inventory of properties to sell to customers. The branch will not be exposed to greater risks than it would face in a traditional real estate financing transaction since the parties will structure the transaction to be the functional equivalent of a standard mortgage. Third, UBK will not hold legal title in perpetuity because it will transfer title at the end of the lease term or earlier if the lessee pays the remainder of the purchase price. Also, similar to a traditional mortgage, if the lessee defaults on the lease, UBK would consider the property to be OREO and dispose of it in accordance with 12 CFR Part 34. Thus, UBK's net lease proposal satisfies the terms and intent of section 29 while providing access to credit to a discrete group that has previously been unable to obtain financing to purchase homes.

IV. Conclusion

Based upon the foregoing discussion, and the commitments and representations made by UBK, we conclude that UBK's net lease proposal is permissible. If you have further questions concerning the foregoing, or need any additional information, please feel free to contact me or Denver Edwards, Attorney, at 212–790–4010.

Jonathan H. Rushdoony
District Counsel
Northeastern District
1114 Avenue of the Americas, Suite 3900
New York, New York 10036–7780

807—October 27, 1997

12 CFR 22

Dear [ ]:

This letter responds to your correspondence regarding whether various provisions of the OCC's regulations on flood insurance apply to certain home equity lines of credit. As discussed more fully below, it is our belief that the flood insurance requirements would be triggered by the extension of the term of the home equity lines of credit referenced in your letter.

Background

Your letter states that, in response to restrictions in the Truth in Lending Act[1] and its implementing regulation, Regulation Z,[2] on the ability of creditors to terminate and accelerate or amend open-end consumer credit plans secured by a consumer's principal dwelling, and to avoid being committed to long-term home equity lines of credit that may not be profitable or prudent in the future, some creditors have begun to offer short-term home equity lines of credit with an automatic renewal or extension feature. To illustrate, you provided a sample clause that may be included in such a credit contract:

> TERM: You can obtain advances of credit for one year (the "draw period") from the date you open your account. At the end of the draw period, we may, at our sole discretion, extend the draw period for additional one year terms. You will be notified in writing if at the end of the draw period, or the draw period as previously extended, we elect not to further extend your draw period. After the draw

[1] 15 USC 1647.

[2] 12 CFR 226.5b(f).

period ends, including all extensions thereof, you will no longer be able to obtain advances ("repayment period").

Discussion

The Flood Disaster Protection Act (as amended) (the "FDPA") and the OCC's implementing regulation, 12 CFR part 22, generally prohibit national banks from making, increasing, extending, or renewing a designated loan[3] unless the building or mobile home and any personal property securing the loan is covered by flood insurance for the term of the loan.[4] The National Flood Insurance Act (NFIA) requirements are also triggered whenever a lender "makes, increases, extends, or renews" a loan secured by a building or a mobile home. These requirements include:

- Making a determination (using the standard flood hazard determination form ("SFHD form") developed by the director of the Federal Emergency Management Agency ("FEMA")) whether the building or mobile home offered as collateral security for the loan is or will be located in a special flood hazard area in which flood insurance is available under the NFIA;[5]
- If the property is located in a special flood hazard area ("SFHA"), providing written notices to the borrower and loan servicer that (a) informs them that the property is located in a SFHA; (b) describes the flood insurance purchase requirements; (c) states, if applicable, that flood insurance is available under the National Flood Insurance Program or through private insurers; and (d) states whether federal disaster relief assistance may be available in the event of damage to the building or mobile home caused by flooding in a federally declared disaster;[6] and
- If flood insurance must be purchased, notifying the director of FEMA (or the director's designee) in writing of the identity of the servicer of the loan.[7]

The NFIA provides that a lender may rely on a previous flood determination whenever a lender increases, extends, or renews a loan if:

- the previous determination was made not more than seven years before the date of the transaction, and
- the basis of the previous determination has been set forth on the SFHD form,

unless:

- map revisions or updates after the previous determination have resulted in the building or mobile home being located in a SFHA, or
- the lender contacts the director of FEMA and determines that recent map revisions or updates affecting the property have occurred since the date of the previous determination.[8]

This provision helps to reduce the burden on banks (and servicers acting on behalf of the banks) to make new flood determinations when the bank or servicer is merely "extending, increasing, or renewing" a pre-existing loan. Note that banks and servicers cannot rely on this provision when they "make" a loan.

The burden of the requirement that the bank notify the director of FEMA of the identity of the servicer of the loan has also been lessened because the director of FEMA has designated the insurance provider to receive the notice.[9] This notice requirement is fulfilled when a flood insurance policy is first written—the insurance provider indicates on the policy application the name of the bank making the loan.[10] Assuming that flood insurance coverage would be written on a year-to-year basis to coincide with the one-year term of the home equity lines of credit, each time the policy is renewed and the bank that is named on the policy remains the servicer, the notice requirement is satisfied. However, if there is a change of servicer of the loan, either because the bank assigns or transfers the loan and/or its servicing, the bank (or a subsequent servicer acting on behalf of the bank) would need to notify the insurance provider of a change in servicer.[11]

As mentioned before, the NFIA (and part 22) require, if appropriate, a notification to the borrower and servicer whenever the bank "makes, increases, extends, or re-

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[3] A "designated loan" is a loan secured by a building or mobile home that is located or to be located in a special flood hazard area in which flood insurance is available under the National Flood Insurance Act of 1968 (as amended) (the "NFIA"). 12 CFR 22.2(e).

[4] *See* 42 USC 4012a(b)(1); 12 CFR 22.3(a).

[5] *See* 42 USC 4104b(c); 12 CFR 22.6.

[6] *See* 42 USC 4104a(a); 12 CFR 22.9.

[7] *See* 42 USC 4104a(b)(1); 12 CFR 22.10(a).

[8] *See* 42 USC 4104b(e).

[9] *See* 12 CFR 22.10(a).

[10] *See* "Mandatory Purchase of Flood Insurance Guidelines," FEMA 186 (May 1997) at 30. (This publication may be obtained from FEMA by calling 1–800–358–9616 and requesting document 000083.) It is assumed that the bank making the loan is the servicer of the loan.

[11] *See* 42 USC 4104a(b)(1); 12 CFR 22.10(b).

news" a loan secured by a building or mobile home located or to be located in a SFHA, regardless of whether flood insurance is available. The statute does not provide for any exceptions to this notice requirement.

The home equity lines of credit that your client lenders offer have a one-year term, during which funds may be drawn. The bank may, at its sole discretion, extend the term of the lines on a yearly basis. It is our opinion that, for purposes of the flood insurance requirements, extending the term of the lines is "extending" a loan. Thus, the flood insurance requirements described above are triggered each year at the time the term of the lines is extended.

I trust this reply is responsive to your letter. If you have further questions, please contact me or Margaret Hesse, an attorney on my staff, at 202–874–5750.

Michael S. Bylsma
Director
Community and Consumer Law Division

808—November 3, 1997

12 USC 84 *[file D2B]*

Dear [ ]:

This responds to your letter to Leslie Linville, District Counsel, Midwestern District, in which you raised several questions concerning the aggregation of loans to borrowers that hold an undivided interest in feedlot cattle which are used as collateral for those loans. In your letter, you set forth three hypothetical situations concerning borrowers who hold undivided interests in cattle held in the same feedlot pen and ask whether the loans to such borrowers would be aggregated under the "common enterprise" test in the OCC lending limits regulation. 12 CFR 32.5(c). You are seeking this guidance because [ ]'s business includes lending to persons holding undivided interests in feedlot cattle, which was the subject of an OCC examination. I apologize for the delay in responding to you, but I wanted a complete review of the issues raised by your letter.

Hypothetical Feedlot Operations

Your letter presents three hypotheticals for consideration and, I understand, is not intended to address the particular facts that were the subject of the previous examination. In the first hypothetical, you indicate that two borrowers, who each have 50 percent undivided interests in the same pen, are individual cattle feeders and that each borrows separately from the bank up to the bank's lending limit to purchase and feed cattle in the undivided pen. Neither has another source of income from which the loans may be fully repaid, and the bank is relying on the proceeds the borrowers will receive from the sale of the cattle to repay the bank's loans. As cattle are marketed, proceeds are divided equally between the borrowers.

The next hypothetical provides a slight variation to the basic fact pattern set forth in the first hypothetical. In the second hypothetical there are two borrowers who also own 50 percent undivided interests in the same pen. In this hypothetical, however, the borrowers contribute the same amount of feed to the livestock, the cattle are purchased and sold together, and the borrowers issue separate checks to purchase the cattle and receive separate checks when the cattle are sold. Each of the borrowers also has between 8 percent and 10 percent of income that is not derived from the sale of the livestock.

Finally, in the third hypothetical, one of the borrowers is the owner of the feedlot where the two borrowers hold cattle in undivided pens. As part of an agreement to put cattle in the feedlot, the owner of the feedlot agrees to purchase a 25 percent interest in each pen.

In evaluating these hypothetical questions, or in evaluating any transaction, all relevant facts and circumstances must be reviewed before a determination can be made as to whether the transaction constitutes a violation of the legal lending limits applicable to national banks. Thus, while I can give you some guidance on the hypotheticals presented in your letter, a full review of all of the facts surrounding any loan must be made on a case-by-case basis.

Discussion

A. Lending Limits Requirements

Loans and extensions of credit made by a national bank are subject to the lending limits set forth in 12 USC 84. Generally, loans to any one person outstanding at one time must not exceed 15 percent of the unimpaired capital and unimpaired surplus of the national bank. *See* 12 USC 84(a). In the case of loans secured by livestock, a national bank may loan an additional 10 percent of the bank's unimpaired capital and surplus to each borrower. *See* 12 CFR 32.3(b)(3).

Under certain circumstances, loans to one borrower will be attributed to another borrower, and those loans will be combined with a bank's loans to the second borrower when calculating a bank's compliance with its legal lending limits. For example, the combination rules applicable to national banks provide that loans or extensions of credit to one borrower will be attributed to another person and each person will be deemed to be a borrower when (1) the proceeds of the loan are to be used for the direct benefit of the other person, or (2) when a "common enterprise" is deemed to exist between the persons. *See* 12 CFR 32.5(a).

Twelve CFR 32.5 sets forth four rules under which a common enterprise may be found to exist. First, a common enterprise will be deemed to exist where the expected source of repayment for the loan is the same for each borrower and neither borrower has another source of income from which the loan may be fully repaid. *See* 12 CFR 32.5(c)(1). Second, a common enterprise will be found where loans are made to persons who are related through common control and have substantial financial interdependence. *See* 12 CFR 32.5(c)(2). Third, a common enterprise will be found if separate persons borrow from a bank for the purpose of acquiring a business enterprise of which those persons will own more than 50 percent of the voting securities or voting interests. *See* 12 CFR 32.5(c)(3). In addition, a common enterprise will be found if the facts and circumstances of a particular transaction support that conclusion. *See* 12 CFR 32.5(c)(4).

B. Prior Violations

Before discussing the hypotheticals, since you raised the issue in your letter, I would like to explain why certain loans in a previous examination of [ ] ("bank") were cited as a violation. The violation cited in the bank's examination report involved loans to *[Co.]* et al. and was based on the OCC's interpretation of what constitutes a "common enterprise" as defined in 12 CFR 32.5(c)(l) and (c)(4). The fact that ownership of the cattle by the borrowers was represented by an undivided interest was incidental to the violation. As stated in the bank's report of examination, other relevant facts and circumstances contributed to the OCC's determination that a common enterprise existed, including: (a) common control as evidenced by a *[Co.]* corporate resolution that gave *[A]* and *[B]* management control with respect to monetary activities; (b) common management as evidenced by the fact that *[C]* managed the operations of both entities; and (c) common expenses shared by both entities.

C. Application of Common Enterprise Test to Hypotheticals

In evaluating your hypotheticals, or in the examination process, the OCC does not combine loans to separate borrowers under the common enterprise test in 12 CFR 32.5 unless the facts and circumstances indicate the existence of some form of joint enterprise, such as a partnership or joint venture, or common control and substantial financial interdependence among borrowers. It is the responsibility of the bank's management to maintain credit files with sufficient documentation to support treating borrowers as separate entities.

In the first hypothetical, if we assume that each borrower's cattle are the sole source of repayment, the simple fact that the cattle are placed in a common feedlot pen does not by itself mean that the expected source of repayment is the *same* for each borrower for the purpose of the common enterprise test in 12 CFR 32.5(c)(1). As a result, the OCC would not combine these loans in the absence of other relevant facts and circumstances that would support the conclusion that a common enterprise existed.

In the second hypothetical, there are additional facts to consider. The cattle are purchased and sold together and the borrowers contribute the same amount of feed to the livestock. However, the borrowers also issue separate checks to purchase the cattle and receive separate checks when the cattle are sold and have between 8 percent and 10 percent of their income that is not related to the sale of the cattle. As I understand the second hypothetical, these facts alone would not constitute a common enterprise and, accordingly, the loans to the borrowers would not be combined under 12 CFR 32.5(c).

Additional facts and circumstances may, however, warrant combining loans. For example, a common enterprise would be deemed to exist if the facts and circumstances reflect common control and substantial financial interdependence among the borrowers. 12 CFR 32.5(c)(2). If the specific facts and circumstances of a feedlot operation reflected that the borrowers made purchase and sale decisions jointly and that each party was bound by the business decisions of the other, a joint enterprise or partnership could exist and, accordingly, borrowers' loans would be combined.

As to the facts set out in the third hypothetical, I would also conclude that no common enterprise existed. The additional facts alone are, in my view, not sufficient to establish the existence of a partnership or otherwise constitute substantial financial interdependence among borrowers required under the common enterprise test. Under these facts, a common enterprise would not exist provided that business decisions are made separately by each owner. The fact that the feedlot owner, as an incentive to the borrower to place his cattle in the feedlot owner's lot, agrees to purchase interests in the borrower's cattle does not, by itself, constitute a common enterprise. Some other form of joint business decision making or financial interdependence would have to exist in order for the OCC to consider the arrangement a common enterprise.

Conclusion

The conclusions above were based solely on the limited facts presented in the hypotheticals you posed. Additional relevant facts could, of course, result in different conclusions. Moreover, it is critical to recognize that, separate and apart from applicable lending limits, banks should avoid inappropriate concentrations of credit. A concentration of credit occurs in various situations, including when a bank makes a large portion of its loans to a single industry. Because of the risks presented when national banks lend more than 25 percent of their capital structure to a single industry, a national bank must have policies in place to address risks associated with undue concentrations of credit. Section 216.1 of the *OCC Handbook for National Bank Examiners.* Regardless of whether loans comply with the specific limitations of the lending limits standards, they must always be consistent with safe and sound banking practices, which include avoidance of excessive concentrations of credit.

I apologize again for the delay in this response. Please call me at 202–874–5300 if you would like to discuss this further.

Eric Thompson
Director
Bank Activities and Structure Division

Mergers—October 1 to December 31, 1997

Mergers—October 1 to December 31, 1997

Most transactions in this section do not have accompanying decisions. In those cases, the OCC reviewed the competitive effects of the proposals by using its standard procedures for determining whether the transaction has minimal or no adverse competitive effects. The OCC found the proposals satisfied its criteria for transactions that clearly had no or minimal adverse competitive effects. In addition, the Attorney General either filed no report on the proposed transaction or found that the proposal would not have a significantly adverse effect on competition.

Nonaffiliated mergers (mergers consummated involving two or more nonaffiliated operating banks), from October 1 to December 31, 1997[1]

Title and location (charter number)	Total assets[2]
California	
High Desert National Bank, Hesperia (017298)	$41,466,000
and BBC Interim Bank, San Bernardino	1,000
merged on December 4, 1997 under the title of High Desert National Bank, Hesperia (017298)	$41,466,000
Delaware	
The First National Bank of Wyoming, Wyoming (009428)	98,696,000
and JCPenney National Bank, Harrington (003883)	89,702,000
merged on October 24, 1997 under the title of The First National Bank of Wyoming, Wyoming (009428)	188,398,000
Kansas	
The Farmers National Bank of Stafford, Stafford (008883)	43,542,000
and United Bank, Inman	23,455,000
merged on October 1, 1997 under the title of The Farmers National Bank of Stafford, Stafford (008883)	66,737,000
Massachusetts	
BankBoston, National Association, Boston (000200)	48,612,338,000
and Pacific National Bank of Nantucket, Nantucket Island (000714)	101,035,000
merged on October 31, 1997 under the title of BankBoston, National Association, Boston (000200)	48,727,246,000
North Carolina	
First Charter National Bank, Concord (003903)	383,978,000
and Carolina State Bank, Shelby	141,488,000
merged on December 22, 1997 under the title of First Charter National Bank, Concord (003903)	525,466,000
Ohio	
The Huntington National Bank, Columbus (007745)	21,118,558,000
and FMB–First Michigan Bank, Zeeland	1,330,836,000
and FMB–First Michigan Bank, Grand Rapids	541,176,000
and FMB–Lumberman's Bank, Muskegon	442,279,000
and FMB–Northwestern Bank, Boyne City	163,380,000
and FMB–State Savings Bank, Lowell	137,121,000
and FMB–Commercial Bank, Greenville	139,778,000
and FMB–Sault Bank, Sault Ste. Marie	129,697,000
and FMB–Security Bank, Manistee	108,348,000
and FMB–Community Bank, Dowagiac	100,538,000
and FMB–Oceana Bank, Hart	106,953,000
and FMB–Reed City Bank, Reed City	78,508,000
and FMB–Maynard Allen Bank, Portland	76,989,000
and FMB–Old State Bank, Fremont	72,194,000
and FMB–Arcadia Bank, Kalamazoo	125,589,000
and FMB–Trust, Holland	2,369,000
merged on September 30, 1997 under the title of The Huntington National Bank, Columbus (007745)	25,265,219,000

[1] Nonaffiliated mergers include mergers, consolidations, or purchase and assumptions of nonaffiliated operating banks or savings and loan associations, when the resulting bank is a national bank. Note that earlier mergers that were not previously published are also included in this issue.

[2] Asset figures for merging institutions are not necessarily as of the date of the merger and thus may not sum to the total assets given for the merged bank.

Nonaffiliated mergers (continued)

Title and location (charter number)	Total assets
The Huntington National Bank, Columbus (007745)	24,675,847,000
and The Bank of Winter Park, Winter Park	88,350,000
merged on October 31, 1997 under the title of **The Huntington National Bank, Columbus** (007745)	24,773,035,000
Oklahoma	
Central National Bank & Trust Company of Enid, Enid (012044)	225,393,000
and First State Bank, Woodward	30,757,000
merged on October 6, 1997 under the title of **Central National Bank & Trust Company of Enid, Enid** (012044)	263,995,000
First National Bank and Trust Company of Ardmore, Ardmore (013677)	219,475,000
and Ringling State Bank, Ringling	31,065,000
merged on October 1, 1997 under the title of **First National Bank and Trust Company of Ardmore, Ardmore** (013677)	250,540,000
Texas	
Bayshore National Bank of La Porte, La Porte (015468)	186,511,000
and Texas Bank, Baytown, on November 12, 1997	41,547,000
and Texas National Bank of Baytown, Baytown (016073), on November 20, 1997	14,101,000
and First Bank of Deer Park, Deer Park, on November 20, 1997	30,887,000
merged on those respective dates under the title of **Bayshore National Bank of La Porte, La Porte** (015468)	273,410,000
First National Bank of Huntsville, Huntsville (004208)	129,816,000
and The Crockett State Bank, Crockett	43,942,000
merged on December 31, 1997 under the title of **First National Bank of Huntsville, Huntsville** (004208)	169,414,000

Affiliated mergers (mergers consummated involving affiliated operating banks), from October 1 to December 31, 1997[1]

Title and location (charter number)	Total assets[2]
Alabama	
The First National Bank of Ashland, Ashland (009580)	51,438,000
and Citizens Bank of Talladega, Talladega	36,329,000
merged on December 12, 1997 under the title of First Citizen's Bank, National Association, Talladega (009580)	87,767,000
Arkansas	
First National Bank, Searcy (015631)	268,816,000
and Charter State Bank, Beebe	34,957,000
merged on November 21, 1997 under the title of First National Bank, Searcy (015631)	303,773,000
California	
Chase Trust Company, National Association, Los Angeles (023470)	240,000
and The Chase Manhattan Trust Company of California National Association, San Francisco (020435)	3,638,000
and Chase Manhattan Trust Company of California, San Francisco	22,370,000
merged on November 15, 1997 under the title of Chase Trust Company, National Association, Los Angeles (023470)	26,248,000
Colorado	
Colorado Business Bank, National Association, Denver (016723)	159,659,000
and Colorado Business Bank, National Association, Littleton (018205)	76,859,000
merged on December 29, 1997 under the title of Colorado Business Bank, National Association, Denver (016723)	236,518,000
Florida	
First National Bank of Naples, Naples (021830)	429,051,000
and Mercantile Bank of Naples, Naples	118,983,000
merged on November 20, 1997 under the title of First National Bank of Naples, Naples (021830)	548,034,000
Illinois	
Capstone Bank, National Association, Watseka (015022)	1,000
and Goodland State Bank, Goodland	1,000
merged on August 31, 1997 under the title of Capstone Bank, National Association, Watseka (015022)	1,000
First Mid-Illinois Bank & Trust, National Association, Mattoon (010045)	1,000
and Heartland Savings Bank, Mattoon	1,000
merged on November 15, 1997 under the title of First Mid-Illinois Bank & Trust, National Association, Mattoon (010045)	1,000
Mercantile Bank National Association, Hartford (023172)	9,612,907,000
and Mercantile Bank of Illinois, Alton	659,069,000
and Mark Twain Illinois Bank, Belleville	185,785,000
merged on August 22, 1997 under the title of Mercantile Bank National Association, Hartford (023172)	10,427,563,000
Roosevelt Bank, National Association, Chesterfield (023552)	7,140,000,000
and Mercantile Bank National Association, Hartford (023172)	10,427,563,000
merged on November 13, 1997 under the title of Mercantile Bank National Association, Hartford (023552)	17,567,563,000
Mercantile Bank of Pike County National Association, Bowling Green (023578)	60,373,000
and Mercantile Bank National Association, Hartford (023552)	15,695,770,000
merged on December 12, 1997 under the title of Mercantile Bank National Association, Hartford (023578)	15,641,821,000
Indiana	
Old National Bank In Evansville, Evansville (012444)	1,000
and People's Bank and Trust Company, Mount Vernon	1,000
merged on October 17, 1997 under the title of Old National Bank in Evansville, Evansville (012444)	1,000
Iowa	
First National Bank Iowa, Iowa City (013697)	482,401,000
and West Branch State Bank, West Branch	40,513,000
merged on December 15, 1997 under the title of First National Bank Iowa, Iowa City (013697)	522,807,000

[1] Affiliated mergers include mergers, consolidations, and purchase and assumptions of affiliated institutions, when the resulting bank is a national bank. Note that earlier mergers that were not previously published are also included in this issue.

[2] Asset figures for merging institutions are not necessarily as of the date of the merger and thus may not sum to the total assets given for the merged bank.

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Boatmen's Bank Iowa, National Association, Des Moines (022681)	620,153,000
and Boatmen's National Bank of Northwest Iowa, Spencer (022333)	121,846,000
and Boatmen's Bank of North Iowa, Mason City	229,042,000
and Boatmen's Bank of Fort Dodge, Fort Dodge	104,196,000
merged on August 15, 1997 under the title of **Boatmen's Bank Iowa, National Association, Des Moines** (022681)	1,075,237,000
Kansas	
Security National Bank, Manhattan (023038)	102,470,000
and Citizens State Bank, Osage City	44,942,000
merged on December 31, 1997 under the title of **Security National Bank, Manhattan** (023038)	147,935,000
Humboldt National Bank, Humboldt (006963)	60,223,000
and First Commercial Bank, National Association, Overland Park (022961)	43,268,000
merged on December 30, 1997 under the title of **First Commercial Bank, National Association, Overland Park** (006963)	102,954,000
Kentucky	
Peoples First National Bank and Trust Company, Paducah (012961)	1,198,606,000
and PFC Interim National Bank II, Clarksville (023469)	60,755,000
merged on August 15, 1997 under the title of **Peoples First National Bank and Trust Company, Paducah** (012961)	1,259,352,000
Missouri	
Metropolitan National Bank, Springfield (017591)	108,082,000
and Citizens State Bank, Marshfield	110,111,000
merged on December 5, 1997 under the title of **Metropolitan National Bank, Springfield** (017591)	218,207,000
Commerce Bank, National Association, Kansas City (018112)	4,824,444,000
and Commerce Bank, National Association, Clayton (020919)	3,325,838,000
merged on December 31, 1997 under the title of **Commerce Bank, National Association, Kansas City** (018112)	8,028,197,000
Nebraska	
FirsTier Bank, National Association, Omaha (001633)	1,742,693,000
and FirsTier Bank, National Association, Council Bluffs (009306)	161,944,000
merged on September 23, 1995 under the title of **FirsTier Bank, National Association, Omaha** (001633)	1,895,415,000
North Carolina	
First Union National Bank, Charlotte (015650)	108,613,222,000
and Signet Bank, Richmond	11,870,799,000
merged on November 29, 1997 under the title of **First Union National Bank, Charlotte** (015650)	120,484,021,000
North Dakota	
First American Bank, National Association, Minot (023297)	360,707,000
and First American Bank, National Association, Devils Lake (003397)	64,021,000
merged on November 15, 1997 under the title of **First American Bank, National Association, Minot** (023297)	424,728,000
Ohio	
National City Bank, Cleveland (000786)	10,551,671,000
and National City Bank, Northeast, Akron (017393)	3,241,829,000
and National City Bank, Northwest, Toledo (022582)	1,554,849,000
and National City Bank of Ashland, Ashland (000183)	187,959,000
merged on October 31, 1997 under the title of **National City Bank, Cleveland** (000786)	22,189,978,000
Bank One Trust Company, National Association, Columbus (016235)	1,132,361,000
and Liberty Bank and Trust Company of Tulsa, National Association, Tulsa (005171)	22,290,000
merged on December 5, 1997 under the title of **Bank One Trust Company, National Association, Columbus** (016235)	1,154,851,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Oklahoma	
Bank One, Oklahoma, National Association, Oklahoma City (011230)	3,269,819,000
and Bank One, Oklahoma City, Oklahoma City	587,652,000
merged on December 5, 1997 under the title of Bank One, Oklahoma, National Association, Oklahoma City (011230)	3,857,471,000
Pennsylvania	
PNC Bank, National Association, Pittsburgh (001316)	57,494,640,000
and PNC Mortgage Bank, National Association, Pittsburgh (022670)	1,800,019,000
merged on November 30, 1997 under the title of PNC Bank, National Association, Pittsburgh (001316)	59,294,659,000
PNC Bank, National Association, Pittsburgh (001316)	59,294,659,000
and PNC Bank New York, National Association, Jamestown (023464)	2,978,000
merged on December 1, 1997 under the title of PNC Bank, National Association, Pittsburgh (001316)	59,297,637,000
Rhode Island	
Fleet National Bank, Providence (001338)	49,825,673,000
and Fleet Bank, Albany	11,485,831,000
merged on November 14, 1997 under the title of Fleet National Bank, Providence (001338)	60,177,558,000
South Dakota	
Marquette Bank South Dakota, National Association, Sioux Falls (015537)	131,399,000
and Tri-County State Bank, Chamberlain	61,229,000
and Farmers and Merchants Bank, Huron	155,834,000
and Dakota State Bank, Milbank	79,650,000
and Bank of South Dakota, Watertown	116,663,000
merged on November 1, 1997 under the title of Marquette Bank South Dakota, National Association, Sioux Falls (015537)	544,775,000
Tennessee	
NationsBank of Tennessee, National Association, Nashville (022567)	5,288,501,000
and Boatmen's Bank of Tennessee, Memphis	1,022,428,000
merged on October 17, 1997 under the title of NationsBank of Tennessee, National Association, Nashville (022567)	6,310,929,000
Texas	
Norwest Bank Texas, National Association, Lubbock (014208)	3,194,529,000
and Norwest Bank Texas, South, National Association, San Antonio (010148)	1,774,390,000
and Norwest Bank Texas, North Central, Fort Worth	1,136,105,000
merged on October 11, 1997 under the title of Norwest Bank Texas, National Association, San Antonio (014208)	5,623,571,000
Norwest Bank Texas, National Association, San Antonio (014208)	5,629,181,000
and Norwest Bank Texas, South Central, Victoria	2,421,150,000
merged on November 22, 1997 under the title of Norwest Bank Texas, National Association, San Antonio (014208)	8,050,331,000
First National Bank of Paris, Paris (003638)	100,395,000
and Collin County National Bank, McKinney (023072)	39,392,000
merged on August 31, 1997 under the title of First National Bank of Paris, Paris (003638)	139,787,000
Hibernia National Bank of Texas, Texarkana (003785)	405,438,000
and First National Bank of Paris, Paris (003638)	139,787,000
merged on August 31, 1997 under the title of Hibernia National Bank of Texas, Texarkana (003785)	554,109,000
Hibernia National Bank of Texas, Texarkana (003785)	405,438,000
and OrangeBank, Orange	120,663,000
merged on November 5, 1997 under the title of Hibernia National Bank of Texas, Texarkana (003785)	405,438,000
The Herring National Bank, Vernon (007010)	108,000,000
and First Bank & Trust of Clarendon, Clarendon	32,000,000
merged on October 1, 1997 under the title of The Herring National Bank, Vernon (007010)	140,000,000
Utah	
First Security Bank, National Association, Ogden (002597)	11,823,000
and First Security Bank of Wyoming, Rock Springs	210,436,000
merged on November 24, 1997 under the title of First Security Bank, National Association, Ogden (002597)	12,034,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
West Virginia	
The City National Bank of Charleston, Charleston (014807)	527,656,000
and Blue Ridge Bank, National Association, Martinsburg (023326)	131,841,000
and Peoples National Bank, Point Pleasant (023327)	153,746,000
and First State Bank and Trust, National Association, Rainelle (023328)	105,490,000
and Bank of Ripley, National Association, Ripley (023356)	87,194,000
and The Home National Bank of Sutton, Sutton (009604)	75,864,000
and The Merchants National Bank of Montgomery, Montgomery (009740)	138,201,000
and The First National Bank of Hinton, Hinton (005562)	92,280,000
and Peoples State Bank, National Association, Clarksburg (023355)	28,704,000
and The Old National Bank of Huntington, Huntington (017102)	54,907,000
merged on December 22, 1997 under the title of The City National Bank of Charleston, Charleston (014807)	1,319,831,000
Wisconsin	
AMCORE Bank, National Association, South Central, Monroe (000230)	230,936,000
and Belleville State Bank, Belleville	40,639,000
merged on October 17, 1997 under the title of AMCORE Bank, National Association, South Central, Monroe (000230)	271,576,000

Affiliated mergers—thrift (mergers consummated involving affiliated national banks and savings and loan associations), from October 1 to December 31, 1997

Title and location (charter number)	Total assets[1]
California	
International City Bank National Association, Long Beach (018383)	12,425,000
and Flagship Bank, F.S.B, San Diego	67,322,000
merged on December 31, 1997 under the title of International City Bank National Association, Long Beach (018383)	79,190,000
Massachusetts	
BankBoston, National Association, Boston (000200)	57,450,047,000
and Bank of Boston Connecticut, Hartford	5,216,358,000
merged on October 16, 1997 under the title of BankBoston, National Association, Boston (000200)	59,317,952,000
West Virginia	
One Valley Bank, National Association, Charleston (016433)	1,707,354,000
and One Valley Bank, F.S.B., Point Pleasant	60,150,000
merged on October 31, 1997 under the title of One Valley Bank, National Association, Charleston (016433)	1,753,030,000

[1] Asset figures for merging institutions are not necessarily as of the date of the merger and thus may not sum to the total assets given for the merged bank.

Tables on the Corporate Structure of the National Banking System

Annual summary of nonaffiliated mergers (mergers consummated involving two or more nonaffiliated operating banks), January 1 to December 31, 1997

Title and location (charter number)	Total assets
Alabama	
The American National Bank of Union Springs, Union Springs (012962)	$39,841,000
and The First National Bank of Union Springs, Union Springs (007467)	44,492,000
merged on May 30, 1997 under the title of AmeriFirst Bank, National Association, Union Springs (012962)	$84,333,000
SouthTrust Bank, National Association, Birmingham (014569)	27,345,112,000
and Barnett Bank of Southwest Georgia, Columbus	247,647,000
merged on September 19, 1997 under the title of SouthTrust Bank, National Association, Birmingham (014569)	27,592,759,000
California	
City National Bank, Beverly Hills (014695)	3,907,095,000
and Riverside National Bank, Riverside (015489)	248,358,000
merged on January 24, 1997 under the title of City National Bank, Beverly Hills (014695)	4,429,032,000
High Desert National Bank, Hesperia (017298)	41,466,000
and BBC Interim Bank, San Bernardino	1,000
merged on December 4, 1997 under the title of High Desert National Bank, Hesperia (017298)	41,466,000
Colorado	
First National Bank of the Rockies, Meeker (007435)	63,716,000
and Rio Blanco State Bank, Rangely	14,182,000
and Rocky Mountain State Bank, Rangely	13,094,000
merged on May 2, 1997 under the title of First National Bank of the Rockies, Meeker (007435)	92,800,000
Canon National Bank, Canon City (016392)	57,579,000
and Greenhorn Valley Bank, Colorado City	10,567,000
merged on July 14, 1997 under the title of Canon National Bank, Canon City (016392)	67,155,000
Delaware	
The First National Bank of Wyoming, Wyoming (009428)	98,696,000
and JCPenney National Bank, Harrington (003883)	89,702,000
merged on October 24, 1997 under the title of The First National Bank of Wyoming, Wyoming (009428)	188,398,000
Florida	
SouthTrust Bank of Florida, National Association, St. Petersburg (023021)	4,452,767,000
and Equity Bank, Palm Beach County	68,933,000
merged on February 28, 1997 under the title of SouthTrust Bank of Florida, National Association, St. Petersburg (023021)	4,742,317,000
The Huntington National Bank of Florida, Maitland (021058)	1,128,274,000
and Citizens National Bank of Leesburg, Leesburg (014684)	524,071,000
merged on February 28, 1997 under the title of The Huntington National Bank of Florida, Maitland (021058)	1,734,473,000
Illinois	
National Bank, Hillsboro (014510)	128,849,000
and State Bank of Keyesport, Keyesport	8,571,000
merged on January 17, 1997 under the title of National Bank, Hillsboro (014510)	137,191,000
Indiana	
The Peoples National Bank and Trust Company of Washington, Washington (003842)	90,139,000
and The Union Bank, Loogootee	50,134,000
merged on March 4, 1997 under the title of The Peoples National Bank and Trust Company of Washington, Washington (003842)	140,273,000
Kansas	
Sunflower Bank, National Association, Salina (004742)	546,610,000
and Bank of the Southwest, Dodge City	55,341,000
merged on April 7, 1997 under the title of Sunflower Bank, National Association, Salina (004742)	601,981,000

Annual summary of nonaffiliated mergers (continued)

Title and location (charter number)	Total assets
The Farmers National Bank of Stafford, Stafford (008883)	43,542,000
and United Bank, Inman	23,455,000
merged on October 1, 1997 under the title of **The Farmers National Bank of Stafford, Stafford** (008883)	66,737,000
Louisiana	
Deposit Guaranty National Bank of Louisiana, Hammond (014086)	725,409,000
and Capital Bank, Delhi	185,632,000
merged on March 31, 1997 under the title of **Deposit Guaranty National Bank of Louisiana, Hammond** (014086)	911,041,000
Massachusetts	
BankBoston, National Association, Boston (000200)	48,612,338,000
and Pacific National Bank of Nantucket, Nantucket Island (000714)	101,035,000
merged on October 31, 1997 under the title of **BankBoston, National Association, Boston** (000200)	48,727,246,000
Mississippi	
Deposit Guaranty National Bank, Jackson (015548)	423,177,000
and Bank of Commerce, Baton Rouge	69,300,000
merged on June 30, 1997 under the title of **Deposit Guaranty National Bank, Jackson** (015548)	1,023,593,000
Trustmark National Bank, Jackson (010523)	5,377,083,000
and Perry County Bank, New Augusta	43,685,000
merged on September 19, 1997 under the title of **Trustmark National Bank, Jackson** (010523)	5,418,761,000
New Jersey	
United National Bank, Califon (Lebanon Twp) (005621)	1,008,007,000
and Farrington Bank, North Brunswick	63,621,000
merged on February 28, 1997 under the title of **United National Bank, Lebanon Township (Califon)** (005621)	1,071,628,000
Valley National Bank, Passaic (015790)	4,591,372,000
and The Midland Bank and Trust Company, Paramus	426,233,000
merged on March 1, 1997 under the title of **Valley National Bank, Passaic** (015790)	5,017,605,000
New York	
Safra National Bank of New York, New York (020948)	1,478,730,000
and United Mizrahi Bank and Trust Company, New York	297,422,000
merged on December 31, 1996 under the title of **Safra National Bank of New York, New York** (020948)	1,780,152,000
Union Chelsea National Bank, New York (016629)	190,641,000
and Excel Bank, National Association, New York (022893)	72,238,000
merged on March 1, 1997 under the title of **Excel Bank, National Association, New York** (016629)	262,879,000
North Carolina	
First Charter National Bank, Concord (003903)	383,978,000
and Carolina State Bank, Shelby	141,488,000
merged on December 22, 1997 under the title of **First Charter National Bank, Concord** (003903)	525,466,000
Ohio	
The Huntington National Bank, Columbus (007745)	21,118,558,000
and FMB–First Michigan Bank, Zeeland	1,330,836,000
and FMB–First Michigan Bank, Grand Rapids	541,176,000
and FMB–Lumberman's Bank, Muskegon	442,279,000
and FMB–Northwestern Bank, Boyne City	163,380,000
and FMB–State Savings Bank, Lowell	137,121,000
and FMB–Commercial Bank, Greenville	139,778,000
and FMB–Sault Bank, Sault Ste. Marie	129,697,000
and FMB–Security Bank, Manistee	108,348,000
and FMB–Community Bank, Dowagiac	100,538,000
and FMB–Oceana Bank, Hart	106,953,000
and FMB–Reed City Bank, Reed City	78,508,000
and FMB–Maynard Allen Bank, Portland	76,989,000
and FMB–Old State Bank, Fremont	72,194,000
and FMB–Arcadia Bank, Kalamazoo	125,589,000
and FMB–Trust, Holland	2,369,000
merged on September 30, 1997 under the title of **The Huntington National Bank, Columbus** (007745)	25,265,219,000

Annual summary of nonaffiliated mergers (continued)

Title and location (charter number)	Total assets
The Huntington National Bank, Columbus (007745)	24,675,847,000
and The Bank of Winter Park, Winter Park	88,350,000
merged on October 31, 1997 under the title of **The Huntington National Bank, Columbus** (007745)	24,773,035,000
Oklahoma	
Amquest Bank, National Association, Lawton (015345)	318,343,000
and The American National Bank of Lawton, Lawton (012067)	59,905,000
merged on April 25, 1997 under the title of **Amquest Bank, National Association, Lawton** (012067)	375,781,000
The First National Bank in Durant, Durant (014005)	152,296,000
and Boswell State Bank, Boswell	9,755,000
merged on August 11, 1997 under the title of **The First National Bank in Durant, Durant** (014005)	162,051,000
First National Bank and Trust Company of Ardmore, Ardmore (013677)	219,475,000
and Ringling State Bank, Ringling	31,065,000
merged on October 1, 1997 under the title of **First National Bank and Trust Company of Ardmore, Ardmore** (013677)	250,540,000
Central National Bank & Trust Company of Enid, Enid (012044)	225,393,000
and First State Bank, Woodward	30,757,000
merged on October 6, 1997 under the title of **Central National Bank & Trust Company of Enid, Enid** (012044)	263,995,000
Tennessee	
First Commercial Bank, National Association of Memphis, Memphis (022278)	138,254,000
and United American Bank of Memphis, Memphis	273,602,000
merged on February 28, 1997 under the title of **First Commercial Bank, National Association of Memphis, Memphis** (022278)	411,856,000
Texas	
First State Bank, National Association, Abilene (017614)	137,752,000
and First State Bank, National Association, Odessa (017935) on December 30, 1996	62,148,000
and Western National Bank, Lubbock (020897) on January 28, 1997	56,468,000
merged on those respective dates under the title of **First State Bank, National Association, Abilene** (017614)	257,254,000
Southwest Guaranty Trust Company, National Association, Houston (023234)	2,364,000
and Charter Trust Company, National Association, Houston (023168)	799,000
merged on March 31, 1997 under the title of **Southwest Guaranty Trust Company, National Association, Houston** (023234)	4,014,000
The Frost National Bank, San Antonio (005179)	4,384,065,000
and Citizens State Bank of Corpus Christi, Corpus Christi	206,613,000
merged on March 7, 1997 under the title of **The Frost National Bank, San Antonio** (005179)	4,578,531,000
Tyler Bank and Trust, National Association, Tyler (022629)	232,683,000
and City National Bank, Whitehouse (020473)	39,498,000
merged on April 17, 1997 under the title of **Tyler Bank and Trust, National Association, Tyler** (022629)	272,181,000
First National Bank of Winnsboro, Winnsboro (005674)	96,131,000
and Winnsboro Bank and Trust, Winnsboro	37,256,000
merged on May 1, 1997 under the title of **First National Bank of Winnsboro, Winnsboro** (005674)	128,907,000
Southwest Bank of Texas National Association, Houston (017479)	1,073,498,000
and Pinemont Bank, Houston	235,311,000
merged on August 1, 1997 under the title of **Southwest Bank of Texas National Association, Houston** (017479)	1,307,069,000
Bayshore National Bank of La Porte, La Porte (015468)	186,511,000
and Texas Bank, Baytown on November 12, 1997	41,547,000
and Texas National Bank of Baytown, Baytown (016073) on November 20, 1997	14,101,000
and First Bank of Deer Park, Deer Park on November 20, 1997	30,887,000
merged on those respective dates under the title of **Bayshore National Bank of La Porte, La Porte** (015468)	273,410,000
First National Bank of Huntsville, Huntsville (004208)	129,816,000
and The Crockett State Bank, Crockett	43,942,000
merged on December 31, 1997 under the title of **First National Bank of Huntsville, Huntsville** (004208)	169,414,000

Annual summary of nonaffiliated mergers—thrift (mergers consummated involving nonaffiliated national banks and savings and loan associations), January 1 to December 31, 1997

Title and location (charter number)	Total assets
Colorado	
Peoples National Bank, Monument (021717)	50,985,000
and Colorado Springs Savings and Loan Association, Colorado Springs	70,892,000
merged on January 10, 1997 under the title of Peoples National Bank, Monument (021717)	123,065,000
Florida	
SouthTrust Bank of Florida, National Association, St. Petersburg (023021)	4,452,767,000
and Charter Bank, Delray Beach	229,423,000
merged on March 28, 1997 under the title of SouthTrust Bank of Florida, National Association, St. Petersburg (023021)	4,971,740,000
Illinois	
TCF National Bank Illinois, Chicago (023254)	899,239,000
and Standard Federal Bank for Savings, Burr Ridge	2,436,222,000
and Standard Interim Federal Savings Bank, Burr Ridge	175,915,000
merged on September 4, 1997 under the title of TCF National Bank Illinois, Burr Ridge (023254)	3,349,878,000
Kansas	
Southwest Kansas National Bank, Ulysses (018323)	32,528,000
and Southwestern Savings and Loan Association of Hugoton, Hugoton	23,272,000
merged on July 29, 1997 under the title of Southwest Kansas National Bank, Ulysses (018323)	52,600,000
Maryland	
American Trust Bank, National Association, Cumberland (023045)	424,918,000
and First Federal Savings Bank of Western Maryland, Cumberland	345,505,000
merged on May 29, 1997 under the title of American Trust Bank, National Association, Cumberland (023045)	424,918,000
The Centreville National Bank of Maryland, Centreville (002341)	144,000,000
and Kent Savings & Loan Association, F.A., Chestertown	23,600,000
merged on April 1, 1997 under the title of The Centreville National Bank of Maryland, Centreville (002341)	164,600,000
Mississippi	
Deposit Guaranty National Bank, Jackson (015548)	898,581,000
and Citizens Savings Association Federal Association, Baton Rouge	73,924,000
merged on August 1, 1997 under the title of Deposit Guaranty National Bank, Jackson (015548)	983,084,000
Pennsylvania	
First Union National Bank, Avondale (022693)	27,045,733,000
and Centre Square Trust Company, Philadelphia	1,000
merged on March 3, 1997 under the title of First Union National Bank, Avondale (022693)	27,045,733,000

Annual summary of affiliated mergers (mergers consummated involving affiliated operating banks), January 1 to December 31, 1997

Title and location (charter number)	Total assets
Alabama	
SouthTrust Bank of Alabama, National Association, Birmingham (014569)	13,272,231,000
and SouthTrust Bank of South Mississippi, Biloxi	140,420,000
and SouthTrust Bank of North Carolina, Charlotte	1,225,174,000
and SouthTrust Bank of Northwest Florida, Marianna	395,321,000
and SouthTrust Bank of Russell County, Phenix City	40,304,000
and SouthTrust Bank of Florida, National Association, St. Petersburg (023021)	4,892,694,000
and SouthTrust Bank of Georgia, National Association, Atlanta (022520)	5,586,196,000
and SouthTrust Bank of Columbus, National Association, Columbus (021473)	173,503,000
and SouthTrust Bank of Tennessee, National Association, Nashville (023156)	324,657,000
and SouthTrust Bank of South Carolina, National Association, Charleston (021875)	452,565,000
merged on June 2, 1997 under the title of SouthTrust Bank, National Association, Birmingham (014569)	31,809,458,000
The First National Bank of Ashland, Ashland (009580)	51,438,000
and Citizens Bank of Talladega, Talladega	36,329,000
merged on December 12, 1997 under the title of First Citizens Bank, National Association, Talladega (009580)	87,767,000
Arkansas	
Boatmen's National Bank of Arkansas, Little Rock (016009)	1,679,955,000
and Boatmen's National Bank of Batesville, Batesville (014493)	154,991,000
and Boatmen's National Bank of Conway, Conway (018778)	188,116,000
and Boatmen's National Bank of Hot Springs, Hot Springs (002832)	299,163,000
and Boatmen's National Bank of North Central Arkansas, Bull Shoals (015039)	214,783,000
and Boatmen's National Bank of Pine Bluff, Pine Bluff (014056)	250,853,000
and Boatmen's National Bank of Russellville, Russellville (018780)	169,663,000
and Boatmen's National Bank of Northwest Arkansas, Fayetteville (018781)	503,614,000
and Boatmen's Bank of Northeast Arkansas, Jonesboro	265,021,000
merged on August 15, 1997 under the title of Boatmen's National Bank of Arkansas, Little Rock (016009)	3,726,159,000
First National Bank, Searcy (015631)	268,816,000
and Charter State Bank, Beebe	34,957,000
merged on November 21, 1997 under the title of First National Bank, Searcy (015631)	303,773,000
California	
Bank of America National Trust and Savings Association, San Francisco (013044)	175,627,978,000
and Bank of America Alaska, National Association, Anchorage (018023)	245,233,000
merged on January 1, 1997 under the title of Bank of America National Trust and Savings Association, San Francisco (013044)	175,873,211,000
Bank of America National Trust and Savings Association, San Francisco (013044)	175,627,978,000
and Bank of America NW, National Association, Seattle (011280)	17,273,000
merged on January 1, 1997 under the title of Bank of America National Trust and Savings Association, San Francisco (013044)	192,900,978,000
Bank of America National Trust and Savings Association, San Francisco (013044)	175,627,978,000
and Bank of America Nevada, Las Vegas	4,191,547,000
merged on January 1, 1997 under the title of Bank of America National Trust and Savings Association, San Francisco (013044)	179,819,525,000
Bank of America National Trust and Savings Association, San Francisco (013044)	175,627,978,000
and Bank of America New Mexico, National Association, Albuquerque (022409)	943,721,000
merged on January 1, 1997 under the title of Bank of America National Trust and Savings Association, San Francisco (013044)	176,571,699,000
Bank of America National Trust and Savings Association, San Francisco (013044)	175,627,978,000
and Bank of America Arizona, Phoenix	8,822,831,000
merged on January 1, 1997 under the title of Bank of America National Trust and Savings Association, San Francisco (013044)	184,450,809,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
City National Bank, Beverly Hills (014695)	3,907,000,000
and Ventura County National Bank, Oxnard (017507)	182,000
and Frontier Bank, National Association, La Palma (017767)	86,000
merged on January 17, 1997 under the title of **City National Bank, Beverly Hills** (014695)	4,320,000,000
Wells Fargo Bank, National Association, San Francisco (001741)	99,165,167,000
and Wells Fargo Bank (Colorado), National Association, Denver (012517)	2,278,287,000
merged on June 1, 1997 under the title of **Wells Fargo Bank, National Association, San Francisco** (001741)	101,443,454,000
National Bank of Southern California, Newport Beach (017623)	349,610,000
and Monarch Bank, Laguna Niguel	80,170,000
merged on June 4, 1997 under the title of **National Bank of Southern California, Newport Beach** (017623)	429,780,000
First Coastal Bank, National Association, El Segundo (018454)	25,900,000
and Marina Bank, Marina del Rey	29,700,000
merged on June 26, 1997 under the title of **First Coastal Bank, National Association, El Segundo** (018454)	55,600,000
Bank of America National Trust and Savings Association, San Francisco (013044)	206,831,943,000
and Bank of America Illinois, Chicago	16,418,000,000
merged on July 1, 1997 under the title of **Bank of America National Trust and Savings Association, San Francisco** (013044)	223,249,943,000
Chase Trust Company, National Association, Los Angeles (023470)	240,000
and The Chase Manhattan Trust Company of California National Association, San Francisco (020435)	3,638,000
and Chase Manhattan Trust Company of California, San Francisco	22,370,000
merged on November 15, 1997 under the title of **Chase Trust Company, National Association, Los Angeles** (023470)	26,248,000
Colorado	
Colorado Community First National Bank, Fort Morgan (007004)	165,408,000
and Colorado Community First State Bank - Co, Denver	577,382,000
and Colorado Community First National Bank, Trinidad (014148)	69,522,000
and Colorado Community First State Bank of Steamboat Springs, Steamboat Springs	119,064,000
merged on April 1, 1997 under the title of **Colorado Community First National Bank, Fort Morgan** (007004)	931,376,000
Colorado Business Bank, National Association, Denver (016723)	159,659,000
and Colorado Business Bank, National Association, Littleton (018205)	76,859,000
merged on December 29, 1997 under the title of **Colorado Business Bank, National Association, Denver** (016723)	236,518,000
Connecticut	
Sachem Trust National Association, Guilford (022784)	1,764,000
and Webster Trust Company, National Association, Waterbury (023465)	240,000
merged on August 1, 1997 under the title of **Webster Trust Company, National Association, Guilford** (022784)	2,004,000
Delaware	
NationsBank of Delaware, National Association, Dover (022279)	6,695,000,000
and Boatmen's Credit Card Bank, Albuquerque	696,000,000
merged on April 21, 1997 under the title of **NationsBank of Delaware, National Association, Dover** (022279)	7,711,000,000
Advanta National Bank USA, Wilmington (015033)	2,700,000,000
and Advanta National Bank, Wilmington (022724)	1,800,000,000
merged on June 30, 1997 under the title of **Advanta National Bank, Wilmington** (015033)	4,500,000,000
Florida	
SunTrust Bank, South Florida, National Association, Fort Lauderdale (014732)	3,385,380,000
and SunTrust Bank, Treasure Coast, National Association, Fort Pierce (017528)	769,006,000
merged on April 1, 1997 under the title of **SunTrust Bank, South Florida, National Association, Fort Lauderdale** (014732)	4,154,386,000
First National Bank and Trust Company of the Treasure Coast, Stuart (014838)	806,782,000
and Port St. Lucie National Bank, Port St. Lucie (021778)	129,323,000
merged on May 30, 1997 under the title of **First National Bank and Trust Company of the Treasure Coast, Stuart** (014838)	936,323,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
First National Bank of Naples, Naples (021830)	429,051,000
and Mercantile Bank of Naples, Naples	118,983,000
merged on November 20, 1997 under the title of First National Bank of Naples, Naples (021830)	548,034,000
Barnett Bank, National Association, Jacksonville (009049)	39,940,848,000
and Barnett Bank of Southeast Georgia National Association, Brunswick (014483)	193,228,000
merged on August 28, 1997 under the title of Barnett Bank, National Association, Jacksonville (009049)	40,167,840,000
Illinois	
LaSalle National Bank, Chicago (014362)	12,027,976,000
and LaSalle National Trust, National Association, Chicago (022159)	140,618,000
merged on January 1, 1997 under the title of LaSalle National Bank, Chicago (014362)	12,039,884,000
Mt. Carmel National Bank, Mt. Carmel (023252)	99,727,000
and Citizens Bank of Illinois, National Association, Mt. Vernon (014387)	496,607,000
merged on February 14, 1997 under the title of Citizens Bank of Illinois, National Association, Mt. Vernon (023252)	597,334,000
Grand National Bank, Wauconda (014935)	945,000,000
and First Security Bank of Cary-Grove, Cary on March 7, 1997	80,000,000
and First National Bank of Northbrook, Northbrook (015655) on March 21, 1997	206,000,000
and First Bank South, Dixon on April 4, 1997	168,000,000
and First Bank North, Freeport on April 18, 1997	227,000,000
merged on those respective dates under the title of Grand National Bank, Wauconda (014935)	1,626,000,000
Bank One, Illinois, National Association, Springfield (023237)	692,379,000
and Bank One, Bloomington-Normal, Bloomington	150,095,000
and Bank One, Champaign-Urbana, Champaign	271,619,000
and Bank One, Peoria, Peoria	291,205,000
and Bank One, Chicago, National Association, Evanston (013709)	1,758,219,000
and Bank One, Rockford, National Association, Rockford (000479)	760,659,000
merged on February 15, 1997 under the title of Bank One, Illinois, National Association, Springfield (023237)	3,890,566,000
TCF National Bank Illinois, Chicago (023254)	673,545,000
and Bank of Chicago, Chicago	188,512,000
merged on April 7, 1997 under the title of TCF National Bank Illinois, Chicago (023254)	877,691,000
AmBank Illinois, National Association, Robinson (013605)	168,593,000
and Bank of Casey, Casey	111,930,000
merged on March 1, 1997 under the title of AmBank Illinois, National Association, Robinson (013605)	168,593,000
LaSalle Northwest National Bank, Chicago (014450)	2,110,424,000
and Columbia National Bank of Chicago, Chicago (015260)	836,192,000
merged on April 28, 1997 under the title of LaSalle Bank National Association, Chicago (014450)	3,021,092,000
The Old Second National Bank of Aurora, Aurora (004596)	458,303,000
and First State Bank of Maple Park, Maple Park	62,125,000
merged on June 12, 1997 under the title of The Old Second National Bank of Aurora, Aurora (004596)	518,860,000
The National Bank of Canton, Canton (013838)	151,037,000
and The Union National Bank of Macomb, Macomb (001872)	104,314,000
merged on June 30, 1997 under the title of The National Bank of Canton, Canton (013838)	255,351,000
Mercantile Bank National Association, St. Louis (023172)	7,441,073,000
and Mark Twain Bank, Ladue	2,025,319,000
and Mercantile Bank of Illinois National Association, Hartford (013464)	439,439,000
merged on June 20, 1997 under the title of Mercantile Bank National Association, Hartford (023172)	9,781,742,000
The Citizens National Bank of Paris, Paris (006451)	119,910,000
and The Oakland National Bank, Oakland (002212)	20,220,000
merged on July 14, 1997 under the title of The Citizens National Bank of Paris, Paris (006451)	140,130,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
LaSalle Bank National Association, Chicago (014450)	3,230,983,000
and LaSalle Bank Illinois, Franklin Park	1,260,580,000
and LaSalle Bank, Westmont	960,857,000
merged on September 2, 1997 under the title of LaSalle Bank National Association, Chicago (014450)	5,390,799,000
Capstone Bank, National Association, Watseka (015022)	1,000
and Goodland State Bank, Goodland	1,000
merged on August 31, 1997 under the title of Capstone Bank, National Association, Watseka (015022)	1,000
First Mid-Illinois Bank & Trust, National Association, Mattoon (010045)	1,000
and Heartland Savings Bank, Mattoon	1,000
merged on November 15, 1997 under the title of First Mid-Illinois Bank & Trust, National Association, Mattoon (010045)	1,000
The First National Bank of Chicago, Chicago (000008)	53,930,816,000
and NBD Bank, National Association, Fox River Grove (014555)	1,000
merged on September 30, 1997 under the title of The First National Bank of Chicago, Chicago (000008)	54,084,701,000
Norwest Bank Illinois, National Association, Galesburg (022636)	298,378,000
and The Farmers National Bank of Geneseo, Geneseo (002332)	198,769,000
merged on August 22, 1997 under the title of Norwest Bank Illinois, National Association, Galesburg (022636)	497,147,000
Mercantile Bank National Association, Hartford (023172)	9,612,907,000
and Mercantile Bank of Illinois, Alton	659,069,000
and Mark Twain Illinois Bank, Belleville	185,785,000
merged on August 22, 1997 under the title of Mercantile Bank National Association, Hartford (023172)	10,427,563,000
Roosevelt Bank, National Association, Chesterfield (023552)	7,140,000,000
and Mercantile Bank National Association, Hartford (023172)	10,427,563,000
merged on November 13, 1997 under the title of Mercantile Bank National Association, Hartford (023552)	17,567,563,000
Mercantile Bank of Pike County National Association, Bowling Green (023578)	60,373,000
and Mercantile Bank National Association, Hartford (023552)	15,695,770,000
merged on December 12, 1997 under the title of Mercantile Bank National Association, Hartford (023578)	15,641,821,000
Indiana	
Bank One, Indianapolis, National Association, Indianapolis (013759)	6,392,887,000
and Bank One, Bloomington, National Association, Bloomington (001888)	575,542,000
and Bank One Crawfordsville National Association, Crawfordsville (000571)	149,197,000
and Bank One Lafayette National Association, Lafayette (011148)	996,173,000
and Bank One, Marion, Indiana National Association, Marion (013717)	115,148,000
and Bank One Merrillville, National Association, Gary (015455)	618,203,000
and Bank One, Rensselaer, National Association, Rensselaer (014288)	131,908,000
and Bank One, Richmond, National Association, Richmond (000017)	307,851,000
merged on March 22, 1997 under the title of Bank One, Indiana, National Association, Indianapolis (013759)	9,130,546,000
The Merchants National Bank of Terre Haute, Terre Haute (023076)	476,000,000
and The Rockville National Bank, Rockville (005067)	52,000,000
and Clinton State Bank, Clinton	62,000,000
merged on February 14, 1997 under the title of The Merchants National Bank of Terre Haute, Terre Haute (023076)	476,000,000
The National City Bank of Evansville, Evansville (012132)	422,862,000
and The Farmers and Merchants Bank, Fort Branch	40,665,000
merged on June 14, 1997 under the title of The National City Bank of Evansville, Evansville (012132)	422,862,000
Bank Calumet National Association, Hammond (014379)	639,202,000
and Bank Calumet National Association, Chicago Heights (014343)	90,793,000
merged on June 5, 1997 under the title of Bank Calumet National Association, Hammond (014379)	729,995,000
Old National Bank in Evansville, Evansville (012444)	1,000
and People's Bank and Trust Company, Mount Vernon	1,000
merged on October 17, 1997 under the title of Old National Bank in Evansville, Evansville (012444)	1,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Iowa	
The Harlan National Bank, Harlan (010354)	52,563,000
and The First National Bank, Missouri Valley (003189)	45,863,000
and Citizens National Bank, Avoca (022285)	33,086,000
merged on December 31, 1996 under the title of **Midstates Bank, National Association, Harlan** (010354)	131,512,000
First National Bank, Iowa City, Iowa, Iowa City (013697)	403,866,000
and First National Bank, Cedar Rapids, Iowa, Cedar Rapids (022405)	71,292,000
merged on March 15, 1997 under the title of **First National Bank Iowa, Iowa City** (013697)	473,847,000
First Interim Bank of Des Moines, National Association, Des Moines (023377)	122,800,000
and First Interim Bank of Altoona, National Association, Altoona (023370)	18,000
and First Interim Bank of Ankeny, National Association, Ankeny (023371)	17,800,000
and First Interim Bank of Carlisle, National Association, Carlisle (023372)	7,100,000
and First Interim Bank of Clear Lake, National Association, Clear Lake (023373)	26,200,000
and First Interim Bank of Davenport, National Association, Davenport (023374)	324,800,000
and First Interim Bank of Doon, National Association, Doon (023375)	3,200,000
and First Interim Bank of Hampton, National Association, Hampton (023366)	20,700,000
and First Interim Bank of Iowa Falls, National Association, Iowa Falls (023367)	25,800,000
and First Interim Bank of Knoxville, National Association, Knoxville (023368)	43,200,000
and First Interim Bank of Mason City, National Association, Mason City (023384)	101,100,000
and First Interim Bank of Nevada, National Association, Nevada (023382)	52,100,000
and First Interim Bank of Pella, National Association, Pella (023383)	32,500,000
and First Interim Bank of Red Oak, National Association, Red Oak (023379)	20,500,000
and First Interim Bank of Rock Valley, National Association, Rock Valley (023381)	40,800,000
and First Interim Bank of Wellman, National Association, Wellman (023369)	25,300,000
and First Interim Bank of West Des Moines, National Association, West Des Moines (023380)	30,300,000
and First Interim Bank of Williamsburg, National Association, Williamsburg (023376)	21,600,000
merged on May 31, 1997 under the title of **First Interim Bank of Des Moines, National Association, Des Moines** (023377)	609,700,000
Metrobank, National Association, Davenport (023175)	7,000,000
and Metrobank - Illinois, National Association, East Moline (023217)	253,000,000
merged on June 1, 1997 under the title of **Metrobank, National Association, Davenport** (023175)	260,000,000
Firstar Bank Iowa, National Association, Des Moines (016324)	2,726,204,000
and Firstar First Interim Bank, National Association, Clinton (023493)	240,000
and Firstar Second Interim Bank, National Association, Dewitt (023494)	60,000
and Firstar National Bank, Dubuque (023495)	314,664,000
merged on September 8, 1997 under the title of **Firstar Bank Iowa, National Association, Des Moines** (016324)	3,041,168,000
First National Bank Iowa, Iowa City (013697)	482,401,000
and West Branch State Bank, West Branch	40,513,000
merged on December 15, 1997 under the title of **First National Bank Iowa, Iowa City** (013697)	522,807,000
Boatmen’s Bank Iowa, National Association, Des Moines (022681)	620,153,000
and Boatmen’s National Bank of Northwest Iowa, Spencer (022333)	121,846,000
and Boatmen’s Bank of North Iowa, Mason City	229,042,000
and Boatmen’s Bank of Fort Dodge, Fort Dodge	104,196,000
merged on August 15, 1997 under the title of **Boatmen’s Bank Iowa, National Association, Des Moines** (022681)	1,075,237,000
Kansas	
Commerce Bank, National Association, Hays (022705)	105,669,000
and Commerce Bank, National Association, Wichita (011010)	743,382,000
merged on April 18, 1997 under the title of **Commerce Bank, National Association, Wichita** (022705)	849,051,000
The First National Bank of Winfield, Winfield (003218)	126,488,000
and The Exchange State Bank, Douglass	15,657,000
merged on August 25, 1997 under the title of **The First National Bank of Winfield, Winfield** (003218)	142,079,000
Security National Bank, Manhattan (023038)	102,470,000
and Citizens State Bank, Osage City	44,942,000
merged on December 31, 1997 under the title of **Security National Bank, Manhattan** (023038)	147,935,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Humboldt National Bank, Humboldt (006963)	60,223,000
and First Commercial Bank, National Association, Overland Park (022961)	43,268,000
merged on December 30, 1997 under the title of First Commercial Bank, National Association, Overland Park (006963)	102,954,000
Kentucky	
Pikeville National Bank & Trust Company, Pikeville (007030)	1,529,407,000
and Commercial Bank, Middlesboro	103,623,000
and The Exchange Bank of Kentucky, Mount Sterling	61,287,000
and Farmers National Bank, Williamsburg (007174)	127,551,000
and First American Bank, Russell	214,344,000
and The Woodford Bank and Trust Company, Versailles	104,922,000
and Farmers-Deposit Bank, Flemingsburg	88,310,000
and First Security Bank & Trust Co., Whitesburg	91,157,000
merged on January 1, 1997 under the title of Community Trust Bank, National Association, Pikeville (007030)	1,529,407,000
Community First Bank, National Association, Ripley (003291)	27,200,000
and Community First Bank, Maysville	45,000,000
merged on July 1, 1997 under the title of Community First Bank, National Association, Maysville (003291)	72,200,000
Whitaker Bank, National Association, Lexington (022246)	57,687,000
and The First National Bank of Carlisle, Carlisle (005959)	29,655,000
and The Garrard Bank & Trust Company, Lancaster	45,720,000
merged on July 1, 1997 under the title of Whitaker Bank, National Association, Lexington (022246)	133,062,000
Peoples First National Bank and Trust Company, Paducah (012961)	1,198,606,000
and PFC Interim National Bank II, Clarksville (023469)	60,755,000
merged on August 15, 1997 under the title of Peoples First National Bank and Trust Company, Paducah (012961)	1,259,352,000
Louisiana	
Deposit Guaranty National Bank of Louisiana, Hammond (014086)	399,916,000
and The Jefferson Guaranty Bank, Metairie	297,865,000
merged on January 3, 1997 under the title of Deposit Guaranty National Bank of Louisiana, Hammond (014086)	668,473,000
Whitney National Bank, New Orleans (014977)	3,480,063,000
and First National Bank of Houma, Houma (014503)	225,493,000
merged on August 15, 1997 under the title of Whitney National Bank, New Orleans (014977)	3,705,556,000
Maryland	
American Trust Bank, National Association, Cumberland (023045)	418,943,000
and Washington County National Bank, Williamsport (001551)	147,885,000
merged on June 6, 1997 under the title of American Trust Bank, National Association, Cumberland (023045)	566,828,000
Massachusetts	
BayBank, National Association, Boston (022977)	11,126,665,000
and BayBank NH, National Association, Derry (023104)	795,274,000
merged on May 23, 1997 under the title of BayBank, National Association, Boston (022977)	11,907,414,000
BankBoston, National Association, Boston (000200)	40,300,000,000
and BayBank, National Association, Boston (022977)	11,100,000,000
merged on May 23, 1997 under the title of BankBoston, National Association, Boston (000200)	51,400,000,000
Michigan	
First of America Bank–Michigan, National Association, Grand Rapids (000191)	1,272,183,000
and First of America Bank–Indiana, Indianapolis	1,305,724,000
merged on June 30, 1997 under the title of First of America Bank, National Association, Kalamazoo (000191)	15,077,776,000
Great Lakes National Bank Michigan, Ann Arbor (023255)	2,182,828,000
and Great Lakes National Bank Ohio, Hamilton (023268)	148,389,000
merged on September 26, 1997 under the title of Great Lakes National Bank Michigan, Ann Arbor (023255)	2,187,075,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Minnesota	
Bank Midwest, Minnesota Iowa, National Association, Fairmont (013095)	114,297,000
and Bank Midwest, Minnesota Iowa, National Association, Okoboji (023086)	79,210,000
merged on June 1, 1997 under the title of Bank Midwest, Minnesota Iowa, National Association, Fairmont (013095)	193,507,000
Community First National Bank, Fergus Falls (002030)	167,955,000
and Community First National Bank, Little Falls (013353)	232,846,000
and Community First National Bank, Worthington (008989)	332,364,000
merged on January 1, 1997 under the title of Community First National Bank, Fergus Falls (002030)	733,165,000
Norwest Bank Minnesota West, National Association, Moorhead (013075)	416,608,000
and American Bank Moorhead, Moorhead	145,627,000
merged on January 18, 1997 under the title of Norwest Bank Minnesota West, National Association, Moorhead (013075)	572,131,000
First Bank National Association, Minneapolis (000710)	21,850,300,000
and Colorado National Bank, Denver (001651)	6,894,000,000
and Colorado National Bank Aspen, Aspen (015815)	52,000,000
and First Bank National Association, Chicago (013672)	928,200,000
and First Bank National Association, Omaha (001633)	3,510,700,000
and First Bank of South Dakota, (National Association), Sioux Falls (012881)	1,939,600,000
and First Bank (National Association), Milwaukee (007347)	1,156,500,000
and First Interim Bank of Des Moines, National Association, Des Moines (023377)	609,800,000
and First Interim Bank of Casper, National Association, Casper (023387)	281,500,000
merged on June 1, 1997 under the title of First Bank National Association, Minneapolis (000710)	35,540,500,000
The First National Bank of Waseca, Waseca (006544)	81,849,000
and Bank of Ellendale, Ellendale	19,083,000
merged on July 11, 1997 under the title of The First National Bank of Waseca, Waseca (006544)	102,068,000
First National Bank of East Grand Forks, East Grand Forks (013405)	33,700,000
and First Bank National Association, Minneapolis (000710)	34,525,900,000
merged on July 11, 1997 under the title of First Bank National Association, East Grand Forks (013405)	35,549,400,000
First American Bank, National Association, Breckenridge (023287)	61,566,000
and First American Bank, National Association, Wahpeton (023296)	6,628,000
merged on July 15, 1997 under the title of First American Bank, National Association, Breckenridge (023287)	68,194,000
First Bank National Association, East Grand Forks (013405)	34,549,400,000
and United States National Bank of Oregon, Portland (004514)	33,460,800,000
merged on August 1, 1997 under the title of U.S. Bank National Association, Minneapolis (013405)	68,063,400,000
First American Bank, National Association, Moorhead (023204)	3,650,000
and First American Bank, National Association, Lisbon (023291)	91,770,000
merged on August 1, 1997 under the title of First American Bank, National Association, Moorhead (023204)	95,420,000
Mississippi	
Trustmark National Bank, Jackson (010523)	5,087,382,000
and National Bank of Commerce of Corinth, Corinth (014538)	136,297,000
merged on February 28, 1997 under the title of Trustmark National Bank, Jackson (010523)	5,223,679,000
Deposit Guaranty National Bank, Jackson (015548)	4,521,143,000
and Deposit Guaranty National Bank of Louisiana, Shreveport (014086)	943,848,000
merged on on June 9, 1997 under the title of Deposit Guaranty National Bank, Jackson (015548)	4,853,589,000
Deposit Guaranty National Bank, Jackson (015548)	4,521,143,000
and Commercial National Bank in Shreveport, Shreveport (013648) on July 14, 1997	1,195,315,000
and The Merchants National Bank of Fort Smith, Fort Smith (007240) August 11, 1997	332,446,000
merged on those respective dates under the title of Deposit Guaranty National Bank, Jackson (015548)	6,992,752,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Missouri	
UMB Bank, National Association, Kansas City (013936)	2,958,919,000
and UMB Bank Kansas, National Association, Kansas City (023206)	738,607,000
merged on April 26, 1997 under the title of **UMB Bank, National Association, Kansas City** (013936)	3,534,491,000
Commerce Bank of Hannibal National Association, Hannibal (020919)	78,435,000
and Commerce Bank, National Association, Clayton (020913)	3,054,406,000
merged on December 31, 1996 under the title of **Commerce Bank, National Association, Clayton** (020919)	3,127,841,000
Commerce Bank, National Association, Kansas City (018112)	4,830,174,000
and The Shawnee State Bank, Shawnee	202,589,000
merged on May 1, 1997 under the title of **Commerce Bank, National Association, Kansas City** (018112)	5,022,962,000
Magna Bank, National Association, Brentwood (023001)	5,430,992,000
and Magna Bank, National Association, Waterloo (013702)	1,318,795,000
merged on July 18, 1997 under the title of **Magna Bank, National Association, Brentwood** (023001)	6,741,274,000
Metropolitan National Bank, Springfield (017591)	108,082,000
and Citizens State Bank, Marshfield	110,111,000
merged on December 5, 1997 under the title of **Metropolitan National Bank, Springfield** (017591)	218,207,000
Commerce Bank, National Association, Kansas City (018112)	4,824,444,000
and Commerce Bank, National Association, Clayton (020919)	3,325,838,000
merged on December 31, 1997 under the title of **Commerce Bank, National Association, Kansas City** (018112)	8,028,197,000
Nebraska	
FirsTier Bank, National Association, Omaha (001633)	1,742,693,000
and FirsTier Bank, National Association, Council Bluffs (009306)	161,944,000
merged on September 23, 1995 under the title of **FirsTier Bank, National Association, Omaha** (001633)	1,895,415,000
New Mexico	
Sunwest Bank of Albuquerque, National Association, Albuquerque (012485)	2,240,707,000
and Sunwest Bank of Clovis National Association, Clovis (008767)	175,809,000
and Sunwest Bank of Hobbs National Association, Hobbs (016741)	78,119,000
and Sunwest Bank of Las Cruces National Association, Las Cruces (016596)	92,411,000
and Sunwest Bank of Raton National Association, Raton (012924)	87,738,000
and Sunwest Bank of Rio Arriba National Association, Espanola (015312)	87,023,000
and Sunwest Bank of Roswell National Association, Roswell (014912)	170,518,000
and Sunwest Bank of Farmington, Farmington	81,847,000
and Sunwest Bank of Gallup, Gallup	175,987,000
and Sunwest Bank of Grant County, Silver City	105,682,000
and Sunwest Bank of Santa Fe, Santa Fe	289,493,000
merged on August 15, 1997 under the title of **Sunwest Bank of Albuquerque, National Association, Albuquerque** (012485)	3,585,334,000
North Carolina	
First Union National Bank of North Carolina, Charlotte (015650)	32,421,535,000
and First Union National Bank of Florida, Jacksonville (017695)	39,259,452,000
and First Union National Bank of Georgia, Atlanta (021161)	12,877,840,000
merged on June 5, 1997 under the title of **First Union National Bank, Charlotte** (015650)	81,828,827,000
NationsBank, National Association, Charlotte (014448)	80,870,000,000
and NationsBank, National Association (South), Atlanta (013068)	46,776,000,000
merged on June 1, 1997 under the title of **NationsBank, National Association, Charlotte** (014448)	123,153,000,000
NationsBank, National Association, Charlotte (014448)	123,513,000,000
and Boatmen's Bank of Vandalia, Vandalia	41,000,000
merged on June 11, 1997 under the title of **NationsBank, National Association, Charlotte** (014448)	123,201,000,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
NationsBank, National Association, Charlotte (014448)	123,201,000,000
and Boatmen's Bank of Rolla, Rolla	109,000,000
and Boatmen's River Valley Bank, Lexington	74,000,000
and Boatmen's Bank of Pulaski County, Richland	46,000,000
and Boatmen's Osage Bank, Butler	108,000,000
and Boatmen's Bank of Mid-Missouri, Columbia	301,000,000
and Boatmen's Bank of Marshall, Marshall	76,000,000
and Boatmen's Bank of Kennett, Kennett	126,000,000
and Boatmen's National Bank of Coles County, Charleston (014024)	122,000,000
and Boatmen's Bank of South Central Illinois, Mount Vernon	235,000,000
and Boatmen's Bank of Quincy, Quincy	190,000,000
and Boatmen's Bank of Franklin County, Benton	158,000,000
and Boatmen's Bank of Troy, Troy	65,000,000
and Boatmen's Bank of Southwest Missouri, Carthage	248,000,000
and Boatmen's National Bank of Central Illinois, Hillsboro (002789)	110,000,000
and Boatmen's First National Bank of West Plains, West Plains (005036)	143,000,000
and Boatmen's National Bank of Boonville, Boonville (014559)	53,000,000
and Boatmen's National Bank of Lebanon, Lebanon (010695)	107,000,000
and Boatmen's National Bank of Cape Girardeau, Cape Girardeau (004611)	454,000,000
and NationsBank, National Association (Mid-West), Kansas City (022885)	9,139,000,000
and The Boatmen's National Bank of St. Louis, St. Louis (013236)	11,905,000,000
merged on June 13, 1997 under the title of NationsBank, National Association, Charlotte (014448)	150,369,000,000
Wachovia Bank of North Carolina, National Association, Winston-Salem (015673)	26,751,374,000
and Wachovia Bank of South Carolina, National Association, Charleston (002044)	7,326,969,000
and Wachovia Bank of Georgia, National Association, Augusta (001559)	18,918,575,000
merged on June 1, 1997 under the title of Wachovia Bank, National Association, Winston-Salem (001559)	45,794,982,000
First Union National Bank, Charlotte (015650)	81,828,827,000
and First Union National Bank of South Carolina, Greenville (021183)	3,226,366,000
and First Union National Bank of Tennessee, Nashville (022649)	3,151,432,000
and First Union National Bank of Maryland, Rockville (023118)	4,053,675,000
and First Union National Bank of Virginia, Roanoke (002737)	10,658,980,000
and First Union National Bank of Washington, D.C., Washington (015127)	2,217,409,000
and First Union Bank of Connecticut, Stamford	5,963,890,000
merged on July 31, 1997 under the title of First Union National Bank, Charlotte (015650)	108,467,420,000
NationsBank, National Association, Charlotte (014448)	80,870,144,000
and Boatmen's National Bank of Oklahoma, Tulsa (018308)	4,154,935,000
and Boatmen's Bank of Southern Missouri, Springfield	1,227,860,000
merged on July 11, 1997 under the title of NationsBank, National Association, Charlotte (014448)	86,252,939,000
NationsBank, National Association, Charlotte (014448)	150,370,324,000
and Boatmen's Trust Company of Kansas, Prairie Village	390,000
merged on September 19, 1997 under the title of NationsBank, National Association, Charlotte (014448)	150,370,714,000
NationsBank, National Association, Charlotte (014448)	80,870,144,000
and Boatmen's National Bank of Arkansas, Little Rock (016009)	3,726,159,000
and Sunwest Bank of Albuquerque, National Association, Albuquerque (012485)	3,585,334,000
and Boatmen's Bank Iowa, National Association, Des Moines (022681)	1,075,237,000
merged on August 15, 1997 under the title of NationsBank, National Association, Charlotte (014448)	89,256,874,000
NationsBank, National Association, Charlotte (014448)	170,220,962,000
and Boatmen's National Bank of Newark, Newark (018779)	13,572,000
and Boatmen's National Bank of South Arkansas, Camden (014096)	106,083,000
merged on August 15, 1997 under the title of NationsBank, National Association, Charlotte (014448)	170,300,590,000
First Union National Bank, Charlotte (015650)	108,613,222,000
and Signet Bank, Richmond	11,870,799,000
merged on November 29, 1997 under the title of First Union National Bank, Charlotte (015650)	120,484,021,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
North Dakota	
Community First National Bank, Fargo (005087)	371,456,000
and Community First National Bank, Dickinson (004384)	146,669,000
merged on January 1, 1997 under the title of Community First National Bank, Fargo (005087)	518,125,000
First American Bank, National Association, Minot (023297)	360,707,000
and First American Bank, National Association, Devils Lake (003397)	64,021,000
merged on November 15, 1997 under the title of First American Bank, National Association, Minot (023297)	424,728,000
Ohio	
Bank One, Columbus, National Association, Columbus (007621)	9,266,062,000
and Bank One, Akron, National Association, Akron (017008)	2,726,004,000
and Bank One, Cleveland, National Association, Cleveland (014686)	2,569,963,000
merged on May 17, 1997 under the title of Bank One, National Association, Columbus (007621)	24,635,255,000
Bank One, National Association, Columbus (007621)	9,266,062,000
and Bank One, Fremont, National Association, Fremont (013997)	277,736,000
and Bank One, Mansfield, Mansfield	407,593,000
and Bank One, Youngstown, National Association, Youngstown (013586)	1,208,462,000
merged on May 17, 1997 under the title of Bank One, National Association, Columbus (007621)	24,635,255,000
Bank One, National Association, Columbus (007621)	9,266,062,000
and Bank One, Athens, National Association, Athens (007744)	251,275,000
and Bank One, Cambridge, National Association, Cambridge (006566)	212,779,000
and Bank One, Marion, Marion	236,860,000
and Bank One, Marietta, National Association, Marietta (004164)	205,329,000
and Bank One, Coshocton, National Association, Coshocton (013923)	183,935,000
and Bank One, Dover, National Association, Dover (004293)	306,660,000
and Bank One, Portsmouth, National Association, Portsmouth (007781)	246,593,000
merged on May 17, 1997 under the title of Bank One, National Association, Columbus (007621)	24,635,255,000
Bank One, National Association, Columbus (007621)	9,266,062,000
and Bank One, Cincinnati, National Association, Cincinnati (003234)	1,436,703,000
and Bank One, Sidney, National Association, Sidney (007862)	266,023,000
and Bank One, Lima, National Association, Lima (015340)	820,018,000
and Bank One, Dayton, National Association, Dayton (002604)	4,507,542,000
merged on May 17, 1997 under the title of Bank One, National Association, Columbus (007621)	24,635,255,000
KeyBank National Association, Cleveland (014761)	27,636,399,000
and Key Trust Company of Florida, National Association, Naples (021914)	7,928,000
merged on June 23, 1997 under the title of KeyBank National Association, Cleveland (014761)	27,640,081,000
The Huntington National Bank, Columbus (007745)	14,405,504,000
and The Huntington National Bank of Florida, Maitland (021058)	1,156,938,000
and The Huntington National Bank of Indiana, Noblesville (021917)	1,186,161,000
and Huntington National Bank West Virginia, Charleston (014396)	2,157,293,000
and Huntington Banks of Michigan, Troy	2,080,353,000
and The Huntington Trust Company, National Association, Columbus (021416)	21,285,000
and The Huntington Trust Company of Florida, National Association, Naples (021553)	1,189,000
merged on June 30, 1997 under the title of The Huntington National Bank, Columbus (007745)	20,998,887,000
KeyBank National Association, Cleveland (014761)	36,530,548,000
and KeyBank National Association, Salt Lake City (023276)	1,432,261,000
and KeyBank National Association, Bedford (023284)	46,652,000
merged on June 30, 1997 under the title of KeyBank National Association, Cleveland (014761)	63,527,177,000
National City Bank, Cleveland (000786)	10,551,671,000
and National City Bank, Northeast, Akron (017393)	3,241,829,000
and National City Bank, Northwest, Toledo (022582)	1,554,849,000
and National City Bank of Ashland, Ashland (000183)	187,959,000
merged on October 31, 1997 under the title of National City Bank, Cleveland (000786)	22,189,978,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Bank One Trust Company, National Association, Columbus (016235)	398,600,000
and Bank One Wisconsin Trust Company, National Association, Milwaukee (016823)	26,600,000
and Bank One Alpha Interim Trust Company, National Association, Milwaukee (023352)	1,000
merged on August 1, 1997 under the title of **Bank One Trust Company, National Association, Columbus** (016235)	425,200,000
Bank One Trust Company, National Association, Columbus (016235)	1,132,361,000
and Liberty Bank and Trust Company of Tulsa, National Association, Tulsa (005171)	22,290,000
merged on December 5, 1997 under the title of **Bank One Trust Company, National Association, Columbus** (016235)	1,154,851,000
Oklahoma	
Landmark Bank, National Association, Ada (023055)	120,000
and First Heritage National Bank, Davis (005126)	52,206,000
merged on February 21, 1997 under the title of **Landmark Bank, National Association, Ada** (023055)	52,206,000
Bank of the Lakes, National Association, Owasso (023235)	120,000
and Bank of the Lakes, Langley	54,363,000
merged on February 18, 1997 under the title of **Bank of the Lakes, National Association, Owasso** (023235)	54,363,000
Bank of Commerce, National Association, Catoosa (023265)	120,000
and Adair State Bank, Adair	12,170,000
merged on June 2, 1997 under the title of **Bank of Commerce, National Association, Catoosa** (023265)	12,170,000
Bank One, Oklahoma, National Association, Oklahoma City (011230)	3,269,819,000
and Bank One, Oklahoma City, Oklahoma City	587,652,000
merged on December 5, 1997 under the title of **Bank One, Oklahoma, National Association, Oklahoma City** (011230)	3,857,471,000
Oregon	
United States National Bank of Oregon, Portland (004514)	13,385,000,000
and U.S. Bank of California, Sacramento	3,806,563,000
and U.S. Bank of Idaho, Boise	3,823,744,000
and U.S. Bank of Nevada, Reno	1,144,657,000
and U.S. Bank of Washington, National Association, Seattle (014394)	9,703,758,000
and U.S. Bank of Utah, Salt Lake City	892,283,000
merged on June 13, 1997 under the title of **United States National Bank of Oregon, Portland** (004514)	32,027,104,000
United States National Bank of Oregon, Portland (004514)	32,857,006,000
and Business & Professional Bank, Woodland	227,532,000
and Sun Capital Bank, St. George	72,966,000
merged on July 18, 1997 under the title of **United States National Bank of Oregon, Portland** (004514)	33,187,625,000
Pennsylvania	
Omega Bank, National Association, State College (010506)	529,776,000
and Montour Bank, Danville	43,442,000
merged on December 31, 1996 under the title of **Omega Bank, National Association, State College** (010506)	573,218,000
PNC Bank, National Association, Pittsburgh (001316)	56,291,024,000
and PNC Mortgage Bank, National Association, Pittsburgh (022670)	1,800,019,000
merged on November 30, 1997 under the title of **PNC Bank, National Association, Pittsburgh** (001316)	58,091,043,000
PNC Bank, National Association, Pittsburgh (001316)	56,360,656,000
and PNC Bank New York, National Association, Jamestown (023464)	2,978,000
merged on December 1, 1997 under the title of **PNC Bank, National Association, Pittsburgh** (001316)	57,287,938,000
Rhode Island	
Fleet National Bank, Providence (001338)	49,825,673,000
and Fleet Bank, Albany	11,485,831,000
merged on November 14, 1997 under the title of **Fleet National Bank, Providence** (001338)	60,177,558,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
South Dakota	
Marquette Bank South Dakota, National Association, Sioux Falls (015537)	131,399,000
and Tri-County State Bank, Chamberlain	61,229,000
and Farmers and Merchants Bank, Huron	155,834,000
and Dakota State Bank, Milbank	79,650,000
and Bank of South Dakota, Watertown	116,663,000
merged on November 1, 1997 under the title of Marquette Bank South Dakota, National Association, Sioux Falls (015537)	544,775,000
Tennessee	
First American National Bank, Nashville (003032)	9,422,666,000
and CommunityFirst Bank, Hartsville	91,474,000
merged on January 2, 1997 under the title of First American National Bank, Nashville (003032)	9,522,752,000
NationsBank of Tennessee, National Association, Nashville (022567)	5,288,501,000
and Boatmen's Bank of Tennessee, Memphis	1,022,428,000
merged on October 17, 1997 under the title of NationsBank of Tennessee, National Association, Nashville (022567)	6,310,929,000
SunTrust Bank, East Tennessee, National Association, Knoxville (018101)	385,282,000
and SunTrust Bank, Northeast Tennessee, National Association, Johnson City (022966)	1,122,643,000
merged on September 5, 1997 under the title of SunTrust Bank, East Tennessee, National Association, Knoxville (018101)	1,607,925,000
First American National Bank, Nashville (003032)	9,732,299,000
and First American National Bank of Kentucky, Bowling Green (022665)	282,010,000
merged on July 1, 1997 under the title of First American National Bank, Nashville (003032)	9,613,134,000
Texas	
Norwest Bank Texas, National Association, Lubbock (014208)	2,194,010,000
and Norwest Bank Texas, Wichita Falls, National Association, Wichita Falls (007617)	362,406,000
and Norwest Bank Texas, Midland, National Association, Midland (022650)	395,219,000
and Norwest Bank Texas, Big Spring, National Association, Big Spring (013984)	213,044,000
merged on January 24, 1997 under the title of Norwest Bank Texas, National Association, Lubbock (014208)	2,874,428,000
Norwest Bank Texas, South, National Association, San Antonio (010148)	237,931,000
and Norwest Bank Texas, San Antonio, National Association, San Antonio (014963)	124,383,000
and Norwest Bank Texas, Kelly Field, National Association, San Antonio (014794)	195,328,000
merged on March 21, 1997 under the title of Norwest Bank Texas, South, National Association, San Antonio (010148)	557,545,000
Ballinger National Bank, Ballinger (023183)	4,000,000
and The First National Bank of Rotan, Rotan (008693)	28,482,000
merged on April 1, 1997 under the title of Ballinger National Bank, Ballinger (023183)	32,482,000
First National Bank of Dublin, Dublin (020026)	27,127,000
and The First State Bank, De Leon	21,553,000
merged on December 31, 1996 under the title of First National Bank of Dublin, Dublin (020026)	48,680,000
Northern Trust Bank of Texas National Association, Dallas (018644)	453,009,000
and Bent Tree National Bank, Dallas (016968)	79,000,000
merged on March 21, 1997 under the title of Northern Trust Bank of Texas National Association, Dallas (018644)	532,009,000
Norwest Bank Texas, South, National Association, San Antonio (010148)	824,644,000
and Norwest Bank Texas, Robstown, National Association, Robstown (023003)	67,184,000
and Norwest Bank Texas, Alice, Alice	154,445,000
and Norwest Bank Texas, Premont, Premont	23,208,000
merged on May 9, 1997 under the title of Norwest Bank Texas, South, National Association, San Antonio (010148)	1,069,981,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Norwest Bank Texas, South, National Association, San Antonio (010148)	1,084,002,000
and Norwest Bank Texas, Bandera, Bandera	79,576,000
and Norwest Bank Texas, Comfort, Comfort	50,970,000
and Norwest Bank Texas, Kerrville, National Association, Kerrville (014861)	230,774,000
and Norwest Bank Texas, Waco, National Association, Waco (002189)	355,185,000
merged on June 13, 1997 under the title of Norwest Bank Texas, South, National Association, San Antonio (010148)	1,799,740,000
Summit Community Bank, National Association, Fort Worth (018188)	99,356,000
and Alta Mesa National Bank, Fort Worth (016999)	95,801,000
merged on March 10, 1997 under the title of Summit Community Bank, National Association, Fort Worth (018188)	195,157,000
Gateway National Bank, Dallas (017164)	79,471,000
and New Gateway Bank (State Interim Bank), Dallas	5,000
merged on March 17, 1997 under the title of Gateway National Bank, Dallas (017164)	79,471,000
NationsBank of Texas, National Association, Dallas (021834)	32,910,977,000
and Boatmen's Trust Company of Texas, Houston	9,442,576,000
merged on September 19, 1997 under the title of NationsBank of Texas, National Association, Dallas (021834)	42,353,553,000
Norwest Bank Texas, National Association, Lubbock (014208)	3,194,529,000
and Norwest Bank Texas, South, National Association, San Antonio (010148)	1,774,390,000
and Norwest Bank Texas, North Central, Fort Worth	1,136,105,000
merged on October 11, 1997 under the title of Norwest Bank Texas, National Association, San Antonio (014208)	5,623,571,000
Norwest Bank Texas, National Association, San Antonio (014208)	5,629,181,000
and Norwest Bank Texas, South Central, Victoria	2,421,150,000
merged on November 22, 1997 under the title of Norwest Bank Texas, National Association, San Antonio (014208)	8,050,331,000
First National Bank of Paris, Paris (003638)	100,395,000
and Collin County National Bank, McKinney (023072)	39,392,000
merged on August 31, 1997 under the title of First National Bank of Paris, Paris (003638)	139,787,000
Hibernia National Bank of Texas, Texarkana (003785)	405,438,000
and First National Bank of Paris, Paris (003638)	139,787,000
merged on August 31, 1997 under the title of Hibernia National Bank of Texas, Texarkana (003785)	554,109,000
Hibernia National Bank of Texas, Texarkana (003785)	405,438,000
and OrangeBank, Orange	120,663,000
merged on November 5, 1997 under the title of Hibernia National Bank of Texas, Texarkana (003785)	405,438,000
The Herring National Bank, Vernon (007010)	108,000,000
and First Bank & Trust of Clarendon, Clarendon	32,000,000
merged on October 1, 1997 under the title of The Herring National Bank, Vernon (007010)	140,000,000
Utah	
KeyBank National Association, Salt Lake City (023276)	1,432,261,000
and KeyBank National Association, Portland (023281)	3,878,738,000
and KeyBank National Association, Albany (023279)	15,486,227,000
and KeyBank National Association, Portland (023275)	3,028,475,000
and KeyBank National Association, Burlington (023277)	667,503,000
and KeyBank National Association, Tacoma (023278)	345,569,000
and KeyBank National Association, Tacoma (023347)	8,066,911,000
and KeyBank National Association, Anchorage (023280)	967,096,000
and KeyBank National Association, Fort Collins (023274)	1,342,332,000
and KeyBank National Association, Boise (023282)	1,540,985,000
merged on June 30, 1997 under the title of KeyBank National Association, Salt Lake City (023276)	36,530,538,000
Zions First National Bank, Salt Lake City (004341)	5,565,763,000
and Zions Bank, Montpelier	24,126,000
merged on August 15, 1997 under the title of Zions First National Bank, Salt Lake City (004341)	5,685,470,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
First Security Bank, National Association, Ogden (002597)	11,823,000
and First Security Bank of Wyoming, Rock Springs	210,436,000
merged on November 24, 1997 under the title of **First Security Bank, National Association, Ogden** (002597)	12,034,000
Vermont	
Vermont National Bank, Brattleboro (001430)	1,467,886,000
and Vermont Federal National Bank, Exeter (023488)	429,443,000
merged on September 22, 1997 under the title of **Vermont National Bank, Brattleboro** (001430)	1,897,329,000
West Virginia	
Progressive Bank, National Association, Wheeling (016248)	105,685,000
and Progressive Bank, National Association–Bellaire, Bellaire (013996)	19,421,000
merged on August 22, 1997 under the title of **Progressive Bank, National Association, Wheeling** (016248)	125,106,000
The Matewan National Bank, Williamson (010370)	386,439,000
and Matewan National Bank/Kentucky, Pikeville (006622)	197,147,000
merged on September 19, 1997 under the title of **The Matewan National Bank, Williamson** (010370)	568,486,000
The City National Bank of Charleston, Charleston (014807)	527,656,000
and Blue Ridge Bank, National Association, Martinsburg (023326)	131,841,000
and Peoples National Bank, Point Pleasant (023327)	153,746,000
and First State Bank and Trust, National Association, Rainelle (023328)	105,490,000
and Bank of Ripley, National Association, Ripley (023356)	87,194,000
and The Home National Bank of Sutton, Sutton (009604)	75,864,000
and The Merchants National Bank of Montgomery, Montgomery (009740)	138,201,000
and The First National Bank of Hinton, Hinton (005562)	92,280,000
and Peoples State Bank, National Association, Clarksburg (023355)	28,704,000
and The Old National Bank of Huntington, Huntington (017102)	54,907,000
merged on December 22, 1997 under the title of **The City National Bank of Charleston, Charleston** (014807)	1,319,831,000
Wisconsin	
AMCORE Bank, National Association, South Central, Monroe (000230)	230,936,000
and Belleville State Bank, Belleville	40,639,000
merged on October 17, 1997 under the title of **AMCORE Bank, National Association, South Central, Monroe** (000230)	271,576,000
Wyoming	
First Interim Bank of Casper, National Association, Casper (023387)	93,700,000
and First Interim Bank of Cheyenne, National Association, Cheyenne (023386)	187,800,000
merged on May 31, 1997 under the title of **First Interim Bank of Casper, National Association, Casper** (023387)	281,452,000

Annual summary of affiliated mergers—thrift (mergers consummated involving affiliated national banks and savings and loan associations), January 1 to December 31, 1997

Title and location (charter number)	Total assets
California	
National Bank of the Redwoods, Santa Rosa (018541)	252,385,000
and Allied Bank, F.S.B., Santa Rosa	280,961,000
merged on March 24, 1997 under the title of National Bank of the Redwoods, Santa Rosa (018541)	512,264,000
International City Bank National Association, Long Beach (018383)	12,425,000
and Flagship Bank, F.S.B., San Diego	67,322,000
merged on December 31, 1997 under the title of International City Bank National Association, Long Beach (018383)	79,190,000
Kentucky	
Trans Financial Bank, National Association, Bowling Green (022833)	1,435,977,000
and Trans Financial Bank, F.S.B., Russellville	365,328,000
merged on July 26, 1997 under the title of Trans Financial Bank, National Association, Bowling Green (022833)	1,465,994,000
Massachusetts	
BankBoston, National Association, Boston (000200)	57,450,047,000
and Bank of Boston Connecticut, Hartford	5,216,358,000
merged on October 16, 1997 under the title of BankBoston, National Association, Boston (000200)	59,317,952,000
Michigan	
Michigan National Bank, Farmington Hills (016660)	8,951,516,000
and Michigan Bank, F.S.B., Troy	80,050,000
merged on August 31, 1997 under the title of Michigan National Bank, Farmington Hills (016660)	9,028,946,000
Minnesota	
First Bank National Association, Minneapolis (000710)	17,082,000,000
and First Bank, F.S.B., Fargo	4,913,000
merged on May 31, 1997 under the title of First Bank National Association, Minneapolis (000710)	21,850,000,000
Pennsylvania	
First Western Bank, National Association, New Castle (000562)	1,077,570,000
and First Western Bank, Federal Savings Bank, Sharon	609,389,000
merged on September 8, 1997 under the title of First Western Bank, National Association, New Castle (000562)	1,686,928,000
Utah	
First Security Bank, National Association, Ogden (002597)	11,814,743,000
and First Security Bank of Oregon, Salem	467,698,000
merged on May 23, 1997 under the title of First Security Bank, National Association, Ogden (002597)	12,282,441,000
Washington	
U.S. Bank of Washington, National Association, Seattle (014394)	9,278,309,000
and U.S. Savings Bank of Washington, Bellingham	763,400,000
merged on January 31, 1997 under the title of U.S. Bank of Washington, National Association, Seattle (014394)	10,049,308,000
West Virginia	
One Valley Bank, National Association, Charleston (016433)	1,707,354,000
and One Valley Bank, F.S.B., Point Pleasant	60,150,000
merged on October 31, 1997 under the title of One Valley Bank, National Association, Charleston (016433)	1,753,030,000

Changes in the corporate structure of the national banking system, by state, July 1 to December 31, 1997

	In operation July 1, 1997	Organized and opened for business	Merged	Voluntary liquidations	Payouts	12 USC 214 Converted to non-national institutions	12 USC 214 Merged with non-national institutions	In operation December 31, 1997
Alabama	34	0	0	0	0	0	0	34
Alaska	5	0	1	0	0	0	0	4
Arizona	14	1	0	0	0	0	0	15
Arkansas	76	1	11	0	0	0	0	66
California	109	3	1	0	0	2	4	105
Colorado	90	1	2	0	0	0	0	89
Connecticut	9	1	1	0	0	0	0	9
Delaware	23	0	1	0	0	0	0	22
District of Columbia	8	1	1	1	0	0	0	7
Florida	97	7	3	0	0	0	3	99
Georgia	60	3	1	0	0	0	0	62
Hawaii	1	0	0	0	0	0	0	1
Idaho	2	0	1	0	0	0	0	1
Illinois	237	8	6	0	0	0	3	236
Indiana	50	0	1	0	0	0	0	49
Iowa	55	6	6	0	0	0	1	54
Kansas	119	0	1	0	0	2	0	116
Kentucky	72	2	3	0	0	1	0	71
Louisiana	27	0	2	0	0	0	0	25
Maine	9	0	1	0	0	0	1	7
Maryland	22	1	1	1	0	0	0	21
Massachusetts	24	1	1	0	0	0	1	22
Michigan	40	0	0	0	0	1	0	39
Minnesota	137	6	1	0	0	0	0	142
Mississippi	24	0	0	0	0	0	0	24
Missouri	49	3	1	0	0	2	0	47
Montana	25	0	0	1	0	1	1	22
Nebraska	99	1	0	0	0	0	1	99
Nevada	5	2	0	0	0	0	0	7
New Hampshire	9	1	2	0	0	0	0	8
New Jersey	26	0	0	0	0	0	0	27
New Mexico	26	0	7	0	0	0	0	20
New York	70	1	2	0	0	0	0	68
North Carolina	10	0	0	0	0	0	0	10
North Dakota	22	1	3	0	0	0	0	20
Ohio	118	2	11	0	0	0	1	108
Oklahoma	121	1	2	0	0	1	2	117
Oregon	6	0	2	0	0	0	0	4
Pennsylvania	116	0	1	0	0	0	1	114
Rhode Island	1	0	0	0	0	0	0	2
South Carolina	24	0	1	0	0	0	0	23
South Dakota	25	0	0	0	0	0	1	24
Tennessee	43	2	3	0	0	0	0	42
Texas	423	11	4	0	0	0	3	427
Utah	9	0	1	0	0	0	0	8
Vermont	13	0	1	0	0	0	0	12
Virginia	35	1	1	0	0	0	4	31
Washington	23	1	2	0	0	0	1	21
West Virginia	43	0	10	0	0	0	0	33
Wisconsin	63	1	1	0	0	0	0	63
Wyoming	20	0	0	0	0	0	0	20
United States	2,768	70	101	3	0	10	28	2,696

Notes: The column "organized and opened for business" includes all state banks converted to national banks, as well as newly formed national banks. The column titled "merged" includes all mergers, consolidations, and purchases and assumptions of branches in which the resulting institution is a nationally chartered bank. Also included in this column are immediate FDIC-assisted merger transactions in which the resulting institution is a nationally chartered bank. The column titled "voluntary liquidations" includes only straight liquidations of national banks. No liquidations pursuant to a purchase and assumption transaction are included in this total. Liquidations resulting from purchases and assumptions are included in the "merged" column. The column titled "payouts" includes failed national banks in which the FDIC is named as receiver and no other depository institution is named as successor. The column titled "merged with non-national institutions" includes all mergers, consolidations, and purchases and assumptions of branches in which the resulting institution is a non-national institution. Also included in this column are immediate FDIC-assisted merger transactions in which the resulting institution is a non-national institution.

Applications for new, full-service national bank charters, approved and denied, by state, July 1 to December 31, 1997

Title and location	Approved	Denied
California		
Auburn National Bank, Auburn	July 24	
California National Bank, Beverly Hills	October 30	
Delaware		
Commerce Bank/Delaware, National Association, Wilmington	November 19	
District of Columbia		
America's First Bank, National Association, Washington	December 1	
Florida		
Indian Rocks National Bank, Largo	September 26	
Tarpon Coast National Bank, Port Charlotte	December 11	
Georgia		
The Buckhead Community Bank, National Association, Atlanta	October 30	
Illinois		
Crystal Lake Bank & Trust Company, National Association, Crystal Lake	November 24	
Indiana		
First Bank Richmond, National Association, Richmond	December 30	
Iowa		
Magna Interim Bank—Decorah, National Association, Decorah	July 14	
Magna Interim Bank—Des Moines, National Association, Des Moines	July 14	
Magna Interim Bank—Iowa City, National Association, Iowa City	July 14	
Magna Interim Bank—Vinton, National Association, Vinton	July 14	
Magna Interim Bank—Waterloo, National Association, Waterloo	July 14	
Firstar First Interim Bank, National Association, Clinton	August 28	
Firstar Second Interim Bank, National Association, Dewitt	August 28	
Iowa		
Magna Interim—Cedar Rapids, National Association, Cedar Rapids	July 14	
Kentucky		
Kentucky National Bank, Elizabethtown	September 5	
Michigan		
The Stephenson National Bank, Menominee	October 3	
Minnesota		
Northern National Bank, Nisswa	July 17	
Missouri		
Community First National Bank of West Plains, West Plains	August 28	
New York		
Banco De Prestamos National Bank, Jackson Heights (Queens)	July 7	
North Dakota		
First Bank National Association ND, Fargo	July 2	
Oklahoma		
Bank of Elgin, National Association, Lawton	September 10	
Oklahoma		
U.S. National Bank, Midwest City	September 9	
South Carolina		
Florence National Bank, Florence	November 7	
Florence County National Bank, Florence	December 4	

Applications for new, full-service national bank charters (continued)

Title and location	Approved	Denied
Texas		
First Community Bank, National Association, (FCB), Grand Prairie	July 14	
Compubank, National Association, Houston	August 20	
First Independent National Bank, Plano	September 17	
Citizens National Bank of Childress, Childress	October 2	
First National Bank of Borger, Borger	October 2	
First State Bank of Canadian, National Association, Canadian	October 2	
First Mercantile Bank, National Association, Dallas	October 9	
Bank of the Hills, National Association, Kerrville	October 27	
American First National Bank, Houston	December 12	
Virginia		
First National Exchange Bank, Roanoke	November 26	
Wisconsin		
First Value Bank, National Association, Grand Chute	July 14	

Applications for new, limited-purpose national bank charters, approved and denied, by state, July 1 to December 31, 1997

Title and location	Type of bank	Approved	Denied
Arizona			
Jewelers National Bank, Tempe	Credit card	August 4	
California			
Chase Trust Company, National Association, Los Angeles	Trust (non-deposit)	August 12	
Connecticut			
Webster Trust Company, National Association, Waterbury	Trust (non-deposit)	July 31	
District of Columbia			
ASB Trust Company, National Association, Washington	Trust (non-deposit)	August 18	
Florida			
State Street Global Advisors, National Association, Naples	Trust (non-deposit)	September 30	
TCM Bank, National Association, Tampa	Credit card	October 7	
Georgia			
Cedar Hill National Bank, Lawrenceville	Credit card	October 27	
Louisiana			
United Credit Card Bank, National Association, Baton Rouge	Credit card	November 3	
Massachusetts			
Congress Trust, National Association, Boston	Trust (non-deposit)	December 5	
Nebraska			
Nebraska Trust Company, National Association, Fremont	Trust (non-deposit)	December 17	
Oklahoma			
Banctrust, National Association, Oklahoma City	Trust (non-deposit)	September 10	
Pennsylvania			
New Trust Company, National Association, Pittsburgh	Trust (non-deposit)	October 23	
Rhode Island			
Fleet Bank (RI), National Association, Providence	Credit card	October 27	
Texas			
San Angelo Trust Company, National Association, San Angelo	Trust (non-deposit)	September 2	
BFNB Trust Company, National Association, Amarillo	Trust (non-deposit)	September 10	
Credicard National Bank, San Antonio	Credit card	November 21	

New, full-service national bank charters issued, July 1 to December 31, 1997

Title and location	Charter number	Date opened
California		
Mission Community Bank, National Association, San Luis Obispo	023171	December 18
Colorado		
TCF National Bank Colorado, Englewood	023269	July 1
Florida		
Pelican National Bank, Naples	023178	August 25
Edison National Bank, Fort Myers	023329	August 29
Indian Rocks National Bank, Largo	023498	October 17
Georgia		
Rockdale National Bank, Conyers	023349	October 14
Eagle National Bank, Stockbridge	023184	December 2
Illinois		
Crystal Lake Bank & Trust Company, National Association, Crystal Lake	023574	December 19
Illinois		
Mount Prospect National Bank, Mt. Prospect	023406	September 15
Iowa		
Magna Interim—Cedar Rapids, National Association, Cedar Rapids	023423	July 18
Community National Bank, Waterloo	023351	August 18
Firstar First Interim Bank, National Association, Clinton	023493	September 8
Firstar Second Interim Bank, National Association, Dewitt	023494	September 8
Kentucky		
Somerset National Bank, Somerset	023358	August 1
Kentucky National Bank, Elizabethtown	023434	October 15
Minnesota		
Northern National Bank, Nisswa	023450	October 10
Missouri		
Community First National Bank of West Plains, West Plains	023481	November 13
North Dakota		
First Bank National Association ND, Fargo	023446	July 31
Oklahoma		
U.S. National Bank, Midwest City	023440	December 2
Texas		
Resource Bank, National Association, Dallas	023248	October 3
Texas National Bank, Tomball	023266	October 14
Southwestern National Bank, Houston	023081	November 3
Citizens National Bank of Childress, Childress	023512	December 4
First National Bank of Borger, Borger	023511	December 4
First State Bank of Canadian, National Association, Canadian	023513	December 4
Washington		
Yakima National Bank, Yakima	023224	August 4

New, limited-purpose national bank charters issued, July 1 to December 31, 1997

Title and location	Charter number	Date opened
Arizona		
Jewelers National Bank, Tempe	023403	October 1
California		
Neighborhood National Bank, San Diego	022770	September 19
Chase Trust Company, National Association, Los Angeles	023470	November 15
Connecticut		
Webster Trust Company, National Association, Waterbury	023465	August 1
District of Columbia		
ASB Trust Company, National Association, Washington	023485	November 12
Florida		
State Street Global Advisors, National Association, Naples	023492	November 17
Massachusetts		
Boston Equiserve Trust Company, National Association, Canton	023148	August 1
Nevada		
Eaglemark Bank, National Association, Carson City	023154	August 25
Rhode Island		
Fleet Bank (RI), National Association, Providence	023536	November 14
Texas		
Western National Trust Company, National Association, Odessa	023271	July 7
San Angelo Trust Company, National Association, San Angelo	023448	October 3
BFNB Trust Company, National Association, Amarillo	023500	December 31

State-chartered banks converted to full-service national banks, July 1 to December 31, 1997

Title and location	Effective date	Total assets
Arkansas		
Mercantile Bank of Arkansas National Association, (023540), conversion of Mercantile Bank of Arkansas, North Little Rock	October 28	$1,283,531,000
Florida		
Citizens and People's Bank, National Association, (023416), conversion of First Bank of Baldwin County, Cantonment	August 15	35,108,000
Independent National Bank, (023484), conversion of Independent Bank of Ocala, Ocala	October 15	56,561,000
Illinois		
First National Bank of Elmhurst, (023404), conversion of Bank of Elmhurst, Elmhurst	July 1	136,262,000
Evanston Bank, National Association, (023339), conversion of Evanston Bank, Evanston	July 2	77,194,000
Iowa		
Community First National Bank, (023417), conversion of Community First State Bank, Decorah	July 1	158,346,000
Maryland		
Maryland Bank and Trust Company, National Association, (023430), conversion of Maryland Bank and Trust Company, Lexington Park	August 1	177,836,000
Minnesota		
Stearns Bank Evansville National Association, (023459), conversion of Farmers' State Bank of Evansville, Evansville	October 15	25,805,000
Stearns Bank Holdingford National Association, (023457), conversion of Security State Bank of Holdingford, Holdingford	October 15	26,926,000
Stearns Bank Upsala National Association, (023458), conversion of Farmers State Bank of Upsala, Upsala	October 15	21,971,000
Missouri		
Mercantile Bank of Pike County National Association, (023578), conversion of Mercantile Bank of Pike County, Bowling Green	December 12	60,373,000
Roosevelt Bank, National Association, (023552), conversion of Roosevelt Bank, Chesterfield	November 13	7,181,527,000
Nebraska		
Community First National Bank, (023415), conversion of Community First State Bank, Alliance	July 1	317,544,000
Ohio		
Summit Bank, National Association, (023439), conversion of Summit Bank, Akron	July 7	82,476,000
Texas		
The First National Bank of Amarillo, (023451), conversion of Fritch State Bank, Amarillo	June 30	18,768,000
San Angelo National Bank, (023445), conversion of Southwest Bank of San Angelo, San Angelo	September 26	1,000
Wisconsin		
Community First National Bank, (023433), conversion of Community First State Bank, Spooner	July 1	97,446,000

State-chartered banks converted to limited-purpose national banks, July 1 to December 31, 1997

Title and location	Effective date	Total assets
Illinois		
Grand Premier Trust and Investment, Inc., National Association, (023392), conversion of Grand Premier Trust & Investment, Inc., Freeport	August 1	530,000
Minnesota		
Marquette Trust Company, National Association, (023388), conversion of Marquette Trust Company, Minnetonka	July 25	1,345,000
First American Trust, National Association, (023483), conversion of First American Trust Company of Minnesota, St. Cloud	September 1	2,341,444,000
New York		
PNC Bank New York, National Association, (023464), conversion of PNC Trust Company of New York, Jamestown	December 1	2,978,000

Nonbanking institutions converted to full-service national banks, July 1 to December 31, 1997

Title and location	Effective date	Total assets
Florida		
Natbank, National Association, (023523), conversion of Natbank, F.S.B., Hollywood	December 31	50,000,000
Georgia		
NationsBank, National Association (Glynn County), (023489), conversion of First Federal Savings Bank of Brunswick, Georgia, Brunswick	November 1	250,000,000
Illinois		
Covest Banc, National Association, (023418), conversion of First Federal Bank for Savings, Des Plaines	August 1	551,761,000
First Robinson Savings Bank, National Association, (023393), conversion of First Robinson Savings & Loan, F.A., Robinson	June 27	70,163,000
Iowa		
Firstar National Bank, (023495), conversion of Firstar Bank, F.S.B., Dubuque	September 8	299,000,000,000
Nevada		
Norwest Bank Nevada, National Association, (023444), conversion of Norwest Bank Nevada, F.S.B., Las Vegas	September 1	2,823,847,000
New Hampshire		
Vermont Federal National Bank, (023488), conversion of Vermont Federal Bank, F.S.B., Exeter	September 22	429,443,000
Ohio		
Signal Bank, National Association, (023344), conversion of First Federal Savings and Loan Association of Wooster, Wooster	July 3	1,066,135,000
Tennessee		
PFC Interim National Bank II, (023469), conversion of Guaranty Federal Savings Bank, Clarksville	August 15	60,755,000
Community National Bank of Tennessee, (023542), conversion of Lexington First Federal Savings Bank, Lexington	December 11	27,940,000
Virginia		
One Valley Bank—Central Virginia, National Association, (023467), conversion of One Valley Bank—Central Virginia, Lynchburg	October 31	362,892,241,000

National banks in voluntary liquidation, July 1 to December 31, 1997

Title and location	Charter number	Effective date
District of Columbia		
ASB Trust Company, National Association, Washington	023485	November 12
Maryland		
State Street Bank and Trust Company of Maryland, National Association, Columbia	021554	July 31
Montana		
The First National Bank and Trust, Wibaux	008259	December 4

National banks merged out of the national banking system, July 1 to December 31, 1997

Title and location	Charter number	Effective date
California		
Liberty National Bank, Huntington Beach	017306	June 30
San Dieguito National Bank, Encinitas	016930	June 30
High Desert National Bank, Hesperia	017298	December 4
National Bank of Southern California, Newport Beach	017623	December 15
Florida		
Regions Bank, National Association, Longwood	021591	November 7
Universal National Bank, Miami	018309	June 20
County National Bank of South Florida, North Miami Beach	015026	December 2
Illinois		
The First National Bank of Manlius, Manlius	008648	October 11
Mercantile Bank of Sterling–Rock Falls National Association, Sterling	013963	April 19
Tampico National Bank, W/S–Tampico	014574	October 11
Iowa		
Mercantile Bank of Dubuque, National Association, Dubuque	000317	October 3
Maine		
Atlantic Bank, National Association, Portland	018377	October 1
Massachusetts		
First National Bank of the Berkshires, Lee	000885	December 5
Montana		
First Interstate Bank of Montana, National Association, Kalispell	004803	June 20
Nebraska		
The First National Bank of Wilcox, Wilcox	007861	November 24
Ohio		
Van Wert National Bank, Van Wert	013797	November 1
Oklahoma		
The Peoples National Bank, Kingfisher	009954	September 19
The First National Bank of Leedey, Leedey	012109	June 9
Pennsylvania		
First National Bank and Trust Co., Waynesboro	011866	September 26
South Dakota		
The First National Bank of Eden, Eden	011506	September 15
Texas		
Houston National Bank, Houston	018560	October 27
The Texas National Bank of Waco, Waco	006572	July 14
West Columbia National Bank, West Columbia	015015	August 22
Virginia		
Premier Bank—Central, National Association, Honaker	022946	October 20
Patriot National Bank, Reston	022033	August 1
Premier Bank, National Association, Tazewell	006123	October 20
Premier Bank—South, National Association, Wytheville	022945	September 22
Washington		
American First National Bank, Everett	018404	August 1

National banks converted out of the national banking system, July 1 to December 31, 1997

Title and location	Effective date	Total assets
California		
Hacienda National Bank, Santa Maria, (021519)	December 26	24,178,000
First National Bank of Ventura, Ventura, (021508)	June 30	46,845,000
Kansas		
First National Bank, Emporia, (005529)	October 3	32,657,000
The First National Bank of Goff, Goff, (007416)	June 30	5,473,000
Kentucky		
The First National Bank of Louisa, Louisa, (007110)	October 1	39,513,000
Michigan		
Charter National Bank, Taylor, (013874)	July 21	195,588,000
Missouri		
The First National Bank of Salem, Salem, (007921)	October 16	81,228,000
First City National Bank, Springfield, (018299)	April 24	89,635,000
Montana		
First National Bank of Eureka, Eureka, (015397)	December 18	25,300,000
Oklahoma		
Oklahoma National Bank & Trust Company of Chickasha, Chickasha, (009938)	June 2	70,000,000

Federal branches and agencies of foreign banks in operation, July 1 to December 31, 1997

	In operation July 1, 1997	Opened July 1–December 31	Closed July 1–December 31	In operation December 31, 1997
Federal branches				
California	3	0	0	3
Connecticut	1	0	0	1
District of Columbia	1	0	0	1
New York	45	0	1	44
Washington	1	0	0	1
Limited federal branches				
California	7	0	0	7
District of Columbia	2	0	0	2
New York	4	0	0	4
Federal agencies				
Florida	1	0	1	0
Illinois	1	0	0	1
Total United States	66	0	2	64

Tables on the Financial Performance of National Banks

Tables are provided by the Financial and Statistical Analysis Division and include data for nationally chartered, FDIC-insured commercial banks that file a quarter-end call report. Data for the current period are preliminary and subject to revision. Figures in the tables may not sum to totals because of rounding.

Assets, liabilities, and capital accounts of national banks
December 31, 1996 and December 31, 1997
(Dollar figures in millions)

	December 31, 1996	December 31, 1997	Change December 31, 1996–December 31, 1997 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	2,726	2,597	(129)	(4.73)
Total assets	$2,528,057	$2,893,910	$365,854	14.47
Cash and balances due from depositories	207,356	231,732	24,376	11.76
Noninterest-bearing balances, currency and coin	150,661	153,974	3,313	2.20
Interest bearing balances	56,695	77,758	21,063	37.15
Securities	380,615	452,111	71,496	18.78
Held-to-maturity securities, amortized cost	70,242	69,438	(804)	(1.14)
Available-for-sale securities, fair value	310,373	382,673	72,300	23.29
Federal funds sold and securities purchased	91,686	106,784	15,097	16.47
Net loans and leases	1,609,472	1,805,826	196,354	12.20
Total loans and leases	1,641,464	1,840,662	199,198	12.14
Loans and leases, gross	1,643,979	1,842,874	198,895	12.10
Less: Unearned income	2,515	2,212	(303)	(12.05)
Less: Reserve for losses	31,992	34,836	2,845	8.89
Assets held in trading account	72,869	93,468	20,600	28.27
Other real estate owned	2,764	2,111	(653)	(23.62)
Intangible assets	34,657	49,615	14,957	43.16
All other assets	128,637	152,263	23,626	18.37
Total liabilities and equity capital	2,528,057	2,893,910	365,854	14.47
Deposits in domestic offices	1,525,565	1,685,304	159,740	10.47
Deposits in foreign offices	275,478	319,551	44,073	16.00
Total deposits	1,801,043	2,004,855	203,812	11.32
Noninterest-bearing deposits	397,722	417,603	19,881	5.00
Interest-bearing deposits	1,403,321	1,587,252	183,931	13.11
Federal funds purchased and securities sold	183,751	241,991	58,241	31.70
Demand notes issued to U.S. Treasury	10,456	14,157	3,701	35.39
Other borrowed money	177,116	199,236	22,120	12.49
With remaining maturity of one year or less	117,296	125,896	8,600	7.33
With remaining maturity of more than one year	59,821	73,341	13,520	22.60
Trading liabilities less revaluation losses	8,695	15,274	6,579	75.66
Subordinated notes and debentures	32,421	43,106	10,684	32.95
All other liabilities	107,407	130,299	22,892	21.31
Trading liabilities revaluation losses	40,152	51,800	11,648	29.01
Other	67,255	78,499	11,243	16.72
Total equity capital	207,167	244,992	37,825	18.26
Perpetual preferred stock	493	479	(14)	(2.78)
Common stock	17,963	17,772	(191)	(1.06)
Surplus	96,178	120,628	24,450	25.42
Net undivided profits and capital reserves	93,243	107,013	13,770	14.77
Cumulative foreign currency translation adjustment	(710)	(900)	(191)	NM

NM indicates calculated percent change is not meaningful.

Quarterly income and expenses of national banks
Fourth quarter 1996 and fourth quarter 1997

(Dollar figures in millions)

	Fourth quarter 1996	Fourth quarter 1997	Change Fourth quarter 1996–fourth quarter 1997 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	2,726	2,597	(129)	(4.73)
Net income	$8,035	$9,343	$1,308	16.27
Net interest income	24,359	26,952	2,593	10.64
Total interest income	45,607	51,609	6,001	13.16
On loans	35,634	39,626	3,992	11.20
From lease financing receivables	933	1,392	459	49.18
On balances due from depositories	828	1,173	345	41.70
On securities	6,210	7,164	955	15.38
From assets held in trading account	707	764	56	7.96
On federal funds sold and securities repurchased	1,294	1,488	194	15.00
Less: Interest expense	21,248	24,657	3,409	16.04
On deposits	15,256	17,550	2,294	15.04
Of federal funds purchased and securities sold	2,517	2,942	425	16.87
On demand notes and other borrowed money*	2,912	3,511	599	20.58
On subordinated notes and debentures	562	653	91	16.11
Less: Provision for losses	2,708	3,581	873	32.25
Noninterest income	15,412	17,241	1,828	11.86
From fiduciary activities	1,801	2,095	294	16.33
Service charges on deposits	2,903	3,390	487	16.76
Trading revenue	846	827	(20)	(2.33)
From interest rate exposures	481	334	(148)	(30.67)
From foreign exchange exposures	380	571	191	50.21
From equity security and index exposures	(42)	(62)	(20)	NM
From commodity and other exposures	27	(16)	(43)	NM
Total other noninterest income	9,862	10,929	1,066	10.81
Gains/losses on securities	181	656	475	NM
Less: Noninterest expense	24,699	27,302	2,602	10.54
Salaries and employee benefits	9,807	10,774	966	9.85
Of premises and fixed assets	3,180	3,377	197	6.19
Other noninterest expense	11,712	13,151	1,439	12.29
Less: Taxes on income before extraordinary items	4,510	4,622	112	2.49
Income/loss from extraordinary items, net of income taxes	(0)	(0)	0	(84.59)
Memoranda:				
Net operating income	7,915	8,918	1,004	12.68
Income before taxes and extraordinary items	12,545	13,965	1,420	11.32
Income net of taxes before extraordinary items	8,035	9,343	1,307	16.27
Cash dividends declared	8,206	11,261	3,054	37.22
Net charge-offs to loan and lease reserve	2,822	3,444	621	22.01
Charge-offs to loan and lease reserve	3,955	4,579	625	15.80
Less: Recoveries credited to loan and lease reserve	1,132	1,136	4	0.32

* Includes mortgage indebtedness

NM indicates calculated percent change is not meaningful.

Year-to-date income and expenses of national banks
Through December 31, 1996 and through December 31, 1997
(Dollar figures in millions)

	December 31, 1996	December 31, 1997	Change December 31, 1996–December 31, 1997 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	2,726	2,597	(129)	(4.73)
Net income	**$30,498**	**$35,816**	**$5,317**	**17.43**
Net interest income	**94,565**	**106,641**	**12,077**	**12.77**
Total interest income	177,309	200,278	22,969	12.95
On loans	138,004	155,554	17,550	12.72
From lease financing receivables	3,247	4,858	1,612	49.64
On balances due from depositories	3,080	3,728	648	21.02
On securities	25,174	27,555	2,381	9.46
From assets held in trading account	2,975	2,978	3	0.11
On federal funds sold and securities repurchased	4,829	5,604	775	16.05
Less: Interest expense	82,745	93,637	10,892	13.16
On deposits	59,154	67,060	7,905	13.36
Of federal funds purchased and securities sold	9,928	11,087	1,159	11.67
On demand notes and other borrowed money*	11,631	12,983	1,352	11.63
On subordinated notes and debentures	2,031	2,508	476	23.45
Less: Provision for losses	**9,598**	**13,032**	**3,434**	**35.78**
Noninterest income	**56,102**	**65,425**	**9,323**	**16.62**
From fiduciary activities	6,611	8,004	1,393	21.08
Service charges on deposits	10,920	12,853	1,933	17.70
Trading revenue	3,023	3,761	738	24.41
From interest rate exposures	1,584	1,634	50	3.15
From foreign exchange exposures	1,307	2,077	771	58.99
From equity security and index exposures	74	40	(33)	(45.39)
From commodity and other exposures	58	9	(49)	(84.63)
Total other noninterest income	35,548	40,807	5,259	14.79
Gains/losses on securities	**482**	**1,206**	**725**	**150.45**
Less: Noninterest expense	**93,691**	**104,670**	**10,979**	**11.72**
Salaries and employee benefits	37,375	41,585	4,210	11.26
Of premises and fixed assets	12,002	13,238	1,235	10.29
Other noninterest expense	44,314	49,848	5,534	12.49
Less: Taxes on income before extraordinary items	**17,446**	**19,762**	**2,316**	**13.27**
Income/loss from extraordinary items, net of income taxes	**86**	**8**	**(78)**	**NM**
Memoranda:				
Net operating income	30,097	35,027	4,930	16.38
Income before taxes and extraordinary items	47,859	55,570	7,711	16.11
Income net of taxes before extraordinary items	30,413	35,808	5,395	17.74
Cash dividends declared	25,279	28,575	3,296	13.04
Net charge-offs to loan and lease reserve	9,968	12,649	2,682	26.90
Charge-offs to loan and lease reserve	13,831	16,874	3,043	22.00
Less: Recoveries credited to loan and lease reserve	3,863	4,224	361	9.35

* Includes mortgage indebtedness
NM indicates calculated percent change is not meaningful.

Assets of national banks by asset size
December 31, 1997
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Total assets	$2,893,910	$69,069	$268,738	$475,998	$2,080,104	$5,014,884
Cash and balances due from	231,732	3,804	13,860	31,346	182,722	355,120
Securities	452,111	19,159	71,663	90,309	270,980	871,870
Federal funds sold and securities purchased	106,784	3,882	10,374	17,866	74,661	261,874
Net loans and leases	1,805,826	39,196	160,860	308,343	1,297,427	2,915,949
Total loans and leases	1,840,662	39,727	163,250	316,046	1,321,640	2,970,667
Loans and leases, gross	1,842,874	39,898	163,655	316,228	1,323,093	2,975,192
Less: Unearned income	2,212	170	405	183	1,453	4,525
Less: Reserve for losses	34,836	531	2,390	7,703	24,212	54,718
Assets held in trading account	93,468	7	79	837	92,546	296,752
Other real estate owned	2,111	93	256	213	1,549	3,794
Intangible assets	49,615	219	1,417	6,956	41,022	61,673
All other assets	237,333	4,878	9,536	19,243	203,676	373,960
Gross loans and leases by type:						
Loans secured by real estate	725,463	22,281	97,275	127,370	478,536	1,243,874
1–4 family residential mortgages	363,608	11,184	47,421	62,720	242,283	620,826
Home equity loans	67,588	519	5,004	10,843	51,222	98,081
Multifamily residential mortgages	23,346	545	3,107	4,752	14,943	41,191
Commercial RE loans	190,050	6,147	31,131	37,355	115,416	340,356
Construction RE loans	47,388	1,525	7,058	9,795	29,010	88,202
Farmland loans	10,176	2,361	3,538	1,759	2,519	27,062
RE loans from foreign offices	23,306	0	16	146	23,144	28,157
Commercial and industrial loans	508,582	6,690	28,405	63,206	410,281	795,932
Loans to individuals	371,496	6,049	28,438	106,410	230,599	561,424
Credit cards	168,257	426	6,211	62,988	98,632	231,179
Installment loans	203,239	5,623	22,227	43,421	131,967	330,245
All other loans and leases	237,333	4,878	9,536	19,243	203,676	373,960
Securities by type:						
U.S Treasury securities	67,383	4,509	13,949	15,460	33,465	154,618
Mortgage-backed securities	218,302	4,136	22,152	46,876	145,138	384,147
Pass-through securities	145,516	2,645	14,528	31,896	96,447	256,482
Collateralized mortgage obligations	72,786	1,490	7,624	14,980	48,690	127,665
Other securities	166,426	10,515	35,562	27,972	92,377	333,105
Other U.S. government securities	59,388	6,866	20,859	15,957	15,706	147,965
State and local government securities	36,132	2,965	11,071	7,489	14,606	76,891
Other debt securities	55,840	299	1,819	1,759	51,964	82,567
Equity securities	15,067	385	1,813	2,768	10,101	25,681
Memoranda:						
Agricultural production loans	20,153	4,283	4,954	3,125	7,791	44,886
Pledged securities	218,122	6,603	30,933	45,332	135,254	400,733
Book value of securities	448,126	19,076	71,222	89,486	268,342	864,097
Available-for-sale securities	378,688	13,732	52,075	71,993	240,888	701,212
Held-to-maturity securities	69,438	5,344	19,147	17,493	27,454	162,885
Market value of securities	453,120	19,206	71,866	90,495	271,553	873,605
Available-for-sale securities	382,673	13,815	52,516	72,816	243,526	708,985
Held-to-maturity securities	70,447	5,391	19,351	17,679	28,027	164,620

Past-due and nonaccrual loans and leases of national banks by asset size
December 31, 1997
(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Loans and leases past due 30–89 days	$24,253	$647	$2,145	$5,346	$16,114	$38,939
Loans secured by real estate	10,061	325	1,057	1,601	7,078	16,527
1–4 family residential mortgages	6,004	210	646	876	4,273	9,841
Home equity loans	628	6	40	93	489	944
Multifamily residential mortgages	312	5	27	48	232	461
Commercial RE loans	1,804	64	232	345	1,163	3,307
Construction RE loans	774	19	82	208	466	1,255
Farmland loans	123	23	30	29	41	285
RE loans from foreign offices	415	0	0	2	414	434
Commercial and industrial loans	3,847	171	427	760	2,489	6,608
Loans to individuals	9,256	148	624	2,807	5,677	13,911
Credit cards	4,509	14	171	1,771	2,553	6,205
Installment loans	4,747	135	453	1,036	3,123	7,706
All other loans and leases	1,089	3	37	179	871	1,893
Loans and leases past due 90+ days	6,563	133	426	2,090	3,915	9,884
Loans secured by real estate	1,731	69	177	468	1,017	2,815
1–4 family residential mortgages	1,119	41	103	328	648	1,774
Home equity loans	110	1	6	33	71	168
Multifamily residential mortgages	16	2	2	3	10	39
Commercial RE loans	339	14	46	77	203	580
Construction RE loans	108	4	14	25	65	164
Farmland loans	20	8	7	2	3	66
RE loans from foreign offices	17	0	0	(0)	17	22
Commercial and industrial loans	465	36	88	96	246	1,016
Loans to individuals	4,251	27	155	1,502	2,567	5,883
Credit cards	3,061	6	93	1,253	1,709	3,964
Installment loans	1,189	21	61	249	858	1,919
All other loans and leases	117	1	6	25	86	170
Nonaccrual loans and leases	11,232	284	902	1,375	8,671	18,588
Loans secured by real estate	6,005	145	486	771	4,603	9,718
1–4 family residential mortgages	2,566	51	191	333	1,991	4,060
Home equity loans	180	1	9	17	153	264
Multifamily residential mortgages	220	3	19	29	169	354
Commercial RE loans	2,076	53	194	316	1,514	3,540
Construction RE loans	364	13	44	54	252	696
Farmland loans	140	24	29	21	67	269
RE loans from foreign offices	458	0	0	1	457	536
Commercial and industrial loans	3,496	119	314	377	2,687	5,791
Loans to individuals	1,205	19	81	171	935	2,311
Credit cards	278	0	31	98	149	981
Installment loans	927	19	50	73	786	1,330
All other loans and leases	526	1	22	57	446	768

Liabilities of national banks by asset size
December 31, 1997
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Total liabilities and equity capital	$2,893,910	$69,069	$268,738	$475,998	$2,080,104	$5,014,884
Deposits in domestic offices	$1,685,304	$59,357	$219,014	$315,702	$1,091,231	$2,895,501.
Deposits in foreign offices	319,551	0	466	6,372	312,713	526,195
Total deposits	2,004,855	59,357	219,480	322,074	1,403,944	3,421,696
Noninterest to earnings	417,603	9,839	36,955	70,906	299,903	676,399
Interest bearing	1,587,252	49,518	182,525	251,168	1,104,041	2,745,297
Other borrowed funds	470,658	1,601	20,071	96,443	352,543	822,994
Subordinated notes and debentures	43,106	6	209	4,045	38,846	61,989
All other liabilities	130,299	753	3,435	9,391	116,720	290,310
Equity capital	244,992	7,352	25,543	44,046	168,051	417,896
Total deposits by depositor:						
Individuals and corporations	1,799,146	53,821	201,535	295,751	1,248,039	3,042,198
U.S., state, and local governments	68,793	4,634	14,319	16,248	33,592	132,197
Depositories in the U.S.	55,043	419	1,978	6,663	45,983	79,502
Foreign banks and governments	69,227	2	168	1,459	67,598	141,908
Certified and official checks	9,779	481	1,480	1,932	5,884	17,741
All other foreign office deposits	2,868	0	0	20	2,849	8,151
Domestic deposits by depositor:						
Individuals and corporations	1,572,040	53,821	201,200	290,237	1,026,781	2,693,309
U.S., state, and local governments	68,793	4,634	14,319	16,248	33,592	132,197
Depositories in the U.S.	30,701	419	1,948	6,391	21,942	43,490
Foreign banks and governments	4,760	2	67	893	3,799	9,597
Certified and official checks	9,011	481	1,480	1,932	5,117	16,907
Foreign deposits by depositor:						
Individuals and corporations	227,106	0	335	5,514	221,257	348,889
Depositories in the U.S.	24,342	0	30	272	24,041	36,011
Foreign banks and governments	64,466	0	101	566	63,799	132,310
Certified and official checks	768	0	0	0	768	833
All other deposits	2,868	0	0	20	2,849	8,151
Deposits in domestic officesby type:						
Transaction deposits	449,080	18,658	60,929	79,485	290,007	762,923
Demand deposits	367,790	9,829	36,192	66,038	255,731	591,329
NOW accounts	79,857	8,641	24,265	13,223	33,729	168,489
Savings deposits	634,244	11,964	57,418	117,713	447,148	1,002,189
Money market deposit accounts	432,922	5,926	32,437	69,829	324,730	651,644
Other savings deposits	201,323	6,038	24,982	47,885	122,418	350,545
Time deposits	601,980	28,735	100,666	118,503	354,075	1,130,389
Small time deposits	409,727	21,243	72,368	81,952	234,165	745,183
Large time deposits	192,253	7,493	28,298	36,552	119,910	385,206

Off-balance-sheet items of national banks by asset size
December 31, 1997
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Unused commitments	$2,121,531	$174,469	$119,760	$406,678	$1,420,623	$3,084,894
Home equity lines	76,136	367	4,836	10,960	59,974	105,181
Credit card lines	1,194,887	169,781	91,217	322,568	611,321	1,656,646
Commercial RE, construction, and land	69,997	1,009	5,535	9,773	53,679	110,329
All other unused commitments	780,511	3,312	18,172	63,377	695,650	1,212,738
Letters of credit:						
Standby letters of credit	122,903	182	1,674	10,295	110,753	203,516
Financial letters of credit	95,117	115	1,007	8,489	85,506	163,397
Performance letters of credit	27,786	67	667	1,806	25,247	40,118
Commercial letters of credit	18,594	44	586	1,067	16,898	29,294
Securities borrowed and lent:						
Securities borrowed	11,363	30	578	3,726	7,030	21,642
Securities lent	46,003	20	546	6,204	39,233	297,304
Financial assets transferred with recourse:						
Mortgages—outstanding principal balance	7,661	20	164	1,206	6,271	18,560
Mortgages—amount of recourse exposure	5,138	18	129	1,021	3,969	8,818
All other—outstanding principal balance	149,067	5	2,710	51,812	94,540	205,043
All other—amount of recourse exposure	9,423	5	242	2,839	6,337	11,885
Spot foreign exchange contracts	142,607	0	1	45	142,561	316,646
Credit derivatives (notional value)						
Reporting bank is the guarantor	2,637	0	20	0	2,617	14,287
Reporting bank is the beneficiary	6,358	0	0	0	6,358	40,441
Derivative contracts (notional value)	8,704,481	516	4,601	59,749	8,639,615	25,063,699
Futures and forward contracts	3,747,970	39	286	5,905	3,741,740	9,550,630
Interest rate contracts	1,358,040	39	260	4,472	1,353,269	4,082,788
Foreign exchange contracts	2,360,456	0	26	627	2,359,803	5,358,917
All other futures and forwards	29,475	0	0	806	28,669	108,926
Option contracts	2,458,689	477	2,087	15,393	2,440,733	5,753,700
Interest rate contracts	1,702,556	477	2,077	15,359	1,684,643	3,984,566
Foreign exchange contracts	643,332	0	0	1	643,331	1,457,290
All other options	112,801	0	9	33	112,759	311,844
Swaps	2,488,826	0	2,208	38,451	2,448,167	9,704,640
Interest rate contracts	2,362,637	0	2,208	37,737	2,322,692	9,017,971
Foreign exchange contracts	112,354	0	0	712	111,642	613,677
All other swaps	13,835	0	0	2	13,833	72,992
Memoranda: Derivatives by purpose						
Contracts held for trading	7,873,794	400	27	4,443	7,868,923	23,499,764
Contracts not held for trading	821,692	116	4,553	55,306	761,717	1,509,206
Memoranda: Derivatives by position						
Held for trading—positive fair value	112,024	0	0	50	111,974	366,737
Held for trading—negative fair value	110,808	0	0	47	110,761	366,616
Not for trading—positive fair value	5,831	0	9	465	5,357	11,255
Not for trading—negative fair value	3,281	0	27	155	3,099	7,984

Quarterly income and expenses of national banks by asset size
Fourth quarter 1997
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100. million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Net income	$9,343	$198	$800	$1,716	$6,629	$15,284
Net interest income	26,952	744	2,814	5,296	18,098	44,629
Total interest income	51,609	1,314	5,093	9,341	35,860	88,483
On loans	39,626	951	3,797	7,470	27,408	64,456
From lease financing receivables	1,392	4	23	103	1,262	1,972
On balances due from depositories	1,173	10	24	57	1,082	1,968
On securities	7,164	291	1,096	1,442	4,335	13,632
From assets held in trading account	764	0	1	13	750	2,693
On fed. funds sold & securities repurchased	1,488	57	152	257	1,023	3,758
Less: Interest expense	24,657	570	2,279	4,046	17,762	43,854
On deposits	17,550	548	2,015	2,676	12,311	30,952
Of federal funds purchased & securities sold	2,942	9	133	531	2,270	5,670
On demand notes & other borrowed money*	12,983	49	443	3,115	9,376	23,073
On subordinated notes and debentures	653	0	3	50	600	1,062
Less: Provision for losses	3,581	49	265	1,204	2,064	5,460
Noninterest income	17,241	466	1,237	3,186	12,353	27,134
From fiduciary activities	2,095	3	199	308	1,585	4,249
Service charges on deposits	3,390	92	275	534	2,488	4,906
Trading revenue	827	(0)	5	30	791	1,194
From interest rate exposures	334	(0)	4	16	313	537
From foreign exchange exposures	571	0	1	3	567	1,282
From equity security and index exposures	(62)	0	0	7	(70)	(305)
From commodity and other exposures	(16)	0	(0)	3	(19)	(319)
Total other noninterest income	10,929	371	756	2,314	7,488	16,782
Gains/losses on securities	656	4	10	39	603	867
Less: Noninterest expense	27,302	879	2,612	4,626	19,184	44,384
Salaries and employee benefits	10,774	343	1,123	1,496	7,811	18,340
Of premises and fixed assets	3,377	91	317	466	2,504	5,707
Other noninterest expense	13,151	446	1,173	2,663	8,869	20,338
Less: Taxes on income before extraord. items	4,622	87	383	974	3,178	7,506
Income/loss from extraord. items, net of taxes	8	2	3	3	0	19
Memoranda:						
Net operating income	8,918	195	794	1,690	6,239	14,711
Income before taxes and extraordinary items	13,965	285	1,184	2,690	9,807	22,786
Income net of taxes before extraordinary items	9,343	198	800	1,716	6,629	15,280
Cash dividends declared	11,261	203	748	2,849	7,460	16,107
Net loan and lease losses	3,444	36	220	1,235	1,952	5,051
Charge-offs to loan and lease reserve	4,579	52	289	1,436	2,803	6,733
Less: Recoveries credited to loan and lease reserve	1,136	15	70	200	851	1,682

* Includes mortgage indebtedness

Year-to-date income and expenses of national banks by asset size
Through December 31, 1997
(Dollar figures in millions)

	National banks					Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Net income	$35,816	$816	$3,414	$6,205	$25,381	$59,236
Net interest income	106,641	2,840	10,901	20,529	72,371	174,515
Total interest income	200,278	5,002	19,520	36,139	139,617	339,554
On loans	155,554	3,580	14,529	28,978	108,467	249,761
From lease financing receivables	4,858	15	82	371	4,390	6,951
On balances due from depositories	3,728	36	78	212	3,402	6,358
On securities	27,555	1,177	4,335	5,614	16,429	52,844
From assets held in trading account	2,978	0	5	54	2,919	10,059
On fed. funds sold & securities repurchased	5,604	195	490	910	4,009	13,581
Less: Interest expense	93,637	2,162	8,619	15,610	67,245	165,039
On deposits	67,060	2,081	7,665	10,231	47,083	117,298
Of federal funds purchased & securities sold	11,087	32	499	2,089	8,466	20,633
On demand notes & other borrowed money*	12,983	49	443	3,115	9,376	23,073
On subordinated notes and debentures	2,508	0	12	175	2,320	4,035
Less: Provision for losses	13,032	153	827	4,798	7,255	19,785
Noninterest income	65,425	1,496	4,740	11,399	47,790	104,500
From fiduciary activities	8,004	10	768	1,159	6,067	16,152
Service charges on deposits	12,853	338	1,046	2,023	9,445	18,546
Trading revenue	3,761	(0)	24	95	3,642	8,028
From interest rate exposures	1,634	(0)	24	57	1,553	4,010
From foreign exchange exposures	2,077	0	0	12	2,066	3,951
From equity security and index exposures	40	0	0	15	25	48
From commodity and other exposures	9	0	0	11	(2)	20
Total other noninterest income	40,807	1,148	2,902	8,122	28,636	61,773
Gains/losses on securities	1,206	6	20	103	1,078	1,843
Less: Noninterest expense	104,670	3,018	9,787	17,546	74,320	169,958
Salaries and employee benefits	41,585	1,227	4,257	5,830	30,271	71,768
Of premises and fixed assets	13,238	328	1,214	1,795	9,901	21,995
Other noninterest expense	49,848	1,462	4,316	9,921	34,148	76,195
Less: Taxes on income before extraord. items	19,762	356	1,637	3,485	14,284	31,898
Income/loss from extraord. items, net of taxes	8	2	3	3	0	19
Memoranda:						
Net operating income	35,027	810	3,397	6,133	24,686	58,007
Income before taxes and extraordinary items	55,570	1,171	5,047	9,687	39,664	91,114
Income net of taxes before extraordinary items	35,808	814	3,410	6,202	25,381	59,216
Cash dividends declared	28,575	496	2,036	5,842	20,201	42,604
Net loan and lease losses	12,649	102	674	4,183	7,691	18,294
Charge-offs to loan and lease reserve	16,874	158	935	5,065	10,715	24,426
Less: Recoveries credited to loan and lease reserve	4,224	56	261	882	3,025	6,132

* Includes mortgate indebtedness

Quarterly net loan and lease losses of national banks by asset size
Fourth quarter 1997
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Net charge-offs to loan and lease reserve	$3,444	$36	$220	$1,235	$1,952	$5,051
Loans secured by real estate	124	3	14	25	82	243
1–4 family residential mortgages	71	2	6	10	53	134
Home equity loans	33	(0)	2	8	23	41
Multifamily residential mortgages	1	0	1	2	(2)	3
Commercial RE loans	13	2	5	4	3	44
Construction RE loans	(16)	(0)	1	(0)	(16)	(4)
Farmland loans	11	0	1	(0)	10	15
RE loans from foreign offices	11	0	0	0	10	11
Commercial and industrial loans	446	15	57	34	340	724
Loans to individuals	2,836	17	145	1,160	1,514	3,998
Credit cards	2,165	4	92	1,035	1,035	3,036
Installment loans	671	14	53	126	478	962
All other loans and leases	37	1	4	16	16	85
Charge-offs to loan and lease reserve	4,579	52	289	1,436	2,803	6,733
Loans secured by real estate	326	6	22	56	243	516
1–4 family residential mortgages	95	3	9	15	68	172
Home equity loans	44	(0)	2	10	31	54
Multifamily residential mortgages	9	0	1	2	6	14
Commercial RE loans	137	2	8	23	103	205
Construction RE loans	15	0	1	4	9	36
Farmland loans	13	1	1	0	11	18
RE loans from foreign offices	15	0	0	0	14	17
Commercial and industrial loans	680	22	79	66	512	1,164
Loans to individuals	3,400	23	184	1,291	1,903	4,805
Credit cards	2,454	5	111	1,115	1,224	3,480
Installment loans	946	18	73	177	679	1,324
All other loans and leases	173	1	5	23	145	247
Recoveries credited to loan and lease reserve	1,136	15	70	200	851	1,682
Loans secured by real estate	202	2	8	31	161	273
1–4 family residential mortgages	24	1	3	5	15	38
Home equity loans	10	0	0	2	8	13
Multifamily residential mortgages	8	0	0	1	8	12
Commercial RE loans	124	0	4	19	100	161
Construction RE loans	30	0	1	4	25	40
Farmland loans	1	0	0	0	1	3
RE loans from foreign offices	4	0	0	0	4	6
Commercial and industrial loans	234	7	22	32	172	440
Loans to individuals	564	6	39	131	389	807
Credit cards	289	1	19	80	189	444
Installment loans	275	4	20	51	200	362
All other loans and leases	136	0	1	7	129	162

Year-to-date net loan and lease losses of national banks by asset size
Through December 31, 1997
(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	2,597	1,377	1,030	147	43	9,143
Net charge-offs to loan and lease reserve	12,649	102	674	4,183	7,691	18,294
Loans secured by real estate	421	8	50	43	321	723
1–4 family residential mortgages	298	4	34	30	230	467
Home equity loans	119	0	3	24	92	145
Multifamily residential mortgages	3	1	1	1	(0)	16
Commercial RE loans	(14)	3	8	(6)	(19)	39
Construction RE loans	(43)	(0)	2	(5)	(40)	(17)
Farmland loans	12	1	1	(1)	11	16
RE loans from foreign offices	47	0	0	1	47	57
Commercial and industrial loans	1,299	43	140	133	983	2,119
Loans to individuals	10,760	51	476	3,975	6,259	15,161
Credit cards	8,260	13	311	3,533	4,402	11,707
Installment loans	2,500	37	165	441	1,857	3,454
All other loans and leases	170	1	9	32	129	291
Charge-offs to loan and lease reserve	16,874	158	935	5,065	10,715	24,426
Loans secured by real estate	1,103	16	86	156	844	1,678
1–4 family residential mortgages	397	7	49	47	293	622
Home equity loans	159	0	5	30	124	195
Multifamily residential mortgages	27	1	2	5	19	51
Commercial RE loans	378	5	24	61	288	589
Construction RE loans	62	1	4	11	46	114
Farmland loans	19	2	2	1	14	31
RE loans from foreign offices	61	0	0	1	60	75
Commercial and industrial loans	2,140	68	215	271	1,586	3,591
Loans to individuals	13,095	73	620	4,577	7,824	18,388
Credit cards	9,485	18	381	3,922	5,163	13,478
Installment loans	3,610	55	239	655	2,661	4,910
All other loans and leases	536	1	13	61	461	770
Recoveries credited to loan and lease reserve	4,224	56	261	882	3,025	6,132
Loans secured by real estate	682	8	37	113	524	955
1–4 family residential mortgages	99	3	15	17	63	156
Home equity loans	40	0	2	7	32	50
Multifamily residential mortgages	24	0	1	4	19	35
Commercial RE loans	392	2	15	67	308	550
Construction RE loans	105	1	3	16	86	131
Farmland loans	7	1	1	2	3	15
RE loans from foreign offices	13	0	0	0	13	17
Commercial and industrial loans	841	25	76	137	603	1,471
Loans to individuals	2,336	23	145	603	1,565	3,227
Credit cards	1,226	5	70	389	761	1,771
Installment loans	1,110	18	74	214	804	1,456
All other loans and leases	366	0	4	29	332	479

Number of national banks by state and asset size
December 31, 1997

	National banks					Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
All institutions	2,597	1,377	1,030	147	43	9,143
Alabama	34	19	14	0	1	175
Alaska	3	1	0	2	0	6
Arizona	14	5	3	5	1	41
Arkansas	63	26	35	2	0	226
California	98	46	48	1	3	336
Colorado	88	59	26	3	0	216
Connecticut	7	3	4	0	0	26
Delaware	18	3	7	5	3	34
District of Columbia	5	1	4	0	0	6
Florida	86	41	35	9	1	266
Georgia	61	29	31	1	0	353
Hawaii	1	0	1	0	0	14
Idaho	1	0	1	0	0	16
Illinois	230	113	103	11	3	784
Indiana	42	10	24	8	0	185
Iowa	52	32	18	2	0	453
Kansas	116	89	26	1	0	403
Kentucky	67	37	25	5	0	271
Louisiana	25	11	9	4	1	158
Maine	5	1	4	0	0	17
Maryland	21	4	15	1	1	83
Massachusetts	15	5	9	0	1	46
Michigan	39	17	19	2	1	163
Minnesota	139	87	47	3	2	520
Mississippi	24	10	12	2	0	107
Missouri	45	23	18	4	0	404
Montana	20	17	1	2	0	96
Nebraska	99	77	19	3	0	326
Nevada	7	3	0	4	0	25
New Hampshire	8	1	6	1	0	21
New Jersey	26	2	17	6	1	71
New Mexico	20	8	10	2	0	58
New York	64	25	32	5	2	153
North Carolina	10	2	5	0	3	60
North Dakota	19	10	8	1	0	117
Ohio	103	45	44	9	5	235
Oklahoma	117	84	31	2	0	320
Oregon	3	0	3	0	0	41
Pennsylvania	114	35	68	6	5	212
Rhode Island	3	0	0	2	1	9
South Carolina	23	9	13	1	0	80
South Dakota	23	13	7	2	1	106
Tennessee	42	11	22	7	2	232
Texas	417	279	126	9	3	839
Utah	8	3	2	2	1	49
Vermont	11	5	5	1	0	21
Virginia	29	6	20	2	1	151
Washington	19	13	6	0	0	80
West Virginia	33	15	14	4	0	100
Wisconsin	61	30	28	3	0	361
Wyoming	19	12	5	2	0	52
U.S. territories	0	0	0	0	0	19

Total assets of national banks by state and asset size
December 31, 1997
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
All institutions	$2,893,910	$69,069	$268,738	$475,998	$2,080,104	$5,014,884
Alabama	35,147	1,209	3,223	0	30,715	101,182
Alaska	4,210	56	0	4,154	0	4,848
Arizona	35,765	107	1,187	19,657	14,815	39,329
Arkansas	13,093	1,620	8,309	3,164	0	28,734
California	376,469	2,311	12,454	5,194	356,509	474,743
Colorado	20,947	3,002	5,014	12,931	0	33,913
Connecticut	852	206	646	0	0	4,772
Delaware	83,243	145	2,004	19,723	61,371	127,880
District of Columbia	1,072	31	1,042	0	0	1,152
Florida	81,465	2,545	11,453	24,638	42,828	116,928
Georgia	15,938	1,679	8,838	5,421	0	69,249
Hawaii	296	0	296	0	0	22,893
Idaho	173	0	173	0	0	1,387
Illinois	162,453	5,602	26,809	39,012	91,030	265,360
Indiana	41,562	436	7,696	33,431	0	66,528
Iowa	14,479	1,604	4,435	8,439	0	43,306
Kansas	12,872	3,930	7,144	1,798	0	31,317
Kentucky	25,977	2,129	4,189	19,659	0	50,999
Louisiana	30,515	580	2,564	16,900	10,470	46,728
Maine	1,113	67	1,046	0	0	4,921
Maryland	16,511	233	5,122	1,118	10,038	35,220
Massachusetts	67,520	269	2,297	0	64,954	123,437
Michigan	31,751	930	3,725	11,813	15,282	118,830
Minnesota	112,416	3,983	11,802	8,563	88,068	131,878
Mississippi	15,640	588	2,573	12,479	0	34,362
Missouri	27,035	1,064	5,218	20,754	0	63,418
Montana	3,486	566	121	2,799	0	9,029
Nebraska	14,908	3,423	4,040	7,446	0	25,860
Nevada	18,407	134	0	18,273	0	25,889
New Hampshire	5,502	40	1,956	3,507	0	11,688
New Jersey	42,637	171	5,097	12,819	24,550	79,905
New Mexico	7,316	381	2,596	4,340	0	11,307
New York	333,979	1,681	11,003	8,558	312,738	1,119,202
North Carolina	380,010	137	2,514	0	377,359	433,139
North Dakota	4,212	355	2,490	1,367	0	8,938
Ohio	189,713	2,207	14,855	23,714	148,937	230,612
Oklahoma	20,241	4,291	7,138	8,812	0	34,073
Oregon	414	0	414	0	0	5,779
Pennsylvania	224,967	1,907	19,942	7,914	195,204	267,582
Rhode Island	70,069	0	0	6,185	63,884	77,287
South Carolina	4,020	410	2,241	1,368	0	17,477
South Dakota	23,101	441	2,239	5,435	14,986	30,328
Tennessee	54,302	817	5,903	23,600	23,981	75,053
Texas	180,263	13,353	27,699	31,960	107,250	235,142
Utah	21,821	184	305	6,864	14,468	39,599
Vermont	3,500	339	1,336	1,825	0	7,112
Virginia	23,349	309	4,439	7,937	10,663	77,806
Washington	1,805	471	1,334	0	0	11,688
West Virginia	12,782	847	4,100	7,836	0	21,588
Wisconsin	18,961	1,620	6,884	10,457	0	72,499
Wyoming	5,630	658	838	4,135	0	8,302
U.S. territories	0	0	0	0	0	34,687

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Comptroller of the Currency
Administrator of National Banks

Northeastern District

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New York, NY 10036–7780

212–819–9860

Southeastern District

Atlanta District Office
Marquis One Tower, Suite 600
245 Peachtree Center Ave., NE
Atlanta, GA 30303–1223

404–659–8855

Midwestern District

Kansas City District Office
2345 Grand Boulevard
Suite 700
Kansas City, MO 64108–2683

816–556–1800

Central District

Chicago District Office
One Financial Place, Suite 2700
440 South LaSalle Street
Chicago, IL 60605–1073

312–360–8800

Southwestern District

Dallas District Office
1600 Lincoln Plaza, Suite 1600
500 North Akard Street
Dallas, TX 75201–3394

214–720–0656

Western District

San Francisco District Office
50 Fremont Street
Suite 3900
San Francisco, CA 94105–2292

415–545–5900

Headquarters

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