Comptroller of the Currency
Administrator of National Banks

Quarterly Journal

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Comptroller . . . . John D. Hawke, Jr.

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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

Comptroller John D. Hawke, Jr., has held office as the 28th Comptroller of the Currency since December 8, 1998, after being appointed by President Clinton during a congressional recess. He was confirmed subsequently by the U.S. Senate for a five-year term starting on October 13, 1999. Prior to his appointment Mr. Hawke served for 3½ years as Under Secretary of the Treasury for Domestic Finance. He oversaw development of policy and legislation on financial institutions, debt management, and capital markets; served as chairman of the Advanced Counterfeit Deterrence Steering Committee; and was a member of the board of the Securities Investor Protection Corporation. Before joining Treasury, he was a senior partner at the Washington, D.C., law firm of Arnold & Porter, which he joined as an associate in 1962. In 1975 he left to serve as general counsel to the Board of Governors of the Federal Reserve System, returning in 1978. At Arnold & Porter he headed the financial institutions practice. From 1987 to 1995 he was chairman of the firm.

Mr. Hawke has written extensively on the regulation of financial institutions, including *Commentaries on Banking Regulation,* published in 1985. From 1970 to 1987 he taught courses on federal regulation of banking at Georgetown University Law Center. He has also taught courses on bank acquisitions and serves as chairman of the Board of Advisors of the Morin Center for Banking Law Studies. In 1987 Mr. Hawke served on a committee of inquiry appointed by the Chicago Mercantile Exchange to study the role of futures markets in the October 1987 stock market crash. He was a founding member of the Shadow Financial Regulatory Committee and served on it until joining Treasury.

Mr. Hawke was graduated from Yale University in 1954 with a B.A. in English. From 1955 to 1957 he served on active duty with the U.S. Air Force. After graduating in 1960 from Columbia University School of Law, where he was editor-in-chief of the *Columbia Law Review,* Mr. Hawke clerked for Judge E. Barrett Prettyman on the U.S. Court of Appeals for the District of Columbia Circuit. From 1961 to 1962 he was counsel to the Select Subcommittee on Education, U.S. House of Representatives.

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. 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. Send suggestions or questions to Rebecca 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 73150, Chicago, IL 60673-7150.** The *Quarterly Journal* is on the Web at http://www.occ.treas.gov/qj/qj.htm.

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The Administrator of National Banks

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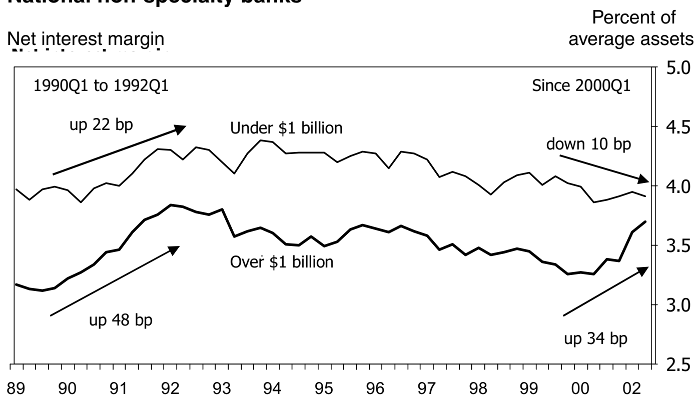
Condition and Performance of Commercial Banks

Summary

The same factors that drove bank performance at the end of 2001 continued in play in the first quarter of 2002. Most important, low short-term rates and wide spreads between short- and long-term rates boosted aggregate net interest margins and earnings. Assets also continued to grow, despite the sluggish economy. The result was record aggregate net income, in dollar terms, with return on equity approaching the record levels of the late 1990s. For national banks, return on equity rose both quarter-over-quarter and year-over-year. This performance stands in sharp contrast to the record decline in U.S. corporate profits in 2001.

Figure 1—NIM rises for large banks, falls for small banks
National non-specialty banks



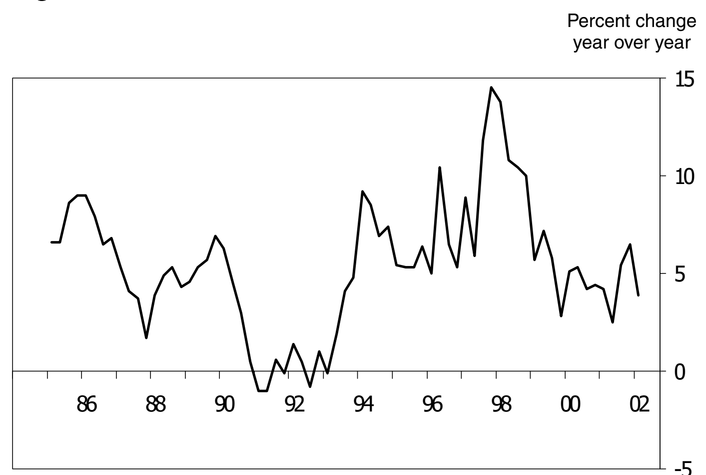
Not all banks have benefited from these favorable trends. Most of the advantages of the low-interest-rate environment have gone to large banks; they are large net borrowers in the wholesale funds market, and have therefore been the major beneficiaries of the drop in the cost of funds. In the first quarter of 2002, net interest margins (NIMs) continued to rise for large banks as a group but fell for small banks, continuing a two-year trend. Asset growth was also predominantly in the large banks.

Asset quality continued to deteriorate for both small and large banks, especially in the commercial and industrial (C&I) sector. Noncurrent loans showed further deterioration in all major categories at both large and small banks.

Key Trends

Net interest income showed strong year-over-year growth in the first quarter, the result of widening net interest margins and growth in total assets. Growth in net interest income more than offset higher provisioning costs, resulting in a 19 percent increase in net income for the quarter, compared to the first quarter of 2001. In contrast, during the recession of 1990–91, asset growth was hardly discernible, and net income declined.

Figure 2—Total assets of national banks



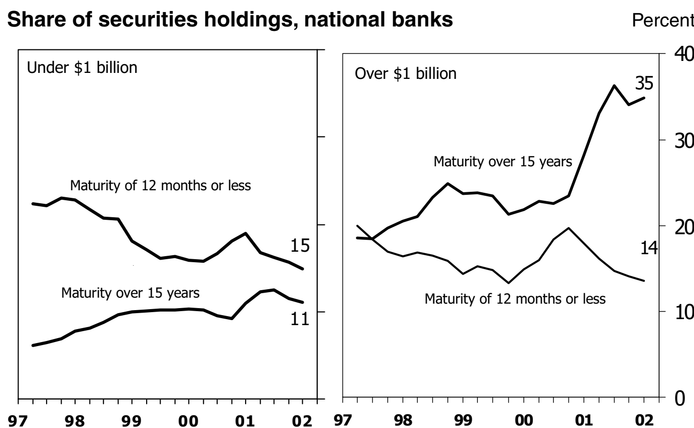
Net interest margins rose for the banking system as a whole, largely the result of low short-term interest rates. But while first-quarter NIM rose for large banks (over $1 billion in assets), it fell for small banks (under $1 billion in assets). Since the first quarter of 2000, large-bank NIM has risen by 34 basis points, and now stands close to the highest level since the data series began in 1984. Over the same two years, small-bank NIM has fallen by 10 basis points, and now stands at its lowest level since the recession year of 1991. During that earlier recession, NIM rose for both large and small banks, but a shrinking asset base led to only a modest rise in net interest income.

In contrast, bank assets continued to grow during the recent recession. Total assets rose over the last several quarters as new deposits flowed into banks. Some of this increase funded new loans. A modest increase in loan volume combined with a substantial boost in NIM contributed to significant gains in net interest income. An even larger share of new assets—and of the increase in net interest income—came from increased holding of securities, primarily at large banks.

In their securities portfolios, both small and large banks have moved toward longer maturities to take advantage of the steep yield curve. Since 1997, both small and large banks have roughly doubled their portfolio shares of securities with maturities over 15 years. Over the same period, both small and large banks have decreased their portfolio shares of securities with maturities of 12 months or less. This movement toward longer maturities raises interest income but also increases interest-rate risk. This lengthening of asset maturities, however, is accompanied by a significant increase in the use of interest-rate derivatives. This reduces interest-rate risk for the national banking system.

Figure 3—Banks holding more long-term securities

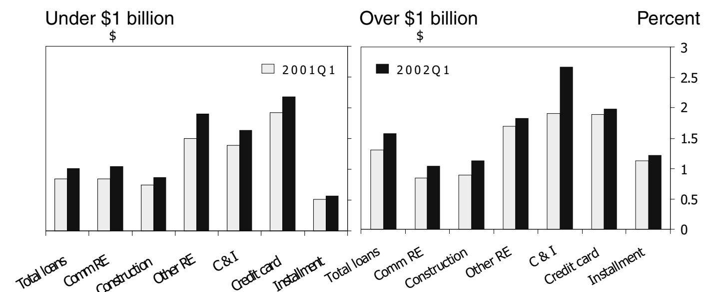
Share of securities holdings, national banks



Asset quality continued to deteriorate during the first quarter across all classes of loans, for both small and large banks. Banks reported higher noncurrent ratios for commercial real estate and construction loans, and modestly higher noncurrent ratios for home mortgage loans. But as in recent quarters, the biggest problems are in the commercial and industrial (C&I) sector. Corporate profits fell dramatically in 2001 across the economy and have yet to show definitive signs of recovery. Profits of U.S. nonfinancial corporations fell 25 percent from 2000 to 2001, with some sectors chalking up double- and even triple-digit declines. This compares with no change in profits during the recession years of 1990 and 1991. In 2001, Fortune 500 companies set a record for a one-year decline in aggregate profits. Eight companies accounted for three-fourths of the losses for the Fortune 500, although 100 of these 500 companies lost money. The result was more pressure on credit quality, particularly for large banks, which have most of the exposure to the large, troubled companies.

Figure 4—Loan quality deteriorates in all major categories

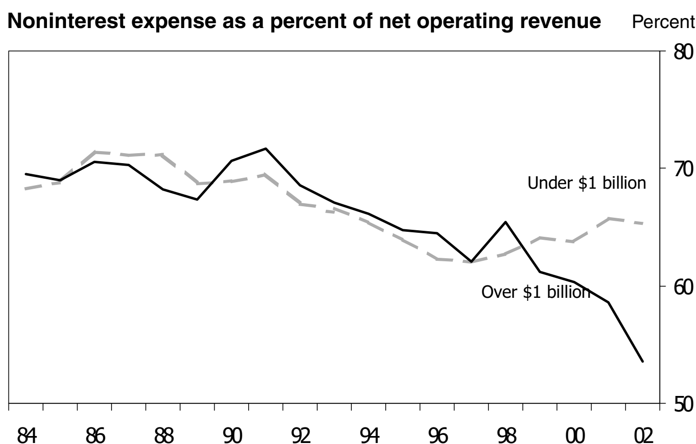
Loans noncurrent, national non-speciality banks



Since the beginning of the recession in early 2001, credit quality has held up better at small banks than at their larger counterparts. But this aggregate result conceals important differences among the smaller banks. For example, from the first quarter of 2001 to the first quarter of 2002, 8 percent of small banks, but only 2 percent of large banks, had noncurrent ratios above 3 percent (the long-term national average is about 1 percent). This probably contributed to the higher percentage of small banks with weak returns: in the first quarter, only 2 percent of large banks, but 8 percent of small banks, showed a return on assets of less than 0.5 percent (the long-term national average is also about 1 percent).

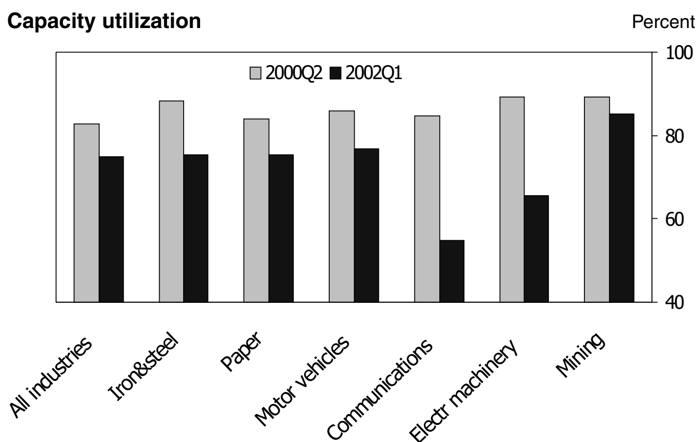
Since 1997, large banks have also had better success in reducing noninterest expense, which has declined as a fraction of net operating revenue for large banks, but has risen for small banks. Until 1998, noninterest expense account for about the same fraction of net operating revenues at both small and large banks. Since then the ratio has dropped from 65 percent to 54 percent for large banks, but has risen slightly for small banks. First-quarter results showed a further decline for large banks, although the results were distorted by a change in the accounting rules concerning the treatment of merger-related goodwill. Most conspicuous has been the difference in salary expense. Salaries now account for less than 25 percent of net operating revenue at large banks, compared to about 33 percent at small banks.

Figure 5—Noninterest expense has fallen for large banks



Overcapacity continues to be a problem in many sectors—both in the old economy (e.g., iron and steel, electrical machinery), and the new economy (e.g., telecommunications, computers), where capacity expanded rapidly during the investment boom of the 1990s. Even robust economic growth would not quickly soak up this excess capacity. The overhang of excess capacity is likely to hold down profits in many sectors and delay an improvement in credit quality.

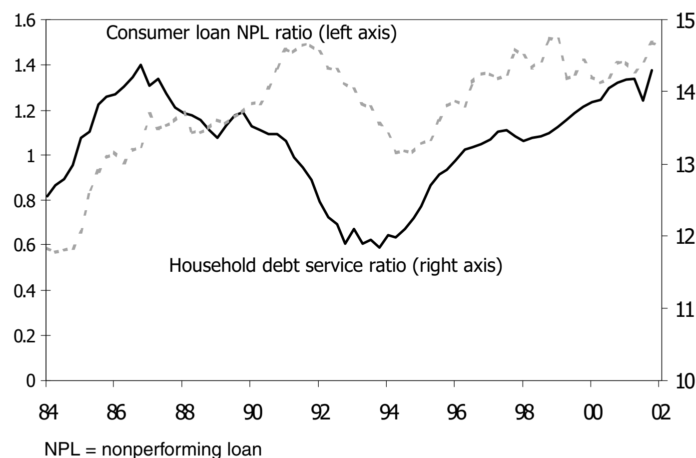
Figure 6—Overcapacity continues in many sectors



Community banks have less direct exposure to the weakest industries, because they are not an important source of loans for large manufacturers. Nonetheless, community banks remain exposed indirectly, as they serve the communities where many troubled firms are located. Community banks located in areas with a heavy tech or telecom presence may face particular problems. Most vulnerable are business-oriented community banks, those specializing in business loans, or loans for business real estate.

The consumer side remained strong through the recession, in contrast to the corporate side. Fueled by tax cuts and decreases in energy prices, consumer spending grew every quarter in 2001 and continues to grow in 2002. Another factor in the strong performance of the consumer sector has been the rapid appreciation in home prices. This has made consumers feel wealthier and more inclined to spend money. In some regions, home prices have risen substantially faster than household income; this is not sustainable in the long run. If a correction comes, it would dampen consumer sentiment in these regions, cutting into consumer spending. Household debt levels (the ratio of consumer plus mortgage debt to disposable income) rose steadily from early 1998 until the third quarter of 2001. Debt levels then eased off briefly as homeowners took advantages of 40-year lows in interest rates to refinance their mortgages (70 percent of mortgage originations in the fourth quarter of 2001 were refinancings). But debt levels have risen again and now stand at a 15-year high. The nonperforming ratio for consumer loans tends to move with the household debt service ratio, although with a one- or two-year lag. This suggests that consumer loan quality could deteriorate over the next year or two.

Figure 7—Household debt service ratio near



NPL = nonperforming loan

Key indicators, FDIC-insured national banks
Annual 1998–2001, year-to-date through March 31, 2002, first quarter 2001, and first quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Number of institutions reporting	2,456	2,364	2,230	2,137	2,118	2,201	2,118
Total employees (FTEs)	974,871	983,186	948,652	966,538	973,383	966,697	973,383
Selected income data ($)							
Net income	$37,608	$42,591	$38,959	$44,349	$13,514	$11,396	$13,514
Net interest income	110,985	114,557	115,905	125,663	35,136	29,746	35,136
Provision for loan losses	15,242	15,549	20,558	28,996	8,337	5,325	8,337
Noninterest income	81,344	92,647	96,184	99,535	26,239	25,008	26,239
Noninterest expense	122,604	125,807	128,535	131,145	32,781	32,159	32,781
Net operating income	35,549	42,416	40,209	43,122	13,372	11,353	13,372
Cash dividends declared	25,414	29,870	32,327	27,745	13,270	7,044	13,270
Net charge-offs to loan and lease reserve	14,492	14,179	17,240	25,179	8,238	4,799	8,238
Selected condition data ($)							
Total assets	3,183,385	3,271,262	3,414,443	3,635,542	3,574,174	3,440,201	3,574,174
Total loans and leases	2,015,585	2,127,927	2,227,071	2,272,752	2,268,128	2,251,529	2,268,128
Reserve for losses	36,810	37,683	40,021	45,569	47,874	40,646	47,874
Securities	516,120	537,316	502,297	576,012	572,595	487,106	572,595
Other real estate owned	1,833	1,572	1,553	1,794	1,861	1,640	1,861
Noncurrent loans and leases	19,513	20,815	27,161	34,579	35,639	29,404	35,639
Total deposits	2,137,946	2,154,272	2,250,464	2,384,464	2,351,051	2,262,231	2,351,051
Domestic deposits	1,785,856	1,776,126	1,827,126	2,001,303	1,982,322	1,871,697	1,982,322
Equity capital	274,193	278,011	293,836	340,972	344,410	306,161	344,410
Off-balance-sheet derivatives	10,953,514	12,077,568	15,502,911	20,291,557	21,529,752	16,522,210	21,529,752
Performance ratios (annualized %)							
Return on equity	14.29	15.57	13.71	13.89	15.75	15.11	15.75
Return on assets	1.24	1.35	1.18	1.26	1.50	1.32	1.50
Net interest income to assets	3.67	3.63	3.50	3.56	3.90	3.45	3.90
Loss provision to assets	0.50	0.49	0.62	0.82	0.92	0.62	0.92
Net operating income to assets	1.18	1.35	1.21	1.22	1.48	1.32	1.48
Noninterest income to assets	2.69	2.94	2.91	2.82	2.91	2.90	2.91
Noninterest expense to assets	4.05	3.99	3.88	3.72	3.64	3.73	3.64
Loss provision to loans and leases	0.79	0.76	0.95	1.28	1.47	0.95	1.47
Net charge-offs to loans and leases	0.75	0.70	0.80	1.11	1.45	0.85	1.45
Loss provision to net charge-offs	105.12	109.66	119.24	115.16	101.20	110.95	101.20
Performance ratios (%)							
Percent of institutions unprofitable	5.94	7.06	6.91	7.25	7.41	6.45	7.41
Percent of institutions with earnings gains	61.60	62.18	66.64	56.90	62.70	54.34	62.28
Nonint. income to net operating revenue	42.29	44.71	45.35	44.20	42.75	45.67	42.75
Nonint. expense to net operating revenue	63.75	60.72	60.60	58.24	53.41	58.73	53.41
Condition ratios (%)							
Nonperforming assets to assets	0.68	0.70	0.86	1.02	1.06	0.91	1.06
Noncurrent loans to loans	0.97	0.98	1.22	1.52	1.57	1.31	1.57
Loss reserve to noncurrent loans	188.65	181.03	147.35	131.78	134.33	138.23	134.33
Loss reserve to loans	1.83	1.77	1.80	2.01	2.11	1.81	2.11
Equity capital to assets	8.61	8.50	8.61	9.38	9.64	8.90	9.64
Leverage ratio	7.43	7.49	7.49	7.82	8.00	7.59	8.00
Risk-based capital ratio	11.79	11.71	11.85	12.62	12.91	12.11	12.91
Net loans and leases to assets	62.16	63.90	64.05	61.26	62.12	64.27	62.12
Securities to assets	16.21	16.43	14.71	15.84	16.02	14.16	16.02
Appreciation in securities (% of par)	0.82	–2.45	–0.01	0.48	0.15	0.80	0.15
Residential mortgage assets to assets	20.41	20.60	19.60	22.54	22.25	20.53	22.25
Total deposits to assets	67.16	65.85	65.91	65.59	65.78	65.76	65.78
Core deposits to assets	49.72	47.01	45.61	48.07	48.39	46.60	48.39
Volatile liabilities to assets	31.77	34.81	35.18	31.24	30.86	33.01	30.86

Loan performance, FDIC-insured national banks
Annual 1998–2001, year-to-date through March 31, 2002, first quarter 2001, and first quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Percent of loans past due 30–89 days							
Total loans and leases	1.27	1.16	1.26	1.38	1.26	1.21	1.26
Loans secured by real estate (RE)	1.33	1.22	1.42	1.42	1.20	1.35	1.20
1–4 family residential mortgages	1.50	1.61	1.95	1.80	1.52	1.72	1.52
Home equity loans	0.97	0.77	1.07	0.98	0.64	0.88	0.64
Multifamily residential mortgages	0.94	0.69	0.59	0.75	0.64	0.70	0.64
Commercial RE loans	1.02	0.70	0.72	0.86	0.78	0.84	0.78
Construction RE loans	1.82	1.07	1.12	1.28	1.44	1.27	1.44
Commercial and industrial loans	0.81	0.71	0.71	0.95	1.03	0.72	1.03
Loans to individuals	2.44	2.36	2.40	2.39	1.99	2.11	1.99
Credit cards	2.52	2.53	2.50	2.51	2.36	2.46	2.36
Installment loans and other plans	2.37	2.24	2.31	2.65	1.95	2.04	1.95
All other loans and leases	0.46	0.50	0.58	0.84	0.90	0.75	0.90
Percent of loans noncurrent							
Total loans and leases	0.97	0.98	1.22	1.52	1.57	1.31	1.57
Loans secured by real estate (RE)	0.98	0.87	0.93	1.04	1.09	0.99	1.09
1–4 family residential mortgages	0.95	0.91	1.06	1.05	1.20	1.12	1.20
Home equity loans	0.41	0.32	0.41	0.42	0.38	0.43	0.38
Multifamily residential mortgages	0.88	0.43	0.55	0.49	0.45	0.41	0.45
Commercial RE loans	1.01	0.84	0.77	1.03	1.05	0.85	1.05
Construction RE loans	0.80	0.63	0.82	1.15	1.13	0.90	1.13
Commercial and industrial loans	0.86	1.11	1.66	2.44	2.62	1.88	2.62
Loans to individuals	1.59	1.52	1.46	1.58	1.57	1.48	1.57
Credit cards	2.06	2.00	1.89	2.05	2.17	2.15	2.17
Installment loans and other plans	1.19	1.16	1.06	1.41	1.23	1.11	1.23
All other loans and leases	0.31	0.40	0.85	1.18	1.07	0.84	1.07
Percent of loans charged-off, net							
Total loans and leases	0.75	0.70	0.80	1.11	1.45	0.85	1.45
Loans secured by real estate (RE)	0.05	0.10	0.12	0.26	0.20	0.15	0.20
1–4 family residential mortgages	0.07	0.14	0.14	0.32	0.18	0.14	0.18
Home equity loans	0.16	0.19	0.23	0.35	0.26	0.34	0.26
Multifamily residential mortgages	0.07	0.02	0.03	0.04	0.04	0.06	0.04
Commercial RE loans	–0.02	0.03	0.07	0.18	0.22	0.10	0.22
Construction RE loans	–0.01	0.03	0.05	0.15	0.18	0.12	0.18
Commercial and industrial loans	0.38	0.54	0.87	1.50	1.53	1.01	1.53
Loans to individuals	2.92	2.65	2.84	3.14	5.07	2.70	5.07
Credit cards	5.03	4.51	4.43	5.07	9.02	4.24	9.02
Installment loans and other plans	1.23	1.27	1.54	1.66	1.94	1.46	1.94
All other loans and leases	1.58	0.93	0.96	1.80	0.50	0.41	0.50
Loans outstanding ($)							
Total loans and leases	$2,015,585	$2,127,927	$2,227,071	$2,272,752	$2,268,128	$2,251,529	$2,268,128
Loans secured by real estate (RE)	764,944	853,141	892,140	976,116	967,965	918,890	967,965
1–4 family residential mortgages	381,597	433,807	443,002	472,710	453,456	457,319	453,456
Home equity loans	66,091	67,267	82,672	102,094	110,539	86,034	110,539
Multifamily residential mortgages	23,201	26,561	28,026	30,074	31,269	28,676	31,269
Commercial RE loans	200,469	214,145	221,267	236,473	240,213	224,093	240,213
Construction RE loans	56,261	71,578	76,899	91,482	90,578	83,017	90,578
Farmland loans	10,930	11,957	12,350	12,615	12,723	12,406	12,723
RE loans from foreign offices	26,396	27,825	27,923	30,668	29,186	27,344	29,186
Commercial and industrial loans	583,903	622,004	646,990	597,222	588,700	650,210	588,700
Loans to individuals	386,410	348,634	370,363	390,349	411,922	366,392	411,922
Credit cards*	176,408	147,179	176,372	166,998	187,475	152,596	187,475
Other revolving credit plans	NA	NA	NA	29,265	29,821	19,740	29,821
Installment loans	210,003	201,455	193,991	194,087	194,626	194,055	194,626
All other loans and leases	282,367	306,041	319,144	310,996	302,367	317,573	302,367
Less: Unearned income	2,039	1,893	1,565	1,931	2,826	1,536	2,826

*Prior to March 2001, credit cards included “Other revolving credit plans.”

Key indicators, FDIC-insured national banks by asset size
First quarter 2001 and first quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Number of institutions reporting	1,072	999	954	951	134	126	41	42
Total employees (FTEs)	25,774	23,351	94,738	94,490	117,509	108,297	728,676	747,245
Selected income data ($)								
Net income	$146	$133	$814	$741	$1,499	$1,684	$8,937	$10,955
Net interest income	546	515	2,412	2,459	4,120	4,041	22,668	28,121
Provision for loan losses	31	29	174	202	562	688	4,558	7,419
Noninterest income	231	196	1,348	1,282	2,795	3,014	20,635	21,747
Noninterest expense	554	507	2,439	2,511	4,122	3,844	25,044	25,919
Net operating income	142	131	793	736	1,459	1,673	8,959	10,833
Cash dividends declared	86	80	356	358	1,124	575	5,478	12,259
Net charge-offs to loan and lease reserve	17	19	122	142	508	605	4,152	7,472
Selected condition data ($)								
Total assets	55,154	52,489	249,593	250,751	417,486	407,212	2,717,968	2,863,723
Total loans and leases	32,722	31,195	156,032	155,693	266,130	259,989	1,796,644	1,821,251
Reserve for losses	441	435	2,167	2,230	5,227	4,576	32,812	40,633
Securities	13,375	13,101	59,028	62,006	86,104	86,057	328,600	411,431
Other real estate owned	68	73	211	256	155	229	1,206	1,303
Noncurrent loans and leases	321	366	1,343	1,587	2,729	2,608	25,011	31,077
Total deposits	46,440	44,278	201,840	203,596	270,208	262,599	1,743,743	1,840,578
Domestic deposits	46,440	44,278	201,583	203,073	267,988	260,280	1,355,687	1,474,691
Equity capital	6,248	5,872	25,402	25,378	39,080	42,110	235,431	271,050
Off-balance-sheet derivatives	62	28	2,959	1,252	39,613	35,875	16,670,121	21,623,665
Performance ratios (annualized %)								
Return on equity	9.45	9.11	13.00	11.82	15.59	16.49	15.40	16.14
Return on assets	1.07	1.02	1.31	1.19	1.43	1.67	1.31	1.51
Net interest income to assets	4.01	3.95	3.89	3.95	3.94	4.01	3.33	3.88
Loss provision to assets	0.23	0.22	0.28	0.32	0.54	0.68	0.67	1.02
Net operating income to assets	1.04	1.00	1.28	1.18	1.40	1.66	1.31	1.49
Noninterest income to assets	1.70	1.50	2.18	2.06	2.67	2.99	3.03	3.00
Noninterest expense to assets	4.07	3.88	3.94	4.03	3.95	3.81	3.67	3.57
Loss provision to loans and leases	0.38	0.37	0.45	0.52	0.85	1.09	1.01	1.62
Net charge-offs to loans and leases	0.21	0.25	0.32	0.37	0.77	0.96	0.92	1.63
Loss provision to net charge-offs	187.10	148.14	141.72	142.37	110.63	113.66	109.77	99.29
Performance ratios (%)								
Percent of institutions unprofitable	9.98	12.51	3.25	3.05	2.99	1.59	0.00	2.38
Percent of institutions with earnings gains	51.12	53.35	56.81	68.56	59.70	78.57	63.41	83.33
Nonint. income to net operating revenue	29.72	27.58	35.85	34.27	40.42	42.72	47.65	43.61
Nonint. expense to net operating revenue	71.34	71.28	64.87	67.13	59.62	54.48	57.83	51.98
Condition ratios (%)								
Nonperforming assets to assets	0.71	0.84	0.62	0.75	0.70	0.71	0.98	1.15
Noncurrent loans to loans	0.98	1.17	0.86	1.02	1.03	1.00	1.39	1.71
Loss reserve to noncurrent loans	137.32	119.04	161.37	140.47	191.51	175.45	131.19	130.75
Loss reserve to loans	1.35	1.40	1.39	1.43	1.96	1.76	1.83	2.23
Equity capital to assets	11.33	11.19	10.18	10.12	9.36	10.34	8.66	9.46
Leverage ratio	11.12	10.93	9.73	9.46	8.23	9.21	7.23	7.64
Risk-based capital ratio	18.09	18.03	15.07	15.01	13.28	14.99	11.66	12.45
Net loans and leases to assets	58.53	58.60	61.65	61.20	62.49	62.72	64.90	62.18
Securities to assets	24.25	24.96	23.65	24.73	20.62	21.13	12.09	14.37
Appreciation in securities (% of par)	1.32	0.54	1.37	0.51	0.90	0.38	0.65	0.04
Residential mortgage assets to assets	21.62	21.98	24.09	24.51	26.10	27.15	19.33	21.36
Total deposits to assets	84.20	84.36	80.87	81.19	64.72	64.49	64.16	64.27
Core deposits to assets	70.74	71.06	67.19	68.35	54.28	54.96	43.04	45.29
Volatile liabilities to assets	15.32	15.11	18.05	16.84	26.88	24.39	35.68	33.30

Loan performance, FDIC-insured national banks by asset size
First quarter 2001 and first quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Percent of loans past due 30–89 days								
Total loans and leases	1.55	1.56	1.32	1.23	1.37	1.23	1.17	1.26
Loans secured by real estate (RE)	1.33	1.33	1.12	1.02	1.10	0.99	1.44	1.27
1–4 family residential mortgages	1.52	1.50	1.29	1.28	1.17	1.07	1.88	1.63
Home equity loans	0.85	0.55	0.78	0.49	0.98	0.61	0.87	0.65
Multifamily residential mortgages	0.72	0.44	0.83	0.37	0.83	0.50	0.64	0.72
Commercial RE loans	0.97	1.09	0.90	0.80	0.91	0.77	0.80	0.77
Construction RE loans	1.83	1.59	1.26	1.15	1.36	1.47	1.22	1.47
Commercial and industrial loans	1.95	1.82	1.55	1.45	1.41	1.49	0.60	0.95
Loans to individuals	2.03	2.20	1.97	1.96	2.06	1.88	2.13	2.01
Credit cards	1.99	2.39	3.17	3.92	2.28	1.85	2.48	2.41
Installment loans and other plans	2.07	2.23	1.78	1.72	2.00	2.06	2.08	1.94
All other loans and leases	1.48	1.62	1.36	1.35	1.11	0.71	0.70	0.89
Percent of loans noncurrent								
Total loans and leases	0.98	1.17	0.86	1.02	1.03	1.00	1.39	1.71
Loans secured by real estate (RE)	0.83	1.02	0.72	0.86	0.75	0.79	1.09	1.18
1–4 family residential mortgages	0.72	0.90	0.61	0.75	0.69	0.67	1.27	1.36
Home equity loans	0.21	0.54	0.39	0.32	0.39	0.39	0.44	0.39
Multifamily residential mortgages	0.37	0.87	0.53	0.47	0.58	0.42	0.35	0.45
Commercial RE loans	0.97	1.11	0.82	1.03	0.84	0.99	0.85	1.07
Construction RE loans	0.66	0.92	0.76	0.86	0.94	1.02	0.92	1.21
Commercial and industrial loans	1.67	1.85	1.33	1.59	1.52	1.52	1.94	2.78
Loans to individuals	0.64	0.82	0.86	0.94	1.38	1.30	1.56	1.65
Credit cards	1.35	2.05	2.88	4.09	2.28	1.98	2.11	2.17
Installment loans and other plans	0.62	0.78	0.48	0.52	0.71	0.83	1.28	1.39
All other loans and leases	1.10	1.35	0.90	1.21	0.53	0.53	0.85	1.11
Percent of loans charged-off, net								
Total loans and leases	0.21	0.25	0.32	0.37	0.77	0.96	0.92	1.63
Loans secured by real estate (RE)	0.03	0.08	0.05	0.09	0.14	0.17	0.17	0.23
1–4 family residential mortgages	0.04	0.05	0.07	0.09	0.11	0.11	0.15	0.21
Home equity loans	0.00	0.02	0.07	0.06	0.91	0.23	0.28	0.27
Multifamily residential mortgages	0.00	–0.02	0.00	0.03	0.01	0.02	0.08	0.04
Commercial RE loans	0.01	0.17	0.05	0.12	0.05	0.19	0.13	0.25
Construction RE loans	0.07	0.02	0.03	0.03	0.12	0.38	0.14	0.16
Commercial and industrial loans	0.49	0.44	0.34	0.35	0.63	0.91	1.08	1.66
Loans to individuals	0.67	0.82	1.54	1.96	2.42	3.39	2.88	5.56
Credit cards	1.69	3.54	5.30	9.05	3.93	5.97	4.28	9.48
Installment loans and other plans	0.63	0.70	0.71	0.87	1.06	1.31	1.65	2.17
All other loans and leases	0.11	0.18	0.22	0.23	0.34	0.18	0.42	0.54
Loans outstanding ($)								
Total loans and leases	$32,722	$31,195	$156,032	$155,693	$266,130	$259,989	$1,796,644	$1,821,251
Loans secured by real estate (RE)	18,961	18,369	97,576	100,813	136,952	138,297	665,401	710,487
1–4 family residential mortgages	8,740	8,011	41,181	38,997	62,927	64,230	344,471	342,219
Home equity loans	462	474	4,005	4,550	9,023	9,122	72,544	96,392
Multifamily residential mortgages	411	446	3,467	3,771	4,882	5,172	19,916	21,880
Commercial RE loans	5,465	5,618	35,201	38,453	42,293	42,059	141,135	154,083
Construction RE loans	1,701	1,689	9,563	10,630	15,787	15,813	55,966	62,447
Farmland loans	2,182	2,130	4,154	4,410	1,892	1,774	4,178	4,409
RE loans from foreign offices	0	0	5	2	148	128	27,191	29,057
Commercial and industrial loans	5,658	5,273	28,463	27,752	52,215	48,406	563,875	507,270
Loans to individuals	4,456	4,035	20,593	18,019	58,613	50,838	282,730	339,029
Credit cards	159	163	3,342	2,212	25,747	22,313	123,348	162,786
Other revolving credit plans	74	67	431	370	1,839	2,208	17,396	27,177
Installment loans	4,222	3,805	16,820	15,437	31,027	26,317	141,986	149,067
All other loans and leases	3,707	3,565	9,620	9,300	18,462	22,527	285,784	266,974
Less: Unearned income	60	47	220	191	111	79	1,145	2,509

Key indicators, FDIC-insured national banks by region
First quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Number of institutions reporting	236	293	424	435	508	222	2,118
Total employees (FTEs)	298,934	252,055	197,611	65,730	55,705	103,348	973,383
Selected income data ($)							
Net income	$3,868	$3,555	$2,850	$1,038	$480	$1,724	$13,514
Net interest income	10,617	8,534	7,385	2,786	1,542	4,272	35,136
Provision for loan losses	4,212	1,025	1,382	717	135	866	8,337
Noninterest income	10,202	5,556	4,458	2,200	617	3,207	26,239
Noninterest expense	10,879	7,821	6,187	2,697	1,337	3,860	32,781
Net operating income	3,805	3,486	2,820	1,027	487	1,746	13,372
Cash dividends declared	5,385	6,343	706	425	192	220	13,270
Net charge-offs to loan and lease reserve	4,126	1,038	1,454	725	97	798	8,238
Selected condition data ($)							
Total assets	980,717	1,012,152	833,816	223,920	155,717	367,851	3,574,174
Total loans and leases	616,976	598,433	563,212	151,822	88,249	249,436	2,268,128
Reserve for losses	17,320	10,294	10,771	2,915	1,380	5,194	47,874
Securities	158,710	159,672	142,400	30,999	41,533	39,281	572,595
Other real estate owned	266	722	458	101	130	185	1,861
Noncurrent loans and leases	12,687	8,418	8,805	1,822	989	2,917	35,639
Total deposits	668,147	694,799	507,752	130,037	126,308	224,008	2,351,051
Domestic deposits	431,812	629,008	463,545	118,257	125,279	214,421	1,982,322
Equity capital	95,725	97,659	72,312	22,884	15,007	40,825	344,410
Off-balance-sheet derivatives	7,135,402	12,199,232	1,417,503	7,079	9,203	761,333	21,529,752
Performance ratios (annualized %)							
Return on equity	16.29	14.35	15.79	18.72	12.88	17.29	15.75
Return on assets	1.55	1.40	1.35	1.84	1.23	1.89	1.50
Net interest income to assets	4.26	3.35	3.50	4.95	3.96	4.68	3.90
Loss provision to assets	1.69	0.40	0.65	1.27	0.35	0.95	0.92
Net operating income to assets	1.53	1.37	1.34	1.82	1.25	1.91	1.48
Noninterest income to assets	4.10	2.18	2.11	3.91	1.58	3.51	2.91
Noninterest expense to assets	4.37	3.07	2.93	4.79	3.43	4.23	3.64
Loss provision to loans and leases	2.71	0.69	0.98	1.88	0.61	1.40	1.47
Net charge-offs to loans and leases	2.66	0.70	1.03	1.90	0.44	1.29	1.45
Loss provision to net charge-offs	102.09	98.76	95.06	98.88	139.15	108.44	101.20
Performance ratios (%)							
Percent of institutions unprofitable	8.05	9.22	4.25	5.52	6.10	17.12	7.41
Percent of institutions with earnings gains	70.76	68.60	66.98	60.23	55.71	54.95	62.28
Nonint. income to net operating revenue	49.00	39.43	37.64	44.13	28.57	42.88	42.75
Nonint. expense to net operating revenue	52.26	55.51	52.24	54.10	61.94	51.61	53.41
Condition ratios (%)							
Nonperforming assets to assets	1.34	0.91	1.15	0.86	0.72	0.85	1.06
Noncurrent loans to loans	2.06	1.41	1.56	1.20	1.12	1.17	1.57
Loss reserve to noncurrent loans	136.52	122.28	122.34	159.97	139.42	178.05	134.33
Loss reserve to loans	2.81	1.72	1.91	1.92	1.56	2.08	2.11
Equity capital to assets	9.76	9.65	8.67	10.22	9.64	11.10	9.64
Leverage ratio	8.26	7.65	7.34	9.04	8.38	8.92	8.00
Risk-based capital ratio	13.14	12.58	12.22	13.58	13.98	14.02	12.91
Net loans and leases to assets	61.14	58.11	66.25	66.50	55.79	66.40	62.12
Securities to assets	16.18	15.78	17.08	13.84	26.67	10.68	16.02
Appreciation in securities (% of par)	0.12	-0.27	0.28	0.88	0.48	0.65	0.15
Residential mortgage assets to assets	14.17	26.15	25.22	21.60	27.37	24.58	22.25
Total deposits to assets	68.13	68.65	60.89	58.07	81.11	60.90	65.78
Core deposits to assets	36.32	55.17	49.34	48.46	67.99	51.42	48.39
Volatile liabilities to assets	42.50	24.53	28.81	29.86	18.53	27.77	30.86

Loan performance, FDIC-insured national banks by region
First quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Percent of loans past due 30–89 days							
Total loans and leases	1.43	0.84	1.48	1.53	1.23	1.20	1.26
Loans secured by real estate (RE)	1.12	0.97	1.67	1.01	1.07	1.01	1.20
1–4 family residential mortgages	1.31	1.28	2.29	1.08	1.15	1.19	1.52
Home equity loans	0.47	0.67	0.86	0.46	0.32	0.29	0.64
Multifamily residential mortgages	0.39	0.46	0.83	0.20	0.49	0.99	0.64
Commercial RE loans	0.71	0.53	1.15	0.88	0.83	0.62	0.78
Construction RE loans	0.89	1.08	1.69	1.06	1.60	1.95	1.44
Commercial and industrial loans	1.27	0.57	1.06	1.64	1.29	1.09	1.03
Loans to individuals	2.21	1.35	1.91	2.16	1.64	2.07	1.99
Credit cards	2.51	2.62	2.08	2.27	0.92	2.10	2.36
Installment loans and other plans	2.39	1.42	2.05	2.01	1.75	2.40	1.95
All other loans and leases	0.88	0.52	1.21	1.35	1.49	0.60	0.90
Percent of loans noncurrent							
Total loans and leases	2.06	1.41	1.56	1.20	1.12	1.17	1.57
Loans secured by real estate (RE)	1.39	0.84	1.51	0.66	0.88	0.70	1.09
1–4 family residential mortgages	1.50	0.85	2.06	0.59	0.75	0.56	1.20
Home equity loans	0.30	0.32	0.56	0.24	0.38	0.20	0.38
Multifamily residential mortgages	0.25	0.48	0.45	0.45	0.69	0.48	0.45
Commercial RE loans	0.84	1.01	1.40	0.88	1.06	0.76	1.05
Construction RE loans	1.26	0.99	1.11	0.73	0.80	1.68	1.13
Commercial and industrial loans	2.83	3.02	2.37	1.21	1.86	2.18	2.62
Loans to individuals	2.29	0.45	0.80	1.74	0.66	1.64	1.57
Credit cards	2.27	1.76	1.71	2.05	0.74	2.13	2.17
Installment loans and other plans	3.23	0.46	0.68	0.99	0.70	0.62	1.23
All other loans and leases	1.24	0.92	0.99	1.53	1.17	0.75	1.07
Percent of loans charged-off, net							
Total loans and leases	2.66	0.70	1.03	1.90	0.44	1.29	1.45
Loans secured by real estate (RE)	0.18	0.13	0.39	0.11	0.06	0.11	0.20
1–4 family residential mortgages	0.10	0.15	0.42	0.07	0.04	0.03	0.18
Home equity loans	0.07	0.20	0.48	0.17	0.11	0.10	0.26
Multifamily residential mortgages	–0.01	0.01	0.11	–0.01	–0.01	0.00	0.04
Commercial RE loans	0.13	0.09	0.50	0.25	0.09	0.10	0.22
Construction RE loans	0.38	0.11	0.06	–0.03	0.01	0.62	0.18
Commercial and industrial loans	1.48	1.65	1.71	0.86	0.90	1.38	1.53
Loans to individuals	8.18	1.50	2.34	5.05	1.11	4.54	5.07
Credit cards	11.59	7.25	5.64	6.82	2.20	5.77	9.02
Installment loans and other plans	3.20	1.44	1.70	0.44	1.09	1.68	1.94
All other loans and leases	0.57	0.17	0.76	0.15	0.30	0.71	0.50
Loans outstanding ($)							
Total loans and leases	$616,976	$598,433	$563,212	$151,822	$88,249	$249,436	$2,268,128
Loans secured by real estate (RE)	161,895	297,432	267,075	60,872	48,238	132,453	967,965
1–4 family residential mortgages	69,006	148,565	119,036	34,730	18,344	63,776	453,456
Home equity loans	20,252	32,503	38,341	3,806	1,256	14,382	110,539
Multifamily residential mortgages	3,846	9,280	10,738	1,609	1,639	4,156	31,269
Commercial RE loans	33,485	74,566	65,662	13,434	17,678	35,387	240,213
Construction RE loans	8,819	26,564	29,810	4,236	7,665	13,485	90,578
Farmland loans	482	2,789	3,473	3,058	1,655	1,265	12,723
RE loans from foreign offices	26,004	3,165	15	0	0	1	29,186
Commercial and industrial loans	187,680	163,700	142,770	24,666	22,705	47,178	588,700
Loans to individuals	168,032	61,118	70,502	50,653	12,257	49,360	411,922
Credit cards	104,877	587	11,024	36,270	291	34,425	187,475
Other revolving credit plans	17,539	3,433	4,873	832	628	2,515	29,821
Installment loans	45,615	57,098	54,605	13,551	11,338	12,420	194,626
All other loans and leases	101,551	76,522	82,951	15,645	5,153	20,546	302,367
Less: Unearned income	2,181	339	86	14	105	101	2,826

Key indicators, FDIC-insured commercial banks
Annual 1998–2001, year-to-date through March 31, 2002, first quarter 2001, and first quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Number of institutions reporting	8,773	8,579	8,315	8,080	8,005	8,238	8,005
Total employees (FTEs)	1,626,978	1,657,602	1,670,861	1,705,135	1,722,872	1,683,014	1,722,872
Selected income data ($)							
Net income	$61,784	$71,543	$71,002	$74,232	$21,732	$19,836	$21,732
Net interest income	182,752	192,142	203,960	215,198	58,637	51,851	58,637
Provision for loan losses	22,215	21,817	30,011	43,151	11,652	7,954	11,652
Noninterest income	123,688	144,450	153,453	157,167	41,467	40,155	41,467
Noninterest expense	194,131	204,208	216,104	222,337	56,145	55,058	56,145
Net operating income	59,226	71,309	72,591	71,405	21,377	19,335	21,377
Cash dividends declared	41,004	51,936	53,854	54,029	19,581	13,455	19,581
Net charge-offs to loan and lease reserve	20,740	20,367	24,786	36,492	11,113	6,969	11,113
Selected condition data ($)							
Total assets	5,442,531	5,735,160	6,244,612	6,569,348	6,504,593	6,316,420	6,504,593
Total loans and leases	3,238,287	3,491,659	3,819,545	3,895,658	3,893,313	3,831,342	3,893,313
Reserve for losses	57,262	58,766	64,144	72,146	74,861	64,738	74,861
Securities	979,855	1,046,530	1,078,983	1,179,695	1,185,913	1,049,095	1,185,913
Other real estate owned	3,150	2,796	2,912	3,569	3,809	3,065	3,809
Noncurrent loans and leases	31,253	32,999	42,942	55,018	57,198	46,115	57,198
Total deposits	3,681,428	3,831,104	4,179,634	4,391,613	4,352,204	4,186,279	4,352,204
Domestic deposits	3,109,395	3,175,515	3,472,968	3,762,107	3,748,683	3,515,184	3,748,683
Equity capital	462,142	479,732	530,721	597,378	604,782	547,517	604,782
Off-balance-sheet derivatives	33,007,227	34,819,179	40,571,148	45,057,985	46,331,935	43,951,066	46,331,935
Performance ratios (annualized %)							
Return on equity	13.93	15.31	14.02	13.09	14.46	14.71	14.46
Return on assets	1.19	1.31	1.19	1.15	1.33	1.26	1.33
Net interest income to assets	3.51	3.51	3.41	3.35	3.59	3.30	3.59
Loss provision to assets	0.43	0.40	0.50	0.67	0.71	0.51	0.71
Net operating income to assets	1.14	1.30	1.21	1.11	1.31	1.23	1.31
Noninterest income to assets	2.37	2.64	2.57	2.44	2.54	2.56	2.54
Noninterest expense to assets	3.73	3.73	3.61	3.46	3.44	3.51	3.44
Loss provision to loans and leases	0.72	0.66	0.82	1.12	1.20	0.83	1.20
Net charge-offs to loans and leases	0.67	0.61	0.67	0.94	1.14	0.73	1.14
Loss provision to net charge-offs	104.81	107.11	121.08	118.25	104.85	114.13	104.85
Performance ratios (%)							
Percent of institutions unprofitable	6.11	7.51	7.34	7.88	6.75	6.97	6.75
Percent of institutions with earnings gains	61.22	62.83	67.35	56.41	64.00	52.12	63.59
Nonint. income to net operating revenue	40.36	42.92	42.93	42.21	41.42	43.64	41.42
Nonint. expense to net operating revenue	63.35	60.67	60.46	59.71	56.09	59.84	56.09
Condition ratios (%)							
Nonperforming assets to assets	0.65	0.63	0.74	0.92	0.97	0.79	0.97
Noncurrent loans to loans	0.97	0.95	1.12	1.41	1.47	1.20	1.47
Loss reserve to noncurrent loans	183.22	178.08	149.37	131.13	130.88	140.38	130.88
Loss reserve to loans	1.77	1.68	1.68	1.85	1.92	1.69	1.92
Equity capital to assets	8.49	8.36	8.50	9.09	9.30	8.67	9.30
Leverage ratio	7.54	7.79	7.70	7.79	7.95	7.68	7.95
Risk-based capital ratio	12.23	12.16	12.12	12.72	13.00	12.28	13.00
Net loans and leases to assets	58.45	59.86	60.14	58.20	58.70	59.63	58.70
Securities to assets	18.00	18.25	17.28	17.96	18.23	16.61	18.23
Appreciation in securities (% of par)	1.07	–2.31	0.20	0.82	0.35	0.99	0.35
Residential mortgage assets to assets	20.93	20.78	20.20	21.70	21.68	20.45	21.68
Total deposits to assets	67.64	66.80	66.93	66.85	66.91	66.28	66.91
Core deposits to assets	49.39	46.96	46.39	48.80	49.10	46.54	49.10
Volatile liabilities to assets	31.68	34.94	34.97	31.38	31.42	34.09	31.42

Loan performance, FDIC-insured commercial banks
Annual 1998–2001, year-to-date through March 31, 2002, first quarter 2001, and first quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Percent of loans past due 30–89 days							
Total loans and leases	1.26	1.14	1.26	1.37	1.26	1.23	1.26
Loans secured by real estate (RE)	1.26	1.09	1.26	1.31	1.16	1.23	1.16
1–4 family residential mortgages	1.44	1.43	1.72	1.67	1.44	1.51	1.44
Home equity loans	0.98	0.75	0.98	0.91	0.62	0.85	0.62
Multifamily residential mortgages	0.86	0.57	0.55	0.69	0.64	0.64	0.64
Commercial RE loans	0.99	0.69	0.74	0.90	0.85	0.87	0.85
Construction RE loans	1.50	0.98	1.06	1.21	1.23	1.24	1.23
Commercial and industrial loans	0.88	0.79	0.83	1.02	1.09	0.88	1.09
Loans to individuals	2.43	2.33	2.47	2.47	2.06	2.15	2.06
Credit cards	2.58	2.59	2.66	2.69	2.50	2.54	2.50
Installment loans and other plans	2.33	2.18	2.34	2.56	1.96	2.06	1.96
All other loans and leases	0.51	0.54	0.65	0.84	0.87	0.87	0.87
Percent of loans noncurrent							
Total loans and leases	0.97	0.95	1.12	1.41	1.47	1.20	1.47
Loans secured by real estate (RE)	0.91	0.79	0.81	0.96	1.00	0.87	1.00
1–4 family residential mortgages	0.88	0.82	0.90	0.96	1.05	0.94	1.05
Home equity loans	0.42	0.33	0.37	0.39	0.36	0.44	0.36
Multifamily residential mortgages	0.83	0.41	0.44	0.43	0.43	0.39	0.43
Commercial RE loans	0.95	0.77	0.72	0.96	1.01	0.79	1.01
Construction RE loans	0.81	0.67	0.76	1.06	1.06	0.86	1.06
Commercial and industrial loans	0.99	1.18	1.66	2.41	2.61	1.82	2.61
Loans to individuals	1.52	1.42	1.41	1.50	1.49	1.41	1.49
Credit cards	2.22	2.05	2.01	2.15	2.28	2.18	2.28
Installment loans and other plans	1.06	1.04	0.98	1.22	1.10	1.03	1.10
All other loans and leases	0.34	0.39	0.69	0.96	0.90	0.80	0.90
Percent of loans charged-off, net							
Total loans and leases	0.67	0.61	0.67	0.94	1.14	0.73	1.14
Loans secured by real estate (RE)	0.05	0.08	0.09	0.19	0.15	0.11	0.15
1–4 family residential mortgages	0.07	0.11	0.11	0.22	0.14	0.10	0.14
Home equity loans	0.14	0.15	0.18	0.27	0.21	0.26	0.21
Multifamily residential mortgages	0.05	0.02	0.03	0.04	0.04	0.03	0.04
Commercial RE loans	0.00	0.03	0.05	0.14	0.16	0.09	0.16
Construction RE loans	0.01	0.04	0.05	0.13	0.14	0.08	0.14
Commercial and industrial loans	0.42	0.58	0.81	1.43	1.45	0.90	1.45
Loans to individuals	2.69	2.32	2.43	2.72	3.98	2.44	3.98
Credit cards	5.19	4.45	4.39	5.11	8.19	4.44	8.19
Installment loans and other plans	1.04	1.04	1.18	1.28	1.47	1.17	1.47
All other loans and leases	1.55	1.02	0.92	1.64	0.45	0.38	0.45
Loans outstanding ($)							
Total loans and leases	$3,238,287	$3,491,659	$3,819,545	$3,895,658	$3,893,313	$3,831,342	$3,893,313
Loans secured by real estate (RE)	1,345,589	1,510,342	1,673,172	1,802,270	1,810,583	1,702,445	1,810,583
1–4 family residential mortgages	668,706	737,110	790,030	811,981	794,049	796,798	794,049
Home equity loans	96,647	102,339	127,541	154,303	166,492	130,158	166,492
Multifamily residential mortgages	43,242	53,168	60,406	64,135	65,859	61,160	65,859
Commercial RE loans	370,544	417,633	466,453	506,538	518,735	470,577	518,735
Construction RE loans	106,719	135,632	162,613	193,088	194,444	174,286	194,444
Farmland loans	29,096	31,902	34,096	35,529	36,007	34,359	36,007
RE loans from foreign offices	30,635	32,558	32,033	36,695	34,997	35,108	34,997
Commercial and industrial loans	898,556	969,257	1,051,055	983,539	966,844	1,045,525	966,844
Loans to individuals	570,863	558,424	606,663	631,647	649,241	597,496	649,241
Credit cards*	228,781	212,051	249,372	232,891	247,874	216,385	247,874
Other revolving credit plans	NA	NA	NA	34,332	35,047	24,256	35,047
Installment loans	342,081	346,373	357,291	364,424	366,319	356,855	366,319
All other loans and leases	427,397	457,309	491,566	481,312	470,490	488,666	470,490
Less: Unearned income	4,117	3,673	2,912	3,110	3,844	2,790	3,844

*Prior to March 2001, credit cards included Other revolving credit plans.

Key indicators, FDIC-insured commercial banks by asset size
First quarter 2001 and first quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Number of institutions reporting	4,759	4,437	3,087	3,177	312	310	80	81
Total employees (FTEs)	96,899	89,362	290,536	297,223	247,293	243,759	1,048,286	1,092,528
Selected income data ($)								
Net income	$566	$551	$2,425	$2,480	$3,011	$3,314	$13,833	$15,387
Net interest income	2,231	2,140	7,636	8,177	8,537	8,625	33,447	39,694
Provision for loan losses	127	130	543	692	1,214	1,374	6,071	9,456
Noninterest income	571	526	3,089	3,130	5,039	5,515	31,456	32,296
Noninterest expense	1,948	1,837	6,793	7,099	7,936	7,852	38,381	39,357
Net operating income	552	540	2,365	2,506	2,917	3,258	13,501	15,073
Cash dividends declared	365	355	1,125	1,331	3,761	2,305	8,204	15,589
Net charge-offs to loan and lease reserve	67	78	361	453	1,035	1,256	5,506	9,326
Selected condition data ($)								
Total assets	229,488	221,127	780,990	821,079	879,185	896,730	4,426,756	4,565,657
Total loans and leases	139,943	134,806	505,865	533,156	563,778	559,491	2,621,756	2,665,861
Reserve for losses	1,967	1,946	7,202	7,816	10,426	10,020	45,143	55,079
Securities	54,171	53,917	171,932	188,157	189,085	213,961	633,907	729,878
Other real estate owned	269	326	727	975	415	633	1,654	1,875
Noncurrent loans and leases	1,409	1,565	4,368	5,289	5,857	6,219	34,482	44,125
Total deposits	193,946	187,753	638,947	671,123	607,846	610,273	2,745,541	2,883,055
Domestic deposits	193,945	187,753	637,147	669,472	595,575	600,183	2,088,517	2,291,274
Equity capital	25,666	23,947	76,357	79,833	81,656	90,628	363,838	410,373
Off-balance-sheet derivatives	140	58	7,627	4,864	79,228	70,982	44,265,570	46,428,077
Performance ratios (annualized %)								
Return on equity	8.94	9.22	12.92	12.55	15.04	14.93	15.43	15.04
Return on assets	1.00	1.00	1.26	1.22	1.37	1.49	1.26	1.34
Net interest income to assets	3.94	3.90	3.95	4.01	3.89	3.87	3.04	3.45
Loss provision to assets	0.22	0.24	0.28	0.34	0.55	0.62	0.55	0.82
Net operating income to assets	0.97	0.98	1.22	1.23	1.33	1.46	1.23	1.31
Noninterest income to assets	1.01	0.96	1.60	1.54	2.29	2.48	2.86	2.80
Noninterest expense to assets	3.44	3.34	3.52	3.49	3.61	3.52	3.49	3.42
Loss provision to loans and leases	0.37	0.39	0.43	0.52	0.86	0.99	0.93	1.41
Net charge-offs to loans and leases	0.19	0.23	0.29	0.34	0.74	0.91	0.84	1.39
Loss provision to net charge-offs	188.82	165.84	150.19	152.73	117.21	109.42	110.28	101.39
Performance ratios (%)								
Percent of institutions unprofitable	10.34	10.19	2.36	2.49	2.56	2.26	1.25	2.47
Percent of institutions with earnings gains	46.94	57.47	58.79	70.70	63.14	76.13	60.00	71.60
Nonint. income to net operating revenue	20.39	19.72	28.80	27.68	37.12	39.00	48.47	44.86
Nonint. expense to net operating revenue	69.51	68.90	63.34	62.79	58.46	55.53	59.14	54.67
Condition ratios (%)								
Nonperforming assets to assets	0.73	0.86	0.65	0.77	0.72	0.77	0.83	1.05
Noncurrent loans to loans	1.01	1.16	0.86	0.99	1.04	1.11	1.32	1.66
Loss reserve to noncurrent loans	139.61	124.35	164.88	147.77	178.03	161.11	130.92	124.83
Loss reserve to loans	1.41	1.44	1.42	1.47	1.85	1.79	1.72	2.07
Equity capital to assets	11.18	10.83	9.78	9.72	9.29	10.11	8.22	8.99
Leverage ratio	10.95	10.56	9.37	9.23	8.34	8.99	7.07	7.40
Risk-based capital ratio	17.43	17.02	14.30	14.20	12.89	14.25	11.65	12.43
Net loans and leases to assets	60.12	60.08	63.85	63.98	62.94	61.27	58.21	57.18
Securities to assets	23.61	24.38	22.01	22.92	21.51	23.86	14.32	15.99
Appreciation in securities (% of par)	1.33	0.48	1.37	0.52	0.95	0.30	0.88	0.31
Residential mortgage assets to assets	21.14	21.55	23.32	23.73	25.42	26.39	18.91	20.39
Total deposits to assets	84.51	84.91	81.81	81.74	69.14	68.06	62.02	63.15
Core deposits to assets	71.04	71.74	67.72	68.31	55.14	55.44	39.83	43.31
Volatile liabilities to assets	15.09	14.66	18.12	17.25	27.54	25.51	39.19	35.94

Loan performance, FDIC-insured commercial banks by asset size
First quarter 2001 and first quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Percent of loans past due 30–89 days								
Total loans and leases	1.77	1.74	1.37	1.29	1.34	1.26	1.16	1.23
Loans secured by real estate (RE)	1.53	1.50	1.18	1.09	1.04	1.00	1.28	1.21
1–4 family residential mortgages	1.77	1.73	1.38	1.40	1.10	1.09	1.62	1.52
Home equity loans	0.99	0.71	0.85	0.56	0.91	0.64	0.84	0.63
Multifamily residential mortgages	0.73	0.61	0.71	0.53	0.85	0.49	0.54	0.73
Commercial RE loans	1.22	1.20	0.92	0.85	0.88	0.89	0.80	0.80
Construction RE loans	1.42	1.59	1.46	1.15	1.27	1.26	1.13	1.23
Commercial and industrial loans	2.05	1.98	1.57	1.51	1.38	1.46	0.69	0.95
Loans to individuals	2.38	2.43	2.08	2.07	2.22	2.07	2.14	2.05
Credit cards	2.18	2.27	4.23	4.67	2.65	2.45	2.45	2.44
Installment loans and other plans	2.43	2.48	1.85	1.82	2.03	1.98	2.08	1.96
All other loans and leases	1.87	1.87	1.40	1.48	1.21	0.86	0.77	0.79
Percent of loans noncurrent								
Total loans and leases	1.01	1.16	0.86	0.99	1.04	1.11	1.32	1.66
Loans secured by real estate (RE)	0.87	1.02	0.71	0.87	0.79	0.86	0.95	1.08
1–4 family residential mortgages	0.78	0.89	0.65	0.76	0.78	0.83	1.07	1.18
Home equity loans	0.31	0.34	0.38	0.33	0.41	0.38	0.46	0.36
Multifamily residential mortgages	0.43	0.75	0.46	0.52	0.54	0.39	0.32	0.40
Commercial RE loans	0.97	1.13	0.73	0.95	0.81	0.94	0.80	1.07
Construction RE loans	0.78	1.01	0.84	1.01	0.92	1.04	0.85	1.10
Commercial and industrial loans	1.51	1.74	1.34	1.46	1.58	1.78	1.92	2.92
Loans to individuals	0.88	0.95	0.88	0.88	1.24	1.27	1.54	1.62
Credit cards	2.01	1.70	3.33	3.31	2.23	2.34	2.12	2.24
Installment loans and other plans	0.87	0.95	0.57	0.61	0.66	0.71	1.24	1.30
All other loans and leases	1.04	1.26	1.02	1.24	0.70	0.76	0.78	0.88
Percent of loans charged-off, net								
Total loans and leases	0.19	0.23	0.29	0.34	0.74	0.91	0.84	1.39
Loans secured by real estate (RE)	0.04	0.06	0.04	0.09	0.10	0.14	0.14	0.18
1–4 family residential mortgages	0.04	0.05	0.05	0.07	0.09	0.10	0.13	0.17
Home equity loans	0.04	0.02	0.07	0.04	0.52	0.16	0.24	0.24
Multifamily residential mortgages	0.11	0.05	0.02	0.05	–0.01	0.06	0.05	0.03
Commercial RE loans	0.05	0.10	0.05	0.11	0.06	0.15	0.13	0.20
Construction RE loans	0.08	0.09	0.02	0.10	0.12	0.25	0.09	0.11
Commercial and industrial loans	0.34	0.48	0.44	0.51	0.67	1.22	1.01	1.63
Loans to individuals	0.67	0.73	1.39	1.67	2.78	3.29	2.58	4.52
Credit cards	2.05	3.55	5.93	8.40	5.05	6.87	4.25	8.42
Installment loans and other plans	0.62	0.66	0.69	0.83	1.22	1.22	1.31	1.69
All other loans and leases	0.19	0.20	0.25	0.27	0.36	0.40	0.40	0.47
Loans outstanding ($)								
Total loans and leases	$139,943	$134,806	$505,865	$533,156	$563,778	$559,491	$2,621,756	$2,665,861
Loans secured by real estate (RE)	81,030	80,135	328,834	356,014	305,442	314,848	987,140	1,059,586
1–4 family residential mortgages	36,870	34,530	130,176	127,641	127,617	123,848	502,135	508,030
Home equity loans	2,018	2,271	13,718	16,087	17,641	19,233	96,780	128,901
Multifamily residential mortgages	1,755	1,841	10,955	12,558	12,478	13,892	35,972	37,569
Commercial RE loans	22,771	23,984	122,577	140,210	104,527	112,580	220,702	241,961
Construction RE loans	7,267	7,310	37,658	44,582	38,730	40,927	90,632	101,625
Farmland loans	10,348	10,199	13,706	14,900	4,125	4,034	6,180	6,874
RE loans from foreign offices	0	0	44	36	324	334	34,739	34,627
Commercial and industrial loans	24,458	23,150	91,897	94,311	123,555	114,458	805,614	734,925
Loans to individuals	18,392	16,424	59,703	56,423	101,345	92,933	418,055	483,460
Credit cards	502	420	7,152	6,056	38,980	33,357	169,750	208,041
Other revolving credit plans	306	304	1,725	1,547	2,756	3,829	19,470	29,366
Installment loans	17,584	15,700	50,827	48,820	59,609	55,747	228,835	246,053
All other loans and leases	16,249	15,240	26,110	26,992	33,999	37,713	412,308	390,545
Less: Unearned income	187	144	679	584	563	461	1,361	2,655

Key indicators, FDIC-insured commercial banks by region
First quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Number of institutions reporting	636	1,378	1,712	2,082	1,328	869	8,005
Total employees (FTEs)	542,125	456,253	321,825	117,828	104,623	180,218	1,722,872
Selected income data ($)							
Net income	$6,497	$5,603	$4,413	$1,512	$863	$2,844	$21,732
Net interest income	18,133	14,203	11,322	4,259	2,751	7,969	58,637
Provision for loan losses	5,452	1,730	1,797	877	216	1,580	11,652
Noninterest income	17,888	8,961	6,483	2,552	985	4,598	41,467
Noninterest expense	20,760	13,378	9,511	3,743	2,327	6,427	56,145
Net operating income	6,293	5,451	4,363	1,493	863	2,913	21,377
Cash dividends declared	7,421	8,621	1,454	799	337	949	19,581
Net charge-offs to loan and lease reserve	5,330	1,547	1,817	837	150	1,432	11,113
Selected condition data ($)							
Total assets	2,224,880	1,616,851	1,297,689	372,613	276,485	716,076	6,504,593
Total loans and leases	1,151,769	1,006,562	865,629	251,223	160,361	457,770	3,893,313
Reserve for losses	26,857	16,287	15,350	4,557	2,393	9,417	74,861
Securities	389,943	285,080	238,309	63,967	73,951	134,662	1,185,913
Other real estate owned	571	1,384	799	279	324	452	3,809
Noncurrent loans and leases	21,893	12,229	12,789	2,876	1,772	5,638	57,198
Total deposits	1,413,472	1,125,060	839,973	251,843	226,599	495,257	4,352,204
Domestic deposits	969,099	1,050,047	781,159	240,063	225,547	482,768	3,748,683
Equity capital	196,273	153,419	113,450	37,508	26,802	77,331	604,782
Off-balance-sheet derivatives	31,691,475	12,304,889	1,512,574	9,332	9,912	803,754	46,331,935
Performance ratios (annualized %)							
Return on equity	13.32	14.51	15.65	16.47	13.06	15.08	14.46
Return on assets	1.16	1.38	1.35	1.62	1.25	1.59	1.33
Net interest income to assets	3.24	3.51	3.46	4.56	3.99	4.47	3.59
Loss provision to assets	0.97	0.43	0.55	0.94	0.31	0.89	0.71
Net operating income to assets	1.12	1.35	1.33	1.60	1.25	1.63	1.31
Noninterest income to assets	3.19	2.21	1.98	2.73	1.43	2.58	2.54
Noninterest expense to assets	3.71	3.30	2.91	4.01	3.38	3.60	3.44
Loss provision to loans and leases	1.89	0.69	0.83	1.39	0.54	1.39	1.20
Net charge-offs to loans and leases	1.85	0.62	0.84	1.33	0.38	1.26	1.14
Loss provision to net charge-offs	102.28	111.82	98.93	104.83	143.38	110.37	104.85
Performance ratios (%)							
Percent of institutions unprofitable	10.53	8.35	4.67	4.42	6.17	11.97	6.75
Percent of institutions with earnings gains	66.82	67.13	68.46	62.34	57.23	58.69	63.59
Nonint. income to net operating revenue	49.66	38.68	36.41	37.47	26.36	36.59	41.42
Nonint. expense to net operating revenue	57.63	57.75	53.42	54.96	62.29	51.14	56.09
Condition ratios (%)							
Nonperforming assets to assets	1.08	0.84	1.07	0.85	0.76	0.86	0.97
Noncurrent loans to loans	1.90	1.21	1.48	1.14	1.11	1.23	1.47
Loss reserve to noncurrent loans	122.68	133.18	120.03	158.42	135.03	167.02	130.88
Loss reserve to loans	2.33	1.62	1.77	1.81	1.49	2.06	1.92
Equity capital to assets	8.82	9.49	8.74	10.07	9.69	10.80	9.30
Leverage ratio	7.48	7.93	7.73	9.13	8.66	9.05	7.95
Risk-based capital ratio	13.06	12.53	12.44	13.71	14.31	14.22	13.00
Net loans and leases to assets	50.56	61.25	65.52	66.20	57.13	62.61	58.70
Securities to assets	17.53	17.63	18.36	17.17	26.75	18.81	18.23
Appreciation in securities (% of par)	–0.11	0.73	0.31	0.77	0.52	0.64	0.35
Residential mortgage assets to assets	16.57	25.66	24.56	20.90	26.11	22.01	21.68
Total deposits to assets	63.53	69.58	64.73	67.59	81.96	69.16	66.91
Core deposits to assets	35.10	56.61	52.37	57.72	67.83	57.99	49.10
Volatile liabilities to assets	44.78	23.35	27.67	23.29	19.02	23.94	31.42

Loan performance, FDIC-insured commercial banks by region
First quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Percent of loans past due 30–89 days							
Total loans and leases	1.30	0.97	1.47	1.57	1.33	1.20	1.26
Loans secured by real estate (RE)	1.11	0.98	1.56	1.12	1.16	0.97	1.16
1–4 family residential mortgages	1.24	1.31	2.07	1.19	1.33	1.13	1.44
Home equity loans	0.46	0.61	0.79	0.58	0.42	0.51	0.62
Multifamily residential mortgages	0.35	0.48	1.18	0.20	0.61	0.57	0.64
Commercial RE loans	0.81	0.69	1.19	0.97	0.88	0.66	0.85
Construction RE loans	0.92	0.88	1.56	1.07	1.50	1.65	1.23
Commercial and industrial loans	1.07	0.72	1.29	1.68	1.42	1.27	1.09
Loans to individuals	2.26	1.78	1.86	2.32	1.77	1.94	2.06
Credit cards	2.65	2.80	2.06	2.57	1.40	2.07	2.50
Installment loans and other plans	2.20	1.70	1.96	1.97	1.84	1.99	1.96
All other loans and leases	0.73	0.55	1.12	1.65	1.66	0.82	0.87
Percent of loans noncurrent							
Total loans and leases	1.90	1.21	1.48	1.14	1.11	1.23	1.47
Loans secured by real estate (RE)	1.11	0.81	1.34	0.77	0.93	0.77	1.00
1–4 family residential mortgages	1.09	0.85	1.66	0.66	0.83	0.59	1.05
Home equity loans	0.28	0.32	0.50	0.29	0.34	0.25	0.36
Multifamily residential mortgages	0.28	0.40	0.56	0.49	0.86	0.35	0.43
Commercial RE loans	1.00	0.89	1.33	0.93	1.01	0.84	1.01
Construction RE loans	1.15	0.88	1.25	0.82	0.87	1.29	1.06
Commercial and industrial loans	3.22	2.51	2.36	1.29	1.71	2.32	2.61
Loans to individuals	2.11	0.81	0.75	1.67	0.70	1.45	1.49
Credit cards	2.50	2.08	1.65	2.15	1.04	2.06	2.28
Installment loans and other plans	2.03	0.65	0.66	0.88	0.72	0.51	1.10
All other loans and leases	0.85	0.81	0.88	1.35	1.37	1.00	0.90
Percent of loans charged-off, net							
Total loans and leases	1.85	0.62	0.84	1.33	0.38	1.26	1.14
Loans secured by real estate (RE)	0.12	0.12	0.29	0.08	0.07	0.09	0.15
1–4 family residential mortgages	0.08	0.12	0.30	0.06	0.08	0.03	0.14
Home equity loans	0.06	0.19	0.38	0.14	0.14	0.06	0.21
Multifamily residential mortgages	0.01	0.01	0.12	0.02	–0.01	0.03	0.04
Commercial RE loans	0.09	0.11	0.35	0.12	0.08	0.09	0.16
Construction RE loans	0.22	0.08	0.12	0.09	0.03	0.29	0.14
Commercial and industrial loans	1.48	1.43	1.47	0.66	0.76	1.96	1.45
Loans to individuals	5.93	1.57	2.01	4.71	0.99	4.09	3.98
Credit cards	10.68	3.52	5.34	7.12	3.32	5.60	8.19
Installment loans and other plans	1.86	1.27	1.48	0.45	0.92	1.52	1.47
All other loans and leases	0.45	0.22	0.66	0.17	0.37	0.72	0.45
Loans outstanding ($)							
Total loans and leases	$1,151,769	$1,006,562	$865,629	$251,223	$160,361	$457,770	$3,893,313
Loans secured by real estate (RE)	371,143	546,854	433,605	118,584	91,622	248,775	1,810,583
1–4 family residential mortgages	182,900	239,618	184,756	55,479	33,874	97,422	794,049
Home equity loans	33,662	53,004	52,843	5,601	1,596	19,786	166,492
Multifamily residential mortgages	15,547	16,467	17,265	3,361	2,775	10,444	65,859
Commercial RE loans	85,628	158,097	122,011	32,525	34,996	85,478	518,735
Construction RE loans	20,712	69,488	47,824	10,493	14,333	31,594	194,444
Farmland loans	1,318	7,014	8,842	11,124	4,049	3,658	36,007
RE loans from foreign offices	31,376	3,165	64	0	0	391	34,997
Commercial and industrial loans	327,763	240,106	223,341	42,718	37,206	95,710	966,844
Loans to individuals	265,598	122,719	95,334	61,117	22,090	82,383	649,241
Credit cards	128,647	16,108	12,548	38,639	609	51,322	247,874
Other revolving credit plans	18,992	4,954	5,553	982	727	3,840	35,047
Installment loans	117,958	101,657	77,233	21,495	20,754	27,221	366,319
All other loans and leases	189,712	97,488	113,514	28,845	9,623	31,307	470,490
Less: Unearned income	2,448	605	166	40	181	404	3,844

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.

Recent Corporate Decisions

The OCC publishes monthly, in its publication *Interpretations and Actions,* corporate decisions that represent new or changed policy, or present issues of general interest to the public or the banking industry. In addition, summaries of selected corporate decisions appear in each issue of the *Quarterly Journal.* In the first quarter of 2002, the following corporate decisions were of particular importance because they were precedent-setting or otherwise represented issues of importance. The OCC's decision documents for these decisions may be found in *Interpretations and Actions* using the decision number at the end of each summary.

Charter

On September 28, 2001, the OCC granted preliminary conditional approval for the establishment of Alger National Trust Company, Morristown, New Jersey, by Alger Associates, Inc., New York, New York, an investment management firm. The national trust bank will offer fiduciary services in connection with collective investment funds, IRAs, and wrap accounts. The approval is subject to the typical conditions imposed on newly chartered national trust banks. The OCC granted final approval on January 28, 2002. [Conditional Approval No. 492]

Conversion

On March 13, 2002, the OCC granted approval for Charter One Bank, FSB, Cleveland, Ohio to a national bank. Two community organizations expressed concerns with the bank's record of lending to African Americans and to low-and-moderate income areas. The OCC investigation into those concerns found no information that was inconsistent with approval under the Community Reinvestment Act. [Corporate Decision Letter No. 2002-6]

On March 27, 2002, the OCC granted conditional approval for Legacy Trust Company, Houston, Texas, to convert to a national trust bank. In addition to the typical conditions imposed on all trust banks converting to national associations, the OCC imposed ongoing requirements for maintaining capital and an audit committee. [Conditional Approval No. 518]

Change in Bank Control

On January 9, 2002, the OCC decided two interrelated filings that, first established a new national trust bank, and, second, changed the ownership of the new bank. First, the OCC granted conditional approval of the application by The Midway National Bank of St. Paul, St. Paul, Minnesota, to charter Securian Trust Company, National Association, St. Paul, Minnesota. Upon establishment, Midway transferred its trust business to the new bank. The new bank offers personal trust, employee benefit plans, and agency account services. The OCC's approval is subject to the typical conditions imposed on newly chartered national trust banks. Then, the OCC posed no objection to the change in bank control notice filed by Securian Financial Group, Inc., St. Paul, Minnesota, to acquire control of Securian Trust Company, National Association. Securian Financial Group, Inc., is a stock subsidiary of Minnesota Life Insurance, St. Paul, Minnesota. [Conditional Approval No. 511]

Mergers

On January 2, 2002, the OCC granted approval for M&I Marshall & Ilsley Trust Company of Arizona, Scottsdale, Arizona; Marshall & Ilsley Trust Company of Florida, Naples, Florida; and, Marshall & Ilsley Trust Company, Milwaukee, Wisconsin, to merge into M&I National Trust Company, Milwaukee, Wisconsin. After the merger, M&I National Trust Company will continue engaging in fiduciary activities through its offices in all three states. [Corporate Decision No. 2002-1]

On March 1, 2002, the OCC granted approval for Wachovia Bank, National Association, Winston-Salem, North Carolina, to merge into First Union National Bank, Charlotte, North Carolina. The bank resulting from that merger, headquartered in Charlotte, North Carolina, chose to operate under the title of Wachovia Bank, National Association. While the OCC did not receive any public comments on this application, the OCC ensured that the comments received in June 2001 in connection with the holding company merger had been considered by OCC examiners in rendering the latest CRA Public Evaluations for both banks. [CRA Decision Letter No. 111]

Operating Subsidiaries

On January 9, 2002, the OCC granted approval for the Bank of Lancaster County, National Association, Strasburg, Pennsylvania, to establish an operating subsidiary to provide employee benefit, compensation advisory and related administrative services, and other human resources services. The subsidiary will provide the services to the bank's business customers and other businesses in the Bank's market area. [Corporate Decision No. 2002-2]

On February 18, 2002, the OCC granted approval for Bank of America, National Association, Charlotte, North Carolina; Citibank, National Association, New York, New York; and, Wells Fargo Bank, National Association, San Francisco, California, to expand the activities of Identrus LLC, an existing operating subsidiary, to use Identrus' certification network system to provide secure and certified payment initiation products to commercial buyers and sellers with no previous trading relationship. [Corporate Decision No. 2002-04]

Speeches and Congressional Testimony

Of the Comptroller of the Currency

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Of the First Senior Deputy Comptroller and Chief Counsel

Statement of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency, before the U.S. House Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, on regulatory burden on America's banking system, Washington, D.C., March 14, 2002 47

Remarks of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency, before the Mid-Atlantic Bank Compliance Conference, on compliance and section 5 of the Federal Trade Commission Act, Annapolis, Maryland, March 22, 2002. 50

Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the Women in Housing and Finance, on federal preemption and the relationship between the U.S. Constitution and state laws, Washington, D.C., February 12, 2002

One of the things I find so impressive about Women in Housing and Finance (WHF) is the range of interests, occupations, and backgrounds of its members—so very different from many of the industry organizations, comprising ever-narrower sub-specialties, with which we bank regulators spend so much of our time.

WHF, by contrast, has no political ax to grind or hidden agenda to advance. It brings together women—and men—who, apart from an association with the housing and financial industries, broadly defined, may be united primarily by respect for their mutual accomplishments—and by the pleasure of each other's company.

By the same token, it is a genuine pleasure to be in *your* company today.

I want to speak today about a subject that has largely been the preserve of legal scholars and banking attorneys—federal preemption, and, more specifically, the relationship between the U.S. Constitution and state laws that are intended by the states to be applicable to banks.

The OCC's role with respect to preemption was recently the subject of a lead article in the *Wall Street Journal*. The authors' thesis was that in supporting the preemption of state laws for the benefit of national banks, the OCC was reflecting an "anti-consumer" bias. Instead of going to court "to check the economic power of banking titans," as the *Journal* colorfully put it, the OCC has consistently defended national banks' claims of immunity from local laws intended to protect consumers.

Moreover, the authors argued, the OCC has aggressively supported the preemption of state laws in order to keep national banks, which, as we all know, pay two-and-one-half times more, on average, in supervisory fees than state banks, from converting to state charters.

Well, as often seems to be the case with such stories, the authors got it partly right and partly wrong.

There is no question that national banks' immunity from many state laws is a significant benefit of the national charter—a benefit that the OCC has fought hard over the years to preserve. The ability of national banks to conduct a multistate business subject to a single uniform set of federal laws, under the supervision of a single regulator, free from visitorial powers of various state authorities, is a major advantage of the national charter.

To understand *why* Congress saw fit to create national banks as instruments of federal policy with this significant immunity from state authority, it's necessary to step back briefly in time.

Banks have never been the most popular of American institutions, and in the early days of the Republic, banks that operated under a broad grant of national authority may have been most unpopular of all. It was Jefferson who spoke for many of his generation when he said that "banking institutions are more dangerous than standing armies." Given what Americans had just been through at the hands of the British Army, that was saying quite a lot.

But even Jefferson conceded that if banks were an evil, they were a necessary one. That was the dilemma we've been wrestling with ever since.

In 1791, at the urging of Alexander Hamilton, Congress created the First Bank of the United States—our first venture into the area of central banking. When the bank's 20-year charter expired, the bank expired with it. But a crumbling economy led lawmakers five years later to create the Second Bank of the United States, which proved no more popular than the first. And state-chartered banks, of which there were well over 100 by 1816, took advantage of that unpopularity by encouraging state legislatures to pass a variety of discriminatory laws, hoping to rein in, if not destroy, the sometimes overbearing Second Bank.

Maryland's contribution was an annual tax of $15,000 levied against its Baltimore branch. When the bank refused to pay, it was successfully sued in state court. In the name of its cashier, J.W. McCulloch, the Second Bank appealed that verdict to the U.S. Supreme Court.

What emerged was one of the landmark decisions in our history. Speaking for a unanimous court, Chief Justice Marshall declared constitutional Congress's creation of a national bank and declared unconstitutional Maryland's

attempt to weaken it through taxation. On the first point, Marshall elaborated the "loose constructionist" view of federal power associated with Hamilton, an expansive view based on a strong union.

On the second point, regarding Maryland's attack on the Second Bank, Marshall invoked the Supremacy Clause—paragraph 2 of Article VI—holding that the Constitution of the United States, and the laws promulgated under it, are the law of the land and carry a presumption of supremacy over the states. "The States," Marshall affirmed, "have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control the operations" of any agency created by lawful exercise of federal authority.

Of course, the states could still send elected representatives to Washington to accomplish the same end by federal legislation or presidential authority, and under President Andrew Jackson, legislation to extend the life of the Second Bank was vetoed.

With the loss of this centralizing and stabilizing influence, the U.S. banking system stumbled into near-anarchy. Indeed, one is hard pressed to call it a system at all, because standards and practices varied enormously from state to state. In states like Indiana and New York, new bank organizers were required to have real capital, and their operations were subject at least to some degree of government supervision. But in many states, banks could organize without a dollar's capital to their name, and supervision was virtually nonexistent. That permitted the shadiest of operators to enter the field—and dominate it in some states.

The currency of the country consisted of notes issued by those banks, and the practice of issuing bank notes with no or inadequate real assets backing them up became a national scandal—and a huge burden on interstate commerce, which depended on a reliable currency. To keep redemption-minded note-holders at a safe distance, bank operators became experts at evasion, moving their hole-in-the-wall offices to frontier backwaters "where only the wildcats roamed." Thus did the Wildcat Era in banking acquire its name.

Like most such characterizations, this one was unfair to the outliers—responsible bankers, in this case, of whom there were many. But the lack of uniformity in the value of currency was itself a great flaw in the nation's banking before the Civil War, because it gave rise to confusion and uncertainty—two major obstacles to economic development.

This situation cried out for a remedy, and the Civil War-era Congress supplied one that served two important objectives: first bringing uniformity to the currency; second, financing the Civil War. The Office of the Comptroller of the Currency was created to charter and supervise national banks, which would serve as the instruments of a uniform and secure national currency, and help stabilize and support the national economy.

When the Comptroller chartered a new national bank, a portion of the bank's paid-in capital was used to purchase Treasury securities, which not only filled the Union's coffers, but which was pledged as backing for circulating notes issued by the banks with the Comptroller's approval.

Operating under a broad and potent grant of enumerated powers and such "incidental powers as shall be necessary to carry on the business of banking," the national banks were designed from the outset to carry on their business under uniform rules, uniformly high standards, and uniform federal supervision. And their notes, backed by government obligations, would circulate at uniform value.

Another feature of national banking was its uniformly national character. Initially the offer of easy conversion to the national charter was expected to provide sufficient incentive for state banking to liquidate itself. But the lagging pace of voluntary conversions led Congress to adopt the Marshall dictum so nicely expressed in the *McCulloch* case—"the power to tax is the power to destroy." It imposed a "death tax" on the notes of state banks, a tax that congressional backers promised would be every bit as effective in driving out state banks as an outright ban, which was also considered.

Of course, they were wrong. State banking was able to adapt simply by substituting deposit-taking for note-issuing, and by taking advantage of state regulations deliberately tailored to permit them to engage in many activities deemed too risky for national banks.

The dual banking system was thus born—not in fulfillment of a national plan, clearly, but in spite of it. Reflecting the country's basic ambivalence about banking and the use of national power, a less confrontational Congress reconciled itself over time to a dual banking system rather than a unified one, embracing a more benign view of state banking as a legitimate expression of state sovereignty and a source of salutary competition for national banks.

With this outcome, the stage was set for future federal–state tensions. First, states sought to determine how much control, if any, they would have over the powerful new

federal financial institutions that operated within their borders. Second, as the sponsors and at least nominal supervisors of state banks, they had a material interest in ensuring that those banks remained competitive—through positive grants of powers and privileges and, if possible, through limits on the powers and privileges of their national competitors.

The courts quickly decided that there *were* limits to the immunity from state law conferred by the national bank charter. For instance, in *McClellan* v. *Chipman,* an 1896 case, the Supreme Court upheld the right of the states to regulate contracts involving a national bank. It also affirmed the state's authority to regulate the transfer of real property. In *Anderson National Bank* v. *Luckett* of 1943, it rejected a bank's claim that it was not subject to state escheat laws.

In later years, Congress, in some cases, adopted state law as the reference point for some national bank powers, as it did in the 1927 McFadden Act, setting out the branching authority of national banks.

On the other hand, in an overwhelming body of case law built up since the enactment of the National Bank Act, the courts, echoing *McCulloch* v. *Maryland*, have been emphatic about where the states may *not* go. State laws may not "stand as an obstacle" to the accomplishment of the purposes for which Congress *created* the national bank charter.

The states may not "prevent or significantly interfere with" the activities lawfully engaged in by national banks. They may not "impair" or "prevent" national banks from exercising congressionally granted powers. They may not regulate at all in areas in which the federal interest predominates or where Congress has "occupied the field" to the exclusion of the states.

Decisions of the Supreme Court have overwhelmingly endorsed the preemption doctrine as it applies to national banks—a record of consistency that transcends changes in the political or philosophical makeup of the court.

In *Davis* v. *Elmira Savings Bank*, an 1896 case, the court rejected an attempt to give preference to a state institution's claim on an insolvent national bank, while in 1954, in *Franklin National Bank* v. *New York*, the court ruled that a state could not regulate a national bank's advertising campaign.

In *Barnett* v. *Nelson*, the court in 1996 once again enjoined the states from erecting obstacles to "the accomplishment and execution of the full purposes and objectives of Congress." In that case, the court found that a Florida state law barring national banks from selling insurance in small towns was in "irreconcilable conflict" with the National Bank Act, and was thus preempted.

While the OCC has no self-executing power to preempt state law, it has, on many occasions, expressed opinions about the preemptive effect of federal law. In recent years, for example, we have opined that state laws that impose restrictions on such financial activities as ATM fees, auctions, and trust services cannot lawfully apply to national banks.

The consequences of these decisions have been to preserve and protect a national banking system operating under unified federal supervision. The rationale for such a system is as compelling today as it was in 1863.

That's certainly true for the ever-growing number of business and retail customers who benefit from access to nationwide banking services. It is doubly true for the multistate and nationwide banking organizations that serve them.

In 1863, as I've already mentioned, state supervision, with few exceptions, was nonexistent or worse. Today each of the 50 states and the District of Columbia have active supervisory schemes in place, based on impressive foundations of laws and regulations singularly theirs. In addition, the Federal Reserve and the Federal Deposit Insurance Corporation, as major players on the supervisory scene, devote thousands of examiners to the supervision of state-chartered banks.

To be sure, state supervisors have responded admirably to the needs of a multistate environment, through a master agreement allocating primary supervisory authority for state banks with interstate branches. Nonetheless, the national bank charter remains the most efficient means of conducting broad interstate banking activities.

It's important to note that, for better or worse, the preemption doctrine is value-blind and agnostic with respect to the desirability of the state law involved. In preemption situations, the only relevant issue is whether the state law would impair or significantly interfere with a national bank's exercise of powers granted to it under federal law. If such an impact is found to exist, federal law must prevail. Any opinions we might have about the desirability or merit of the laws in question are not relevant.

Let me give you a hypothetical example. I have long been convinced, going back to my days as Under Secretary

of the Treasury for Domestic Finance, that many of our concerns about the "unbanked" could be well addressed through effective use of technology. I have repeatedly urged banks to offer low-cost electronic, direct-deposit, debit card-based banking accounts to low- and moderate-income Americans, hoping to help break their dependence on check-cashers, payday lenders, and other higher-cost financial providers.

Now let's say that a state chose to pass a law *requiring* all banks to offer such electronic accounts, defining the nature of the account and imposing a fee cap. I would applaud that action by the states. I would encourage Congress to follow suit. But until it did, I would also have no choice but to hold national banks immune from such a law. Under prevailing rules of preemption, the states simply do not have the authority to order national banks to offer specific types of accounts or to regulate what they charge for services.

While some might view such a position in this hypothetical case as "anti-consumer," I would caution against such simplistic characterizations. Take the case of those local laws that have sought to bar banks from imposing charges for the use of ATMs by persons who do not maintain an account with them—the so-called ATM surcharge laws. Such laws have an undoubted political appeal—given a choice, most people would naturally prefer not to pay a charge for using an ATM, regardless of who owns it.

But a major incentive for banks to deploy ATMs is the expectation of profit from the use of their terminals by noncustomers. Thus, terminal deployers seek out new locations for their ATMs in the hope that many people will find it convenient to use their terminals—either paying a fee for the privilege or becoming a customer to enjoy free use of the ATM.

Noncustomers clearly benefit from the increased deployment of ATMs by banks seeking fees, and would clearly be less well off if anti-surcharge laws diminished the incentives of such banks to seek out new users.

Not only are such laws preempted by federal law, as the courts have consistently held, but they are fundamentally wrong-headed, pretending to help consumers when in fact they do quite the opposite. There is no clearer evidence of this than the dramatic increase in ATM deployment that occurred after the ATM networks abandoned their own rules barring such surcharges.

Let me raise one other caution about preemption. The benefit that national banks enjoy by reason of this important constitutional doctrine cannot be treated as a piece of disposable property that a bank may rent out to a third party that is not a national bank. Preemption is not like excess space in a bank-owned office building. It is an inalienable right of the bank itself.

We have recently seen several instances in which nonbank lenders who would otherwise have been fully subject to various state regulatory laws have sought to rent out the preemption privileges of a national bank to evade such laws. Indeed, the payday lending industry has expressly promoted such a "national bank strategy" as a way of evading state and local laws. Typically, these arrangements are originated by the payday lender, which attempts to clothe itself with the status of an "agent" of the national bank. Yet the predominant economic interest in the typical arrangement belongs to the payday lender, not the bank.

Not only do these arrangements constitute an abuse of the national charter, but they are highly conducive to the creation of safety and soundness problems at the bank, which may not have the capacity to manage effectively a multistate loan origination operation that is in reality the business of the payday lender. As you probably saw, we recently took supervisory action against a small national bank that dramatically demonstrated its inability to manage such a relationship in a safe and sound manner.

Finally, let me say a few more words about the role that the OCC plays in consumer protection. Even if one were to view all state enactments in this area as "pro-consumer," and all OCC support for preemption as "anti-consumer," that simplistic view of life ignores the fact that the overwhelming volume of consumer protections for bank customers have come from federal laws that are clearly applicable to national banks. We conscientiously enforce all of those laws. In fact, we have more than 300 examiners who spend all or part of their time on consumer protection compliance.

And I think we have played a real leadership role in this regard. Not long ago, we required one large credit card bank to make restitution payments of at least $300 million for overreaching against consumers. We have asserted the authority to use our cease-and-desist powers to remedy unfair and deceptive practices that violate the Federal Trade Commission Act, and that authority has been recognized in court. And, as I have already mentioned, we recently forced a national bank to take steps to exit the payday lending business. We take tremendous pride in delivering a high level of protection to consumers without subjecting national banks to excessive—and costly—regulatory burden.

One can hardly think of two subjects that have aroused more intense feeling in our history than banking and the relationship between the federal government and the states. It is a matter of historical fact that emotions ran almost as high in the war against the two Banks of the United States—and war is the metaphor that was almost always used in describing those events—as they did in the all too literal war Americans fought against each other some years later. It seems fitting that the national banking system was one of the byproducts of that conflict.

These two epic issues—banking and federalism—converge in the preemption question. In that sense, it's not surprising that preemption—on one level, an abstruse legal concept—is still capable of generating passionate controversy. But we cannot allow our emotions to rule when it comes to public policy. Balance, sober judgment, and perspective are all crucial. And for that we rely not only on those who govern, but also on an informed, responsible—and historically literate—citizenry.

Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the Institute of International Bankers, on the status of the new Basel Capital Accord, Washington, D.C., March 4, 2002

The New Basel Capital Accord: A Status Report

It's been an extraordinary year since I last spoke to the Institute in this forum—a year that saw both unspeakable tragedy and awe-inspiring heroism. And it saw something else that I think few people expected in the wake of September 11—extraordinary solidarity in the international community. To date, no fewer than 147 nations have frozen assets linked to terrorist organizations. International cooperation in the anti-money-laundering campaign has been exemplary. Dozens of nations are cooperating in the effort to root out terrorist cells. Others have contributed combat and logistical support to the war in Afghanistan and are now contributing significantly to the international effort to rebuild that country's shattered infrastructure.

I believe this experience may have some relevance for those of us who are engaged in the effort to bring about greater harmonization in the supervision of internationally active financial organizations, in particular for the Basel Committee on Banking Supervision. The year 2001 began auspiciously with the release of the second consultative draft of the committee's proposal for a new capital accord—a 500-plus-page set of documents. The committee also announced an ambitious schedule for moving ahead with that proposal: a four-month comment period, final publication of a new accord by year-end 2001, and full implementation in 2004.

As spelled out in the consultative package, the new framework for regulatory capital—which I shall refer to as "Basel II"—aimed to address many of the distortions that have resulted from Basel I, the original 1988 capital accord. Although it represented a breakthrough in many ways, the 1988 accord was found to be seriously deficient in others, and these deficiencies have become more conspicuous with each passing year. It is now widely acknowledged that Basel I inadequately differentiates among institutions of varying risks and risk management capabilities. In some respects, the Basel rules have even proved counterproductive, having encouraged some institutions to move high-quality assets off the balance sheet, thus reducing the average quality of bank loan portfolios.

Despite the good that has come from it—and the good has been substantial—there's now a general and understandable sense that time has overtaken the 1988 accord.

The proposal for a new accord that was rolled out last January is designed to provide a framework that's as sophisticated as the industry itself is today—and yet one that also accommodates the industry's extraordinary diversity, both among and within its home countries.

Before it commenced work in earnest on the proposed new accord, the Basel Committee laid out five objectives to guide its efforts.

- First, any new capital rule should at least maintain the current overall level of capital in the banking system.
- Second, it should promote competitive equality and a level playing field for international banks.
- Third, it should take a comprehensive approach to addressing risks.
- Fourth, its approach to capital adequacy should be appropriately sensitive to the degree of risk inherent in a bank's positions and activities.
- And, finally, a new capital rule should focus on internationally active banks, although its underlying principles should be suitable for application to banks of varying levels of complexity and sophistication.

Those were the guidelines that the committee set for its own work. I would add the following as important principles that should also guide the committee:

- First, I strongly believe that whatever rule we adopt must work in practice as well as in theory. A rule that is intellectually elegant but overly complex and difficult to comprehend and implement may create more problems than it solves.
- Second, the rule has to provide supervisors with sufficient flexibility to accommodate differences among financial institutions. Institutions should not be forced to modify practices that raise no safety and soundness

concerns, and settled, well-functioning markets should not be disrupted, simply in the name of compelling adherence to a common rule.

- Finally, I believe it's exceedingly important from a domestic perspective that we avoid impairing the competitive vitality of U.S. banks, and, from an international perspective, that we avoid placing banks generally at a competitive disadvantage compared to other financial service providers. To be sure, banks play a special role in the economy of every country and thus frequently warrant special treatment. But the line between banking and other financial services is becoming increasingly blurred, and we must recognize that investment banks, insurance companies, and other nonbank institutions are major competitors of banks.

So—how well did we do? Did the document released in January of last year meet these standards, or did it fall short? If the latter, what steps should we now take to correct any deficiencies and to produce an accord that will genuinely contribute to a safer and more competitive global financial system?

To answer those questions, a more detailed review of Basel II—and of the reaction to it from its various constituencies—is in order.

The new accord, as I'm sure you know, is built on three pillars: minimum capital, supervisory review, and market discipline. It would reward banks that have developed the most advanced internal risk-rating systems by allowing them to use those systems in the calculation of their capital requirements—the so-called "internal risk ratings-based approach," or IRB. Banks with less developed capabilities would have a somewhat less advantageous methodology, while banks with more rudimentary risk management systems would utilize risk weights and capital charges established by the committee under a standardized approach.

But even banks adopting the IRB approach would not be unconstrained in calculating their own capital requirements. The primary regulator would still be responsible for evaluating and validating each institution's models and risk-rating system and for assuring that they are applied with consistency and integrity. Banks' internal processes would be subject to regular supervisory testing—and intervention, if necessary. And all internationally active banks, regardless of their complexity, would be required to make a capital allocation for operational risk.

Moreover, the Basel Committee envisions an important role for the financial markets as a barometer of the financial condition and risk profile of regulated institutions—as well as a reality check on the job we do as regulators. Thus, the third pillar of Basel II would require that financial institutions improve the quality and quantity of the information they make public, so that financial markets have the ability to make accurate and informed judgments on the health of each institution.

The transparency pillar has an important additional function that should not be overlooked. It will provide both banks and supervisors with information that will enable them to assess how the requirements of the accord are being observed and applied in other countries. In this respect, it will facilitate a kind of "self-policing" of compliance by banks subject to the accord and their supervisors.

A brief summary obviously cannot do justice to a dense document of 500 pages, but there you have the highlights, at least, of Basel II—the product of months of consultation among the principals and extraordinary effort by the committee secretariat and the staffs of the various committee members. That we have been able to come as far as we have is a tribute to the strong and skillful leadership of Bill McDonough, who brought to bear not only his standing as one of the world's leading central bankers, but his extensive practical background as a banker. By not underestimating the difficulties that stood in its way, Bill has kept the highly collegial but occasionally fractious committee on point and headed in the right direction. Indeed, it is not taking anything away from the great service our members have rendered to say that our proceedings have been marked by spirited exchanges of viewpoints that reflect the wide differences in legal, supervisory, and accounting practice in our respective nations. The committee's proceedings underscored the importance of developing rules that make sense, at least in terms of their broad principles, not only for the G-10, but also for all nations expecting to operate under the Basel framework.

We expected that the reaction to the proposed accord issued in January 2001 would reflect the wide divergence in financial practice around the world, and in this regard we were not disappointed. Some stakeholders urged us to simplify; others asked that it be made even more risk-sensitive—and, at the same time, more complex. Smaller, noncomplex institutions in the United States went on the record as expressing a preference for the status quo; the gains promised under the new accord, they said, seemed not worth the trouble and expense of shifting to a new system. Many institutions particularly objected to the capital charge for operational risk, disagreeing both with

the definition of operational risk *and* with the amount of capital they would be expected to set aside for that purpose. Even the risk rating agencies, which might have been expected to applaud a system that would utilize their services for banks without reliable in-house risk-rating capabilities, worried publicly about conflicts of interest and the possibility that they would be perceived as unduly influenced by the regulators.

The committee's initial cut at Pillar 3 raised very substantial objections, and knowledgeable observers were quick to point out that market discipline, as contemplated in Basel II, can be an elusive concept—difficult to standardize and potentially burdensome in terms of the disclosures the industry would be required to produce. Indeed, just days before last January's release, a Federal Reserve-sponsored working group issued a report that cast doubt on the value of disclosures for regulators given the different risk management methodologies in use among financial institutions. And a day after the release of *that* report, the Treasury Department and the Federal Reserve released a joint study concluding that what some industry analysts had viewed as among the most promising tools for market discipline—the use of subordinated debt—was actually of questionable value.

What we had at the end of the day, then, was strong support for the Basel principles and equally strong opposition to many of the details of the proposed Basel II rules. To the committee's credit, it has devoted a tremendous amount of time and energy in an effort to meet these and other concerns and to continuing the dialogue with the industry. It has already revised downward the proposed charge for operational risk from 20 percent of total regulatory capital to 12 percent in the standardized method, and it has laid the groundwork for a nonformulaic approach to operational risk in the other method—the Advanced Measurement Approach, or AMA—that would look more to a bank's internal assessments, much as the IRB-based approach does with credit risk—although the attractiveness of this approach may be appreciably lessened by the prospect that a "floor" might be imposed. It has also cut back significantly on the volume of disclosure that would be required under Pillar 3. And in the area of retail credit, the committee has issued a working paper on the capital treatment of expected losses and future margin income that is still open for comment.

Throughout this difficult process, the committee has rightly maintained that it would do whatever it took to get the new accord right. Thus, when it became clear that it would be impossible to fairly evaluate the concerns of market participants and still meet our own implementation deadlines, we extended the deadlines. There will now be a third consultative package, although that document will not be released until committee staff has completed an additional review aimed at assessing the overall quantitative impact of a new accord on banks and the banking system. In this "quality assurance" phase, the Basel Committee will focus especially on the highly controversial question of appropriate capital treatment of credits to SMEs, the small- and medium-sized enterprises that are so vital to economic growth and job creation.

The committee is also finalizing calibration of the minimum capital requirement in order to achieve a level of capital that, on average, is approximately equal to the amount of capital produced by the present accord, while still providing incentives to banks to use internal ratings systems.

Merely stating these objectives helps to convey the difficulty of the committee's challenges. How do you satisfy the political imperative of avoiding a reduction in the overall capital of the banking system, while at the same time holding out to the largest and most sophisticated banks that a set of rules better tuned to risk may enable them to enjoy *lower* capital—unless, of course, the new rules will result in an *increase* in the capital of other more risky banks?

In this connection, a comment may be appropriate as to just which banks will be subject to the new accord. The intent is that it will be applied to "internationally active" banks. U.S. regulators have made clear that they do not intend to apply the new accord to the many thousands of community banks that serve local markets in this country.

At the same time, many of us have real questions about how many of our larger banks will be in a position to adopt the IRB approach. I think it is a fair guess that only a very small handful of our largest, most sophisticated banks—perhaps no more than 6 or 8—will qualify, at least initially, for the advanced IRB approach, and even the foundation IRB approach may not be suitable for many large banks.

There are, of course, a number of thorny issues that remain to be worked out. I have been quite concerned, for example, about the approach to operational risk, and have voiced those concerns consistently in committee meetings. I view operational risk as the risk that inheres in the quality of a bank's internal controls. Thus, two banks engaged in an identical line of business may present vastly different quantities of operational risk when the internal

control systems of one are significantly better than those of the other. A one-size-fits-all approach to operational risk—such as a formulaic capital charge based on some percentage of gross revenues or a percentage of the charge for credit risk—while simple to apply, would disadvantage the best-managed banks and provide undeserved advantage to the worst managed. Worst of all, it would provide no incentive to improve internal control systems. For this reason I have repeatedly argued that operational risk is particularly well suited for a Pillar 2 approach. But there are many on the committee who are very cautious about such a use of Pillar 2, believing it would be used for supervisors to provide competitive advantages to their banks. Those holding this view find strong comfort in highly detailed prescriptive rules. While I find the AMA concept quite appealing, I am concerned that it not be so constricted as to diminish its attractiveness to banks.

I have also been concerned about the approach to securitizations. U.S. bank regulators are keenly aware—increasingly so—of the various risks involved in securitization, and we have seen numerous instances in recent times in which badly managed securitizations have caused serious problems for banks. On the other hand, securitization has been an important risk-management and funding technique for many of our best-managed banks, which have developed securitization markets to a high level of efficiency.

While we must address the real risks here, we need to do so with care, so that we don't needlessly or unintentionally disrupt an important market. We must also avoid a "beggar-thy-neighbor" approach. The volume of securitization activity among U.S. banks vastly exceeds that of all of the other G-10 countries combined. While the popularity of securitization is certainly spreading, we must resist the temptation to embrace new rules uncritically when their burden will fall most heavily on countries other than our own.

Finally, I am concerned about the enormous complexity of the proposal. With great respect for the various task forces and working groups that have conscientiously produced extremely thoughtful papers, I would be amazed if every member of the committee has been able to plow through the details of every paper. I'm frank to say that I have not. I suppose it's a character flaw of mine that as soon as I see the symbol for an indefinite integral on a page, my attention starts to flag. Unfortunately, there are many pages of complex formulas in the committee's recent work.

I believe it is essential for a number of reasons that we make a very strong effort to simplify the articulation of the basic rules. Bankers, examiners, legislators, and policy makers need to be able to comprehend the structure and content of the new accord without having to plow through reams of mathematical minutiae. We need a reasonably concise set of black-letter rules that lay out the structure of a new accord, with such elaborating detail as is absolutely necessary left to annexes. And we should not attempt to draft language addressing every possible contingency or detail that might arise, to chase every rabbit down every hole. Again, I believe we should put more reliance on Pillar 2 to fill in the interstices. We in the U.S. have to keep in mind that before the new accord can become effective for our banks, we will have to go through a formal rulemaking proceeding, and while an agency head probably can't be sent to jail for violating the "plain language" requirement we are supposed to observe, we should at least make a stab of it.

The committee has demonstrated that it is not unresponsive to the views and interests of the industry, and I believe that banks that have provided input to the process have contributed immeasurably to our joint effort. I have urged all of our large banks to analyze the Basel proposals and to let us and the committee know their views, and I have personally met with a number of the more engaged banks to discuss the issues. The dialogue in which we have been engaged together—as supervisors and bankers—offers an excellent case study in cooperation, which bodes well for our ability to develop the inevitably complex rules that are so necessary to help us address increasingly complex risks in the global banking system.

But I also believe that we must continuously ask ourselves what "getting it right" really means. While competitive equity and uniformity of application are important objectives of the committee, we need to consider the difficulty of delivering a comprehensive framework that encompasses all the different ways that institutions are operated and supervised across the G-10 and around the world. In the U.S., for example, we have a highly developed system of bank supervision. The OCC has full-time teams of resident examiners on site at our largest banks. In other countries, the task of supervisory oversight may be quite different, with an important role being left to the outside auditors. Given such disparities, what can we expect in the way of uniform application of highly complex and prescriptive rules? Would we be less well served if the Basel process aimed instead at seeking agreement on broad principles and modes of behavior? Should we consider emulating the less prescriptive approach adopted by today's international coalition against terrorism—or by the International Accounting

Standards Board, which promulgates global standards and principles, and leaves implementation and enforcement to national authorities?

More than anything else, the committee needs to work with and understand the dynamics and operational incentives of the banking industry. We need to make certain that the new capital framework reflects and reinforces the best contemporary practice. We must be very careful to avoid micromanaging the institutions that we supervise. And above all we must be cautious not to disrupt or destroy settled markets by adopting new approaches that could have serious unintended consequences.

In light of everything that has occurred over the past year, I believe it is impossible to predict exactly what the Basel Committee's final product will look like—or when we will come to closure. Although we recognize that there are costs associated with further delay, a process that involves such complexity and such a potential for causing unintended consequences should not be rushed. We need to take the required time not only to complete the testing and calibration of the IRB approach, but also to assure that our approach to such issues as operational risk makes good sense.

Over its distinguished history, the Basel Committee has functioned best when it has focused on developing and articulating basic principles. The "Core Principles for Effective Banking Supervision," which the committee adopted in 1997, have made a tremendous contribution to the improvement of supervisory practice worldwide. Basel has been an invaluable forum for supervisors to use for sharing experiences and insights and learning from them. We have done less well when we have tried to make our vastly diverse and complex global banking system—and the variety of our supervisory arrangements—conform to a single model.

The Basel Committee is unalterably committed to the goals of financial stability and effective international bank supervision. But as we continue to learn, it is both necessary and possible to come up with mutually agreeable standards of international conduct without dictating how those standards are to be achieved or enforced. In the world of international politics, sovereign differences can be a source of strength. I believe that's just as true for international bank supervision. As the Basel Committee continues its important work, we must respect those differences—and build on them—in order to achieve a truly prosperous global economy.

Remarks by John D. Hawke Jr., Comptroller of the Currency, before the New York Bankers Association, on the condition of the banking system, New York, March 7, 2002

Judging by the most recent economic indicators—unemployment claims, productivity, consumer confidence, and the like—we may well be in the process of emerging from the nation's yearlong slowdown. But there's also the possibility that today's encouraging numbers may prove to be transient or misleading, and that the economy may be stuck in low gear for some time to come. We just don't know.

In this regard, we should respect the wisdom of the Greek philosopher Plato, who defended the act of prophecy as a moral imperative that allows us—symbolically, at least—to assert control over our fate.

At the same time, Plato conceded that trying to predict the future was a losing proposition.

That hasn't changed. A few weeks ago, federal enforcement authorities brought fraud charges against a well-known infomercial psychic, putting her out of business. One wonders why she didn't see it coming.

Today, bank supervisors have dazzling analytical tools that can be of great value in predicting how the institutions we supervise are likely to fare in the future. The Office of the Comptroller of the Currency's (OCC's) Project Canary, for example, developed an early warning system that helps us identify banks that have the greatest likelihood of developing problems. Of course, we can't be certain about the future any more than Plato could. Circumstances change, and behavioral responses that may radically affect results can't easily be modeled. We are fortunate if our predictive tools do no more than point us in the right direction. But while the future will always be with us, our primary job is to focus on the here and now—to understand the current condition of the banking system and the ability of our banks to cope successfully with the variety of contingencies that may present themselves. And that's what I'd like to talk to you about today.

Last June, I testified before the Senate Banking Committee on the condition of—and the outlook for—the banking system. I told the panel that while there were some negative trends in the industry, banks were far better prepared to deal with a slowing economy than they were at a comparable stage of the last economic downturn, in the late 1980s and early 1990s—a period that we consistently use as a frame of reference not only for assessing the health of the system, but for shaping appropriate supervisory responses as well. I pointed out that with the economic slowdown, the lowered loan underwriting standards that the OCC had been warning about for more than four years were having the effects one might have foreseen, and that problem loans, on both the wholesale and retail sides, were on the upswing as a result. I said that we had concerns about the levels of consumer and corporate leverage, and about signs of trouble in such areas as commercial real estate and subprime consumer loans.

But, I also told the panel that the industry's fundamentals were still strong. Despite the build-up in loan loss reserves, banks were still reporting strong earnings, aided by the favorable interest rate environment and robust noninterest income. Even with the rise in troubled loans, overall asset quality remained high, reflecting the industry's progress in minimizing portfolio concentrations and its embrace of advanced risk management techniques. Perhaps most important of all, capital was strong—50 percent higher, system-wide, than it was in the first quarter of 1990. On the whole, I said, the picture offered no great cause for concern—and reasonable cause for optimism about the industry's ability to achieve a soft landing after nearly a decade in the clouds.

Now, nine months later, it is a good time to examine the changes that have taken place in the economy and the banking system since my Senate testimony. Obviously we have passed through an extraordinarily eventful period—nowhere more eventful than in New York City.

September 11 was a watershed for the economy. It will be a while longer before the fourth quarter 2001 statistics on bank lending are available, but the third-quarter numbers, covering the period through September 30, reflect a key indicator of a slowing economy: a significant drop in loan activity. Overall, the third-quarter decline amounted to just under 1 percent, with the largest decline, 2.2 percent, occurring in commercial and industrial loans. Consumer lending declined at a slower rate, a little over 1 percent. Only commercial real estate defied this trend, growing by 3.6 percent.

When we break out these numbers geographically, the effects of 9/11 are even more dramatic. Predictably, the

northeast was hardest hit of all, lagging behind every other region of the country in nearly every loan category. In consumer loans, for example, negative growth in the Northeast—and among national banks in our large bank program—more than offset small gains in every other part of the country.

Beginning in late September, there was a marked upsurge in consumer borrowing nationwide. However, sharp gains proved short lived, because they were largely the result of cut-rate financing deals offered by the automakers. Once those offers ended, consumers pulled back, taking advantage of low mortgage rates to cash out some of the equity in their homes, which they used to retire higher-cost credit card debt. This was reflected in a December drop in consumer borrowing—the biggest one-month drop on record. Yet American consumers were no less leveraged—and thus no better situated to meet their debt obligations—than they were months earlier.

The year 2001 thus came to an end amid what seemed a steady stream of bad economic news. Americans were confronted by a convergence of negatives: bleak corporate earnings reports, successive rounds of layoffs, the threat of new terrorist attacks, financial turmoil overseas in places such as Argentina, and high-profile bankruptcies that dominated the business news in the weeks following September 11.

The highest profile bankruptcy, that of the Enron Corporation, not only involved losses to its lenders, but it also had a chilling effect on investor psychology, which has adversely affected all publicly traded corporations. Perhaps more significant, it has had a galvanizing effect on public policy makers. So, today we are seeing an acute case of "Enronitis"—nagging doubts about the transparency and fundamental trustworthiness of corporate financial statements, accompanied by severe criticism of corporate governance and deep-seated concerns about the security of private-sector pension plans.

Meanwhile, deterioration of loans already on the books has continued and, in some cases, accelerated. This was especially true of credits to industries that felt the effects of 9/11 most acutely: travel and tourism, insurance, retailing, media and entertainment, and their suppliers. Large-scale layoffs in these industries led to rising defaults; consumer bankruptcy filings shot up by 19 percent in 2001.

Troubled times for the economy always mean challenges for the banking system, and even if the economy has turned the corner, as some indicators suggest, we may still be six to nine months away from the point at which we can expect problem loans to peak. That means more additions to loan loss reserves, with the attendant impact on earnings for the affected banks.

We also have to keep in mind that the most serious credit quality problems so far have been largely confined to large banks or to banks that specialize in lending to high-risk borrowers. That is likely to change, however. Historically, credit quality problems tend to trickle downward, gradually spreading to mid-size and community banks. We can now see that process beginning. So, while things may not get much worse for banks that are suffering already, the ranks of the sufferers are likely to swell.

Yet, what is striking is how little has actually changed for the banking system since September 11. For all of the turmoil of these last months, evidence shows that the banking system is not in appreciably worse shape than it was when I testified before Congress last June—and still is in far, far better shape than it was at a comparable stage of the last business cycle.

In June, the return on assets for all commercial banks was 1.21 percent, more than twice what it was in 1989. As of September 30—the most recent date for which numbers are available—it was 1.17 percent.

In June, nonperforming assets for all commercial banks stood at 0.82 percent of total assets, compared to more than 2.25 percent in 1989. As of September 30, it was 0.85 percent.

In June, the ratio of bank equity to assets equaled 8.76 percent, compared to 6.21 percent in 1989. Today, it stands at 8.93 percent—even higher than it was in June.

In light of all that the economy has been through, I think you'll agree that these numbers are remarkable.

The statistics say a great deal about the resilience and underlying health of the banking system. They also suggest that we are unlikely to see a repeat of the early 1990s, when the banking system's troubles complicated and prolonged the process of economic recovery. Back then, bank supervisors were accused—wrongfully, I believe—of creating a "credit crunch" by taking too tough a hand with their banks. Whatever the merits of that charge, I am committed to assuring that our supervision of national banks doesn't get in the way of economic recovery. This does not, by any means, mean encouraging bad loans, or closing our eyes to them. It does not mean that we should break out in a sweat every time some

entrepreneur who is turned down for a loan sees a "credit crunch" in the offing, like Henny Penny fearing that the sky is falling. Our job is neither to encourage nor dissuade banks from making loans. Our job is to address problems as we see them arise, and to do so in a measured and forthright way. Our job is to do what we can to assure that when creditworthy loans are there to be made, our banks are in sufficiently good condition to make those loans. If we are successful in doing this, we will have made the best contribution we can to a healthy economy. One need only look at Japan to see how a failure to attend to the fundamental health of the banking system can have a devastating effect on economic recovery.

The significance of the recent past is often as difficult to fathom as the future. But there's evidence that the economic pain of recent months may point the way to a more robust and sustainable recovery. For example, the Enron affair may lead to beneficial reforms of some corporate practices. As I have been saying for many years, when corporate managers place undue emphasis on short-term performance and the approval of the analyst community of their quarterly results, they do a disservice to their customers, employees, and shareholders. In the current climate, bankers who move to restore the proper emphasis on fundamentals and long-term shareholder value may find greater support for their efforts than has been the case for a long time.

We are likely to see other companies take steps to better align their accounting practices with the economic substance of their activities, strengthen their internal controls, and improve the quality of the oversight provided by boards of directors. When all is said and done, we could well have a more transparent, more efficient, and more fundamentally sound financial marketplace—a marketplace that will lend strength to the gathering recovery.

We also see compelling evidence that banks are not only strengthening their risk management and loan workout capabilities to deal with credits already on the books, but are exercising a higher level of prudence and responsibility in underwriting new loans.

Recently, the Federal Reserve's survey of senior loan officers showed, in general, continued tightening of credit standards by U.S. banks, with tightening most pronounced in commercial and industrial and commercial real estate loans. But the same survey provided evidence that banks are still willing and able to lend to creditworthy customers. Given the level of liquidity in the banking system, this is not surprising. The percentage of domestic banks that reported having tightened loan terms to large- and middle-market firms actually declined from previous surveys, with particularly striking declines in the percentage of banks that increased loan spreads to these borrowers. On the other hand, an increasing percentage of banks did raise premiums on the riskiest loans, suggesting better assessments of the risk-adjusted returns for these products.

Such policies may indeed help bankers avoid the problems of the future. But it is not too late to deal effectively with many of the problems that bankers face *today*. Most bankers are approaching these problems from a position of strength. That gives you options—and opportunities to take control of your fate. It has never been more important than it is today to keep your eyes on the future rather than the end of the next quarter.

This means:

- Building and maintaining strong credit analysis, portfolio monitoring, and loan review capabilities.

- Recognizing and dealing with deteriorating credits forthrightly, rather than trying to pretend that no deterioration has occurred, or that it will correct itself if left alone.

- Building and maintaining sound workout and collection operations capable of dealing effectively with troubled borrowers.

- Building and maintaining a strong capital base and conservative loan loss reserves, even at a time when profits are being squeezed.

- Continuing to invest in enterprise-wide risk management and portfolio MIS. As an added benefit, bankers who upgrade their internal risk ratings capabilities will be one step ahead of the proposed Basel accord, which is likely to encourage and reward bankers to adopt more robust and accurate credit risk management processes.

Many banks *are* doing these things. Risk recognition and rating accuracy *have* clearly improved since the last time the industry faced comparable challenges. And, many bankers came out of the last recession as true believers in the need for a strong capital base. One leading banker, whose institution had been under severe capital pressure in the 1980s, said at an OCC conference two years ago that never again would he let capital fall even to the level the regulators defined as the minimum needed to be

considered “well-capitalized.” It’s in large part *because* the industry and its regulators have put such strong emphasis on capital that banks are holding up so strongly. Clearly, we have all learned from experience.

And, let me say finally that bank regulators in particular have learned lessons. In the recession of a decade ago, we were criticized for adopting policies that appeared erratic and inconsistent. In some cases, we swung from forbearance to harsh supervisory action against banks whose condition had deteriorated—but too late to avert many failures. We have learned from these experiences—and are determined never to repeat them.

We have learned that ignoring or failing to comment on increasing risk or deteriorating conditions is poor supervision. We serve our banks best—and best serve the public—when we forthrightly convey our concerns to bank managers and encourage them to address changing circumstances. For example, two years ago we became very concerned about the volume of “enterprise value” lending we were seeing—that is, credits whose repayment depended on the borrower’s success in realizing projected cash flows, frequently from start-up ventures. We viewed this as no more than a very chancy kind of unsecured lending—or, perhaps more accurately, as a kind of equity investment, without any upside. We knew we were on to something when we heard loan officers refer to these credits as “airball” loans. We heard some carping about our repeated comments on this subject, but I believe our focus on this practice served banks well. Just recently, one of the country’s leading bankers said to me, somewhat apologetically, “You guys were absolutely right about that enterprise value stuff.”

September 11 cost us much. But it also taught us much—about our strengths and our vulnerabilities, about our friends and our enemies. It taught people around the country and around the world things they never knew about the character of the American people—and especially the character of New Yorkers. Its suddenness reminded us of what Plato tried to teach us two thousand years ago—that try as we might to divine the future, it is—and always will be—essentially unknowable.

We cannot predict the future. But we can certainly influence it with the work we do. And no group has greater power to influence the general prosperity—and its own present and future well-being—more than the banking community. On behalf of the OCC, I would like to congratulate the New York Bankers Association for the fine work that you have done through these enormously challenging times to uphold the promise of better times ahead—for all Americans.

Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the American Bankers Association National Community and Economic Development Conference, on competition and growth in the banking industry, Baltimore, Maryland, March 18, 2002

Banking is one of our nation's most mature industries—mature in the sense that economists use the term—and as I increasingly use it, as a euphemism for advancing age. Indeed, banking grew in lockstep with America, beginning by serving the modest financial needs of a nation of small towns and subsistence farmers, then fueling the rise of the mighty industrial and technological economy we know today.

Banking is also mature in the sense of its penetration of the present-day market for a distinctive array of financial services. The reach of the banking system—in the form of bank-originated home mortgages, small business loans, credit cards, and deposit accounts—is greater today than ever before. Three-quarters of all adults now own at least one credit card; 96 percent of all U.S. households with income over $25,000 annually hold bank deposit accounts. Obviously, today's consumers have a wide range of options among financial providers, and banks must contend with a more crowded marketplace for products and services it once dominated. But gloomy predictions that we would find that the industry's best days were behind it have proved wrong, and the banking franchise today is as strong as ever.

This record is a source of justified pride to the industry. But it also raises the question that industry leaders have been grappling with for years: where do we go from here? Despite the industry's rapid consolidation over the past decade, meaningful gains in the market for traditional bank products have proved highly elusive—and expensive to achieve. Each year, for example, credit card issuers churn out new billions of direct mail solicitations to potential customers, and get proportionately fewer and fewer responses in return—0.6 percent in 2001, down 50 percent in only three years. And bankers have come to recognize that the customers gained in this low-yield manner are likely to stay customers only until a competitor comes along with a better deal. In the zero-sum game that financial services competition has become, every gain to one provider represents a subtraction to another.

So where should banks turn to achieve the growth—and the profits—they feel they must have to attract capital and stay vigorous? Some institutions are taking advantage of recent changes in laws and regulations that now permit them to compete in markets for such products as insurance, securities, and investment services. But while the potential for growth in these areas is no doubt substantial, it's also clear that banks wading into these jungles will find them thick with competitors who have been there longer, know the territory better, and are unlikely to yield their dominance without a fight. Gains in these markets, too, are not likely to come easy—which may be why banks have edged so cautiously into those areas.

So it seems logical for banks to aggressively pursue opportunities to *expand* the market for traditional bank products, by fashioning those products in new and more responsive ways to a broader range of customer needs—in short, by bringing new customers into the mainstream of the banking system. Where those opportunities exist—and how to capitalize on them—are among the questions that have brought us to Baltimore.

The conference program suggests the range of market-building opportunities that are there for the taking. Let me mention three areas that seem to hold particular promise. The first is small business lending. Although the number of minority-owned businesses has increased dramatically in recent years, the use of bank credit by those businesses has lagged well behind that of their peers. According to a recent *Survey of Small Business Finances*, only two-thirds of minority-owned businesses used credit, compared to over three-fourths of all businesses. For African-American-owned businesses, the numbers are even lower. Clearly, there's a subset of the small-business market that banks have only begun to serve.

That's also true in the area of homeownership. Although the U.S. homeownership rate is now nearly 68 percent—an all-time record—the rates for African-Americans and Hispanics remain below 50 percent. The gap between these rates represents approximately $600 billion in potential home mortgages—a sizable market opportunity for banks.

Last but not least, there are important opportunities to build mutually profitable relationships with millions of ordinary Americans who do not conduct all of their routine banking transactions *with* banks. I'll use the term

"underbanked" to encompass two groups. First, there is the nearly 10 percent of American households that still do not have a deposit account at a financial institution and rely heavily on nonbank financial service providers for their basic banking needs. People without formal account relationships may still occasionally use banks as a secondary source of financial services—for example, when they cash a third-party check at the bank of issue. But nonbank financial outlets are where the majority of their financial services are obtained.

I'm also using the term "underbanked" to refer to what is customarily characterized as an entirely separate population: individuals who rely to a greater or lesser extent on high-cost, short-term credit provided by nonbank lenders, often in the form of "payday" or "cash advance" loans.

On first glance, the argument that these are two markets rather than one seems compelling. By definition, people without bank accounts cannot also be payday loan customers—at least as the payday loan business is now generally conducted—for such loans, secured by postdated checks, obviously require customers to have active checking accounts in good standing. That makes for some demographic differences, too. Payday loan customers, like the majority of Americans with banking relationships, out-earn people without bank accounts—although the household income of payday borrowers places them somewhere between the average non-account holder and the average bank customer.

Yet analysis reveals important similarities between those Americans without bank accounts and the typical payday loan customer—similarities suggesting that much of what we know about one population may be applicable to both. First, the two populations may patronize identical nonbank financial outlets, some of which, as I've noted, provide a well-stocked menu of financial services. Second, both populations—irrespective of household income—are likely to contain large numbers of people living near the edge economically, with few financial resources to fall back upon.

But perhaps the most salient similarity is that both populations have turned away from banks—or have been turned away *by* banks—in obtaining at least some of the financial services they regularly need. And that, I believe, may help to explain *why* they are living near the edge. Some may be paying more for financial services than they need to; others are missing out on opportunities to build financial assets and relationships so crucial to long-term financial independence.

What's more, the two groups are underbanked for many of the same reasons—reasons I'll discuss momentarily.

This situation poses a challenge for banks—and an opportunity. The challenge is to understand why people who might become bank customers aren't doing so. The opportunity is to change their minds and their financial habits. It's a high-stakes undertaking—for banks, for current and potential bank customers, and for our economy.

On one point—the magnitude of the potential market for banks—there is little controversy. The nonbank financial industry is huge—and growing.

For example, in 2000, Americans cashed 180 million checks at 11,000 check-cashing outlets, generating fees of $1.5 billion.

No segment of the nonbank financial industry has grown more rapidly than payday lending. Ten years ago, the payday loan industry hardly existed. Today, up to 10,000 outlets nationwide provide payday loans totaling between $8 and $14 billion, generating fees totaling up to $2.2 billion. California alone has more payday loan offices—nearly 2,000—than it does McDonalds and Burger Kings, and other states are not very far behind.

No matter how you slice it—and different sources slice it different ways—the nonbank financial services industry earns immense profits. A U.S. Treasury Department study of check cashing and payday lending showed average pretax returns on sales of 34 percent. Payday lenders in Chicago, according to another study, realized a return on investment of 24 percent. ACE Cash Express, the biggest of the national check-cashing companies, with more than 1,100 outlets, reported average store profits of 23 percent for fiscal year 2001—up 25 percent over a year earlier.

How can we account for this extraordinary growth? The answer lies in an understanding of the needs and the barriers facing the customers of nonbank financial providers. Developing that understanding is a step that mainstream financial institutions must take before they can hope to expand their presence in the underbanked market and provide the underbanked with the benefits of more comprehensive banking relationships.

To assist in that understanding, the Office of the Comptroller of the Currency (OCC) recently sponsored a survey of individuals living in low- and moderate-income neighborhoods of two major urban areas: Los Angeles County and New York City. We polled

over 2000 randomly selected individuals about their financial habits and experiences. From our results we can draw statistically valid inferences about the 2.6 million individuals who live in the low- and moderate-income neighborhoods in these two major urban areas.

One inference that may be drawn from our study is that people who lack formal banking relationships may be just as responsive to market incentives as people who have those relationships. In other words, appearances to the contrary notwithstanding, check-cashing customers, payday borrowers, and consumers of other relatively high-cost nonbank products do business outside the banking system for practical—and economically rational—reasons. This is an exceedingly important point, because it is sometimes mistakenly assumed that people with low incomes lack the acumen to make sound decisions in their own self-interest.

Two complementary realities shape the check-cashing behavior of people without formal banking relationships. First, these individuals generally spend a good deal less in check-cashing fees than one might imagine, given the high per-check fees that check-cashing outlets usually charge. A substantial portion—16 percent—of this segment of our survey population received its income entirely as cash, and thus had no reason to do business with check-cashers. Of those who did receive checks, 23 percent usually cashed them—and usually free of fees—at a bank, most likely the bank on which the check was drawn.

Those who did use check cashers, moreover, tended to use them sparingly. Ninety-seven percent of that population received four or fewer income checks per month; households earning $15,000 a year or less typically received two checks per month. Eighty-five percent of those without formal banking relationships used three or fewer money orders per month. Check-cashing outlets charged an average of $3.38 per check, and an average of $1.00 per money order. Nevertheless, as I've noted, many of those without formal banking relationships did not use check-cashing or money-order services, and not all of those who do use those services obtain them from check-cashing outlets. Thus, when we consider all of those without banking relationships in our study population in New York and Los Angeles, we find that only about one-third of these households wound up incurring total check-cashing and money-order costs of $100 or more per year.

I am by no means belittling the importance of even $100 a year to a low- or moderate-income family—and the reality elsewhere in the country may be different from these findings for two large urban areas. But that may be the best deal available in the current financial services marketplace for people who have to pay for check cashing. As I said, there's a second financial reality that shapes the behavior of check-cashing customers: the fact that while check-cashers charge a lot, most banks charge more for the same services. According to a 1999 study by the U.S. Public Interest Research Group, the average minimum balance required to *avoid* fees for checking accounts at large banks was $616. Consumers who were unable to meet that minimum balance requirement—and a great many simply do not have enough savings to do so—paid an average of $218 a year, or $18 a month, to maintain a checking account. For people who may typically cash only a few checks and make only a few payments per month, such bank accounts do not make sense. Indeed, earlier surveys have strongly indicated that the principal reason people give for not having a bank account is that it costs too much for their needs. And while many banks have developed a variety of inexpensive products appropriate for low-income customers, they are often not well publicized.

In my view, banks that do not now offer these inexpensive products should strongly consider doing so. And those that already have them should do more to bring them to the attention of current and potential customers.

Payday borrowers too often lack good low-cost options. They typically patronize payday lenders not because they are unaware of the high cost of the credit obtained from that source, but because they have few better places to turn. According to a recent Georgetown University study, the typical payday borrower, needing perhaps $200 to deal with an emergency—or simply to bridge from one payday to another—is unlikely to have a usable credit card, an overdraft line of credit, or relatives willing and able to help. As a last resort, they might bounce a check—and face $50 or more in overdraft fees plus the risk of having the account closed—or, if they own their own home, apply for a home equity loan and wait weeks for a line of credit far larger than they actually need. In that light, the $30 or $40 that a payday lender might charge for fast approval of a two-week, $200 loan doesn't seem so far out of line.

It's worth noting here that payday borrowers don't seem to be at all deterred by high annual percentage rates (APRs). The Truth-In-Lending disclosure statements they are given reflect APRs that may range as high as 900 percent, but borrowers seem to focus on the immediate dollar cost rather than the annualized rate.

The real damage, of course, occurs over time. It's not the single payday loan that buries the borrower; it's when payday finally arrives, and the borrower can't comfortably

pay back the loan. Then the borrower must pay another fee to roll the loan over for another two weeks—and then for another. According to the Georgetown study, three-quarters of all payday borrowers renewed their loan at least once, with about 30 percent reporting seven or more renewals. It's when they mount up—when a new loan is taken to repay one that has come due—that the APRs become astronomical and the borrower gets trapped in an increasingly costly cycle.

Similarly, the relatively small sums that people without a formal banking relationship spend to cash a few checks and buy a few money orders are not the problem. It's the compound effect of lost opportunities to build wealth and make a better life that is the problem. It's the cash tucked away—not safely in a savings account, but in a coffee can or hip pocket, vulnerable to theft or loss—that sets people back in their struggle to get ahead. It's a problem measured in homes that will never be purchased, in businesses that will never be built, and in the financial security that will forever remain out of reach.

The loss is one we all share—on many levels. For banks, it's a business loss—and it's an avoidable one. I believe that banks are uniquely positioned to provide options and opportunities that the underbanked currently lack. But doing those things requires first a sophisticated understanding of the market and the opportunities, and second a commitment from banks to fashion products and services that are consistent with reasonable profit expectations and responsive to what these customers want, at competitive prices they can afford.

Prices they can afford, consistent with reasonable risk-related profit. That's the rub. Banks are not in business to give away their services. But the poor and near-poor have limited resources to spend on financial products. We know approximately what those limits are because we know what the underbanked are spending at nonbank outlets today. And some bankers have looked at those numbers and then looked at what it would take to deliver a comparable array of products and services, and concluded that it cannot be done—or that it's too much trouble even to try.

Maybe there was a time they were right. But today's bankers have an ally in the effort to profitably serve the underbanked. The military refers to technology as a "force multiplier"—a means to maximize resources and shift outcomes. It can be that for the banking industry as well, in the effort to profitably serve the underbanked.

Technology has already revealed its potential in this regard. In the Electronic Transfer Accounts (ETA) now being offered by hundreds of financial institutions around the country, we have the prototype of a technology-intensive, utilitarian, low-cost account that has already drawn thousands of previously unbanked Americans into the banking system. The ETA, as you know, allows recipients of many kinds of federal direct-deposit payments to access their funds automatically through debit-card-based electronic funds transfers (EFT).

Encouragingly, financial institutions are beginning to build on the ETA model, offering enhancements designed to make such accounts more useful and more widely available. Taking advantage of their ability to inexpensively batch remittances, some banks are beginning to develop ETA-like accounts that combine direct deposit with bill payment options. Such accounts are proving attractive to individuals accustomed to spending several dollars per month for money orders or electronic bill payments for that purpose. For banks, the key is to keep expenses down and paper to a minimum, and technology holds tremendous promise in that regard.

Keep in mind, too, that banks have some significant competitive advantages that should enable them to offer such accounts at reasonable prices. They alone have access to the payments system; they alone can hold transaction balances; they alone can receive direct deposits; they alone have deposit insurance coverage and access to the discount window. And they alone can offer services unique to banks in conjunction with a variety of other services.

Just think what such accounts offer. To the customer, they provide a safe and cheap repository for funds. No more lost or stolen checks; no more hassles to cash a payment check; no more risk of carrying around a wad of cash and becoming a target for predators. The paycheck goes directly into the bank account, and, with a debit card, the customer can draw funds as she needs them at an automated teller machine (ATM) or a point of sale. And, if the bank has been innovative, the customer may even be able to make basic payments from the account by electronic transfer, either without cost or at a cost far less than a money order.

For the bank, there are also important benefits: no processing of paper checks; no risk of overdrafts; establishing new customer relationships that may be developed into something more. For example, if such customers need small loans, for a car or appliance purchases—or even a payday-type credit—a direct deposit account offers the possibility of a prearranged debit or periodic payments, significantly reducing the bank's risk of default.

Banks are also taking the initiative to address the short-term borrowing needs of their customers, and here again, technology can be a big part of the solution. In one noteworthy development, a prominent national bank has begun to offer a product that provides access to low-cost cash advances for direct deposit customers. Funds can be obtained directly from the bank's ATM network or by speaking to a telephone agent who will transfer the funds into the customer's account. The bank has also automated the underwriting process, cutting costs for both parties to the transaction and virtually eliminating the waiting period for established customers—a matter of considerable importance, as we've seen, for the emergency borrower.

Obviously there are many hurdles to be cleared before such innovations can be judged a success. We have to encourage greater participation in direct deposit. Direct deposit is one of those rare win-wins: employers enjoy significant savings in payroll processing costs; banks gain new business and retail customers; and employees avoid the worry and expense of handling paper checks.

Yet this is an area in which the United States has lagged well behind many other advanced nations—and in which the private sector has lagged behind government. Today, as a result of the EFT 99 legislation, 77 percent of all government payments are made electronically. Seventy-five percent of Social Security payments are made by direct deposit, and at agencies like the OCC, virtually 100 percent of salary payments are deposited directly.

One way we may be able to raise participation rates, as I've already mentioned, is to tie other useful products and services—especially those that can be delivered electronically—to direct deposit accounts.

If banks are to compete effectively against the storefront lenders and check cashers, they will also need to rethink their branching strategies and focus on refining their delivery systems and making them user-friendly. Some customers continue to report being deterred by what they view as an intimidating atmosphere in the typical branch, an objection that banks used to brush off when they could afford to be indifferent to the underbanked market. These days, banks seem to be taking such objections more seriously—a development that may herald a new, more constructive attitude toward this market. Some institutions have acquired check-cashing and payday-lending outlets, where customers can select from the menu of financial products and services in the atmosphere they're accustomed to, while being gradually exposed to the potential benefits of mainstream banking.

Bringing more people, more fully, into the banking system must be a part of any strategy to improve the standard of living in our country. That's a goal I know we all share; it's the goal that has brought us to Baltimore this week.

The OCC is very proud to be the co-sponsor of this event, which holds tremendous promise for our communities and our financial institutions. For those of us in the financial regulatory community, lending assistance in the effort to build bridges to the underbanked is an important part of our official duties. For financial institutions, reaching out to new markets is not only a civic responsibility. It can also be a good business.

Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the National Association for Business Economics, on the global economy and the role of the OCC, Washington, D.C., March 25, 2002

There's a new realism in our thinking about the global economy. We now have a keener awareness of the special security challenges—as well as the more familiar political and financial challenges—that internationally active businesses have to contend with.

This awareness has been forced on us by recent events. The world is a different place today from six months ago. It may stay that way. And that means adjustment—by all parties—to the realities of the new international environment.

By arranging this timely conference on the new uncertainties of the global economy, the NABE has materially contributed to this cause. I congratulate you—and I thank you for the opportunity to be here with you today.

This more balanced, more cautious, perspective on the global economy is an enormously positive development. To the extent that it contributes to a better deployment of our finite stock of human and financial assets, I believe it bodes well for the future of international trade and investment—and, therefore, for our collective well-being.

Let me go further and suggest that the most commonly cited benefits of globalization—new markets, access to innovation, comparative advantage and specialization—are not the *only* important benefits that globalization has brought us.

I am not by any means discounting the importance of the bottom line—probably the second most powerful animating force known to mankind. But I do believe that we're profiting from the global convergence of financial practice—and a similar convergence in financial oversight and supervision—in other ways that have little to do directly with dollars or deutschmarks. Convergence has given us a wider range of experiences on which to draw—and from which to learn.

As U.S. bank supervisors, we're intensely interested in the experiences of our supervisory colleagues around the world. We work closely with them, both bilaterally and through the Basel Committee on Banking Supervision. It's part of our ongoing effort to raise bank supervisory standards and practice—and to bring them into greater harmony among both the advanced nations of the world and the world's emerging economies.

In the United States, our interest in the structure and operations of bank supervision in other nations isn't simply a matter of professional curiosity; it goes deeper than that. For more than a century, the structure of bank supervision in the United States has been a controversial subject. And although U.S. lawmakers have frequently tinkered with that structure, it's resisted fundamental change.

As someone who has spent the better part of a long career working within that structure, I confess to a certain affection for it, in all of its convoluted glory. Moreover, the system works quite well, and the various players have learned how to live with it.

But there are some who think that it's not enough that a system works in practice. They believe it should work in theory as well—and our bank supervisory structure probably fails that test. It's not uncommon for those who have not lived within the present system to view it with chagrin on first exposure. Understandably, it presents an inviting target for rationalization and restructuring.

What the structure of bank supervision in the United States would look like if we were designing it from scratch is an interesting and provocative subject for those of us involved in the supervisory process.

But it's not the subject I'll be addressing today. There's no reason to bog you down in the arcane politics of bank supervision and regulation, or in the details of how our system compares with those in other countries.

Indeed, one of the lessons we have already learned from the Basel Committee's work on a new international capital accord is that it's very difficult to find common institutional arrangements suitable for all countries at all times.

This shouldn't come as a surprise. Institutions spring uniquely from a country's culture and history. Whatever else one might say about the U.S. supervisory structure, which has emerged largely through historical accident, it's come to reflect distinctively American values and habits—

suspicion of authority (especially centralized authority), competition, and egalitarianism.

The structure of our banking system is also uniquely and authentically American. We would not graft our model onto another country and expect it to work, just as we might find that any particular foreign model might fail to gain acceptance here. I think that most Basel Committee members would agree that the range of national practices in financial services and supervision worldwide is *too* wide to be accommodated within a single uniform framework.

But where the Basel Committee *has* been quite successful—in its previous work as well as its current work—has been in identifying common *principles* of effective supervision and leaving it to each nation to decide how those principles should be implemented.

One such principle emerges with striking frequency and clarity from the recent history of financial crisis in countries around the world. Nearly every crisis we examine, no matter where it occurred, provides a reminder of the dangers of politicizing the banking system and its supervision.

We see such interference taking various forms. Central governments may compel banks to make loans in defiance of good credit practices in order to promote certain policy goals, such as protecting inefficient industries. Governments may take an ownership interest in the banking system to facilitate such policies. In some cases, government pressure has forced financial institutions to lend to weakened, but politically powerful, companies or industries.

Pressure may be exerted on supervisory authorities to forbear, or "look the other way," when a bank's condition has deteriorated and supervisory action would be warranted. In some cases, court decisions, legislative action, or other informal influences have undermined supervisors. Where supervisors are removed from office without cause—and appointed to office without regard to their professional competence—the quality of bank supervision inevitably suffers.

But though the means may vary, using the banking system to advance a political agenda rarely succeeds in the long run. Where short-term expediency is given primary weight, the safety and soundness of financial institutions is frequently undermined. And when that happens, the banking system's ability to support an economy's growth and well-being is surely compromised.

I believe that the evidence of specific national cases bears this out.

In some respects, Argentina stands as a textbook example of the dangers of politicizing the banking system, because the consequences there have been so sudden and dramatic. What had been South America's breadbasket—and one of its most vibrant economies—is now an economic basket case, suffering high and rising unemployment and remote prospects for recovery any time soon.

Although a great many factors contributed to the country's decline, it can be argued that Argentina's downfall was sealed in late 2000 with the launching of a series of official actions that had the effect of crippling the nation's banking system. Banks, as well as pension funds, were pressured into relaxing their limits on holding government debt. A committed safety-and-soundness advocate was ousted from his position as governor of the central bank.

The banking system itself was pushed to the brink of insolvency when the government asymmetrically "pesofied" dollar-denominated bank deposits and assets, a move that decimated bank capital. And the imposition of deposit withdrawal limitations destroyed what little public confidence remained in the system. As a result of the country's liquidity crisis, new loans that might help revive the economy are difficult to come by and Argentina's downslide continues—regrettably with no end in sight. It will take many years for the banking system to recover.

Japan's economic problems have also been well chronicled, and the role of a weakened banking system in aggravating those problems is well documented. Not as well recognized is the role played by Japanese bank supervisors, then directed by the ministry of finance, in keeping insolvent institutions afloat.

Reluctant to take action against these institutions, Japanese regulators allowed them to bleed slowly, draining resources that might have aided the country's recovery. A new unified Financial Services Agency, responsible to the prime minister's office, was created to correct the problem. But in part because the habits of regulatory paternalism and opaqueness are proving hard to eradicate, stagnation continues to characterize Japan's economy.

South Korea offers another illuminating primer on how even well-intentioned government actions can undermine a banking system's safety and soundness. Among the fundamental weaknesses in the Korean banking system as late as the mid-1990s was the truly massive scale of the Seoul government's directed lending program.

For years, industries earmarked for support in its export-oriented economy received government-subsidized loans, among many other things. Bank supervisors, through lax supervision, had become instruments of this policy of propping up favored borrowers. Supervisory responsibility was divided between the central bank and the ministry of finance.

But the quality of South Korean supervision, rather than its structure, was the biggest problem. Prudential supervision standards were lax. Banks were not required to undertake in-depth analysis of commercial borrowers. Loans were repeatedly rolled over without meaningful review of the borrowers' abilities to repay. Regulatory limits on concentrations of credit to a single borrower were loose, and they were widely suspended in dealing with favored borrowers. Banks were permitted to grow without adequate risk management safeguards.

When the South Korean economy crashed in 1998, the banking system led the way down. Wisely, the Seoul government recognized the role that inadequate supervision had played in the debacle, and in that year, it undertook a comprehensive restructuring of the country's oversight of financial institutions. Supervision was consolidated into a single agency, independent of the government, and prudential regulations have been brought closer in line with international best practices. At least part of the credit for South Korea's progress toward recovery must go to its effort to reform its supervisory structure—and to the international donor agencies that encouraged it to act.

South Korea seems to have learned from its experiences. So has Turkey. Supervisory changes have been an essential part of the reform efforts initiated by the Turkish authorities over the last several years, and were among the conditions of the International Monetary Fund's 1999 aid package.

Turkey's financial instability has been the result of a combination of factors, including government interference in the state-owned banks. These banks have incurred huge losses due to directed lending. Fragmented, ineffective supervisory oversight was also a factor. But Turkey is enacting sweeping changes in its national supervision, including the creation of a new, independent, professional regulatory body to do the job previously performed by several government entities. Turkey still faces significant hurdles. But most analysts agree that while the country has a way to go, it's headed in the right direction.

There's a final example I'd like to discuss—an example considerably closer to home. The independence of bank supervision in the United States itself has often come into question.

It's a question that has a long and difficult history. During the Great Depression of the 1930s, there was strong sentiment that federal bank supervisors should take marching orders from their superiors in the Treasury Department and from the Federal Reserve. Many people thought that the Comptroller of the Currency should encourage national banks to make loans to good borrowers and bad borrowers alike, and to look the other way as credit quality deteriorated.

Given the gravity of that crisis, with the very survival of the U.S. economy perhaps hanging in the balance, this viewpoint might have been understandable. But had it prevailed, the result could have been disastrous for the banking system, for the federal supervisory agencies, and for the U.S. economy. Fortunately, more sensible heads prevailed, and the statutory firewalls that were designed to protect our independence and shield us from improper influences did their job.

That was not the last of it, however. Over the decades, there have been occasional attempts to draft federal bank examiners into the service of some larger political or economic strategy. For us that's meant contending with pressures that have arisen from time to time to alter our supervision in ways that may be expedient—but may also be fundamentally unsound.

The late 1980s and early 1990s, for example, were a time of great stress in the U.S. banking system and the U.S. economy. The Office of the Comptroller of the Currency was encouraged to overlook weaknesses in the balance sheets of some troubled banks in the hope that the economy would improve and the banks in question would turn the corner on their own. Some called this watchful waiting; a better term might have been wishful thinking.

As it turned out, we did no one any favors—certainly not the affected banks—by allowing problems to go uncorrected. Losses mounted, forcing us finally to take precipitous action to deal with what were by now deeply troubled, if not insolvent, banks. Loans that passed muster in one examination were severely criticized in the next, as examiners demanded large additions to loan loss reserves previously thought adequate—with serious consequences for the credibility of supervisors, among other things.

Many banks failed; bank credit became increasingly difficult to come by, generating talk—and it was mostly talk—of a "credit crunch" ostensibly caused by bank

supervisors. But it's certainly true that the banking system's troubles complicated and prolonged the process of economic recovery a decade ago.

This experience is one that we've been determined to learn from—and never to repeat. It taught us that ignoring or failing to comment on increasing risk or deteriorating conditions—forbearance, to call it what it is—is poor supervision. It reminded us that we serve our banks best when we forthrightly convey our concerns to bank managers and encourage them to address changing circumstances.

It caused us to reaffirm our commitment to the proposition that we best serve the public interest by overseeing the safety and soundness of the national banking system consistently, predictably, and independently, in good times and bad. We make our greatest contribution to a sound economy by assuring that our banks have the capacity to extend credit when creditworthy loan opportunities are presented.

I believe the results speak for themselves. While there are pockets of weakness in the banking system today and the possibility of additional problems ahead, those problems are much less widespread—and much more manageable—than they were at a comparable stage of the last business cycle.

Capital is high—twice as high as it was in 1989. As one might expect after two years of business slowdown, nonperforming assets are up, but not alarmingly so. Loan loss provisions are adequate, even if not as conservative as bank examiners might wish. Overall, the industry is still highly profitable—again, no small accomplishment given the recent condition of the economy.

And here's another quite remarkable development. Although the evidence shows that U.S. banks have gradually been raising their lending standards—a positive development, in our opinion—business credit is still plentiful—much more plentiful than at any similar time since the early 1970s, according to a new Federal Deposit Insurance Corporation study. So much for credit crunch allegations—which seem to emerge principally from marginal borrowers whose banks have prudently cut back on their lines.

Perhaps the foremost reason for the improved availability of business credit is that the banking system has generally remained healthy despite what was until recently a down economy. And now that loan demand is poised to pick up again, banks will be in a condition to respond, and the economy will have the capital it needs in order to resume its upward growth.

Before we become too totally intoxicated with our own accomplishments, however, let me offer two quick caveats. First—and I can't stress this enough—it's important that we not indulge in premature celebration over the news from the front, as it were, because conditions on the battlefield are subject to change. As I said at the outset, the new global economy undoubtedly has many surprises in store for us in the months ahead, and any sense of relief and satisfaction we might feel over the present condition of the banking system must be leavened by a large measure of caution—and humility.

Second, I am not suggesting that bank supervisors deserve all—or even most—of the credit for the banking system's current health. Many of the changes that have taken place over the last decade, and have helped buffer the industry against hard times, have come from bankers themselves.

Banks are much more diversified in their product lines and less concentrated geographically than they were just 10 years ago. That makes them less vulnerable to the kinds of local disturbances that proved so ruinous to financial institutions during the recession of the early 1990s. They have recognized the need for strong capital bases. They have reduced their reliance on volatile interest income, have diversified their revenue streams, and they have invested in advanced risk management techniques that make it possible for them to better measure and manage their risk and thus to limit their exposure to loss.

Bankers too have learned from the last downturn. The historically high levels of capital in the system today are a reflection of the experiences of a decade ago, when adequate capital—by regulatory standards—turned out in some cases to be wholly inadequate to cover the actual volume of loan losses. Some bankers vowed that this would never happen again. And tougher capital regulation reinforced that lesson for bankers who might have missed it on their own.

Clearly, we have all learned from experience.

Yet one can't discount the contribution that bank supervisors have made to the industry's health. Bankers certainly don't. Sometimes it's as simple as our taking the blame for a politically awkward decision by a bank, such as declining a longstanding customer's request for a questionable loan. In that spirit, let me say this to the world: we're happy to serve as any banker's scapegoat if it results in a safer and sounder banking system.

And bankers often express their appreciation to us for helping them recognize weaknesses and arrange appropriate corrective action.

For example, two years ago we became very concerned about the volume of "enterprise value" lending we were seeing—that is, credits whose repayment depended on the borrower's success in realizing projected cash flows, frequently from start-up ventures. We viewed this as no more than a very chancy kind of unsecured lending—or, perhaps more accurately, as a kind of equity investment, without any upside.

We knew we were on to something when we heard loan officers refer to these credits as "airball" loans. We heard some carping about our repeated comments on this subject, but I believe our focus on this practice served banks well. Just recently, one of the country's leading bankers said to me, somewhat apologetically, "You guys were absolutely right about that enterprise value stuff."

The past 24 months—and the past six months especially—have been a trying time for the American economy and the American people. Yet, in part because bank supervisors have been resolute in facing the facts and in addressing problems in the banking system as we saw them developing, I believe the American people are better off. Because we have been able to provide not just quality supervision, but independent supervision, the U.S. banking system is strong today. And thankfully, so is our nation.

Statement of Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency, before the U. S. House Subcommittee on Financial Institutions and Consumer Credit of the Committee on Financial Services, on regulatory burden on America's banking system, Washington, D.C., March 14, 2002

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

Chairman Bachus, Ranking Member Waters, and members of the subcommittee, I appreciate this opportunity to discuss with you ways in which we can reduce unnecessary regulatory burden on America's banking system, and to express the views of the Office of the Comptroller of the Currency (OCC) on the Financial Services Regulatory Relief Act of 2002 (FSRR Act).[1] Let me also thank Ms. Capito, for sponsoring a bill that includes sensible and appropriate regulatory burden relief for national banks and other financial institutions.

Effective bank supervision demands that regulators achieve a balance among several competing, but equally important, objectives. These objectives include fostering banks' ability to conduct their business profitably and competitively, free from burdensome constraints that are not necessary to further the purposes of the banking laws. Unnecessary burdens drive up the costs of doing business for banks and their customers and prevent banks from effectively serving the public. Periodic review of the banking statutes and regulations is an essential means of ensuring that banks are not needlessly encumbered by requirements that are no longer appropriate for today's banking environment.

The OCC itself has a continuing commitment to review its regulations and make changes, consistent with safety and soundness, to enable banks to keep pace with product innovation, new technologies, and changing consumer demand. We also constantly reassess the effectiveness and efficiency of our supervisory processes to focus our efforts on the institutions and activities that present the greatest risks and to reduce unnecessary burdens on demonstrably well-run banks. However, the results that Congress can achieve by removing or reducing regulatory burden imposed by federal statutes can be broader and more far-reaching than regulatory changes. The FSRR Act contains a number of important provisions that will help national banks remain profitable and competitive by eliminating unnecessary burden. The first portion of my testimony will highlight several of these provisions.[2]

A second, and fundamentally important, objective of our supervision is to promote and maintain the safety and soundness of the banking system. The FSRR Act also contains provisions that further this objective, and I will mention a few of these provisions in the second section of my testimony. I will also take this opportunity to briefly discuss certain additional legislative changes that you may wish to consider as the legislation is developed, which would help promote safety and soundness.

National Bank Provisions

The FSRR Act contains several provisions that would streamline and modernize aspects of the corporate governance and interstate operations of national banks. The OCC strongly supports these provisions.

For example, section 101 of the act relieves a restriction in current law that makes it difficult for some national banks to operate as "Subchapter S" corporations. The National Bank Act currently requires all directors of a national bank to own at least $1,000 worth of shares of that bank or an equivalent interest in a bank holding company that controls the bank. The requirement means that all directors must be shareholders, making it difficult or impossible for some banks to comply with the 75-shareholder limit that defines eligibility for treatment as a Subchapter S corporation. These banks are thus ineligible

[1] As of the time this testimony was required to be submitted, the FSRR Act had not been formally introduced. Accordingly, the views of the OCC set forth in this testimony are based on the March 5, 2002, Discussion Draft of the FSRR Act, including certain changes that we have been advised will be made to the draft. References to sections of the act are based on the March 5 Discussion Draft. The OCC will be pleased to work with subcommittee staff, as appropriate, as the legislation progresses.

[2] A detailed section-by-section review of the provisions of Title I, IV, and VI of the March 5, 2002, Discussion Draft of the FSRR Act, which are relevant to the OCC's responsibilities, is attached to this testimony as an appendix.

for the benefit of Subchapter S tax treatment, which avoids a double tax on the bank's earnings. Community banks suffer most from this result.

Section 101 authorizes the Comptroller to permit the directors of banks seeking Subchapter S status to satisfy the qualifying shares requirement by holding a debt instrument that is subordinated to depositors and general creditors of the bank. The holding of such an instrument would not cause a director to be counted as a shareholder for purposes of Subchapter S. The subordinated liability is closely equivalent to an equity interest, however, since the directors could only be repaid if all other claims of depositors and nondeposit general creditors of the bank were first paid in full, including the claims of the Federal Deposit Insurance Corporation (FDIC), if any. The new requirement would thus ensure that directors retain the requisite personal stake in the financial soundness of their bank.

Similarly, section 102 of the act eliminates a requirement in current law that precludes a national bank from prescribing, in its articles of association, the method for election of directors that best suits its business goals and needs. Unlike most other companies and unlike state banks, national banks cannot choose whether or not to permit cumulative voting in the election of their directors. Instead, current law requires a national bank to permit its shareholders to vote their shares cumulatively. Section 102 provides that a national bank's articles of association may permit cumulative voting. This amendment would conform the National Bank Act to modern corporate codes and provide national banks with the same corporate flexibility available to most corporations and state banks.

Section 401 of the act also simplifies the requirements that apply to a national bank that wishes to expand interstate by establishing branches *de novo*. Under the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, interstate expansion through bank mergers generally is subject to a state "opt-out" that had to be in place by June 1, 1997. Under the time frames set by the statute, interstate bank *mergers* were permissible in all 50 states as of September 2001. By contrast, *de novo branching* still requires states to pass legislation to affirmatively "opt-in" to permit out-of-state banks to establish new branches in the state.

This effect of current law is to require that, in many cases, national banks must structure artificial and unnecessarily expensive transactions in order to establish a new branch across a state border—which in some cases, is simply across town in a multi-state metropolitan area. Section 401 repeals the requirement that a state expressly must adopt an "opt-in" statute to permit the *de novo* branching form of interstate expansion for national banks and contains parallel provisions for state member and nonmember banks. National banks and their customers would benefit significantly by this change, which would permit a bank to freely choose which form of interstate expansion is most efficient for its needs and customer demands.

Safety and Soundness Provisions

The FSRR Act also contains a number of provisions that further the objective of promoting and maintaining the safety and soundness of the banking system. One of the most important of these provisions (section 406 of the March 5, 2002, Discussion Draft), expressly authorizes the federal banking agencies to enforce written agreements and conditions imposed in writing in which an institution-affiliated party or controlling shareholder agrees to provide capital to the depository institution. This provision would supersede recent federal court decisions that conditioned the agencies' authority to enforce such conditions or agreements on a showing that the nonbank party to the agreement was "unjustly enriched." These changes will enhance the safety and soundness of depository institutions and protect the deposit insurance funds from unnecessary losses.

The act also contains two provisions that promote safety and soundness by providing the federal banking agencies with greater flexibility to manage resources more efficiently and deal more effectively with problem situations. Current law mandates that most banks be examined on site on prescribed schedules. This can, in certain circumstances, interfere with the ability of the banking agencies to concentrate their supervisory oversight on deteriorating or problem institutions. Section 601 of the bill would permit the agencies, when necessary for safety and soundness purposes, to adjust their mandatory examination schedules to concentrate resources on particularly troublesome institutions.

Current law also provides for criminal penalties to be imposed on a federal bank examiner who examines a bank from which the examiner receives an extension of credit, including a credit card issued by that institution. This limits the flexibility of the OCC and the other banking agencies to assign examiners to particular institutions or examination teams, even if the examiner's skills or expertise would contribute materially to the examination. Section 602 provides that federal banking agency employees may have credit cards without disqualification or recusal, but subject to the safeguard that the cards must be issued under the same terms and conditions as cards issued to the general public.

Additional Safety and Soundness Enhancements

The OCC has identified several additional areas in which amendments to current law would enhance the banking agencies' safety and soundness authority, reduce risk to the deposit insurance funds, and facilitate our enforcement efforts when wrongdoing does occur. We would be happy to work with the other banking agencies to further develop these recommendations and with subcommittee staff to facilitate inclusion of the agencies' recommendations in the FSRR Act as it is developed through the legislative process.

Under the Change in Bank Control Act (CBCA),[3] all acquirers of insured depository institutions are required to provide notice to the appropriate federal banking agency before proceeding with an acquisition. The CBCA gives the agency a specified time period within which to object to the transaction and specifies several bases on which the agency may disapprove a change-in-control notice. It does not, however, expressly permit the agency to impose conditions on the institution in connection with the agency's failure to object to an acquisition of control. While we think the ability to impose conditions designed to ensure the safety and soundness of the bank being acquired may be fairly inferred from the purpose of the statute, in order to eliminate any ambiguity, we recommend that the CBCA be amended to expressly permit the appropriate federal banking agency to impose conditions it determines advisable for safety and soundness reasons, in connection with its decision not to pose objection to a CBCA notice.

We also recommend amending the CBCA so that acquirers of entities possessing dormant bank charters would be subject to the same standards and conditions—including participation by the Federal Deposit Insurance Corporation (FDIC)—as are required when an applicant seeks a *de novo* bank charter. In such a case, acquirers are effectively buying a bank charter without the requirement for prior approval and without the scope of review that the law imposes when applicants seek a new charter, even though the risks presented by the two sets of circumstances may be substantively identical.

Another change that we would support is to clarify that an appropriate federal banking agency may issue cease-and-desist orders against an insured depository institution or an institution-affiliated party who violates conditions imposed by agreements made with *another* appropriate federal banking agency. This issue can arise, for example, when a bank that is subject to requirements imposed by one agency in connection with an application or an enforcement action, converts its charter so that it is regulated by a different agency. Another example occurs when the FDIC imposes conditions in connection with granting deposit insurance but the FDIC is not the appropriate federal banking agency for the insured bank, e.g., a national bank or a state member bank.

In addition, we recommend amending the Federal Deposit Insurance Act to remove the "knowing or reckless" element from the definition of "institution-affiliated party." Under current law, an accountant or other independent contractor of an insured depository institution may be subject to sanctions as an institution-affiliated party in an administrative enforcement action only if the accountant's (or other independent contractor's) wrongful conduct was "knowing or reckless." Accountants who serve as independent contractors to insured depository institutions play a key role in keeping institutions' books and records accurate. In recent years, banking regulators have seen an increase in audit and internal control deficiencies at many insured depository institutions, some of which have caused significant operating losses and led to failures of institutions. Elimination of the "knowing or reckless" standard would remove a significant impediment to the agencies' ability to hold these individuals and firms accountable for violations of law, breaches of fiduciary duty, or unsafe or unsound practices.

Conclusion

Once again, Mr. Chairman, on behalf of the OCC, I thank you for your leadership in pursuing this legislation. As I have indicated, the OCC supports the act and believes that many of its provisions will go far to promote the objectives I have described today. In those areas where we have recommended that you consider additional amendments, we would be pleased to work with your staff to develop appropriate legislative language for the subcommittee's consideration.

I am pleased to have had this opportunity to provide our views on this important initiative, and I would be happy to answer any questions you may have.

[The attachment can be found electronically at http://financialservices.house.gov/media/pdf/031402jw.pdf]

[3] 12 USC 1817(j).

Remarks by Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, Office of the Comptroller of the Currency, before the Mid-Atlantic Bank Compliance Conference, on compliance and section 5 of the Federal Trade Commission Act, Annapolis, Maryland, March 22, 2002

I am very pleased to have this opportunity to speak with you this afternoon. Compliance is a formidable challenge for bankers these days—you don't need me to tell you that. Compliance requirements are many, and many of those requirements are detailed and technical. But compliance also has more dimensions than simply satisfying a complicated set of disclosure requirements. Compliance issues also touch on essentials of bankers' relationships with their customers, on their commitment to treating customers fairly, and on their fundamental principles for customer service.

Compliance is an essential—but not the exclusive—element of a bank's overall strategy for good customer service. Individual consumers may not know precisely if their bank has complied with all the applicable compliance rules, but they immediately know, and have no problem reacting, when they feel they haven't been treated right by their bank. What I'll talk about today is a question that is at the intersection of compliance and customer service—

> "When do marketing practices reach the point that they are not just bad customer service, but also unfair or deceptive practices contrary to law?"

First, I'll describe the contexts where we see this issue coming up. Next, I'll describe some steps the Office of the Comptroller of the Currency (OCC) has taken to address practices that we felt were unfair and deceptive. Then finally—and most importantly—I'm going to offer some guidance on how to *avoid* this type of compliance and customer service problem. Today, the OCC is issuing an advisory letter as part of our efforts to identify potentially problematic practices and provide guidance to national banks on how to avoid them. I'll be describing that advisory letter as part of my remarks today.

Background

Let me begin by describing a bit of the current environment that can give rise to these issues.

Banks' reliance on non-interest income has grown significantly during the 1990s, and has increased to almost half of the operating income of many commercial banks in recent years. Non-interest fee income is being generated from new sources in an ever-expanding array of products and services that banks offer. At the same time, competition to establish—and retain—customer relationships is greater than ever before. Banks recognize the importance of increasing their product offerings to their existing customers, while, at the same time, it has become easier for customers to switch to another financial institution that appears to offer them a better deal.

One way in which banks are competing is by doing more and more marketing. For example, general mailings of credit card solicitations have grown more than fourfold in recent years, to approximately 4.9 billion (or 39 per household) in 2001. Advances in information technology, and the greater availability and sophisticated use of credit bureau information, have made "pre-approved" solicitations for credit cards commonplace in many, many American households. Banks also supplement their own efforts by using agents, like telemarketers, to market the bank's own products and services, and by enabling third-party vendors to offer their products and services to bank customers.

These developments create increased risk that a bank, or an agent or vendor that a bank uses, may engage in over-aggressive marketing efforts that may cross the line and become unfair or deceptive acts or practices. One consequence of this is that the bank may be exposed to liability from private lawsuits or government enforcement actions. Equally important, engaging in these practices undermines a bank's reputation for fair treatment and fair dealing with its customers, and, as a result, harms its ability to retain customers and preserve valuable sources of income.

OCC Authority to Address Unfair or Deceptive Acts or Practices

When a bank's marketing practices cross the line from being bad customer relations to become unfair or deceptive practices, the OCC (and the other federal banking agencies) have authority to intervene. Provisions of the Federal Deposit Insurance Act allow the OCC to initiate cease-and-desist proceedings and to take other appropriate enforcement actions against a bank if the bank has violated any "law, rule, or regulation."

One *law* that can be violated by banks is section 5 of the Federal Trade Commission Act (FTC). This provision declares, in sweeping terms, that "unfair or deceptive acts or practices affecting commerce . . . are unlawful." The FTC Act also expressly provides that the Federal Trade Commission may take actions to prevent violations of section 5 *by nonbanks*, but it does not refer explicitly to the authority of any banking agency to enforce section 5 against banks. In addition, another section of the FTC Act requires the Federal Reserve Board (FRB) to issue regulations defining specific acts and practices by banks as unfair or deceptive, which would be enforced by the banking agencies.

The question that has been raised recently is whether banks can be held accountable by the banking agencies for violations of section 5 of the FTC Act itself—or only for violations of a Federal Reserve Board regulation that provides that a specific practice is unfair or deceptive. The answer to that question, from our perspective, is clear just by looking at the FTC Act itself. The act does not exempt banks from its prohibition on unfair or deceptive practices nor does it provide that enforcement of FTC Act *regulations* is the *exclusive* method for enforcing the FTC Act.

The answer also is clear if you look at the legislative history of the FTC Act and its amendments. The legislative history does *not* suggest that when Congress amended the FTC Act to let the Federal Reserve Board issue regulations, it intended to cut back on the authority the banking agencies already had to enforce the general ban on unfair or deceptive practices in section 5. If Congress had intended that, the OCC, the Federal Deposit Insurance Corporation, and the Federal Reserve would be left powerless to prevent a bank from engaging in blatantly unfair or deceptive practices that harmed consumers until the Federal Reserve Board issued a regulation declaring those specific practices to be unlawful under the FTC Act. It is simply implausible that Congress would have intended to create such a void.

To put it simply, we believe that if a bank engages in a practice that is unfair or deceptive under the FTC Act, but that has not been defined as such in a Federal Reserve Board regulation, it has nevertheless violated a "law" and the banking agencies can use their enforcement authority to address the violation.

Recently, three courts have issued decisions that support this position. The Rhode Island Superior Court has expressly recognized the OCC's authority to enforce section 5 of the FTC Act in two rulings. In reaching its decisions, the court also noted the need for uniformity in national banking policy as an additional policy reason for not imposing different state standards on national bank operations and regulatory oversight.

Two *federal* courts also have rendered decisions that recognize the OCC's authority to enforce the FTC Act. The first, *Roberts* v. *Fleet Bank*, was a decision issued in November by the U.S. District Court for the Eastern District of Pennsylvania. The second, *State of Minnesota* v. *Fleet Mortgage Company*, was a decision issued in December by the U.S. District Court in Minnesota.

Standards that Apply to Deceptive Practices

I imagine that you might now be thinking: "Well, what *standards* determine if a practice is unfair or deceptive if that practice isn't specifically described in a regulation?" That's a very fair question to ask. Today, the OCC is issuing an advisory letter on unfair and deceptive acts and practices that will help provide some answers. The advisory letter describes in detail what our standards are, and how they are derived from the *published precedent* of the Federal Trade Commission in its enforcement of the FTC Act. The primary source material for FTC policy under the FTC Act is their two policy statements—the Policy Statement on Deception, issued in 1983, and the Policy Statement on Unfairness, issued in 1980.

To give you a frame of reference, it might be useful for me to take a moment and briefly describe these standards. Under FTC precedent, *deception* exists when a party's representations or omissions are likely to mislead consumers in a material way. According to the policy statement and the OCC advisory letter, three elements need to be met to find an act deceptive.

First, to be deceptive, the act or practice does not need to actually mislead—it just needs to be likely to mislead. So, a showing that consumers were actually misled would not be necessary. Instead, in determining if something is likely to mislead, one must consider the overall impression created by the representations or omissions of information to see how they reasonably could be interpreted. In fact, under FTC principles, fine print disclosures of critical information will not necessarily prevent marketing materials from being deceptive if the overall impression of the materials is deceptive and if consumers are unlikely to read the fine print or be able to understand it.

Second, something is likely to mislead if it is likely to mislead a *reasonable* consumer. Under FTC precedent

and our advisory, the reasonable consumer is a consumer from the class of people to whom the advertisement or solicitation is directed. So, it is also necessary to consider the issue in the context of the group targeted by the particular act or practice.

Finally, any deception needs to be material. "Materiality" means that the deceptive omission or representation is likely to affect the customer's decision about the product—particularly, if it concerns the cost of the credit product or some other key consideration. Practices that can be misleading or deceptive in a material way include misleading claims about costs of services or products; use of bait-and-switch techniques; and failure to provide promised services.

A practice also may be found to be *unfair* and, therefore, unlawful under section 5 of the FTC Act, generally, if the net effect of the practice is to cause substantial consumer harm that could not reasonably have been avoided by the consumer.

OCC Enforcement Actions Involving Section 5 of the FTC Act

So, how does the OCC become involved in these issues? During the course of a regular safety-and-soundness or compliance examination, through consumer complaints, or through referrals from state authorities, the OCC may become aware of practices by a national bank that may be unfair or deceptive. When these situations surface, the OCC applies the FTC Act standards that I just described. And, we have taken action to address situations where we have found violations.

Almost two years ago, the OCC first used its authority under the FTC Act to take action against a national bank that we determined had engaged in deceptive marketing of credit cards targeted to borrowers with weak credit histories. Let me list a few of the practices that we concluded had "crossed over the line."

The bank used telemarketers who promoted "maximum savings" for consumers who transferred balances and took out a credit card from the bank. But, the interest rates consumers actually received on the bank's card were lower by only three-tenths or seven-tenths of 1 percent. If consumers asked for more information about how much the savings would be if they transferred their balances, the telemarketers were instructed not to provide it. And, customers who were dissatisfied with their new rate were charged a *previously undisclosed* 3 percent balance transfer fee if they then closed their account at the bank.

The bank also offered a "Credit Protection" program in connection with its credit cards. By enrolling in this program, customers could avoid making payments for up to 18 months if they became hospitalized or lost their jobs. However, the marketing materials never disclosed several significant restrictions on the program. For example, coverage for involuntary unemployment was available only when the customer had paid three months of premiums, and coverage was limited to the number of months paid in—which could be considerably less than the 18 months' coverage that was promoted.

As just one more example of the problems we found, the bank marketed one of its cards as a "no annual fee" card, but did not adequately disclose that, to get the card, the customer was required to purchase credit protection coverage—which had an *annual cost* of $156. Consumers that refused to pay for credit protection were, instead, charged an annual fee for the card.

The bank in question entered into a settlement of this matter with the OCC in June of 2000. The consent agreement provided for the bank to pay more than $300 million in restitution to its customers, and for the bank to institute a number of changes to its marketing practices.

The most recent enforcement action by the OCC under the FTC Act was in December of 2001. In that action, we determined that the bank in question also had engaged in deceptive practices with respect to marketing its secured credit card. The bank marketed a credit card to subprime borrowers emphasizing that the card would have a credit line of between $250 and $600; that it could be used for "instant cash"; and that it would have "worldwide acceptance." The bank also said that the card would help borrowers to "be prepared for emergencies."

Despite these marketing claims, roughly 80 percent of applicants received a card with a credit line of the minimum $250. Upon approval, $200 was charged to this credit line for the required savings deposit, and other fees up to $56 also were charged. As a result, most consumers had no—or even negative—available credit when the card was issued. As you might imagine, the OCC received a number of complaints from consumers who had believed the marketing claims that they would have a credit card that they could actually *use.*

How Banks Can Manage the Risks

Let me be clear that while I do *not* think there is a widespread problem among banks, we all should be concerned about marketing practices that could be unfair

or deceptive. Not only do these practices harm consumers, they also can pose significant risks to a bank's reputation, its pocketbook, and ultimately, its safety and soundness. The consequences of engaging in these practices can include expensive litigation, enforcement actions, and monetary judgments.

We are issuing our advisory letter on unfair and deceptive acts and practices to help national banks avoid being placed in that kind of jeopardy.

This leads me to offer some common-sense tips, or "best practices," if you will, derived from that advisory letter, that you might want to consider—to manage your institution's marketing programs:

- As part of your *routine* risk management, review marketing materials for accuracy and to ensure that they fairly and adequately describe the terms, benefits, and material limitations of the product or service being offered. Don't paint a rosy picture in your marketing that is belied by fine print or the terms that are actually likely to be offered. It's important for consumers to receive the information they need about products or services—including any material limitations—without having to do "detective" work or hunt for a magnifying glass.

- If there is a significant possibility that consumers will not receive the terms that have been advertised, that possibility should be made apparent, and you should avoid using terms that might suggest otherwise, such as "fixed for years," "guaranteed," and "pre-approved." A clear, up-front disclosure describing any contract provision that allows you to change the credit terms you have agreed to will go a long way toward preventing customer confusion and, possibly, litigation.

- If you promote a product or service by highlighting particular benefits, make sure that the benefit won't be cut off by exercising a contractual change-in-terms provision or by some other aspect of the transaction. As I mentioned, the OCC found that a bank engaged in deception when it promoted a credit card as having "no annual fees," but required the borrower to purchase a credit protection product for $156 a year.

- As another part of sound risk management, get clear and affirmative consent from consumers if you sell products and services through telemarketing.

- If you offer "free trial periods" in connection with products or services, make it clear if the consumer will be required to cancel the service at the end of the trial period to avoid being billed for service past the trial period.

- And, finally, make sure you have appropriate procedures in place to ensure that consumer complaints and other communications are reviewed for indications that consumers might have been misled.

Conclusion

A challenge bankers face today, in an increasingly competitive business, is to not fall victim to a lowest common denominator approach to marketing—in other words, "My competitors are doing this, why shouldn't I?" The answer to that question ought to be obvious. This is not just a compliance issue. Your customers are your bank's lifeblood. Gaining them and *retaining* them goes to the heart of your future business. Institutions that engage in unfair or deceptive acts or practices will be held accountable—accountable through judgments and penalties *and* accountable through loss of customers and public trust.

As I said at the outset, consumers may not know if particular activities are contrary to legal standards, but they *do* know when they feel they have been misled or haven't been treated right—and they can easily switch their business to another institution. In fact, many of the consumers that were affected by the deceptive practices at issue in the enforcement actions I described did just that.

Banks not only can meet this challenge, they can surpass it. We should not expect consumers—even financially sophisticated consumers—to have to read marketing and other information for hidden meaning, or obliquely stated conditions and limitations, as if they were trained investigators—or heaven forbid—lawyers. Instead, banks can use their position as trusted and highly respected businesses to promote first-class customer relations and the highest integrity in marketing practices for financial products and services.

Take a look at the guidance in our new advisory. Review your marketing materials and practices, and take the steps you need to "get it right." It will help keep you out of trouble—and it's good business.

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Interpretive Letters

921—December 13, 2001

12 USC 21–23
12 USC 51B
12 USC 51A

Re: [ ] (In Organization), [ ], California ("bank")

Dear [ ]:

This is in response to your letter of November 29, 2000, asking whether the bank may adopt articles of association that permit its board of directors to issue blank check preferred stock. For the reasons discussed below, including your representations, we have concluded the bank may adopt such articles.

I. Background

The bank has elected in its bylaws to be governed by the California Corporations Code, and it would like to adopt articles of association ("articles") containing a provision authorizing the bank's board of directors ("board") to issue preferred stock using a blank check procedure ("blank check preferred stock"). Under current OCC procedures, shareholders typically approve an amendment to the articles for each separate issuance of preferred stock. The amendment sets forth the specific terms of the preferred stock.[1] Under the bank's proposal, shareholders will instead approve an amendment to the articles setting an overall authorized amount of preferred stock and delegating to the board the ability to issue and determine the terms of one or more series of preferred stock.[2] From time to time, the board will pass resolutions approving and defining the terms of series of preferred stock. You state that the bank will amend its articles to provide that such resolutions will be incorporated by reference into the articles of association. No further separate shareholder action to amend the articles will be required to issue or determine the terms of preferred stock that may be issued within the authorized amount.

II. Discussion

A. Interpretive Ruling 7.2000(b)

Under Interpretive Ruling 7.2000(b), a national bank may designate in its bylaws and elect to follow the corporate governance procedures of the state in which it is located, to the extent not inconsistent with applicable federal banking statutes or regulations and bank safety and soundness. The bank has designated California corporate governance procedures in its bylaws. Therefore the bank may issue preferred stock through the proposed blank check procedure if consistent with California law, and if not inconsistent with federal banking statutes or regulations and bank safety and soundness.

B. California Law Permits Blank Check Preferred Stock

You represent that California law permits corporations to issue blank check preferred stock. The bank is proposing to use an article derived from Section 202(e) of the California Corporations Code to issue blank check preferred stock.[3]

C. The Bank's Proposed Issuances of Preferred Stock through the Blank Check Procedure Are Consistent with Federal Banking Statutes and Regulations

The principal issue is whether blank check preferred stock is consistent with 12 USC 51a and 51b. We have concluded that the blank check procedure satisfies the shareholder approval and other requirements of these statutes. Neither the plain language nor legislative history of 12 USC 51a or 51b precludes a national bank from using the blank check procedure. Shareholders' adoption or approval[4] of a blank check preferred stock article constitutes the shareholder action required by 12 USC 51a

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[1] Under 12 CFR 5.46(k), a national bank shall obtain the necessary shareholder approval required by statute for any change in its permanent capital. Since 1989 the OCC has not permitted the use of a blank check procedure by national banks to issue preferred stock, as discussed below. Prior to 1989, the OCC had expressly permitted national banks to use the blank check procedure.

[2] The term "series" is defined in the California Corporations Code as "those shares within a class which have the same rights, preferences, privileges and restrictions but which differ in one or more rights, preferences, privileges or restrictions from other shares within the same class." Cal. Corp. Code § 183 (West 1990).

[3] Section 202(e) of the California Corporations Code authorizes the filing of articles with blank check preferred stock features. Sections 401 and 156 of that code require the board to execute and file certificates of determination that include resolutions setting forth the number of shares of series and terms of classes or series of stock. State banks in California may use the blank check procedure to issue preferred stock. *Cf.* Cal. Fin. Code §§ 600.8 & 112 (West 1990) (filing of certificate of determination with secretary of state and commissioner of financial Institutions).

[4] This shareholder action must be consistent with the requirements of 12 USC 21 or 21a. These statutes govern the adoption of, and amendments to, national banks' articles of association.

and 51b to issue and establish the terms of preferred stock. Thus, the bank may incorporate into its articles, board resolutions setting forth the terms of the preferred stock, in the manner specified in the articles.[5]

(1) 12 USC 51a and 51b

Two pertinent federal statutes governing the issuance and terms of preferred stock by national banks are 12 USC 51a and 51b. These two statutes generally require shareholder approval and appropriate article amendments for issuance of preferred stock, and that the terms of preferred stock be set forth in the articles. Twelve USC 51a states:

> Notwithstanding any other provision of law, any national banking association may, with the approval of the Comptroller of the Currency and *by vote of shareholders owning a majority of the stock of such association*, upon not less than five days' notice, given by registered mail or by certified mail pursuant to action taken by its board of directors, issue preferred stock of one or more classes, in such amount and with such par value as shall be approved by said Comptroller, and make such amendments to its articles of association as may be necessary for this purpose; but in the case of any newly organized national banking association which has not yet issued common stock, the requirement of notice to and vote of shareholders shall not apply. No issue of preferred stock shall be valid until the par value of all stock so issued shall be paid in and notice thereof, duly acknowledged before a notary public by the president, vice president, or cashier of said association, has been transmitted to the Comptroller of the Currency and his certificate obtained specifying the amount of such issue of preferred stock and his approval thereof and that the amount has been duly paid in as a part of the capital of such association; which certificate shall be deemed to be conclusive evidence that such preferred stock has been duly and validly issued (emphasis added).

The relevant language in 12 USC 51b provides

> (a) Notwithstanding any other provision of law, whether relating to restriction upon the payment of dividends upon capital stock or otherwise, the holders of such preferred stock shall be entitled to receive such cumulative dividends and shall have such voting and conversion rights and such control of management, and such stock shall be subject to retirement in such manner and upon such conditions, as may be provided in the articles of association, with the approval of the Comptroller of the Currency.

(2) The Blank Check Procedure Is Consistent with the Literal Requirements of 12 USC 51a and 51b

Under current procedures permitted by OCC, the board of directors of a bank approves the terms of each proposed issuance of preferred stock, and submits each proposal to the Comptroller and to shareholders for approval. Before the stock is certified, the board and shareholders each approve an article amendment to reflect the increased level of issued and outstanding stock and the terms of the stock. The plain language of the statutes may be read to be consistent with this procedure. However, other procedures, including the blank check procedure, also are consistent with a plain reading of the statutes.[6] The statutes do not specify precisely when in the process shareholder or Comptroller approval must be obtained or when the articles must be amended. Section 51a does not say that shareholders must separately approve each separate issuance.

Shareholders' adoption or approval of an article or article amendment establishing a blank check procedure for preferred stock constitutes the shareholder action required to issue and establish the terms of preferred stock.[7] In addition, the other statutory requirements are met through the blank check procedure. The board of directors approves a proposed blank check article and its submission to a shareholder vote. Shareholders receive the required notice of the vote (unless no vote is

[5] The language of 12 USC 51a may also be interpreted to require a shareholders' vote and approval for each issuance of preferred stock. However, the statute does not explicitly require this outcome and the interpretation herein is consistent with the language of the statute and OCC's policy on corporate governance generally, as described below.

[6] Prior to 1989, the OCC had permitted national banks to have articles containing provisions for blank check preferred stock. *See*, *e.g.*, letter from Sharon Miyasato, dated April 16, 1985 (unpublished); letter from Elizabeth Malone, dated April 15, 1988 (unpublished). However, in 1989 the OCC limited the scope of those provisions to articles that delegate to directors only the authority to determine exact interest rates and define maturity dates of preferred stock. Interpretive Letter No. 488, March 23, 1989. The OCC stated that as a matter of policy, national bank directors should not have unfettered discretion to change the capital structure of a bank without shareholder approval. In 1996, however, the Office adopted Interpretive Ruling 7.2000, reflecting a general policy to authorize state law governance of corporate practice issues. Therefore, OCC policy has evolved since 1989 in a manner that supports this proposal.

[7] All U.S. jurisdictions today allow the blank check procedure. MODEL BUSINESS CORP. ACT. ANN. § 6.02, Statutory Comparison (1999). Under 12 USC 21, 21a and 51a, national banks generally may incorporate any lawful corporate procedures for adopting or amending articles to issue preferred stock.

required due to the exception clause).[8] The Comptroller approves the amounts and par values of each issuance of the preferred stock (or classes of preferred stock) at the appropriate time, and in the appropriate manner, in the process. The bank makes other amendments to the articles of association *(e.g.,* to reflect the issued and outstanding preferred stock and its terms after it is issued) in the manner specified in the blank check article.[9] Finally, the bank and the Comptroller comply with the appropriate procedures for certification. These actions satisfy all of the requirements of the statutes.[10]

D. Blank Check Preferred Stock Is Consistent with Bank Safety and Soundness

Permitting national banks to issue blank check preferred stock is consistent with bank safety and soundness. Preferred stock offers banks an attractive way to raise needed capital.[11] If banks must hold a shareholder meeting to authorize each separate issuance of preferred stock, they may be unable to raise needed capital expeditiously or compete for funds in a changing market. Blank check preferred stock enables banks to respond quickly to market conditions and sell preferred stock to meet their capital needs.

Issuance of blank check preferred stock affects the interests of existing shareholders. However, a bank board's fiduciary duties to shareholders provide protection against inappropriate use of blank check preferred stock. In addition, banks are required to submit the terms of the sale of the preferred stock to the OCC for its review before issuing any of the preferred shares. *See* 12 CFR 5.46(g). This OCC review provides a safeguard against issuances of preferred stock that are detrimental to a bank's safety and soundness.

[8] The exception clause in the statute provides that "in the case of any newly organized national banking association which has not yet issued common stock, the requirement of notice to and vote of shareholders shall not apply."

[9] Under 12 USC 21a, a national bank's articles may be amended in the manner specified in the articles, unless otherwise specifically provided by law. Thus the bank may incorporate into the articles, resolutions setting forth the terms of the preferred stock, as approved by the Comptroller, in the manner specified in the articles.

[10] We also have examined the legislative history of 12 USC 51a and 51b. Nothing in the legislative history of those statutes specifically precludes national banks from issuing blank check preferred stock in the proposed manner. The statutes were passed under emergency conditions during the banking crisis of 1933 with no hearings and little debate. None of the debate concerned the degree of shareholder approval for the issuance or terms of preferred stock.

[11] The original provisions authorizing national banks to issue preferred stock were added to enable shareholders, the Reconstruction Finance Corporation or others to strengthen the capital sources and add resources to national banks by purchasing preferred stock. 79 CONG. REC. 55, 79 (1933) (remarks of Mr. Barkley, remarks of Mr. Steagall).

III. Conclusion

In conclusion, the bank may amend its articles of association to authorize it to issue preferred stock through the blank check procedure, as discussed above. If so, the articles should require resolutions issuing and defining the terms of series of preferred stock to be incorporated by reference into the articles. If you have any further questions, please feel free to contact me at (202) 874-5210.

Michael C. Dugas
Senior Attorney
Securities and Corporate Practices Division

922—December 13, 2001

12 CFR 16

Re: [ ] ("bank") Proposal to Offer FDIC-Insured Deposit Notes

Dear [ ]:

This responds to your letter of May 8, 2001, requesting an interpretive opinion[1] that certain deposit notes of the bank to be offered and sold through the bank's affiliated retail securities broker–dealer network, would not constitute the sale of "securities" as defined in OCC securities offering regulations at 12 CFR Part 16. Based on your representations and the facts that you provided, it is our opinion that the bank's deposit notes are not securities and, therefore, not subject to registration under Part 16.

A. Background

The bank proposes to issue and market certain FDIC-insured deposit notes through the retail distribution network of [ ] (" ").[2] [ ] is a wholly owned indirect subsidiary of [ ] Corporation, a bank holding company that in turn owns 100 percent of the bank. [ ] is a broker–dealer registered with the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 ("Exchange Act").

[1] We limit our opinion to the applicability of Part 16 to the offering of deposit notes. We offer no views as to any other legal issues the introduction of this product may raise.

[2] The bank in future may sell the deposit notes through unaffiliated broker-dealers or through its other affiliated broker-dealer, [ ], under the same general terms and conditions.

Deposit notes represent transferable individual time deposits of the bank held in book entry form. The bank will offer deposit notes in denominations of $5,000 or $10,000 for terms ranging to 20 years, with fixed or floating rates of interest. The bank, through [ ], will provide purchasers a disclosure statement ("disclosure statement") describing all material terms of the deposit notes, such as restrictions on early withdrawal by customers and information required by Regulation DD[3] of the Board of Governors of the Federal Reserve System ("Federal Reserve Board") to implement the Truth in Savings Act.[4] The deposit notes will be the bank's direct deposit liabilities and FDIC-insured. The bank will include its liabilities for deposit notes in its report of deposits to the local Federal Reserve Bank and maintain reserves in compliance with Regulation D of the Federal Reserve Board.[5]

The bank will market deposit notes through [ ]'s broker–dealer network. [ ] customers will deliver their funds for deposit to [ ]. [ ] will act as the customers' agent in accepting and transferring the money to the bank for deposit. The bank will compensate [ ] on a transaction-related basis for the services it provides. [ ] will not charge depositors any fees on deposit note purchases. Purchasers will receive the same rate of interest regardless of whether they purchase the deposit notes directly from the bank or [ ]. Although the deposit notes are transferable, the bank will disclose that [ ] has sole discretion to maintain a secondary market for deposit notes. Depositors will not receive any liquidity guarantees or assurances with respect to deposit notes.

B. Law

1. The Securities Act and OCC Regulation

The OCC's securities offering disclosure regulations provide that, absent an available exemption, no person may offer and sell a security issued by a national bank without meeting the registration and prospectus delivery requirements of Part 16.[6] Part 16 attempts to achieve the purposes underlying the registration requirements of the Securities Act of 1933 ("Securities Act"), *i.e.,* to provide the investing public full disclosure of the material facts and circumstances regarding the offer and sale of securities by national banks.[7]

Part 16 generally incorporates by reference the definitions, registration and prospectus delivery requirements of the Securities Act and SEC implementing rules, including the Securities Act definition of "security."[8] The Securities Act, however, exempts "any security issued or guaranteed by any bank."[9] Part 16 does not incorporate this exemption; it applies to securities issued by banks. Accordingly, the registration and prospectus delivery requirements of Part 16 would apply to the offer and sale of deposit notes if those bank-issued instruments meet the definition of security in the Securities Act. Although this definition does not specifically include "deposit notes," the definition is broad and courts have construed it broadly.

2. Case Law

The Supreme Court in *SEC* v. *W.J. Howey*, held that an instrument is an "investment contract" and thus a security for purposes of the Securities Act if it evidences: (1) an investment (2) in a common enterprise (3) with a reasonable expectation of profits (4) to be derived from the entrepreneurial or managerial efforts of others.[10] Applying that test, the Supreme Court held that bank-issued insured certificates of deposits ("CDs") were not securities for purposes of the antifraud provisions of the federal securities laws, given the extensive protections that the federal bank regulatory scheme affords depositors.[11]

In *Marine Bank* v. *Weaver,* the Supreme Court recognized an important difference between a bank-issued certificate of deposit[12] and other long-term debt obligations that are securities, since the CD issuer, a federally regulated

[3] 12 CFR Part 230.

[4] 12 USC 4301 *et seq.*

[5] 12 CFR Part 204.

[6] 12 CFR 16.3(a)(1) and (2).

[7] Office of the Comptroller of the Currency, 12 CFR Parts 5 and 16, 59 *Fed. Reg.* 54,790, 54,798 (Nov. 2, 1994).

[8] 12 CFR 16.2. The Securities Act defines a security as " . . . any note, stock, treasury stock, . . . bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, . . . or, in general, any interest or instrument commonly known as a 'security' . . . . " 15 USC 77b(1). In 1994, the OCC revised Part 16 to provide that its registration requirements applied to bank-issued senior and subordinated debt. At the same time, however, the OCC made clear that it did not intend the definition of security in Part 16 to cover insured or uninsured bank deposits or traditional bank products. The preamble to Part 16 stated that "[t]he definition of 'security' in the final rule does not specifically exclude traditional bank products. Nevertheless, the OCC does not intend that the definition cover insured or uninsured deposits or other traditional bank products, including letters of credit, banker's acceptances, or repurchase agreements." 59 *Fed. Reg.* at 54,798.

[9] 12 CFR 16.5.

[10] *SEC* v. *W.J. Howey*, 328 U.S. 293 (1946) ("*Howey*").

[11] *Marine Bank* v. *Weaver,* 455 U.S. 551 (1982) ("*Marine Bank*"). The Court considered the Exchange Act, rather than the Securities Act definition of security, but noted both definitions are "essentially the same." *Id.* at 555 n.3.

[12] Although the Exchange Act definition of security includes a "certificate of deposit, for a security," that term refers to instruments issued by protective committees in corporate reorganizations, rather than bank-issued CDs. *Id.*, 455 U.S. at 557 n. 5. Accordingly, to qualify as a security, a CD must be either a note or an investment contract.

bank, is subject to a comprehensive set of regulations governing the banking industry. For example, insured deposits in federally regulated banks are protected by reserve, reporting, and inspection requirements. The Court distinguished CDs from ordinary long-term debt securities that carry a risk of the borrowers' insolvency and found it unnecessary to provide additional protection under federal securities law. However, a CD does not invariably fall outside of the federal securities law definition of security. Each transaction must be analyzed "on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole."[13]

The Court of Appeals for the Second Circuit, in *Gary Plastic Packaging Corp.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.,* relied on this opening, holding that the insured CDs marketed and sold by a broker–dealer were securities under the federal securities laws.[14] A broker created a program to market bank-issued CDs to its customers. The broker purchased from issuing banks CDs with interest rates below those that the same banks sold directly to customers. The broker resold the CDs at the same, lower rates to its customers. The issuing banks paid the broker as compensation this differential in interest rates between the two types of CDs. The broker also created and maintained a secondary market in those CDs.

The Second Circuit distinguished the CDs in *Gary Plastics* from those in *Marine Bank* based on the activities of the broker. The *Gary Plastics* broker was investigating issuers, marketing CDs, and establishing a secondary market in those instruments, thus creating a "common enterprise" within the meaning of *Howey*. The instrument offered purchasers the possibility of price appreciation due to interest rate movements and an ability to capitalize on those movements in a secondary market. The court found that the broker also contributed expertise to the project by maintaining a pool of willing CD issuers.[15]

Given the differences between the conventional CDs in *Marine Bank* and the investments in *Gary Plastics*, the court found that, "absent the securities laws, plaintiff has no federal protection against fraud and misrepresentation by the defendants in the marketplace."[16] However, the Second Circuit reaffirmed the *Marine Bank* holding that federal banking laws protected CD purchasers from possible abuses by the issuers. Additional federal securities law protection was necessary to protect only against abuses by the *broker* in administering the program.[17]

C. Analysis

Application of both the *Howey* and *Reves* tests confirms that the deposit notes are not investment contracts or notes, and thus not securities for purposes of Part 16. Deposit notes are not investment contracts, but deposit liabilities subject to the same regulatory scheme that applied to the CDs in *Marine Bank.* The bank will include its liabilities for deposit notes in its report of deposits to the local Federal Reserve Bank and maintain reserves pursuant to Regulation D of the Federal Reserve Board. Depositors are assured of the return of their principal and interest, subject to applicable FDIC insurance limits. The bank must meet the requirements of the Truth in Savings Act and Regulation DD in marketing the deposit notes. Since the bank and its deposit note program are subject to an extensive regulatory scheme, it is unnecessary to impose additional federal securities law requirements or corresponding Part 16.

[ ]'s participation in the sale of deposit notes does not change this analysis. [ ]'s activities do not resemble those of the broker-dealer in *Gary Plastics,* which actively designed and administered a deposit-gathering program. [ ] is limiting its role to a sales agent for retail customers, accepting customer funds for deposit with the bank. [ ] is not creating certificates or monitoring the creditworthiness of bank issuers. [ ] does not contribute expertise by maintaining a pool of CD issuers. The bank is the only issuer of deposits in this program.

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[13] *Id.,* 445 U.S. at 558, 560 n. 11.

[14] *Gary Plastic Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., et al.*, 756 F.2d 230 (2d Cir. 1985) ("*Gary Plastics*").

[15] *Id.*, 756 F.2d at 240.

[16] *Id.*

[17] The Supreme Court in *Reves* v. *Ernst & Young*, 494 U.S. 56 (1990) ("*Reves*") later found that application of the *Howey* test for investment contracts may be meaningless in considering whether a different type of instrument, such as notes, is a security. It developed a separate analysis for determining whether a note is a security under the federal securities laws. The Court began by presuming that every "note" is a security, then recognized that some notes "obviously" are not securities. It identified four criteria for determining whether a note has the "family resemblance" necessary for inclusion in a list of notes that courts previously held are not securities. If a note is not sufficiently similar to others on that list, the reviewing court may apply these criteria to determine whether to add another category. These criteria involve the motivations of both parties to the underlying transaction, the plan of distribution for the note, and the reasonable expectations of the investing public. A court then considers whether another factor, *e.g.,* the existence of another regulatory scheme, reduces the risk of the instrument. For example, if the seller intends to finance a general business enterprise and the buyer is motivated by a profit, the note is likely to be a security. But, if the seller has a commercial or consumer purpose, or the buyer has another purpose, *e.g.,* the right to purchase housing, the note is less likely to be a security. If there is "common trading for speculation or investment," the note is more likely a security. A court is likely to affirm the views of the investing public if it reasonably views a note as a security. If there already is a comprehensive regulatory scheme, a court does not also apply the securities laws to the instrument.

In *Gary Plastics*, the defendant's creation and maintenance of a secondary market was crucial in its marketing efforts and permitted holders to profit from interest rate movements. [ ], in contrast, is making no assurances to depositors concerning the existence of a secondary market. Although the deposit notes are transferable, the bank will disclose that [ ] has sole discretion to maintain a secondary market in the deposit notes. Depositors will not receive any liquidity assurances with respect to deposit notes. Because there is no assurance that deposit notes will be more liquid than CDs or other deposits generally, the bank does not offer purchasers an enhanced possibility of price appreciation due to interest rate movements.

The compensation structure in this case is unlike that in *Gary Plastics.* [ ] will receive compensation from the bank on a transaction basis for the services it provides. [ ]will not charge depositors any fees for deposit notes purchases. Purchasers will receive the same rate of interest regardless of whether they purchase deposit notes directly from the bank or [ ].

Given the limited role of [ ] in the program, additional protections afforded by the federal securities laws are unnecessary to protect deposit note purchasers from fraud or other possible abuse. There is no need to treat deposit notes as investment contracts and, thus, securities.[18]

D. Conclusion

For the reasons discussed above, based on your representations and the facts you have provided, it is our opinion that the bank's deposit notes are not securities and, therefore, not subject to registration under Part 16.

[18] Application of the *Reves* factors confirms that deposit notes are not securities. Deposit notes do not resemble the instruments that courts previously determined are not securities, but applying the *Reves* factors warrants adding deposit notes to the list of instruments that are not securities. Although a seller's use of funds gathered through a program for its general business can indicate a security, this reasoning is not sensible in a *banking* context. Banks raise virtually all their deposits for their general banking business and deposits are virtually never securities. The purchaser's motivation will be to obtain an interest-bearing deposit and the bank's motivation is to market a deposit. The investing public cannot reasonably view deposit notes as securities. They will be denominated as deposits, carry FDIC insurance, and will be subject to the same reserve and reporting requirements applicable to deposits generally. The bank will disclose to customers that there are no assurances of a secondary market for deposit notes. Instead, deposit notes will be subject to the redemption restrictions that normally apply to deposits. Finally, deposit notes are subject to precisely the same regulatory scheme that applied to the CDs in *Marine Bank.* Federal banking laws and FDIC insurance obviate the need for additional protections under the federal securities laws.

If you have any questions, please contact me at (202) 874-5210.

Nancy Worth
Counsel
Securities and Corporate Practices Division

923—December 19, 2001

12 USC 25a

Dear [ ]:

This is in response to your letter of November 20, 2001, in which you alleged that a number of banks in the [ ] area are violating 12 USC 25a by advertising lotteries. You included copies of several advertisements and promotional mailings for the OCC's evaluation. I have reviewed all of the items. In addition, I have contacted the legal departments of, *[A]*, and *[B]*, to obtain further information concerning certain of the advertisements and events. Based on this information and review, it is my conclusion that none of the items violate 12 USC 25a. My reasoning is explained in more detail below.

Discussion

Twelve USC 25a prohibits national banks from participating in certain lottery-related activities. Among other things, national banks may not "announce, advertise, or publicize the existence of any lottery." 12 U.S. 25a(a)(3). You believe that the banks have violated this prohibition.

The statute defines "lottery" as follows:

> The term "lottery" includes any arrangement whereby three or more persons (the "participants") advance money or credit to another in exchange for the possibility or expectation that one or more but not all of the participants ("the winners") will receive by reason of their advances more than the amounts they have advanced, the identity of the winners being determined by any means which includes —
>
> (A) a random selection;
> (B) a game, race, or contest; or
> (C) any record or tabulation of the result of one or more events in which any participant has no interest except for its bearing upon the possibility that he may become a winner.

12 USC 25a(c)(2).

With this background in mind, I will now discuss the individual items.

[A] "Focus on Fashion"

The first item is a newspaper advertisement that reads in part as follows:

> *[Co.]*'s
> 13th Annual Charity
> Fashion Show & Luncheon
>
> "Focus on Fashion"
> . . .
> Tickets $35
> Grand Raffle and
> Elegant Basket Raffle
> . . .
> Sponsored by: [*[A]* logo]
> . . .

You asked if this isn't involvement in the sponsoring of the advertisement, citing OCC Interpretive Letter No. 900, June 19, 2000. In that letter, I concluded that a national bank could donate an item for a civic fundraising raffle and be identified in advertisements as the donor of the item, as long as the bank had no involvement with the sponsoring or display of the advertisements.

I contacted *[A],* to obtain information about this advertisement. The bank informed me that the *[Co.]* paid for this ad, not the bank. *[A]* is listed as a sponsor because it donated money for the event. Therefore, the fact situation here is very similar to that in Interpretive Letter No. 900, *i.e.,* the bank is identified as a supporter of the event in an advertisement paid for by someone else. As I concluded in that letter, this type of situation does not violate 12 USC 25a because there has been no action by the bank to publicize the lottery.

[A] "Win the Lottery"

The second item is a newspaper advertisement promoting *[A]* home equity loans. The top of the ad displays the following statement:

> How can the 89,545,673 people who didn't *win the lottery* this weekend make those much-needed home improvements? Introducing our great rates on a home equity line of credit.

(Emphasis added.) In your view, this is announcing the existence of a lottery.

As a statute with criminal penalties, (see 18 USC 1306), 12 USC 25a should be narrowly construed. *See Federal Communications Commission* v. *American Broadcasting Company*, 347 U.S. 284, 296 (1954) (construing 18 USC 1304, also involving lotteries). For that reason, the prohibition against publicizing a lottery should be interpreted to mean an actual, identifiable lottery, not one that is only hypothetical. *See United States* v. *Halseth*, 342 U.S. 277 (1952) (interpreting 18 USC 1302, another lottery statute). The phrase "win the lottery" is simply a figure of speech and does not meet this standard.

[A] Platinum Visa Card

The third item appears to be a promotional mailing for a *[A]* credit card. The mailing includes "terms and conditions for the *[A]* platinum Visa card." Among these terms and conditions is a transaction fee for the purchase of "betting or casino chips or similar items." You believe that this violates the prohibition on publicizing lotteries.

As with the last item, this does not publicize an actual, identifiable lottery. Therefore, in my opinion, it does not violate 12 USC 25a.

[B] [   ] Shuffle

The next item is a newspaper advertisement for the *[B]* [   ] Shuffle 8K race. Although this is not mentioned in the ad, you noted that there was a $30 entry fee to participate in the race, and prizes of $1500, $1000, and $750. You believe this violates 12 USC 25a because it is publicizing a game, race, or contest which, in turn, is a lottery.

I contacted *[B],* which confirmed that it does sponsor this event (and other races) as charity fundraisers every year, and that the bank did pay for this ad.

Referring back to the statutory definition of "lottery," it is an "arrangement" in which the winner is determined by the outcome of, among other things, a "game, race, or contest." It can be seen that the lottery and the race are two separate things: the lottery is the "arrangement," while the race is the means of determining the winner of the lottery. Looking at it another way, under federal case law, one of the essential elements of a lottery is that the winners are selected by chance. *Federal Communications Commission* v. *American Broadcasting Company, supra*. As between the participants in a race, the winner is determined by skill, not chance. Therefore, the race, itself, is not a lottery. Rather, a betting pool among nonparticipants on the outcome of the race would be a lottery.

Accordingly, this advertisement does not violate 12 USC 25a.

[ ] Bowling Party
[ ] Pro Cup

These are newspaper advertisements in which *[B]* is listed as a sponsor of the events. You noted that these are fundraising events in which entry fees are charged and there are prizes for the winners.

It seems likely that these events are not lotteries, for the reasons discussed above. In any event, the bank informed me that it did not pay for either of these ads. Rather, it donated money to the events and was listed as a sponsor in advertisements paid for by the promoters of the events. This brings these ads within the rule of Interpretive Letter No. 900 as discussed above, so there is no violation of 12 USC 25a.

[C] Cancun Raffle

The next item is a newspaper advertisement for a charity raffle offering as a prize a trip to Cancun, Mexico. *[C]* and other companies are listed as sponsors. As *[C]* is not a national bank and is not regulated by the OCC, I will not comment on this item.

[D] Credit Card

The final item is a photocopy of a mailing promoting a credit card offered by *[D]*. This is similar to the *[A]* credit card mailing discussed above. It lists transaction fees for the purchase of "bets, lottery tickets, and casino gaming chips." The discussion of the *[A]* credit card mailing applies equally to this item.

Conclusion

I have carefully reviewed the advertisements and other items that you submitted, and contacted the banks involved to obtain further information where necessary. For the reasons discussed above, I conclude that none of the items violates 12 USC 25a. Either the banks did not pay for the advertisements, or the items do not publicize a lottery within the meaning of the statute.

I hope that this has been responsive to your concerns, and I thank you for bringing this matter to our attention.

Christopher C. Manthey
Counsel
Bank Activities and Structure Division

924—January 2, 2002

12 USC 24(7)

Re: Applying Five Percent Limit on Holding Equity Securities for Hedging Purposes

Dear [ ]:

This is in response to your inquiry regarding the holding of equity securities by [ ] (the "bank") and its direct Edge corporation subsidiary, [ ] (the "Edge corporation"). Specifically, you inquired whether the OCC's five percent limit on a national bank's holdings of equity securities for hedging purposes includes securities held by the Edge Corporation. For the reasons set forth below, we do not apply our policy regarding the five percent limit to securities held by the Edge corporation.

We have previously determined that it is legally permissible for a national bank to purchase and hold equity securities to hedge customer-driven, bank permissible equity derivative transactions, subject to certain conditions.[1] In connection with this determination, the OCC also decided, as a policy matter, that a national bank should not acquire equity securities that constitute more than five percent of a class of stock of any issuer.

The OCC's conclusion that such holdings were permissible for a national bank was based on the National Bank Act, 12 USC 24(Seventh), which broadly authorizes a national bank to engage in activities that are part of or incidental to, the business of banking. We have concluded that equity derivative transactions are authorized as part of the business of banking under Section 24(Seventh). Further, we determined that national banks may purchase equity securities to hedge customer-driven equity derivative transactions as an activity that is incidental to the business of banking.[2] Edge corporations are not authorized under the National Bank Act, but rather under the Federal Reserve Act.[3] Under the Federal Reserve Act, Edge corporations may engage in a broad range of international banking and financial activities.[4] Because the authority for an Edge corporation to invest in companies is distinct and separate from the authority of a national bank to acquire equity securities under its incidental powers

[1] *See* Interpretive Letter No. 892 (September 13, 2000), reprinted in [2000–2001 Transfer Binder] Fed. Banking Law Rep. (CCH) ¶ 81–411.

[2] *See* Interpretive Letter No. 892, *supra*.

[3] 12 USC 611.

[4] 12 USC 615.

under the National Bank Act, we do not apply our policy imposing a five percent limit on holding equity securities for the bank's hedging purposes to securities that are held by an Edge corporation pursuant to a separate authority under the Federal Reserve Act.

If you have any questions, please do not hesitate to contact Donald N. Lamson, assistant director, or Paul Vogel, counsel, Securities and Corporate Practices Division, at (202) 874-5210.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

925—April 12, 2001

12 USC 84

12 CFR 32

Dear [ ]:

I am writing in response to your letter dated March 6, 2001, and supplementary information dated March 9, 2001, requesting our legal opinion. You have asked if loans made by [ ] ("bank") to local [ ] ("local churches") must be combined for purposes of determining the bank's legal lending limit under 12 USC 84. For the reasons set forth below, we believe that the loans to the local churches in question must be combined.

According to the facts set forth in your letter, the bank has four outstanding loans to four separate local churches, which if combined, would not exceed the bank's lending limit. The bank is proposing to lend $500,000 to a fifth area church, [ ] ("5th") to be used for construction of its new church building, and this proposed loan, if combined with the bank's existing loans to local churches, may cause the bank to exceed its lending limit. Each local church is required to enter into a trust agreement with the international office of the parent church, [ ] ("parent church"), under which the local church is a trustee for all real and personal property, and the parent church is the beneficiary of each trust. The legal title to all property rests in the trustee (local church) until such time as the beneficiary (parent church) directs that it be transferred to itself. The trust agreement states that the trust will be revoked when any member (local church) decides to withdraw from the parent church or takes "action contrary to the polity of the [parent church]," at which time "ownership of all property, both real and personal, remains with the [parent church]."[1]

The general rules for combining loans to separate borrowers are found at 12 CFR 32.5(a)(1). The regulation states that loans or extensions of credit will be attributed to another borrower when one of two conditions is satisfied:

(1) When proceeds of a loan or extensions of credit are to be used for the direct benefit of the other person, to the extent of the proceeds so used; or
(2) When a common enterprise is deemed to exist between the persons.

12 CFR 32.5(a)(1). A trust is considered to be a "person" for purposes of the rules. *See* 12 CFR 32.2(k).

Direct Benefit Test

Under the direct benefit test, the proceeds of a loan or extension of credit will be deemed to be used for the direct benefit of another person when those proceeds are transferred to that other person, unless the proceeds are used to acquire property, goods, or services in an arm's-length transaction. 12 CFR 32.5(b). In applying the test to the facts given, it appears that the direct benefit test clearly requires combination of the loans to the local churches.

As noted above, the local church trusts all have an identical beneficiary: the parent church. The trust agreement clearly states that all property is held in trust "for the exclusive use and benefit" of the parent church.[2] Further, the trust agreements are revocable at the direction of the beneficiary (parent church) for several reasons, including when the local church "shall act contrary to [ ] polity."[3] Upon revocation, the local church "shall convey the said real estate upon demand to the State Board of Trustees of [the parent church] in said state, which said state board shall be authorized to use said real estate and personal property, or the proceeds derived from the sale of same . . . for the use and benefit of the [parent church] in that state generally; or the founding of another [ ] *(City, State)* in the same state, or for the promotion of one already existing."[4]

In my opinion, the loans to each local church should be attributed to the parent church and combined under the direct benefit test. Those loans should also be combined

[1] *See* trust agreement*:* S44. CHURCH PROPERTY: IV. All Property Owned in Trust for [ ] *(City, State)*.

[2] *See* trust agreement*:* S44. CHURCH PROPERTY: V. Standard Deeds Recognizing Trust Ownership.

[3] *Id.*

[4] *Id.*

with any loans which may be extended by the bank to the parent church (we understand that there are currently no loans by the bank to the parent church). Because the proceeds of loans made to the local churches are used for transactions which are controlled by trusts having an identical beneficiary (the parent church), and this beneficiary is entitled to the ultimate benefit of those transactions, the loans should be combined and attributed to the beneficiary.

Common Enterprise Test

Under the common enterprise test, found at 12 CFR 32.5(c), a common enterprise will be presumed to exist and loans to separate borrowers will be aggregated when any of the following conditions are met:

(1) When the expected source of repayment for each loan is the same and neither borrower has another source of income from which the loan may be fully repaid;

(2) When the borrowers are related through common control and there exists substantial financial interdependence between those borrowers;

(3) When separate borrowers borrow to acquire a business enterprise where those borrowers will control more than 50 percent of the voting securities of the business enterprise; or

(4) The OCC determines that a common enterprise exists based on an evaluation of the facts and circumstances of particular transactions.

For the purposes of this combination rule, control is deemed to exist when a person directly or indirectly, or acting through or together with one or more persons—

(1) Owns, controls, or has the power to vote 25 percent or more of any class of voting securities of another person;
(2) Controls, in any manner, the election of a majority of the directors, trustees, or other persons exercising similar functions of another person; or
(3) Has the power to exercise a controlling influence over the management or policies of another person.

12 CFR 32.2(g).

Under the first test, a common enterprise will be deemed to exist when the source of repayment for each loan is the same. 12 CFR 32.5(c)(1). In this situation, there appears to be no common enterprise because each loan to each local church has a separate source of repayment—the donations and other revenue generated by each respective church.

Under the second test, a common enterprise will be deemed to exist when the borrowers are related through common control and there exists substantial financial interdependence between them. Substantial financial interdependence is deemed to exist when 50 percent or more of one borrower's gross receipts or gross expenditures (on an annual basis) are derived from transactions with the other borrower. Gross receipts and expenditures include gross revenues, expenses, intercompany loans, dividends, capital contributions, and similar receipts or payments. 12 CFR 32.5(c)(2)(ii). In this case, the trust agreement explicitly states that the parent church controls the local church trusts, thus satisfying the common control element definition in which one person has the power to exercise a controlling influence over the management or policies of another person.[5] However, there does not appear to be substantial financial interdependence, because only five percent of each local church's receipts are sent to the parent church, and the parent church does not routinely fund the expenses of the local churches. Thus, the second common enterprise test is not satisfied.

The third common enterprise test applies when separate borrowers borrow to acquire a single business enterprise. 12 CFR 32.5(c)(3). This test does not apply in this case, because the loans in question are for purposes other than acquiring a business enterprise.

Even if the above-mentioned *per se* tests for combining loans are not met, the OCC will still require the combination of loans to two or more borrowers when it determines that a common enterprise exists based on the facts and circumstances. 12 CFR 32.5(c)(4). On its face, subsection (c)(4) appears to grant to the OCC broad, if not unlimited, discretion in combining loans for lending limit purposes even if the three *per se* rules are not met. However, past OCC rulings and interpretations reveal that a very strong evidentiary record based upon a number of factors must exist before a common enterprise will be found to exist solely on the basis of the facts and circumstances. OCC Interpretive Letter No. 563,

[5] *See* trust agreement: S44. CHURCH PROPERTY: II. Authority of the General Assembly: 1. The General Assembly governs the operation (including ownership of all real and personal property) of the [ ] (*City, State*) at all structural levels: international, national, state/territorial, district, and local.

September 6, 1991, *reprinted in* [1991–1992 Transfer Binder] Fed. Banking L. Rep. (CCH) & ¶83,314, at ¶71,439. Indeed, the OCC has stated that instances where the facts and circumstances test will apply to the exclusion of the *per se* rules will be rare. *Id.; see also* 54 Fed. Reg. 43,402 (1989).

In various interpretive letters, the OCC has considered the following facts and circumstances to be relevant to a common enterprise determination: engaging in supporting lines of business; interchange of goods and services; common ownership of assets; common management; use of common facilities; commingling of assets and liabilities; closely related business activities; similarity in structure, financing and holding; use of same business address; centralized cash management program; likelihood that a financially troubled member of the group would receive financial aid from other members of the group; family relationships among the borrowers; and pledging of assets to support another's loans. Kenneth C. Rojc, *National Bank Lending Limits—A New Framework*, 40 Bus. Law. 903, 923-24 (1985) (citing various OCC interpretive letters). In my opinion, it may be persuasively argued that many of the above facts and circumstances apply in this case, demonstrating that a common enterprise does exist between the local church borrowers. The local churches engage in supporting lines of business and in closely related business activities, the local churches are commonly controlled by the parent church and have similar, if not identical, structures, and the trust agreement provides for a local church to receive financial assistance from either the parent church or other local churches if necessary.[6] However, since I believe that the loans in question must be combined under the direct benefit test, it is not necessary to rely on the facts and circumstances test for determining whether a common enterprise exists.

This analysis is based upon the facts presented and representations made to this office; different circumstances may affect the legal analysis. Our view of the questions presented by your letter reflects current law and may be subject to revision as future developments warrant. If you have any further questions, please contact me at (312) 360-8805.

We trust this is responsive to your inquiry.

Giovanna Cavallo
Senior Attorney
Central District Office

[6] *See* trust agreement*:* S43. FINANCIAL SYSTEM: III. Church Reports; B. Accumulated Delinquent Funds.

926—September 7, 2001

12 USC 24(7)

Subject: Variable Life Insurance

Dear [ ]:

This is in response to your recent letter sent by e-mail requesting confirmation that it is permissible for national banks to purchase variable life insurance in connection with employee compensation or benefit plans. Such insurance is permissible, provided that certain OCC requirements are met.

The OCC's current guidance on purchases of life insurance by national banks is contained in Bulletin 2000–23, July 20, 2000. You appear to be familiar with this issuance. As you recognized, the OCC does not permit national banks to purchase life insurance purely as an investment. Rather, as stated in the bulletin, the purchase must be for a purpose that is incidental to banking. One of the purposes that we have found to meet that standard is insurance purchased in connection with employee compensation or benefit plans. That is, national banks may purchase life insurance in order to fund or recover the cost of compensation or benefits for their employees, officers, or directors. Thus, the quick answer to your question is that it is permissible for national banks to purchase variable life insurance for this purpose, and it does not matter whether the insurance is single premium or annual premium.

However, if the separate account associated with variable life insurance is to contain equity securities, there is a further limitation. This limitation is that the equities in the account must serve to hedge the bank's liability under the compensation or benefit plan that the insurance is intended to fund. As explained on page 13 of Bulletin 2000-23, "an economic hedge exists when changes in the value of the liability or other risk exposure hedged are offset by counterbalancing changes in the value of the hedging instrument." The bulletin goes on to say:

> An example of such a relationship would be where the amount of the bank's deferred compensation obligation is measured by the value of a stock market index, and the separate account contains a stock mutual fund that mirrors the performance of that index. *If the insurance cannot be characterized as an effective hedging transaction, the presence of equity securities in a separate account is impermissible.*

OCC Bulletin 2000-23, page 13 (emphasis added). Thus, equity investments can be used in connection with variable life insurance, but only if this hedging requirement is met.

In my opinion, a defined contribution plan could meet this standard, while a defined benefit plan could not. This is because in a defined contribution plan, the amount of the bank's liability depends upon the performance of the plan benchmark—typically, an equity security or an equity market index—making it possible for the bank to purchase a security that will track that benchmark and offset the liability. In contrast, a defined benefit plan obligates the bank to pay a certain amount regardless of the performance of the bank's investments. It is therefore impossible to effectively hedge the bank's exposure.

As you are aware, the bulletin sets forth a number of due diligence steps that national banks should take in connection with any purchases of life insurance. Please note that for the purchase of variable life containing equity securities, additional due diligence measures are set forth on page 13 of the bulletin.

It is my understanding that separate accounts can be designed to contain only bank-permissible investments, *i.e.*, Treasury and investment grade fixed income securities. See OCC Interpretive Letter 826, March 17, 1998.[1] In my opinion, that type of separate account product would be permissible in connection with a defined benefit plan because there is no hedging requirement for fixed income investments in a separate account.

To summarize, national banks may purchase variable life insurance for the purpose of funding or recovering the cost of employee compensation or benefit plans. It does not matter whether it is structured as a single premium or annual premium product. If such insurance is to contain investments in equity securities, there is an additional requirement that the securities must be related to the bank's compensation or benefit liability in such a way that their values rise and fall together, so that the insurance can be characterized as a hedging transaction. An example of this would be a defined contribution plan linked to an equity benchmark. However, if variable life is to be used in connection with a defined benefit plan, it is my opinion that the separate account must be limited to bank-permissible (fixed income) investments.

[1] Available on the OCC web site at www.occ.treas.gov/interp/may98/intmay98.htm.

I hope that this has answered your question. Please feel free to contact me again if further questions arise.

Christopher C. Manthey
Counsel
Bank Activities and Structure Division

927—October 29, 2001

12 CFR 3

VIA FACSIMILE

Dear [ ]:

This letter is in response to the issues you raised in your October 11 letter to the OCC regarding the appropriate risk-based capital treatment for [ ]'s securitization transactions. The OCC has determined that, for risk-based capital purposes, the bank must: (i) reflect recourse treatment on the securitized assets; and (ii) demonstrate to the satisfaction of the OCC that its policies and practices have been sufficiently modified to warrant application of non-recourse treatment to new securitization transactions. As you were previously instructed by on-site OCC examiners, [ ]'s Report of Condition and Income (Call Report) for the third quarter 2001 should be filed in a manner consistent with this recourse determination for risk-based capital purposes.

The OCC reviewed [ ]'s securitization program in a recent bank examination and determined that certain practices constitute a sale of assets with recourse for risk-based capital purposes. These practices related to the classification of certain delinquent accounts as fraud losses, resulting in repurchase by the bank at par, when the losses were actually attributable to credit quality. Consequently, the assets that were previously treated as sold under generally accepted accounting principles and for risk-based capital purposes will be risk weighted as if they were still on the bank's balance sheet and included in risk-weighted assets for risk-based capital purposes.

The general rule on recourse, contained in the glossary section of the Call Report instructions, describes the appropriate capital treatment for implicit recourse.[1]

[1] *See* the glossary entry "Sales of Assets for Risk-Based Capital Purposes" in the Call Report instructions. These instructions are incorporated by reference in the OCC's risk-based capital regulations. See 12 CFR Part 3, Appendix A, Section 3(b)(1)(iii), footnote 14.

The instructions state, "Regardless of the legal structure of the transaction, if risk of loss is retained by the seller, either contractually or otherwise . . . the seller should treat the transaction as an asset sale with recourse for purposes of risk-based capital and Schedule RC-R even if the sale . . . is stated as being without recourse."

In your letter, you requested clarification of how the securitized assets should be treated prospectively. You state that you have "committed to change [your] accounting policies to eliminate any implication that [your] characterization of certain loan defaults as fraud losses gives rise to a right of recourse against the bank." Despite this commitment, the bank's past practices warrant continued recourse treatment for risk-based capital purposes on a prospective basis for the securitized assets, the securities backed by those assets, and the master trust from which the securities were issued.

The general presumption with securitization transactions is that a bank is not exposed to risk of loss beyond its contractual obligation. It is this presumption that allows banks to treat securitized assets as sold for risk-based capital purposes *(i.e.,* not apply recourse treatment). Once a bank provides support to a securitization beyond the bank's contractual obligation, the presumption of the bank's limited exposure to loss no longer holds. When a bank provides non-contractual credit support to a securitization, the expectation is raised among securitization investors and bank supervisors that the bank will provide similar future support if needed. Allowing a bank to provide support to a securitization and then later allowing that securitization to receive the risk-based capital benefits of sales treatment can create an incentive for banks to repeatedly support a deal and subsequently alter their practices so as not to trigger recourse treatment going forward. Such a situation could result in the bank effectively providing ongoing support to investors, resulting in no risk transference from the bank to third party investors, with the bank holding capital that is not commensurate with its risk exposure. Consequently, long-standing general OCC policy is that once a securitization has been "tainted," the transferred assets are treated as assets sold with recourse for risk-based capital purposes, even if a bank immediately stops its practice of providing support to investors.

The OCC has communicated its policy with respect to implicit recourse in a number of ways over the years. As we have described, the Call Report instructions clearly require recourse treatment for risk-based capital purposes where a bank provides support "contractually or otherwise." The 1994 Bank Accounting Advisory Series (BAAS) included an example of an implicit recourse situation involving the repurchase of performing and delinquent assets from a securitization trust and the subsequent issuance of a new securitization backed by the performing assets. Regulatory sales treatment was disallowed for the subsequent securitization of the repurchased assets. The BAAS noted that all future securitizations by the bank would require close scrutiny to determine whether implicit recourse existed. Recently issued revisions to the BAAS (September, 2001) continue to include an example of implicit recourse in which risk-based capital is required for securitized assets after a bank's prior actions have demonstrated the retention of a risk of loss. The OCC's policy regarding implicit recourse has also been described in the Comptroller's Handbook on Asset Securitization (November 1997) and the preambles to the 2000, 1997, and 1994 proposed rules on recourse.[2]

In your letter, you requested clarification of whether the OCC would permit sales treatment for risk-based capital purposes for new securities that were exchanged for existing securities, where the new securities would be identical to the existing securities. The OCC would continue to require recourse treatment for the assets underlying these new securities. Recourse treatment is linked not only to the securities issued out of the existing master trust, but also to the receivables that back those securities. Issuing new securities that are identical to existing securities would not eliminate the recourse associated with the trust or the outstanding receivable balances that back those securities.

In order to avoid recourse treatment on any new securitization transactions involving new assets in a new master trust, the bank must demonstrate to the OCC's satisfaction that it has changed the practices that have resulted in recourse treatment and that it will not provide support to future securitizations. Factors that might be considered include an improved ability by the bank to distinguish between fraud losses and credit losses, trust documents that more clearly define how losses are to be shared between the bank and the trust, and demonstration over time that the bank's practices do not result in support to investors beyond the bank's contractual obligation.

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[2] *See* "Risk-Based Capital Standards; Recourse and Direct Credit Substitutes; Proposed Rule," *Federal Register,* March 8, 2000 (Volume 65, Number 46); "Risk-Based Capital Standards; Recourse and Direct Credit Substitutes; Proposed Rule," *Federal Register,* November 5, 1997 (Volume 62, Number 214); and "Risk-Based Capital Requirements-Recourse and Direct Credit Substitutes," *Federal Register,* May 25, 1994 (Volume 59, Number 100).

We hope that this letter allows you to better understand our position with respect to your institution's risk-based capital treatment for securitization transactions. Please feel free to contact Tommy Snow at (202) 874-5070 if you have any questions.

Kevin J. Bailey
Senior Advisor
Bank Supervision Policy

928—December 24, 2001

12 USC 24(7)

Dear [ ]:

This responds to your letter of August 3, 2001, seeking, on behalf of the [ ] (the "bank") an interpretive letter from the Office of the Comptroller of the Currency ("OCC") on the authority of national banks to offer certain electronic commerce and security-related services to their wholesale and non-profit organization customers. For the reasons set forth below, we find that the proposed activities are permissible for national banks.

Background

The bank proposes to engage in several activities in association with its electronic payments services. For merchants, government agencies, and non-profit service organizations that are bank customers (the "customers") with previously established Web sites, the bank will design and host[1] a Web site and provide software[2] enabling: 1) the customers to process various forms of payments electronically from their end clients; 2) customers' end clients to electronically schedule and pay for events offered by a customer organization; and 3) the customer to acquire and compile information[3] from their end clients ("client information") in connection with the above described transactions to be used for authentication purposes and to facilitate future interactions between the customer and its end client. Also, in connection with these Internet-related Web-services, the bank will consult with and advise its customers on how the Web site should be designed and operated so the Web site hosted by the bank and the related information is secure from unauthorized access while on the bank's premises, while in transit to and from the bank, and while in the customer's possession. Finally, the bank will also offer electronic bill presentment and payment services for its merchant, government agency, and non-profit service organization customers.

In addition, while the proposed activity will focus on the bank's customers, the bank will also market the Group's Internet-related services to non-customers—who may or may not have an existing Web site—but who wish to have a payment related portion added to a new Web site that can accommodate the services described above. Any person who wishes to have a payment portion of a Web site designed must have a bank account for settlement purposes—thereby becoming a bank customer.

Customers that sign up for the services offered by the bank will be charged various fees, including a licensing or start-up fee when they initially sign up for the services offered by the bank, monthly maintenance and hosting fees, and/or transaction fees in connection with processing payment transactions.

When the bank builds and hosts the customer's Web site, the bank will do so in a manner that is consistent with the appropriate levels of security and confidentiality risk control measures that are consistent with the standards OCC adopted under 15 USC 6801(b) and codified in 12 CFR Part 30, Appendix B (the Interagency Guidelines Establishing Standards for Safeguarding Customer Information).

Bank is aware that the proposed activities will impose added risks to the bank, including transaction risk, legal risk, and reputation risk. Through a series of internal and external audits of the bank's technology, procedures and controls, the bank has identified and reduced operational risks that were identified by making the adjustments recommended in the audits. The bank plans to have regular internal and external audits of the activities. The staff that would conduct the activities have worked closely with the bank's internal auditors on the bank's recently implemented Information Security Program, required under 12 CFR Part 30, so that the program incorporates

[1] The bank will require that it host the portion of the page it develops.

[2] The software will either be developed by the bank or obtained from a third party.

[3] The client information described in above, will consist of information such as the end client's name, mailing address, shipping address, e-mail address, telephone number, preferred credit card numbers for billing purposes, and other billing account information. The client information will primarily be used for authentication and security purposes by the bank on behalf of its customer. However, from the end client's perspective, the client information will enable the customer to provide a more convenient shopping service since the end client will not have to re-key their information when they visit the customer's site again. The client information will also the enable customer to communicate more effectively with its end clients by sending out newsletters or communication to the end client's e-mail address acquired during the setup process.

the current and proposed activities discussed in this letter. OCC has recently completed an information technology review of the bank that included the proposed Web-hosting activities and systems.

Discussion

The OCC has found that, as part of the business of banking and in association with electronic payments services, national banks may provide merchant customers with services that will enable the merchant to operate a commercially enabled Web site.[4] The processing of payments resulting from orders received through a merchant's Web site is also clearly part of the business of banking.[5] Merchant credit and debit card processing services generally involve verifying credit card authorizations at the time of purchase, processing card transactions, settlement of card transactions, and depositing funds into merchants' accounts. The fact that the credit and debit card and other electronic payment transactions would involve purchases of goods or services over the Internet does not change the nature of the service that would be provided.[6] Thus, the bank's proposed payment processing and associated commercial Web site hosting activities are permissible.

OCC has found that the finder authority to host, develop, and support commercially enabled Web sites extends not only to merchants, but also to non-profit service entities such as government agencies that provide goods and services to the public. OCC Conditional Approval No. 361 (March 3, 2000) (national bank may host Web sites for government agencies that offer goods and services to the public). We believe this rationale applies equally to private non-profit organizations that provide goods and services to the public.[7]

Moreover, OCC has found that incidental to a payments processing service and associated commercial Web site hosting, a national bank may provide Web design and development services. The ability to build the Web sites for the participating merchants as part of a commercial Internet services package is critical to the successful marketing of the package.[8] To enhance marketability and reduce costs to merchants, the firms that will compete with the bank in providing Internet commerce products and services are now offering complete packages to merchants, which include the building of the Web sites. *See e.g.*, Bloom, *supra*; Steven Marjanovic, "First Data to Buy Stake in iMall, a Software Firm," *American Banker,* Nov. 9, 1998, at 17; Tami Luhby, "Wells Fargo Opens Door to Web for Small Business," *American Banker,* Sept. 15, 1998.[9]

OCC has long held that, under their incidental powers, national banks may sell non-banking products and services when reasonably necessary to provide banking

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[4] In association with their electronic payments services, national banks may provide a "package" of Internet-based services to retail merchants including: hosting Web sites on the bank's own server; registering merchants with search engines and obtaining Universal Resource Locators; providing an electronic communication pathway for product ordering and payment; maintaining merchants' data associated with the Web sites on its server *(e.g.,* price information, product descriptions, and images); providing merchants with software to create Web sites; providing reports on transactions, Web site "hits," and sales data; and processing credit card transactions. OCC Interpretive Letter No. 856 *reprinted in* [1998–1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–313 (March 5, 1999) (providing or maintaining an Internet Web site for merchants is one device that national banks may use as finders to provide information to the merchants' customers).

[5] OCC Corporate Decision No. 99–50 (Dec. 23, 1999) and OCC Corporate Decision No. 2000–08 (June 1, 2000) (national bank may process for its merchant customers purchases made over the Internet); OCC Interpretive Letter No. 856, *supra. See also* OCC Conditional Approval Letter No. 289 (Oct. 2, 1998) (national banks may acquire a minority interest in a firm that, among other things, provides accounts receivable processing and accounts payable processing); OCC Conditional Approval Letter No. 282 (July 7, 1998) (national bank may acquire an interest in a firm that would, among other things, engage in payments processing for the health care firms); OCC Conditional Approval Letter No. 248 (June 27, 1998) (national bank operating subsidiary may acquire a minority interest in an entity that provides merchant credit and debit card processing services); and OCC Interpretive Letter No. 731 *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,048 (July 1, 1996) (national banks as part of the banking business may collect and process accounts relating to an electronic toll collection system).

[6] Likewise, the fact that some of the bank's Web sites will enable end clients to purchase rights to attend events, rather than goods or conventional services, does not change the permissibility of the activity. OCC has found that national banks can process orders and payments for event and attraction tickets. *See* OCC Interpretive Letter No. 718 *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–033 (March 14, 1996). There is no reason why the bank's electronic finder authority should not include bringing together buyers and sellers of events, which really are a form of services.

[7] As we noted in a prior letter: "In the finder analysis, no distinction should be drawn between bringing together with a government agency those who wish to *purchase* goods or services from that agency and those who wish to *consume* goods or services from that agency. The latter, most likely individuals seeking forms, benefits, or other information from the agency, are not "buyers" in the traditional sense; however, as taxpayers, they are essentially buying information or other goods or services for which their taxes have paid. As such, they qualify as legitimate subjects for finder activities by national banks. *See* Corporate Decision No. 98–13 (Feb. 9, 1998) (national bank operating subsidiary, acting as finder, could bring together individuals who wished to enroll in government-sponsored health insurance program with appropriate government agency)." *Id.* at p. 7.

[8] *See* J. Bloom, "Vendor Groups Woo Banks into Net Services," *American Banker,* May 27, 1999, at 14 (reporting that vice president of the National Retail Federation says merchants of all sizes prefer to outsource the building of virtual stores).

[9] Experts say that without these packages, most smaller companies lack the budget and manpower to do a thorough job of creating and maintaining a commerce-enabled Web site. Bloom, *supra*.

products on a competitive basis by creating a package of related services needed to satisfy consumer demand, meet market competition, and enable the bank to successfully market its banking services. Thus, for example, in OCC Interpretive Letter No. 742, OCC found offering of Internet access service was needed to successfully provide and market the bank's Internet banking service. We found limiting the bank's Internet access services, to block non-banking use, would not meet customer needs or the competing products in the marketplace. See also, OCC Interpretive Letter No. 611, *supra,* (bank selling home banking service can also provide customer access to non-banking services "to increase the customer base and the usage of the program"); OCC Interpretive Letter No. 653, reprinted in [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (December 22, 1994) (national banks may offer non-banking products as part of larger product or service when necessary, convenient and useful to bank permissible activities). *Cf., National Courier Ass'n* v. *Board of Governors,* 516 F. 2d 1229, 1240 (D.C. Cir. 1975) (incidental powers of holding companies to provide specialized courier services when service necessary to obtain full benefit of data processing services).

For this reason, the proposed building of Web sites by the bank for those merchants desiring that service is incidental to the business of banking. Corporate Decision No. 2000–08, *supra* and OCC Interpretive Letter No. 875 *reprinted in* [1999–2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–369 (October 31, 1999). *See also* OCC Interpretive Letter No. 856, *supra* (national bank engaged in permissible Web site hosting activity may provide merchants with software that will enable them to design and modify their Web sites).

As noted above, one of the features the bank proposes to provide for merchants in the designed and hosted Web sites would enable the merchant customer to acquire and compile information from their end clients that would be used primarily for authentication and security purposes and to facilitate additional transactions when the end client returns to the Web site to conduct additional business. This "one-click" shopping information concept is becoming increasingly prevalent in electronic commerce. Major firms such as AOL Time Warner, Inc. and Microsoft are currently developing systems that will allow people to store personal information (such as names, addresses, and credit card numbers) online to simplify their purchasing transactions on the Internet. A. Klein and A. Cha, "AOL May Launch an Internet ID Service," *Washington Post,* July 27, 2001, p. E-1. Similarly, a number of significant electronic merchants and payment processors have developed and are refining an "electronic wallet" which performs much the same function by enabling customers to store identifying, shipping, and payment-related information so that the customer does not need to re-key the information the next time they submit an order. *See* M. Barnett, "It's the Year of the E-Wallet," *The Industry Standard,* June 30, 1999, viewed July 27, 2001, at http://www.cnn.com/tech/computing/9907/01/ewallet.idg/; M. Zane, "NextCard to Offer E-wallet," *ZDNN*, October 18, 1999, viewed July 27, 2001, at http://www.zdnet.com/filters/printerfriendly/0,6061,2374202-2,00.html; Bloom and J. Kutler, "Web Wallet Marketers Struggle for Definition and Acceptance," *The American Banker,* November 4, 1999; and J. Capachin, "Digital Wallets: Their Potential Exceeds Their Performance," *American Banker,* August 17, 2001.

The bank may permissibly offer this "one-click" shopping information service to customers of its commercial Web site services for two reasons. First, the service is incidental to the electronic payments processing service provided by the bank in that it enhances the convenience of the service for both the merchants and their end clients. OCC has held, in Interpretive Letter No. 868 *reprinted in* [1999–2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81263 (August 16, 1999), that a national bank can hold a minority interest in a company that designs and distributes software that performs the same "one-click" shopping function. That letter concludes that the "one-click" shopping software was permissible because it "will facilitate the electronic transfer of funds from consumers to businesses and financial institutions" and thus performed "activities commonly undertaken by banks directly for themselves, other financial institutions, or as part of servicing customers."

Second, processing of the retail based information relating to identity, shipping information, and payment information with respect to end clients and their transactions for merchant customers is permissible because it involves the processing of banking, financial, and economic data. Case authority supports this conclusion. In *Ass'n of Data Processing* v. *Board of Governors*, 745 F.2d 677 (D.C. Cir. 1984), the D.C. Circuit Court of Appeals upheld a Federal Reserve Board finding that data processing and database services were closely related to banking (and thus a proper activity for bank holding companies) if the "data to be

processed . . . are financial, banking or economic. . . . "[10] Further, the court indicated that "economic data" would include: "agricultural matters, *retail sales matters,* housing matters, corporate profits matters, and anything of value in banking and financial decisions." 745 F.2d at 691 (emphasis added).[11]

Likewise, the proposed processing of the retail-based client information is supported by OCC precedent. OCC has long held that as part of the business of banking, national banks may collect, transcribe, process, analyze, and store for itself and others banking, financial, or economic data.[12] OCC precedent establishes that the information that will be included in the bank's E-wallet and client information service is banking, financial or economic data. OCC Corporate Decision No, 2000-08, *supra* (national bank may, as part of its permissible Web hosting services, provide hosted merchants with information and reports relative to the purchases and transactions on their Web sites); OCC Interpretive Letter No. 677, *supra*. *See also* OCC Interpretive Letter No. 741 *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶81–105 (Aug. 19, 1996) (national bank acting as finder for automobile dealers may also maintain a comprehensive system that allows dealers to track information on customers referred and to generate market statistics such as buying trends and cycles); and OCC Interpretive Letter No. 346, *supra*. *See, e.g.,* OCC Interpretive Letter No. 737, *supra* (national bank may provide transaction and information processing services to support an electronic stored value system); OCC Interpretive Letter No. 653, *supra* (national bank may act as an informational and payments interface between insurance underwriters and general insurance agents).[13] Other agency precedent also supports this conclusion.[14]

The bank proposes to offer electronic bill presentment to its Web enabled customers. OCC has found that electronic bill presentment is part of the business of banking.[15]

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[10] In reaching this conclusion the court said: "The record of this proceeding amply demonstrates, if any demonstration is needed, that banks regularly develop and process for their customers large amounts of banking, financial and economic data, and that they do so (and will presumably continue to do so) through the most advanced technological means." 745 F.2d at 689. Compare *National Retailers Corp*. v. *Valley Nat'l Bank*, 411 F. Supp. 308 (D. Ariz. 1976), *aff'd*, 604 F.2d 32 (9th Cir. 1979) (a national bank does not to have the authority to offer a data processing service to retailers involving the collection and compilation of information relating to their retail sales that had been collected by a special cash register). The district court in *National Retailers* held that no express provision of the National Bank Act authorized national banks to publicly market a retail information service ("RIS") and concluded that, since the RIS was not within the enumerated powers, the determining issue was whether the RIS was within the bank's "incidental powers." 411 F. Supp. at 313. Thus, by implication, the court held that the "business of banking" includes only the enumerated powers. This position has since been repudiated by the Supreme Court's ruling in *NationsBank* v. *Variable Life Annuity Co*., 513 U.S. 251 (1995), that the "business of banking" is not limited to the enumerated powers. The *National Retailers* court failed to consider that non-enumerated informational services can come within the "business of banking" and specifically that the processing of banking, financial and related economic data is part of the business of banking. *Ass'n of Data Processing, supra*. In light of these defects, the holding of *National Retailers* is not entitled to much weight.

[11] Federal Reserve Board has approved as closely related to the business of banking a wide range of data processing services for businesses. Letter to Thomas A. Plant, from Virgil Mattingly (Nov. 25, 1997) (data processing support for the bookkeeping, accounting, and recordkeeping of nonfinancial firms); Compagnie de Paribas, 82 *Fed. Res. Bull.* 82 (1996) (data processing for payroll, accounts receivable, and billing services); The Bank of New York, et al., 80 *Fed Res. Bull.* 1107 (1994) (electronic data capture an electronic data interchange services in which merchants are provided with information relating to inventory and the buying patterns of customers that could be used by the merchants for inventory control, targeted marketing, and other purposes); and Banc One Corp., *et al.,* 79 *Fed. Res. Bull.* 1158 (1993) (same).

[12] An earlier version of 12 CFR 7.1019 stated that "as part of its banking business and incidental thereto, a national bank may collect, transcribe, process, analyze, and store for itself and others, banking, financial, or related economic data." OCC Interpretive Ruling 7.3500, 39 *Fed. Reg.* 14195 (Apr. 22, 1974). Although in its 1984 revision of the ruling, the OCC deleted this statement because it believed that "specific examples [of permissible electronic activities] are inappropriate given the imprecision of terms and rapid pace of change in the data processing industry," the "analytical framework" embodied in the ruling remained the same. 49 *Fed. Reg.* 11157 (Mar. 26, 1984). OCC has consistently expressed this view. *See* OCC Interpretive Letter No. 677 *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83625 (June 28, 1995). *See also* OCC Interpretive Letter No. 737 *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–101 (August 19, 1996) (national bank may provide transaction and information processing services to support an electronic stored value system); OCC Interpretive Letter No. 653 *reprinted in* [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (Dec. 22, 1994) (national bank may act as an informational and payments interface between insurance underwriters and general insurance agents); and OCC Interpretive Letter No. 346 *reprinted in* (1985–1987 Transfer Binder) Fed. Banking L. Rep. (CCH) ¶ 85,516 (July 31, 1985) (national banks may maintain records on commodities transactions).

[13] In connection with the client information services it provides to its customers, the bank will have access to personal information regarding its customers' end clients. The OCC expects the bank to limit its use and disclosure of the customer's client information to that which is necessary to perform the services for the bank's customers. The OCC also expects the bank to establish appropriate security measures for safeguarding this information. These issues should be addressed in the bank's agreements with its customers.

[14] Bank of New York, *et al., supra* (electronic data capture and electronic data interchange services in which merchants are provided with information relating to inventory and the buying patterns of customers that can be used by the merchants for inventory control, targeted marketing, and other purposes involve "banking, financial, or economic data") and Banc One Corp., *et al., supra* (same).

[15] *See, e.g.*, OCC Corporate Decision No. 2000-08, *supra*; OCC Conditional Approval No. 304 (March 5, 1999) (electronic bill payment and presentment services over the Internet); OCC Interpretive Letter No. 731, *supra* (operation of electronic toll collection system); OCC Interpretive Letter No. 836, *reprinted in* [1996–1997 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 81-290 (March 12, 1996) (data processing and electronic data interchange system to assist in the billing and collection for medical services).

Finally, the bank also desires to consult with and advise its customers on how a Web site should be designed and operated so that the site hosted by the bank and information related to that site concerning payment transactions and end client information is secure from unauthorized access while on the bank's premises, while in transit to and from the bank, and while in the customer's possession.

Some of the bank's proposed security services are clearly encompassed within the hosting, design, and development services discussed above and thus are not a separate product or service. When transaction and client information is within the bank's environment, the bank will be responsible for the security of the information. The bank will be operating the host server and, through its system design, will specify appropriate logical access controls. Also, by hosting the server, the bank will provide physical security. Finally, in designing and developing the commercially enabled Web sites or a portion thereof the bank will design in appropriate security. Adequate security is part of these authorized services and need not be separately analyzed or authorized.

However, it is contemplated that transactional and client information will be made available to customers and placed in environments under their control. The issue is whether the bank can provide customers with advice on security with respect to the information when it is in customers' environments. For the reasons below, we find that, in this context, the security consulting proposed by the bank is a logical outgrowth of its banking business and, thus, permissible.[16]

To date, OCC has authorized national banks to provide security consulting for other financial institutions as a correspondent service. No-Objection Letter 90–3 *reprinted in* [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH), ¶ 83207 (May 2, 1990); OCC Interpretive Letter No. 398 *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,622 (September 28, 1987); No-Objection Letter 86–15 *reprinted in* [198X–198X Transfer Binder] Fed. Banking L. Rep. (CCH), ¶ 84,021 (June 6, 1986); and OCC Interpretive Letter No. 137 *reprinted in* [1981–1982 Transfer Binder] Fed. Banking L. Rep. (CCH), ¶ 85218 (Dec. 27, 1979). However, the OCC has permitted national banks to provide consulting and advisory services for non-correspondents in many areas that are financially related or in which banks have developed extensive expertise.

For example, national banks may engage in lease consulting services. OCC Interpretive Letter No. 567 *reprinted in* [1991–1992 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶83,337 (October 29, 1991). They may offer financial and consulting services, including market research and analysis, strategic planning, advertising and promotion planning, product development, personnel management, employee relations, affirmative action, and salary and benefit plans to banks and commercial customers. OCC Interpretive Letter No. 137, *supra*. They are permitted to provide consumer financial counseling. *Id.*; OCC Interpretive Letter No. 367 *reprinted in* [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) & 85,537 (August 19, 1986). National banks can also offer employee benefit consulting services (including health benefit consulting) to corporations wishing to establish qualified benefit plans and relocation consulting for employees of a bank or its affiliates, or customers of the bank. OCC Corporate Decision No. 98–51 (November 30, 1998). They may engage in financial consulting and advisory services for other financial institutions and the general public, including, among other things, acting as a conduit in conveying loan terms to prospective borrowers or purchasers, supplying financial information regarding a third party, or engaging on behalf of others in research in contemplation of prospective transactions. OCC Interpretive Letter No. 238 *reprinted in* [1983–1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,402 (February 9, 1982). Finally, OCC has recognized that national banks operating as certification authorities can provide consulting or advisory services to help customers, including other banks, to implement digital signature systems. OCC Conditional Approval No. 267 (January 12, 1998).

Thus, advisory and consulting services are an appropriate way for banks to exercise their core competencies. This has important implications under the logical outgrowth test. As OCC observed in prior precedent:

> Among other things, the "logical outgrowth" test recognizes that the "business of banking" is defined not

[16] The Supreme Court has held that the National Bank Act, in 12 USC 24(Seventh), contains a broad grant of the power to engage in the "business of banking." *See NationsBank of North Carolina, N.A.* v. *Variable Life Annuity Co.*, 513 U.S. 251 (1995) ("*VALIC*"). Specifically, the Court has said that the business of banking "is not limited to the enumerated powers in 24 Seventh and that the Comptroller therefore has discretion to authorize activities beyond those specifically enumerated." 513 U.S. at 258–59, N. 2. In exercising this discretion, the OCC is guided by several factors reflected in case law and followed by OCC precedent: (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; (3) does the activity involve risks similar in nature to those already assumed by banks; and (4) whether the activity is expressly authorized by law for state-chartered banks.

> only by the services and products that banks provide, but also by the core competencies that banks use to produce them. ***
>
> Clearly, "the business of banking is not static. . . . " *New York State Ass'n of Life Underwriters* v. *New York State Banking Department*, 632 N.E.2d 876, 880 (N.Y. 1994). OCC recognizes that the evolution of "business of banking" is not restricted to lines of business reflecting only products banks have sold or functions banks have served previously. Rather, the "business of banking" must be—and is—sufficiently flexible to enable banks to develop and exploit their unique core competencies and optimize the return on those competencies by marketing products and services reflecting or using those competencies. Today, banks face a rapidly changing market that demands rapidly evolving skills. Thus, it is vital that they be able to plan strategically and adapt and respond appropriately.

OCC Conditional Approval No. 267, *supra*.

In that letter, OCC concluded that as part of the business of banking national banks could act as digital certification authorities because, *inter alia,* the certification authority activity was a logical outgrowth of the core competence that banks had developed in verifying and authenticating customer identities through paper and electronic systems. Here we similarly find that rendering advice is one way that banks can and, with appropriate limitations, should be able to exploit their core competencies. Indeed, some OCC letters authorizing advisory activities reflect the rationale that the particular advisory activities are permissible because they involve the bank in providing advice on an activity that the bank could provide directly to the advisee. For example, in concluding that a national bank can offer financial advisory services on credit funding alternatives to public and private entities, OCC found the activity permissible because it "will involve the bank's own expertise developed internally in considering direct loans to these types of borrowers." Unpublished letter from Thomas Taylor (May 25, 1984).

Thus, we find that where a bank would be permitted as part of the business of banking to provide a service and related expertise to an entity, the bank should also be permitted, as part of the business of banking, to employ that expertise to provide advice to that entity as to how the entity can perform the service for itself. This will enable a bank that has developed extensive expertise on a service to share that expertise and competence with persons to whom the bank could have sold the service. The risk exposures of providing advice on an activity, while somewhat different from providing the actual service, would certainly be no greater and can be properly limited and controlled.[17]

Here the bank proposes to provide advice on maintaining the security of information relating to transactions arising from a commercially enabled Web site the bank designed and hosts for its customer. Clearly, the bank could provide safekeeping and security services directly to its customers on this information.[18] The OCC recently issued a letter concluding that, as part of the business of banking, a national bank can provide electronic safekeeping services for personal information and valuable confidential trade or business information. OCC Conditional Approval No. 479, (July 27, 2001). That letter found national banks have established safekeeping functions that encompass securing valuable business records and papers and that the electronic safekeeping of such records is an electronic expression of this established safekeeping function.

The information for which the bank would provide its customers security consulting services would qualify for direct safekeeping under this precedent. Thus, it would be a logical outgrowth for the bank to provide security consulting with respect to that information. In other words, since the bank as part of the business of banking can and will provide safekeeping services for its customers with respect to this information, it is a logical outgrowth of that business for the bank to advise its customers on maintaining the security of that information when it is in the customers' systems and under their control.

The proposed consulting activities would also respond to customer needs or otherwise benefit the bank or its customers. The customers would clearly benefit because the bank could insure that the security program of the customer integrated with the program and systems of the

[17] The advising bank would potentially be liable if it failed to render competent advice. Accordingly, we would expect advising banks to take suitable steps to control that risk, such as keeping adequate records of the advice rendered, obtaining appropriate insurance coverage, and ensuring that the staff rendering the advice is competent, trustworthy, and has appropriate professional credentials. Moreover, we would expect that generally a bank would only render advice on banking services that it has actual direct experience in performing adequately. This would not generally include, for example, a bank that has relied upon outsourcing for an activity. Additionally, when acting in an advisory or consulting capacity, a bank should not actually engage in a management role or exercise any form of operating control over the advisee. Finally, banks providing advisory services should be careful to define clearly in their engagement letters or agreements the scope of advice rendered and the bank's liability for that advice.

[18] In fact, as noted above, the bank will be responsible for the security of this information during the time that it is in the bank's environment and under its control.

bank that initially would hold and process the information. The bank would benefit because it would be able to allocate additional resources to upgrading its security expertise (and enhance its own security) since it would be able to share the cost of that expertise with its consulting customers.

Finally, the proposed advisory activity would involve risks similar in nature to those already assumed by banks. As noted in OCC Conditional Approval No. 479, *supra*:

> [T]he offering of electronic safekeeping of data will expose banks to risks similar to those that banks are already expert in handling. As noted, national banks have long experience in safekeeping of physical items and documents for their customers. In that capacity, they have developed extensive procedures and regimes to handle the responsibilities and risks that arise from this bailment. *See, generally*, Ann Graham, 1 BANKING LAW, Ch. 10 (Safe Deposit Boxes); James McBain, *Safe Deposit Department*, 72 BANKING L. J. 533 (1955). Moreover, OCC has developed guidance on this activity. *Comptroller's Handbook: Consigned Items and Other Customer Services, supra*. Much of this experience, process, and guidance can and should be applied to electronic safekeeping activities. While the use of electronic media to store and access items raises additional risks, banks already have extensive expertise in dealing with these risks and OCC has provided guidance on addressing these risks. In this regard, as noted above, OCC expects that banks offering this service will comply with the requirements under the new Interagency Guidelines Establishing Standards for Safeguarding Customer Information.

Footnotes omitted.

Thus, banks are expert in dealing with business information security risks and in managing the risks of safekeeping activities regarding that information. Moreover, as noted above, banks have considerable experience in managing the special risks that arise when acting in an advisory capacity.

Conclusion

For the reasons set forth below, the proposed activities described in your letter of August 3, 2001, pertaining to electronic commerce and security-related services to their commercial and quasi-commercial customers' activities are permissible for national banks.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

929—February 11, 2002

12 USC 24(7)

12 CFR 28

Subject: [   ] ("bank") Foreign Branch Membership in the London Clearinghouse ("LCH")

Dear [   ]:

This letter responds to your letter and phone conversations concerning the issue of whether it is legally permissible for the bank, via its London branch, to join the LCH as a SwapClear Member ("SCM") to clear interest derivative contracts. For the reasons discussed below, and based on your representations, we believe that the bank's foreign branch LCH membership would be permissible under national banking law, subject to the concurrence of supervisory staff that the activity can be conducted in a safe and sound manner.[1] Conversely, the branch may become an LCH SCM under the Federal Reserve Board's (FRB's) Regulation K.[2]

A national bank must file notice with the OCC when its foreign branch joins a foreign exchange or clearinghouse, whether under the authority of national banking law or Regulation K. The filing requirements for national bank foreign operations are at 12 CFR Part 28. Section 28.3(c) provides that a national bank shall furnish the OCC with information involving the bank's foreign operations in addition to that specifically identified in the regulation. The OCC requires a national bank that becomes a member of a foreign exchange or clearinghouse, by stock acquisition or otherwise, to notify its EIC within 10 days of the membership. A national bank must certify in the notice that its loss exposure is limited as a legal and accounting matter and the bank does not have open-ended liability for the obligations of the exchange or clearinghouse or its members.

I. Background

The LCH provides clearing services to its members in certain exchange-traded and over-the-counter ("OTC") markets. LCH clears: (1) futures and options contracts traded on the International Petroleum Exchange, the London International Financial Futures and Options Exchange, and the London Metal Exchange, (2)

[1] *See* 12 USC 24(Seventh) and 12 CFR 7.7010 and 28.3.

[2] *See* 12 USC 604a; 12 CFR Part 211.

equity transactions effected on virt-x, the London Stock Exchange, and the Irish Stock Exchange (via EquityClear), (3) interest derivative contracts (via SwapClear), and (4) repurchase agreements (via RepoClear). LCH members may be members of one or more of these exchanges. LCH has approximately 113 members that include investment banks, brokerage houses, and producers.

SwapClear provides multilateral clearing, settlement, and payment netting services for OTC interest derivative contracts. LCH becomes the central counterparty for all agreements cleared through SwapClear. LCH nets contracts not only for an SCM's interest derivative contracts, but across all of LCH's product lines, including equity and petroleum products. This results in a net single pay or receive amount per currency per day between LCH and each SCM.

As SCMs, branches have a number of financial obligations to the LCH. LCH members must purchase a single share of LCH stock for $420,000, provide margin, and contribute to a single LCH default fund. LCH pools all its members' default fund contributions for all the exchange-traded and OTC products that it clears. So, for example, if a member defaults on a London Stock Exchange equity contract, an SCM's default fund contribution ultimately is available to cover the losses from that default. Each SCM contributes $3 million to the default fund.[3] All SCM contributions total $145 million. The aggregate default fund contributions for all LCH exchange-traded and OTC business totals approximately $565 million.[4]

LCH's Default Rules define acts that constitute member defaults and describe the actions LCH may take once it declares a member in default. The primary act of default is non-payment of any amount due to LCH.[5] Other acts of default include any breach of LCH Regulations, any breach of exchange or regulatory requirements, and the commencement of insolvency arrangements.[6] The LCH can declare a member in default before the member fails to meet an obligation if it appears the member is, or is likely to become, unable to meet contract obligations.[7]

[3] Contributions are re-calculated quarterly and depend on the levels of each member's clearing activity in relation to the market as a whole. LCH, *Market Protection* (March 1999), at 29. The default fund contribution is the higher of $3 million or 10 percent of the initial margin requirement. LCH General Regulations, Default Rules, and Procedures ("LCH Regulations"), *Default Rule 19E* (February 2001), at 190.

[4] LCH, *Report and Financial Statement* (2000), at 6.

[5] LCH Regulations, *Default Rule 5* (February 2001), at 170, 171.

[6] *Id.*

[7] *Id.*, *Default Rule 3* (February 2001), at 169.

The LCH may take a number of actions against a defaulting member. LCH may close out and settle open contracts of the defaulting member, transfer open positions to another consenting member (with or without margin cover), and enter into new exchange or OTC contracts to hedge the market risk in the defaulting member's open-positions.[8] The LCH may liquidate losses resulting from a member's default, using this priority schedule: (1) the defaulting member's initial margin,[9] (2) the defaulting member's default fund contribution, (3) LCH's year-to-date profits (capped at $14 million), (4) the non-defaulting member's default fund contributions up to $290 million, (5) insurance of $144 million, (6) the remainder of the default fund, and, if necessary, [7] LCH capital.[10]

Upon a default, LCH can request members to make additional contributions to restore the default fund to its original level. LCH's call for additional contributions is voluntary.[11] A non-defaulting member can contribute to the default fund or resign its membership and close out its existing positions.[12] As a result, there is a theoretical cap on a non-defaulting member's contingent liability for the default of other members—the member's original default fund contribution. In addition, since it takes approximately three months for a resigning member to completely withdraw from membership, the member is still responsible during that time for losses on its portfolio and must continue to provide variation margin.

II. Discussion

For the reasons discussed below, we conclude that the bank's foreign branch LCH activities are permissible under national banking law or Regulation K.

A. National Banking Law

National bank foreign branches[13] may engage in general banking activities, which are determined under national

[8] *Id., Default Rule 6* (February 2001), at 171–174.

[9] LCH re-calculates initial margin requirements daily and members must at all times meet the current requirements. LCH, *Market Protection* (March 1999), at 20, 24.

[10] LCH Regulations, *Default Rule 16,* at 183, 184.

[11] *Id., Default Rule 32(b)* (February 2001), at 201.

[12] *Id.*, *Default Rules 32–35* (February 2001), at 201–204.

[13] OCC regulations define the term "foreign branch" to mean an office of a national bank (other than a representative office) that is located outside the United States at which banking or financing business is conducted. 12 CFR 28.2(d). Regulation K defines a "foreign branch" as an office of an organization that conducts a banking or financing business outside the country in which the organization is legally established. 12 CFR 211.2(k).

banking law.[14] National banking law permits national banks, their operating subsidiaries, and their branches to engage in execution and clearing activities, subject to safety and soundness limitations, as activities that are part of the business of banking because the activities are functionally equivalent to bank permissible credit and financial intermediation activities.[15] National banks may provide default fund contributions (indemnification) on their own behalf and on behalf of their foreign branches, as an activity "incidental" or "convenient" or "useful" to these bank permissible activities[16] or as an activity permitted by 12 CFR 28.4(c). Section 28.4(c) expressly permits national banks to guarantee the deposits and other liabilities of their Edge corporations, Agreement corporations, and their corporate instrumentalities in foreign countries. National banks also may own stock in a clearinghouse or exchange to conduct these bank permissible activities.[17]

Clearing is a form of extending credit, one of the main functions of banking institutions.[18] A clearing agent substitutes its credit for that of its customers. A clearing agent is liable to a clearinghouse for performance on all submitted contracts, and assumes, with respect to the exchange, clearinghouse, and counterparties, the risk of its customers' defaults.[19] The clearing function is akin to two other traditional bank credit functions, providing bankers' acceptances and letters of credit.[20] The credit function provided by the bank in its clearing capacity is part of the business of banking, because a principal business of a bank is to extend credit, whatever its form.[21]

National bank clearing and execution activities are functionally equivalent to the primary role of banks as financial intermediaries. The role of a bank is to act as an intermediary, facilitating the flow of money and credit among different parts of the economy.[22] The role of a bank intermediary takes many forms: providing payments transmission services, borrowing from savers and lending to users, participating in the capital markets as here, or using and adopting whatever new methods the economy, markets, and technology develop over time. As the recognized intermediaries between other, non-bank participants in the financial markets and the payment systems, banks possess the expertise to effect transactions between parties and to manage their own intermediation position. Hence, the bank's LCH activities are permissible as part of bank authorized financial intermediary activities.[23]

The OCC has permitted national bank operating subsidiaries to engage in clearing and execution activities identical to those of the bank in LCH, both domestically and abroad.[24] The amount of risk a national bank may

[14] *See* 12 USC 604a; 12 CFR 211.4(a).

[15] Courts have affirmed OCC interpretations that an activity is within the scope of the "business of banking" if it: (1) is functionally equivalent to or a logical outgrowth of a traditional banking activity; (2) would respond to customer needs or otherwise benefit the bank or its customers; and (3) involves risks similar to those already assumed by banks. *See, e.g., Merchant Bank* v. *State Bank*, 77 U.S. 604 (1871); *M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978); *American Insurance Ass'n.* v. *Clarke*, 865 F.2d 278, 282 (2d Cir. 1988). In *IAA* v. *Hawke*, 211 F.3d 638 (D.C. Cir. 2000), the court expressed the position that the "logical outgrowth" rationale needed to be kept within bounds, but endorsed the "functional equivalent" component of the test.

[16] Incidental activities are activities that are permissible for national banks, not because they are part of the powers expressly authorized for bank or the "business of banking," but rather because they are "convenient" or "useful" to those activities. *See NationsBank* v. *Variable Annuity Life Insurance Co.,* 513 U.S. 2251 (1995); *Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427 (1st Cir. 1972); OCC Interpretive Letter No. 742 (August 19, 1996), *reprinted in* [1997–1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–106; OCC Interpretive Letter No. 737 (August 19, 1996), *reprinted in* [1997–1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–101; OCC Interpretive Letter No. 494 (December 20, 1989), *reprinted in* [1989–1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,083.

[17] *See, e.g.,* OCC Interpretive Letter No. 421 (March 14, 1988), *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (national bank permitted to own stock in the Government Securities Clearing Corporation).

[18] *See* OCC Interpretive Letter No. 494, *supra*.

[19] A clearing member is subject to two types of incidental and contingent liabilities. First, a clearing member is obligated to perform all trades of its customers, whether or not the customer is able to perform the trade. Second, a clearing member is exposed to partial contingent liability for the obligations of all other clearing members to the clearing corporation. It is clear that whether a bank's operating subsidiary or branch is liable as broker to a clearing firm or as clearing broker to a clearing corporation, the ultimate liability and investment risk for all trades lies with the customer, against whom an action for recovery may be maintained. The OCC, therefore, does not consider the clearing member's "guarantee" of its customers' trades to the clearing corporation to violate the "without recourse" provision of Section 24(Seventh). *See* OCC Interpretive Letter No. 380 (December 29, 1986), *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604.

[20] *See* OCC Interpretive Letter No. 494, *supra*.

[21] *Id.*

[22] *See, e.g*., OCC No-Objection Letter No. 90-1 (February 16, 1990) *reprinted in* [1989–1990 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,095; OCC No-Objection Letter No. 87-5 (July 20, 1977), *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,034.

[23] *See* OCC Interpretive Letter 892 (September 8, 2000), *reprinted in* [2000–2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–411.

[24] See, e.g., OCC Interpretive Letter No. 494, supra (national bank and operating subsidiary clearing and exchange members); OCC Interpretive Letter No. 422 (April 11, 1988), reprinted in [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (same); OCC Interpretive Letter No. 384 (May 19, 1987), reprinted in Fed. Banking L. Rep. (CCH) ¶ 85,608 (same); OCC Interpretive Letter No. 380, supra (execution, clearance, and exchange membership); OCC Interpretive Letter No. 372 (November 7, 1986), reprinted in [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,542 (same).

assume from exchange and clearing activities must be limited, however, due to safety and soundness concerns.[25] Thus, for example, the OCC has not permitted national banks to guarantee or become liable for customer trades executed by, or otherwise assume the liabilities of, their subsidiaries.[26]

The National Bank Act is silent on the authority on national banks to provide guarantees.[27] The Supreme Court has not held that guarantees are *per se* impermissible for national banks. [28] Instead, the Court has upheld a national bank's power to make guarantees given the specific facts under consideration.[29] Lower courts have tended to generalize these cases, however, in stating that national banks may not provide guarantees.[30]

National banks may provide guarantees, however, if the guarantee qualifies as "incidental"or "convenient"or "useful" to the business of banking under 12 USC 24(Seventh). This reasoning is supported by OCC Interpretive Ruling 7.1017, which confirms the authority of a national bank to lend its credit, bind itself as surety to indemnify another, or otherwise become a guarantor, if the bank has a substantial interest in the performance of the transaction involved. [31] A "substantial interest" exists if the guarantee provided by the bank is "incidental" to another of its authorized activities.[32] The nexus between the bank permissible transaction and the guarantee provides the "substantial interest" for the bank.[33] For example, the interest of a bank in assuring the financial performance of a co-fiduciary constitutes a sufficient interest to justify the issuance of a guarantee.[34] That relationship is analogous to the interest of a bank in assuring the financial performance of an affiliate, including a subsidiary corporation.

We believe that a national bank's provision of a default fund contribution to cover the potential default of customer transactions and, to a limited extent, the obligations of third party participant defaults as a necessary precondition to engaging in bank permissible clearing activity, qualifies as incidental to that activity. The bank has a substantial interest in providing such funds/guarantees on behalf of its branch, in order to retain the ability to provide customers bank permissible clearing and execution services, qualifying the activity as incidental to banking. The branch, as a clearing member, will not directly or indirectly guarantee the performance of its customers on the transactions it clears. Rather, the ultimate liability and investment risk for all trades lies with the customer, against whom the bank may bring an action for recovery.[35] In addition, a national bank, via its branch, may contribute to a default fund to guarantee its obligations and those of other exchange members consistent with the requirements of OCC Interpretive Ruling 7.7010 discussed above.

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[25] *Id.*

[26] *See, e.g.,* OCC Interpretive Letter No. 683 (July 28, 1995), *reprinted in* [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,631 (permitted membership on the London Platinum and Palladium Market provided the bank did not undertake any guarantee or liability for other members trades); OCC Operating Subsidiary Notice Application Control Number: 94-ML-08-0002 (September 21, 1994) (permitted registration as a futures broker with the Monetary Authority of Singapore ("MAS") and clearing membership in the Singapore International Monetary Exchange ("SIMEX") provided that neither MAS nor SIMEX required the bank or its subsidiaries to guarantee or become liable for executed and cleared trades); OCC Interpretive Letter No. 507 (May 5, 1990), *reprinted in* [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,205; OCC Interpretive Letter No. 494, *supra*.

[27] 12 USC 24(Seventh).

[28] *See, e.g., Texas & Pacific Rwy*. v. *Potorff,* 291 U.S. 245 (1934) (national bank has no authority to secure a private deposit); *First N.B. of Aiken* v. *Mott Iron Works,* 258 U.S. 240 (1922) (declining to void a bank's guarantee of contract performance, and holding bank liable since it received the benefit of the guarantee); *Citizens Central N.B*. v. *Appleton,* 216 U.S. 196 (1910) (declining to void one national bank's guarantee to another bank, but deciding based on a theory of implied contract); *Merchants N.B.* v. *Wehrmann,* 202 U.S. 295 (1906) (national bank may not assume unlimited liability as a partner); *Logan City N.B*. v. *Townsend,* 139 U.S. 67 (1891) (declining to accept national bank defense that it had no authority to guarantee a contract and holding bank liable since it benefited from the contract); *Cook County N.B.* v. *U.S.,* 107 U.S. 445 (1883) (not within implied or express powers of national bank to provide the U.S. a priority of payment of claims arising from bank's insolvency).

[29] *See Peoples Bank of Belleville* v. *Manufacturers N.B. of Chicago,* 101 U.S. 181 (1880) (guarantee of notes held within powers of a national bank when the transaction was in substance an "indorsement"); *Cochran* v. *U.S.,* 157 U.S. 286 (1895) (contract of guarantee held within implied powers of a national bank).

[30] *See, e.g., Dunn* v. *McCoy,* 113 F.2d 587 (9th Cir. 1940); *Kimen* v. *Atlas Exchange N.B.*, 92 F.2d 615 (7th Cir. 1937) (invalidating bank sale of bonds to a customer and simultaneous guarantee to repurchase the bonds at any time in the future at par); *Border N.B.* v. *American N. B.*, 282 F. 73 (5th Cir. 1922 (upholding as letter of credit, rather than an impermissible guarantee, an agreement covering the purchase and shipment of 200 tons of sugar); *Bowen* v. *Needles N.B.,* 94 F. 925 (9th Cir. 1899), *cert. denied,* 176 U.S. 682 (1900) (invalidating bank guarantee of payment of customer's checks, in full knowledge that the customer had no funds on deposit with the bank).

[31] 12 CFR 7.1017.

[32] OCC Interpretive Letter No. 376, *supra* (national bank indemnification of lender of securities against loss is incidental to securities lending program and constitutes a "substantial interest" in the activity for purposes of exception to general prohibition against guarantees).

[33] OCC Interpretive Letter No. 218 (September 26, 1981), *reprinted in* [1978–1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,299 (national bank may issue a bill of lading guarantee due to its substantial interest in facilitating liquidation of goods after the previous issuance of a letter or credit). *But see* OCC Interpretive Letter No 79 (July 26, 1979), *reprinted in* [1978–1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,154 (bank does not have a substantial interest in guaranteeing the payment of pension funds held on deposit, which would violate prohibition against pledging private deposits).

[34] *See* 12 CFR 7.1017(a); OCC Interpretive Letter No. 57 (October 5, 1978), *reprinted in* [1978–1979 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,132.

[35] OCC Interpretive Letter No. 380, *supra*.

Furthermore, Section 28.4(c) expressly permits national banks to guarantee the deposits and other liabilities of its Edge corporations, Agreement corporations, and its corporate instrumentalities in foreign countries.[36] Hence, the bank may legally provide a default fund contribution in connection with its bank permissible clearing and execution activities, subject to the satisfaction of supervisory staff that the activity can be conducted in a safe and sound manner.

In addition, it is legally permissible for the bank to purchase a share of stock in LCH to enable the foreign branch to conduct bank permissible exchange and clearinghouse activities on LCH. OCC precedent recognizes that national banks may acquire stock and make noncontrolling stock investments that are not motivated by speculative purposes, but necessary to conduct a banking business.[37] For example, the OCC has permitted national banks to own shares in The Depository Trust and Clearing Corporation ("DTCC"), and the National Securities Clearing Corporations ("NSCC"). The OCC found the investment permissible under Section 24(Seventh) because the only purpose for the holding was to enable the owners to conduct permissible banking activities, *i.e.,* securities clearing and settlement activities through DTC and NSCC.[38]

B. Regulation K

Regulation K provides a separate source of authority for a national bank to join LCH. Regulation K affords foreign branches of national banks additional powers to those they otherwise enjoy under national banking law.

Under Regulation K, national bank foreign branches may, in addition to their authority under national banking law, exercise such further powers as may be usual in connection with the transaction of the business of banking in the country where the branch transacts business.[39] The FRB limits these powers (*i.e.,* permissible activities and investments) to the eight listed at 12 CFR 211.4(a). A national bank may rely on two of the listed powers—investing in securities of clearinghouses and shares of automated electronic payment networks, and the provision of guarantees—to permit foreign branch membership in foreign exchanges and clearinghouses.[40]

Specifically, Section 211.4(a)(3)(i) and (iii) permit foreign branches of national banks to invest in the securities of clearinghouses, as well as shares of automated electronic payment networks that are necessary to the business of the branch. The total investment of a bank's branches in the investments set forth in Section 211.4(a)(3) are subject to a limit of one percent of the total deposits in the bank's branches in that country on the preceding year-end call report date.[41] You state that the bank can invest in LCH under this authority and adhere to the one percent limit.

In addition, foreign branches may be able to provide a default contribution to LCH under Section 211.4(a)(1). Section 211.4(a)(1) permits branches to guarantee debts, or otherwise agree to make payments on the occurrence of readily ascertainable events if the guarantee or agreement specifies a maximum monetary liability. However, except to the extent that the bank is fully secured, it may not have liabilities outstanding for any person on account of such guarantees or agreement which, when aggregated with other unsecured obligations of the same person, exceed the limit contained in 12 USC 84 for loans and extensions of credit.

III. Conclusion

Accordingly, we conclude that the bank's foreign branch membership in LCH as an SCM is permissible under national banking law, subject to the satisfaction of supervisory staff that the activity can be conducted in a safe and sound manner. Conversely, the bank may rely on Regulation K to become a SCM in LCH. In either event, a national bank foreign branch that becomes a member of a foreign exchange or clearinghouse, by stock acquisition or otherwise, must notify its EIC within 10 days of the membership. The bank must certify in the notice that its loss exposure is limited as a legal and accounting matter and the bank does not have open-ended liability for the obligations of the exchange or clearinghouse or its members.

I trust the foregoing is responsive to your inquiry. If you have additional questions, please do not hesitate to contact Donald N. Lamson, assistant director, or Tena M. Alexander, special counsel, Securities and Corporate Practices Division at (202) 874-5210.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

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[36] 12 CFR 28.4(c).

[37] *See* OCC Interpretive Letter No. 892, *supra;* OCC Interpretive Letter No. 878 (December 22, 1999), *reprinted in* [1999–2000 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,375; OCC Interpretive Letter No. 848 (November 23, 1998), *reprinted in* [1998–1999 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,303.

[38] *See* OCC Interpretive Letter No. 421 (March 14, 1988) *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645.

[39] *See* 12 CFR 211.4.

[40] *See* 12 CFR 211.4(a)(1) and (a)(3)(i) and (iii).

[41] *See* 12 CFR 211.4(a)(3)(ii).

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Mergers—January 1 to March 31, 2002

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 January 1 to March 31, 2002

Title and location (charter number)	Total assets
California	
United National Bank, San Marino (017785)	651,541,000
and Central Texas Bank, Flatonia, Texas	141,440,000
merged on February 8, 2002 under the title of **United National Bank, San Marino** (017785)	792,981,000
Kansas	
The Girard National Bank, Girard (013347)	157,042,000
and Kansas State Bank, Holton, Kansas	93,631,000
merged on February 1, 2002 under the title of **The Girard National Bank, Girard** (013347)	247,113,000
First National Bank, Goodland (014163)	312,235,000
and The Security State Bank, Bird City, Kansas	17,361,000
merged on March 21, 2002 under the title of **First National Bank, Goodland** (014163)	329,596,000

Comptroller's Decision

Introduction

On January 2, 2002, application was made to the Comptroller of the Currency for prior authorization to consolidate The Security State Bank, Bird City, Kansas, with First National Bank, Goodland, Kansas, under the charter and the title of First National Bank. This application was based on an agreement entered into between the proponents on January 10, 2002.

Participating Financial Institutions

As of December 31, 2001, The Security State Bank, a state nonmember bank, had total deposits of $14 million and operated one office. On the same date, First National Bank had total deposits of $259 million and operated eight offices. First National Bank is 100 percent owned and controlled by First National Bancshares, Inc., a one-bank holding company.

Competitive Analysis

The relevant geographic market for this proposal is the Cheyenne County banking market. This is the area from which Security derives the bulk of its deposits and where competition between Security and FNB is direct and immediate. Within this banking market, Security operates its only office in Bird City and FNB operates one branch office in St. Francis. Cheyenne County has a population of 3,165. The OCC considers an area with such a small population to be economically insignificant from a competitive standpoint. (See Decision of the Comptroller of the Currency on the application to merge The National Bank and Trust Company of Norwich, New York, with National Bank of Oxford, Oxford, New York, dated April 8, 1983.) Because the OCC does not recognize the market as being economically significant, any anticompetitive effects resulting from this transaction are considered de minimis.

Banking Factors

The Bank Merger Act requires the OCC to consider "... the financial and managerial resources and future prospects of the existing and proposed institutions, and the convenience and needs of the community to be served." We find that the financial and managerial resources of The Security State Bank and First National Bank do not raise concerns that would cause the application to be disapproved. The future prospects of the proponents, individually and combined, are considered favorable and the resulting

bank is expected to meet the convenience and needs of the community to be served as no offices will be closed.

Community Reinvestment Act

A review of the record of this application and other information available to the OCC as a result of its regulatory responsibilities has revealed no evidence that the applicants' records of helping to meet the credit needs of their communities, including low- and moderate-income neighborhoods, is less than satisfactory.

Conclusion

We have analyzed this proposal pursuant to the Bank Merger Act (12 USC 1828(c)) and/or 12 CFR 5.33, and find that it will not lessen significantly competition in any relevant market. Other factors considered in evaluating this proposal are satisfactory. Accordingly, the application is approved.

[Application control number: 2002-WE-02-0001]

Affiliated mergers
(mergers consummated involving two or more affiliated operating banks),
from January 1 to March 31, 2002

Title and location (charter number)	Total assets
Arizona	
Northern Trust Bank of Arizona, National Association, Phoenix (017949)	860,762,000
and Northern Trust Bank of Colorado, Denver, Colorado	92,666,000
merged on February 18, 2002 under the title of **Northern Trust Bank, National Association, Phoenix** (017949)	953,428,000
California	
Pacific Western National Bank, Santa Monica (017423)	378,526,000
and Pacific Western National Bank, Pico Rivera, California (016912)	233,100,000
and First Community Bank of the Desert, Indian Wells, California	138,547,000
merged on January 31, 2002 under the title of **Pacific Western National Bank, Santa Monica** (017423)	761,651,000
New Pacific Capital Bank, National Association, Santa Barbara (024319)	2,500,000
and First National Bank of Central California, Salinas, California (018182)	1,270,218,000
and Santa Barbara Bank & Trust, Santa Barbara, California	2,500,000,000
merged on March 29, 2002 under the title of **Pacific Capital Bank, National Association, Santa Barbara** (024319)	3,797,828,000
City National Bank, Beverly Hills (014695)	9,727,676,000
and CivicBank of Commerce, Oakland, California	510,263,000
merged on February 28, 2002 under the title of **City National Bank, Beverly Hills** (014695)	10,233,903,000
Rancho Santa Fe National Bank, Rancho Santa Fe (017212)	236,964,000
and Capital Bank of North County, Carlsbad, California	140,614,000
merged on March 7, 2002 under the title of **Rancho Santa Fe National Bank, Rancho Santa Fe** (017212)	388,259,000
Colorado	
First National Bank of Colorado, Boulder (024133)	562,930,000
and FNC Trust Group, National Association, Boulder, Colorado (023360)	1,306,000
merged on January 1, 2002 under the title of **First National Bank of Colorado, Boulder** (024133)	546,061,000
Western National Bank of Colorado, Colorado Springs (015383)	319,861,000
and The Bank of Cherry Creek, National Association, Denver, Colorado (022332)	333,743,000
merged on March 22, 2002 under the title of **Western National Bank of Colorado, Colorado Springs** (015383)	653,604,000
Delaware	
U.S. Bank Trust National Association, Wilmington (024090)	5,000,000
and U.S. Bank Trust National Association, New York, New York (022746)	127,000,000
merged on February 28, 2002 under the title of **U.S. Bank Trust National Association, Wilmington** (024090)	132,000,000
Florida	
First National Bank of Florida, Naples (021830)	2,101,586,000
and Bank of Central Florida, Orlando, Florida	240,884,000
merged on January 31, 2002 under the title of **First National Bank of Florida, Naples** (021830)	2,383,891,000
Illinois	
LaSalle Bank National Association, Chicago (014362)	54,407,412,000
and LaSalle Interim Bank National Association, San Diego, California (024330)	3,000,000,000
merged on January 31, 2002 under the title of **LaSalle Bank National Association, Chicago** (014362)	54,414,486,000
Kentucky	
Community Trust Bank, National Association, Pikeville (007030)	2,408,466,000
and Citizens National Bank & Trust of Hazard, Hazard, Kentucky (022988)	139,505,000
merged on March 18, 2002 under the title of **Community Trust Bank, National Association, Pikeville** (007030)	2,547,971,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Maine	
Peoples Heritage Bank, National Association, Portland (024096)	4,377,256,000
and First Massachusetts Bank, National Association, Worcester, Massachusetts (023043)	8,826,126,000
and The Howard Bank, National Association, Burlington, Vermont (018049)	1,000,303,000
and First Vermont Bank, National Association, Brattleboro, Vermont (024042)	740,883,000
and Franklin Lamoille Bank, National Association, St. Albans, Vermont (024041)	324,969,000
and Evergreen Bank, National Association, Glens Falls, New York (024012)	1,364,929,000
and Bank of New Hampshire, National Association, Farmington, New Hampshire (013764)	4,517,251,000
merged on January 1, 2002 under the title of **Banknorth, National Association, Portland** (024096)	21,151,717,000
Banknorth, National Association, Portland (024096)	21,151,717,000
and Banknorth Investment Management Group, National Association, Burlington, Vermont (023042)	37,334,000
merged on January 1, 2002 under the title of **Banknorth, National Association, Portland** (024096)	20,922,067,000
Massachusetts	
First Massachusetts Bank, National Association, Worcester (023043)	6,352,277,000
and Gloucester Bank & Trust Company, Gloucester, Massachusetts	147,685,000
merged on December 31, 2001 under the title of **First Massachusetts Bank, National Association, Worcester** (023043)	5,905,328,000
First Massachusetts Bank, National Association, Worcester (023043)	6,352,277,000
and Andover Bank, Andover, Massachusetts	1,639,363,000
merged on December 31, 2001 under the title of **First Massachusetts Bank, National Association, Worcester** (023043)	7,599,270,000
Missouri	
NorthStar Bank, National Association, Kansas City (023986)	47,895,000
and Admire Bank, Emporia, Kansas	21,646,000
merged on December 28, 2001 under the title of **NorthStar Bank, National Association, Kansas City** (023986)	52,895,000
Montana	
U.S. Bank National Association Mt, Billings (012407)	1,022,300,000
and U.S. Bank Trust National Association Mt, Billings, Montana (022004)	11,000,000
merged on January 10, 2002 under the title of **U.S. Bank National Association Mt, Billings** (012407)	1,033,300,000
Nebraska	
The Fremont National Bank and Trust Company, Fremont (002848)	341,642,000
and Nebraska Trust Company, National Association, Fremont, Nebraska (023571)	5,102,000
merged on January 1, 2002 under the title of **The Fremont National Bank and Trust Company, Fremont** (002848)	348,366,000
New Jersey	
MetLife Bank, National Association, Bridgewater (023743)	209,829,000
and MetLife Trust Company, National Association, Bedminster, New Jersey (016631)	13,437,000
merged on January 1, 2002 under the title of **MetLife Bank, National Association, Bridgewater** (023743)	223,266,000
New York	
Citibank, National Association, New York City (001461)	395,869,000,000
and Universal Cardn Services Corporation, Jacksonville, Florida	1,000,000
merged on January 3, 2002 under the title of **Citibank, National Association, New York City** (001461)	395,869,000,000
Ohio	
U.S. Bank National Association, Cincinnati (000024)	154,347,000,000
and U.S. Bank National Association Mt, Billings, Montana (012407)	1,061,000,000
merged on January 11, 2002 under the title of **U.S. Bank National Association, Cincinnati** (000024)	154,990,000,000
The United National Bank & Trust Company, Canton (014501)	1,066,896,000
and The First National Bank of Zanesville, Zanesville, Ohio (000164)	1,521,090,000
merged on March 7, 2002 under the title of **Unizan Bank, National Association, Canton** (014501)	2,587,986,000
U.S. Bank National Association, Cincinnati (000024)	108,975,000,000
and U.S. Bank Trust Interim National Association, Georgia, Atlanta, Georgia (024315)	58,000,000
and U.S. Bank Trust National Association, Phoenix, Arizona (023067)	60,000,000
and U.S. Bank Trust National Association, San Francisco, California (022508)	153,000,000
and U.S. Bank Trust National Association, Chicago, Illinois (022993)	118,000,000
and U.S. Bank Trust National Association, St. Paul, Minnesota (021467)	80,000,000
and U.S. Bank Trust National Association, Seattle, Washington (023133)	125,000,000
merged January 10, 2002 under the the title of **U.S. Bank National Association, Cincinnati** (000024)	163,122,000,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Oklahoma	
Home National Bank, Blackwell (013891)	484,664,000
and Home National Bank, Scottsdale, Arizona (023108)	96,989,000
merged on March 16, 2002 under the title of **Home National Bank, Blackwell** (013891)	581,653,000
Pennsylvania	
Interim Trust Company, National Association, Hermitage (024283)	2,000,000
and First National Trust Company, Hermitage, Pennsylvania (023778)	1,915,000
and Promistar Trust Company, Johnstown, Pennsylvania	1,864,000
merged on January 18, 2002 under the title of **First National Trust Company, Hermitage** (024283)	3,779,000
First National Bank of Pennsylvania, Greenville (000249)	1,509,660,000
and Promistar Bank, Johnstown, Pennsylvania	2,336,060,000
merged on February 15, 2002 under the title of **First National Bank of Pennsylvania, Greenville** (000249)	3,845,720,000
The Second National Bank of Masontown, Masontown (014333)	195,782,000
and Parkvale Interim Savings Bank, Monroeville, Pennsylvania	1,407,864,000
merged on January 31, 2002 under the title of **The Second National Bank of Masontown, Masontown** (014333)	1,579,157,000
South Dakota	
Citibank (South Dakota), N.A., Sioux Falls (016971)	14,061,508,000
and Universal Bank, National Association, Columbus, Georgia (022791)	12,843,199,000
merged on January 7, 2002 under the title of **Citibank (South Dakota), N.A., Sioux Falls** (016971)	26,904,707,000
Citibank (South Dakota), N.A., Sioux Falls (016971)	26,904,707,000
and Citibank USA, Wilmington, Delaware	2,425,489,000
merged on January 2, 2002 under the title of **Citibank (South Dakota), N.A., Sioux Falls** (016971)	29,330,196,000
Citibank (South Dakota), N.A., Sioux Falls (016971)	41,393,142,000
and Associates National Bank (Delaware), Newark, Delaware (022277)	392,058,000
merged on January 7, 2002 under the title of **Citibank (South Dakota), N.A., Sioux Falls** (016971)	41,785,200,000
Tennessee	
National Bank of Commerce, Memphis (013681)	7,279,512,000
and Central Carolina Bank and Trust Company, Durham, North Carolina	10,615,325,000
merged on December 31, 2001 under the title of **National Bank of Commerce, Memphis** (013681)	20,187,467,000
Virginia	
Cardinal Bank, National Association, Fairfax (023606)	197,485,000
and Cardinal Bank–Manassas/Prince William, National Association, Manassas, Virginia (023857)	57,767,000
merged on March 1, 2002 under the title of **Cardinal Bank, National Association, Fairfax** (023606)	252,252,000
Wisconsin	
M&I National Trust Company, Milwaukee (023617)	2,704,000
and M&I Marshall & Isley Trust Company of Arizona, Scottsdale, Arizona	6,935,000
and Marshall & Isley Trust Company of Florida, Naples, Florida	5,037,000
and Marshall & Isley Trust Company, Milwaukee, Wisconsin	48,918,000
merged on February 1, 2002 under the title of **M&I National Trust Company, Milwaukee** (023617)	65,094,000

Nonaffiliated mergers—thrift
(mergers consummated involving nonaffiliated national banks and savings and loan associations), from January 1 to March 31, 2002

Title and location (charter number)	Total assets
Indiana	
First National Bank & Trust, Kokomo (014519)	1,221,577,000
and Harrington Bank, FSB, Richmond, Indiana	327,843,000
merged on January 18, 2002 under the title of **First National Bank & Trust, Kokomo** (014519)	1,567,775,000

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Assets, liabilities, and capital accounts of national banks
March 31, 2001 and March 31, 2002

(Dollar figures in millions)

	March 31, 2001	March 31, 2002	Change March 31, 2001–March 31, 2002 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	**2,201**	**2,118**	**(83)**	**(3.77)**
Total assets	**$3,440,201**	**$3,574,174**	**$133,973**	**3.89**
Cash and balances due from depositories	**186,066**	**180,552**	**(5,514)**	**(2.96)**
Noninterest-bearing balances, currency and coin	136,863	129,557	(7,306)	(5.34)
Interest bearing balances	49,203	50,995	1,791	3.64
Securities	**487,106**	**572,595**	**85,489**	**17.55**
Held-to-maturity securities, amortized cost	30,476	25,654	(4,823)	(15.82)
Available-for-sale securities, fair value	456,630	546,941	90,311	19.78
Federal funds sold and securities purchased	**130,535**	**144,783**	**14,247**	**10.91**
Net loans and leases	**2,210,882**	**2,220,254**	**9,371**	**0.42**
Total loans and leases	2,251,529	2,268,128	16,599	0.74
Loans and leases, gross	2,253,065	2,270,954	17,889	0.79
Less: Unearned income	1,536	2,826	1,290	83.97
Less: Reserve for losses	40,646	47,874	7,228	17.78
Assets held in trading account	**117,761**	**123,452**	**5,691**	**4.83**
Other real estate owned	**1,640**	**1,861**	**221**	**13.48**
Intangible assets	**72,891**	**90,874**	**17,983**	**24.67**
All other assets	**233,319**	**239,798**	**6,479**	**2.78**
Total liabilities and equity capital	**3,440,201**	**3,574,174**	**133,973**	**3.89**
Deposits in domestic offices	1,871,697	1,982,322	110,625	5.91
Deposits in foreign offices	390,533	368,729	(21,805)	(5.58)
Total deposits	**2,262,231**	**2,351,051**	**88,820**	**3.93**
Noninterest-bearing deposits	428,561	477,931	49,369	11.52
Interest-bearing deposits	1,833,669	1,873,120	39,451	2.15
Federal funds purchased and securities sold	**228,830**	**260,617**	**31,786**	**13.89**
Other borrowed money	**360,805**	**337,243**	**(23,562)**	**(6.53)**
Trading liabilities less revaluation losses	**27,421**	**27,065**	**(356)**	**(1.30)**
Subordinated notes and debentures	**65,850**	**65,586**	**(264)**	**(0.40)**
All other liabilities	**188,904**	**188,203**	**(701)**	**(0.37)**
Trading liabilities revaluation losses	64,116	48,538	(15,578)	(24.30)
Other	124,788	139,665	14,877	11.92
Total equity capital	**306,161**	**344,410**	**38,249**	**12.49**
Perpetual preferred stock	590	1,097	507	85.91
Common stock	13,363	13,007	(356)	(2.67)
Surplus	159,950	197,114	37,164	23.23
Retained earnings and other comprehensive income	134,517	132,477	(2,040)	(1.52)
Other equity capital components	(30)	(24)	6	NM

NM indicates calculated percent change is not meaningful.

Quarterly income and expenses of national banks
First quarter 2001 and first quarter 2002

(Dollar figures in millions)

	First quarter 2001	First quarter 2002	Change First quarter, 2001–first quarter, 2002 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	**2,201**	**2,118**	**(83)**	**(3.77)**
Net income	**$11,396**	**$13,514**	**$2,118**	**18.58**
Net interest income	29,746	35,136	5,390	18.12
Total interest income	61,274	50,982	(10,292)	(16.80)
On loans	47,530	39,273	(8,257)	(17.37)
From lease financing receivables	2,023	1,835	(188)	(9.29)
On balances due from depositories	819	479	(340)	(41.54)
On securities	8,064	7,489	(575)	(7.13)
From assets held in trading account	958	748	(210)	(21.88)
On federal funds sold and securities repurchased	1,681	746	(935)	(55.64)
Less: Interest expense	31,528	15,846	(15,682)	(49.74)
On deposits	20,905	10,608	(10,298)	(49.26)
Of federal funds purchased and securities sold	3,294	1,332	(1,961)	(59.56)
On demand notes and other borrowed money*	6,221	3,124	(3,097)	(49.78)
On subordinated notes and debentures	1,108	782	(326)	(29.42)
Less: Provision for losses	**5,325**	**8,337**	**3,012**	**56.58**
Noninterest income	**25,008**	**26,239**	**1,231**	**4.92**
From fiduciary activities	2,269	2,401	132	5.82
Service charges on deposits	4,003	4,561	559	13.95
Trading revenue	2,153	1,679	(473)	(21.99)
From interest rate exposures	1,081	617	(464)	(42.92)
From foreign exchange exposures	828	780	(48)	(5.79)
From equity security and index exposures	187	252	64	34.35
From commodity and other exposures	57	30	(27)	(46.73)
Investment banking brokerage fees	1,147	1,023	(123)	(10.77)
Venture capital revenue	(51)	168	219	NM
Net servicing fees	2,544	2,800	256	10.07
Net securitization income	2,606	3,579	973	37.34
Insurance commissions and fees	436	460	23	5.33
Net gains on asset sales	1,530	1,194	(336)	(21.98)
Sales of loans and leases	568	1,276	708	124.64
Sales of other real estate owned	(3)	(9)	(7)	NM
Sales of other assets(excluding securities)	965	(73)	(892)	NM
Other noninterest income	8,371	8,373	2	0.02
Gains/losses on securities	**466**	**328**	**(138)**	**(29.63)**
Less: Noninterest expense	**32,159**	**32,781**	**622**	**1.93**
Salaries and employee benefits	12,656	13,715	1,059	8.37
Of premises and fixed assets	3,867	3,840	(27)	(0.69)
Other noninterest expense	14,384	14,324	(61)	(0.42)
Less: Taxes on income before extraordinary items	**6,072**	**6,991**	**919**	**15.14**
Income/loss from extraordinary items, net of income taxes	**(268)**	**(80)**	**189**	**NM**
Memoranda:				
Net operating income	11,353	13,372	2,019	17.79
Income before taxes and extraordinary items	17,736	20,584	2,848	16.06
Income net of taxes before extraordinary items	11,664	13,593	1,929	16.54
Cash dividends declared	7,044	13,270	6,226	88.39
Net charge-offs to loan and lease reserve	4,799	8,238	3,439	71.66
Charge-offs to loan and lease reserve	5,785	9,477	3,692	63.82
Less: Recoveries credited to loan and lease reserve	986	1,238	253	25.66

* Includes mortgage indebtedness.
NM indicates calculated percent change is not meaningful.

Year-to-date income and expenses of national banks
Through March 31, 2001 and through March 31, 2002

(Dollar figures in millions)

	March 31, 2001	March 31, 2002	Change March 31, 2001–March 31, 2002 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	**2,201**	**2,118**	**(83)**	**(3.77)**
Net income	**$11,396**	**$13,514**	**$2,118**	**18.58**
Net interest income	**29,746**	**35,136**	**5,390**	**18.12**
Total interest income	61,274	50,982	(10,292)	(16.80)
On loans	47,530	39,273	(8,257)	(17.37)
From lease financing receivables	2,023	1,835	(188)	(9.29)
On balances due from depositories	819	479	(340)	(41.54)
On securities	8,064	7,489	(575)	(7.13)
From assets held in trading account	958	748	(210)	(21.88)
On federal funds sold and securities repurchased	1,681	746	(935)	(55.64)
Less: Interest expense	31,528	15,846	(15,682)	(49.74)
On deposits	20,905	10,608	(10,298)	(49.26)
Of federal funds purchased and securities sold	3,294	1,332	(1,961)	(59.56)
On demand notes and other borrowed money*	6,221	3,124	(3,097)	(49.78)
On subordinated notes and debentures	1,108	782	(326)	(29.42)
Less: Provision for losses	**5,325**	**8,337**	**3,012**	**56.58**
Noninterest income	**25,008**	**26,239**	**1,231**	**4.92**
From fiduciary activities	2,269	2,401	132	5.82
Service charges on deposits	4,003	4,561	559	13.95
Trading revenue	2,153	1,679	(473)	(21.99)
From interest rate exposures	1,081	617	(464)	(42.92)
From foreign exchange exposures	828	780	(48)	(5.79)
From equity security and index exposures	187	252	64	34.35
From commodity and other exposures	57	30	(27)	(46.73)
Investment banking brokerage fees	1,147	1,023	(123)	(10.77)
Venture capital revenue	(51)	168	219	NM
Net servicing fees	2,544	2,800	256	10.07
Net securitization income	2,606	3,579	973	37.34
Insurance commissions and fees	436	460	23	5.33
Net gains on asset sales	1,530	1,194	(336)	(21.98)
Sales of loans and leases	568	1,276	708	124.64
Sales of other real estate owned	(3)	(9)	(7)	NM
Sales of other assets(excluding securities)	965	(73)	(1,038)	NM
Other noninterest income	8,371	8,373	2	0.02
Gains/losses on securities	**466**	**328**	**(138)**	**(29.63)**
Less: Noninterest expense	**32,159**	**32,781**	**622**	**1.93**
Salaries and employee benefits	12,656	13,715	1,059	8.37
Of premises and fixed assets	3,867	3,840	(27)	(0.69)
Other noninterest expense	14,384	14,324	(61)	(0.42)
Less: Taxes on income before extraordinary items	**6,072**	**6,991**	**919**	**15.14**
Income/loss from extraordinary items, net of income taxes	**(268)**	**(80)**	**189**	**NM**
Memoranda:				
Net operating income	11,353	13,372	2,019	17.79
Income before taxes and extraordinary items	17,736	20,584	2,848	16.06
Income net of taxes before extraordinary items	11,664	13,593	1,929	16.54
Cash dividends declared	7,044	13,270	6,226	88.39
Net charge-offs to loan and lease reserve	4,799	8,238	3,439	71.66
Charge-offs to loan and lease reserve	5,785	9,477	3,692	63.82
Less: Recoveries credited to loan and lease reserve	986	1,238	253	25.66

* Includes mortgage indebtedness
NM indicates calculated percent change is not meaningful.

Assets of national banks by asset size
March 31, 2002

(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	National banks: $100 million to $1 billion	National banks: $1 billion to $10 billion	National banks: Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Total assets	**$3,574,174**	**$52,489**	**$250,751**	**$407,212**	**$2,863,723**	**$6,504,593**
Cash and balances due from	**180,552**	**2,926**	**10,877**	**18,879**	**147,870**	**339,385**
Securities	**572,595**	**13,101**	**62,006**	**86,057**	**411,431**	**1,185,913**
Federal funds sold and securities purchased	**144,783**	**3,168**	**10,617**	**17,384**	**113,614**	**308,543**
Net loans and leases	**2,220,254**	**30,759**	**153,463**	**255,413**	**1,780,618**	**3,818,452**
Total loans and leases	2,268,128	31,195	155,693	259,989	1,821,251	3,893,313
Loans and leases, gross	2,270,954	31,242	155,884	260,068	1,823,760	3,897,157
Less: Unearned income	2,826	47	191	79	2,509	3,844
Less: Reserve for losses	47,874	435	2,230	4,576	40,633	74,861
Assets held in trading account	**123,452**	**0**	**66**	**816**	**122,570**	**314,149**
Other real estate owned	**1,861**	**73**	**256**	**229**	**1,303**	**3,809**
Intangible assets	**90,874**	**156**	**2,040**	**6,233**	**82,444**	**131,801**
All other assets	**239,798**	**2,299**	**11,425**	**22,201**	**203,872**	**402,536**
Gross loans and leases by type:						
Loans secured by real estate	**967,965**	**18,369**	**100,813**	**138,297**	**710,487**	**1,810,583**
1–4 family residential mortgages	453,456	8,011	38,997	64,230	342,219	794,049
Home equity loans	110,539	474	4,550	9,122	96,392	166,492
Multifamily residential mortgages	31,269	446	3,771	5,172	21,880	65,859
Commercial RE loans	240,213	5,618	38,453	42,059	154,083	518,735
Construction RE loans	90,578	1,689	10,630	15,813	62,447	194,444
Farmland loans	12,723	2,130	4,410	1,774	4,409	36,007
RE loans from foreign offices	29,186	0	2	128	29,057	34,997
Commercial and industrial loans	**588,700**	**5,273**	**27,752**	**48,406**	**507,270**	**966,844**
Loans to individuals	**411,922**	**4,035**	**18,019**	**50,838**	**339,029**	**649,241**
Credit cards*	187,475	163	2,212	22,313	162,786	247,874
Other revolving credit plans	29,821	67	370	2,208	27,177	35,047
Installment loans	194,626	3,805	15,437	26,317	149,067	366,319
All other loans and leases	**302,367**	**3,565**	**9,300**	**22,527**	**266,974**	**470,490**
Securities by type:						
U.S. Treasury securities	**18,378**	**750**	**2,691**	**5,396**	**9,542**	**50,632**
Mortgage-backed securities	**341,864**	**3,527**	**22,474**	**46,342**	**269,521**	**615,947**
Pass-through securities	224,381	2,475	13,753	27,079	181,074	380,940
Collateralized mortgage obligations	117,483	1,052	8,722	19,263	88,447	235,007
Other securities	**169,740**	**8,798**	**36,470**	**31,051**	**93,421**	**419,691**
Other U.S. government securities	62,121	6,073	20,890	13,557	21,602	204,409
State and local government securities	43,020	2,100	10,805	8,829	21,286	96,609
Other debt securities	55,648	446	3,393	7,556	44,253	97,114
Equity securities	8,950	179	1,383	1,109	6,280	21,558
Memoranda:						
Agricultural production loans	19,498	3,045	4,951	2,987	8,515	45,084
Pledged securities	272,864	4,988	27,552	39,812	200,512	573,573
Book value of securities	571,906	13,052	61,776	85,808	411,269	1,182,715
Available-for-sale securities	546,252	10,805	52,562	76,864	406,022	1,087,803
Held-to-maturity securities	25,654	2,247	9,214	8,944	5,247	94,911
Market value of securities	572,785	13,123	62,090	86,131	411,442	1,186,840
Available-for-sale securities	546,941	10,854	52,791	77,112	406,184	1,091,002
Held-to-maturity securities	25,844	2,269	9,299	9,018	5,258	95,839

Past-due and nonaccrual loans and leases of national banks by asset size
March 31, 2002

(Dollar figures in millions)

	All national banks	National banks				Memoranda:
		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	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Loans and leases past due 30-89 days	**$28,614**	**$486**	**$1,909**	**$3,203**	**$23,015**	**$49,063**
Loans secured by real estate	**11,649**	**244**	**1,030**	**1,366**	**9,010**	**21,036**
1–4 family residential mortgages	6,881	120	499	688	5,574	11,444
Home equity loans	709	3	22	56	629	1,037
Multifamily residential mortgages	199	2	14	26	158	421
Commercial RE loans	1,879	61	306	322	1,190	4,414
Construction RE loans	1,300	27	123	233	917	2,393
Farmland loans	196	31	66	40	59	571
RE loans from foreign offices	484	0	0	0	484	757
Commercial and industrial loans	**6,046**	**96**	**401**	**723**	**4,825**	**10,565**
Loans to individuals	**8,209**	**89**	**353**	**955**	**6,813**	**13,380**
Credit cards	4,420	4	87	413	3,917	6,188
Installment loans and other plans	3,789	85	266	542	2,896	7,193
All other loans and leases	2,709	58	125	159	2,367	4,082
Loans and leases past due 90+ days	**8,972**	**108**	**401**	**932**	**7,531**	**13,926**
Loans secured by real estate	**2,946**	**55**	**215**	**198**	**2,478**	**4,587**
1–4 family residential mortgages	2,273	31	100	121	2,021	3,079
Home equity loans	109	1	4	11	93	175
Multifamily residential mortgages	27	0	2	2	23	58
Commercial RE loans	277	10	73	40	154	731
Construction RE loans	170	5	20	20	125	322
Farmland loans	44	7	15	5	17	164
RE loans from foreign offices	45	0	0	0	45	57
Commercial and industrial loans	**876**	**21**	**88**	**169**	**598**	**1,654**
Loans to individuals	**4,830**	**18**	**81**	**551**	**4,180**	**7,158**
Credit cards	3,676	3	41	386	3,245	4,937
Installment loans and other plans	1,154	15	40	165	935	2,221
All other loans and leases	**320**	**13**	**18**	**13**	**276**	**527**
Nonaccrual loans and leases	**26,569**	**258**	**1,186**	**1,675**	**23,449**	**43,119**
Loans secured by real estate	**7,602**	**132**	**649**	**894**	**5,927**	**13,437**
1–4 family residential mortgages	3,171	40	191	309	2,630	5,219
Home equity loans	316	1	10	25	279	424
Multifamily residential mortgages	114	3	15	20	76	224
Commercial RE loans	2,245	52	322	375	1,497	4,529
Construction RE loans	854	10	72	141	631	1,743
Farmland loans	188	24	38	24	101	439
RE loans from foreign offices	713	0	0	0	713	859
Commercial and industrial loans	**14,521**	**76**	**354**	**567**	**13,523**	**23,603**
Loans to individuals	**1,631**	**15**	**89**	**109**	**1,417**	**2,528**
Credit cards	386	0	49	55	282	706
Installment loans and other plans	1,245	15	40	55	1,136	1,821
All other loans and leases	**2,913**	**35**	**94**	**105**	**2,679**	**3,704**

Liabilities of national banks by asset size
March 31, 2002

(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	National banks: $100 million to $1 billion	National banks: $1 billion to $10 billion	National banks: Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Total liabilities and equity capital	**3,574,174**	**52,489**	**250,751**	**407,212**	**2,863,723**	**6,504,593**
Deposits in domestic offices	1,982,322	44,278	203,073	260,280	1,474,691	3,748,683
Deposits in foreign offices	368,729	0	523	2,319	365,887	603,522
Total deposits	**2,351,051**	**44,278**	**203,596**	**262,599**	**1,840,578**	**4,352,204**
Noninterest bearing	477,931	7,035	31,874	44,498	394,524	805,659
Interest bearing	1,873,120	37,243	171,722	218,101	1,446,054	3,546,548
Federal funds purchased and securities sold	260,617	523	6,378	41,363	212,353	520,546
Other borrowed funds	**337,243**	**1,389**	**11,556**	**46,031**	**278,266**	**536,947**
Trading liabilities less revaluation losses	**27,065**	**0**	**0**	**209**	**26,856**	**78,054**
Subordinated notes and debentures	**65,586**	**3**	**196**	**3,169**	**62,217**	**92,983**
All other liabilities	**188,203**	**423**	**3,646**	**11,731**	**172,403**	**319,076**
Equity capital	**344,410**	**5,872**	**25,378**	**42,110**	**271,050**	**604,782**
Total deposits by depositor:						
Individuals and corporations	1,828,694	28,096	142,095	208,536	1,449,967	3,382,122
U.S., state, and local governments	105,267	3,715	14,892	15,981	70,680	205,396
Depositories in the U.S.	69,282	614	2,166	3,115	63,387	97,911
Foreign banks and governments	52,895	2	483	1,396	51,014	110,699
Domestic deposits by depositor:						
Individuals and corporations	1,552,033	28,096	142,075	206,877	1,174,984	2,928,606
U.S., state, and local governments	105,267	3,715	14,892	15,981	70,680	205,396
Depositories in the U.S.	26,293	614	2,088	3,115	20,477	48,617
Foreign banks and governments	4,119	2	59	744	3,314	10,407
Foreign deposits by depositor:						
Individuals and corporations	276,662	0	21	1,658	274,983	453,516
Depositories in the U.S.	42,989	0	78	1	42,910	49,294
Foreign banks and governments	48,776	0	424	652	47,700	100,292
Deposits in domestic offices by type:						
Transaction deposits	**344,480**	**13,289**	**49,365**	**39,944**	**241,882**	**649,993**
Demand deposits	281,192	6,955	28,396	31,835	214,006	495,950
Savings deposits	**1,038,665**	**9,743**	**65,003**	**130,062**	**833,857**	**1,819,175**
Money market deposit accounts	760,073	5,483	38,739	89,769	626,082	1,300,965
Other savings deposits	278,592	4,260	26,265	40,293	207,774	518,210
Time deposits	**599,176**	**21,246**	**88,704**	**90,274**	**398,952**	**1,279,514**
Small time deposits	346,413	14,267	57,027	53,809	221,311	724,709
Large time deposits	252,763	6,980	31,677	36,465	177,641	554,805

Off-balance-sheet items of national banks by asset size
March 31, 2002

(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	National banks: $100 million to $1 billion	National banks: $1 billion to $10 billion	National banks: Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Unused commitments	**$3,677,030**	**$80,379**	**$430,367**	**$351,472**	**$2,814,812**	**$5,069,619**
Home equity lines	144,115	356	4,185	9,576	129,998	203,411
Credit card lines	2,482,003	76,147	402,181	289,968	1,713,706	3,170,295
Commercial RE, construction and land	79,642	912	6,877	12,459	59,394	157,916
All other unused commitments	971,270	2,964	17,125	39,469	911,713	1,537,997
Letters of credit:						
Standby letters of credit	**151,417**	**127**	**1,519**	**5,349**	**144,421**	**261,816**
Financial letters of credit	122,340	84	910	3,933	117,414	217,251
Performance letters of credit	29,077	43	609	1,417	27,007	44,565
Commercial letters of credit	**15,224**	**27**	**396**	**462**	**14,339**	**22,134**
Securities lent	**122,097**	**33**	**65**	**9,560**	**112,439**	**616,989**
Spot foreign exchange contracts	**131,067**	**0**	**0**	**109**	**130,958**	**172,045**
Credit derivatives (notional value)						
Reporting bank is the guarantor	68,135	11	25	0	68,100	225,047
Reporting bank is the beneficiary	94,524	10	50	0	94,464	212,505
Derivative contracts (notional value)	**21,529,752**	**28**	**1,252**	**35,766**	**21,492,707**	**46,331,935**
Futures and forward contracts	5,833,420	2	230	1,463	5,831,725	10,086,857
Interest rate contracts	3,664,221	2	204	974	3,663,040	6,221,268
Foreign exchange contracts	2,088,066	0	26	489	2,087,551	3,713,752
All other futures and forwards	81,133	0	0	0	81,133	151,837
Option contracts	4,655,835	0	281	12,039	4,643,515	9,594,204
Interest rate contracts	4,034,564	0	279	11,897	4,022,388	8,040,784
Foreign exchange contracts	460,727	0	0	0	460,727	841,134
All other options	160,545	0	2	142	160,401	712,286
Swaps	10,877,838	5	665	22,264	10,854,903	26,213,322
Interest rate contracts	10,371,413	5	663	17,382	10,353,363	25,015,569
Foreign exchange contracts	458,876	0	2	4,685	454,189	1,071,176
All other swaps	47,548	0	0	197	47,351	126,577
Memoranda: Derivatives by purpose						
Contracts held for trading	19,869,229	0	83	9,159	19,859,987	43,946,927
Contracts not held for trading	1,497,864	7	1,094	26,607	1,470,156	1,947,456
Memoranda: Derivatives by position						
Held for trading—positive fair value	204,961	0	0	110	204,851	527,844
Held for trading—negative fair value	193,873	0	0	100	193,774	499,893
Not for trading—positive fair value	11,133	0	4	360	10,769	15,100
Not for trading—negative fair value	8,390	0	30	143	8,217	11,962

Quarterly income and expenses of national banks by asset size
First quarter 2002

(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	National banks: $100 million to $1 billion	National banks: $1 billion to $10 billion	National banks: Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Net income	**$13,514**	**$133**	**$741**	**$1,684**	**$10,955**	**$21,732**
Net interest income	**35,136**	**515**	**2,459**	**4,041**	**28,121**	**58,637**
Total interest income	50,982	810	3,816	5,981	40,374	88,983
On loans	39,273	617	2,918	4,637	31,102	66,243
From lease financing receivables	1,835	3	25	67	1,740	2,646
On balances due from depositories	479	7	17	17	438	949
On securities	7,489	164	797	1,086	5,441	14,993
From assets held in trading account	748	0	1	11	736	1,884
On fed. funds sold & securities repurchased	746	14	44	106	582	1,620
Less: Interest expense	15,846	295	1,358	1,940	12,253	30,346
On deposits	10,608	276	1,196	1,276	7,859	21,001
Of federal funds purchased & securities sold	1,332	3	34	194	1,102	2,599
On demand notes & other borrowed money*	3,124	16	125	434	2,550	5,644
On subordinated notes and debentures	782	0	3	37	742	1,103
Less: Provision for losses	**8,337**	**29**	**202**	**688**	**7,419**	**11,652**
Noninterest income	**26,239**	**196**	**1,282**	**3,014**	**21,747**	**41,467**
From fiduciary activities	2,401	9	158	377	1,857	5,404
Service charges on deposits	4,561	58	273	411	3,818	7,036
Trading revenue	1,679	0	0	24	1,655	3,152
From interest rate exposures	617	0	2	17	599	1,499
From foreign exchange exposures	780	0	0	1	778	1,214
From equity security and index exposures	252	0	0	5	246	407
From commodity and other exposures	30	0	0	0	30	24
Investment banking brokerage fees	1,023	1	16	58	947	2,109
Venture capital revenue	168	(0)	(0)	0	168	37
Net servicing fees	2,800	50	74	364	2,311	3,537
Net securitization income	3,579	2	83	327	3,167	4,577
Insurance commissions and fees	460	6	16	37	401	827
Net gains on asset sales	1,194	3	66	307	817	1,755
Sales of loans and leases	1,276	4	64	238	971	1,820
Sales of other real estate owned	(9)	(1)	2	(0)	(10)	(10)
Sales of other assets(excluding securities)	(73)	1	0	69	(143)	(54)
Other noninterest income	8,373	66	593	1,109	6,604	13,032
Gains/losses on securities	**328**	**3**	**11**	**16**	**298**	**690**
Less: Noninterest expense	**32,781**	**507**	**2,511**	**3,844**	**25,919**	**56,145**
Salaries and employee benefits	13,715	248	1,094	1,377	10,995	24,850
Of premises and fixed assets	3,840	61	296	384	3,099	7,089
Other noninterest expense	14,324	195	1,099	1,976	11,053	23,101
Less: Taxes on income before extraord. items	**6,991**	**45**	**294**	**855**	**5,797**	**11,144**
Income/loss from extraord. items, net of taxes	**(80)**	**0**	**(4)**	**0**	**(75)**	**(120)**
Memoranda:						
Net operating income	13,372	131	736	1,673	10,833	21,377
Income before taxes and extraordinary items	20,584	179	1,039	2,539	16,827	32,996
Income net of taxes before extraordinary items	13,593	133	745	1,684	11,031	21,852
Cash dividends declared	13,270	80	358	575	12,259	19,581
Net loan and lease losses	8,238	19	142	605	7,472	11,113
Charge-offs to loan and lease reserve	9,477	28	188	724	8,536	12,917
Less: Recoveries credited to loan & lease resv.	1,238	9	47	119	1,064	1,803

* Includes mortgage indebtedness

Year-to-date income and expenses of national banks by asset size
Through March 31, 2002

(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	National banks: $100 million to $1 billion	National banks: $1 billion to $10 billion	National banks: Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Net income	**$13,514**	**$133**	**$741**	**$1,684**	**$10,955**	**$21,732**
Net interest income	**35,136**	**515**	**2,459**	**4,041**	**28,121**	**58,637**
Total interest income	50,982	810	3,816	5,981	40,374	88,983
On loans	39,273	617	2,918	4,637	31,102	66,243
From lease financing receivables	1,835	3	25	67	1,740	2,646
On balances due from depositories	479	7	17	17	438	949
On securities	7,489	164	797	1,086	5,441	14,993
From assets held in trading account	748	0	1	11	736	1,884
On fed. funds sold & securities repurchased	746	14	44	106	582	1,620
Less: Interest expense	15,846	295	1,358	1,940	12,253	30,346
On deposits	10,608	276	1,196	1,276	7,859	21,001
Of federal funds purchased & securities sold	1,332	3	34	194	1,102	2,599
On demand notes & other borrowed money*	3,124	16	125	434	2,550	5,644
On subordinated notes and debentures	782	0	3	37	742	1,103
Less: Provision for losses	**8,337**	**29**	**202**	**688**	**7,419**	**11,652**
Noninterest income	**26,239**	**196**	**1,282**	**3,014**	**21,747**	**41,467**
From fiduciary activities	2,401	9	158	377	1,857	5,404
Service charges on deposits	4,561	58	273	411	3,818	7,036
Trading revenue	1,679	0	0	24	1,655	3,152
From interest rate exposures	617	0	2	17	599	1,499
From foreign exchange exposures	780	0	0	1	778	1,214
From equity security and index exposures	252	0	0	5	246	407
From commodity and other exposures	30	0	0	0	30	24
Investment banking brokerage fees	1,023	1	16	58	947	2,109
Venture capital revenue	168	(0)	(0)	0	168	37
Net servicing fees	2,800	50	74	364	2,311	3,537
Net securitization income	3,579	2	83	327	3,167	4,577
Insurance commissions and fees	460	6	16	37	401	827
Net gains on asset sales	1,194	3	66	307	817	1,755
Sales of loans and leases	1,276	4	64	238	971	1,820
Sales of other real estate owned	(9)	(1)	2	(0)	(10)	(10)
Sales of other assets(excluding securities)	(73)	1	0	69	(143)	(54)
Other noninterest income	8,373	66	593	1,109	6,604	13,032
Gains/losses on securities	**328**	**3**	**11**	**16**	**298**	**690**
Less: Noninterest expense	**32,781**	**507**	**2,511**	**3,844**	**25,919**	**56,145**
Salaries and employee benefits	13,715	248	1,094	1,377	10,995	24,850
Of premises and fixed assets	3,840	61	296	384	3,099	7,089
Other noninterest expense	14,324	195	1,099	1,976	11,053	23,101
Less: Taxes on income before extraord. items	**6,991**	**45**	**294**	**855**	**5,797**	**11,144**
Income/loss from extraord. items, net of taxes	**(80)**	**0**	**(4)**	**0**	**(75)**	**(120)**
Memoranda:						
Net operating income	13,372	131	736	1,673	10,833	21,377
Income before taxes and extraordinary items	20,584	179	1,039	2,539	16,827	32,996
Income net of taxes before extraordinary items	13,593	133	745	1,684	11,031	21,852
Cash dividends declared	13,270	80	358	575	12,259	19,581
Net loan and lease losses	8,238	19	142	605	7,472	11,113
Charge-offs to loan and lease reserve	9,477	28	188	724	8,536	12,917
Less: Recoveries credited to loan & lease resv.	1,238	9	47	119	1,064	1,803

* Includes mortgage indebtedness

Quarterly net loan and lease losses of national banks by asset size
First quarter, 2002

(Dollar figures in millions)

	All national banks	National banks				Memoranda:
		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	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Net charge-offs to loan and lease reserve	**$8,238**	**$19**	**$142**	**$605**	**$7,472**	**$11,113**
Loans secured by real estate	**497**	**4**	**23**	**59**	**412**	**684**
1–4 family residential mortgages	214	1	9	18	186	277
Home equity loans	69	0	1	5	64	82
Multifamily residential mortgages	3	(0)	0	0	2	6
Commercial RE loans	130	2	12	20	96	204
Construction RE loans	41	0	1	15	25	66
Farmland loans	4	0	0	1	3	8
RE loans from foreign offices	36	0	0	0	36	41
Commercial and industrial loans	**2,268**	**6**	**24**	**106**	**2,133**	**3,531**
Loans to individuals	**5,088**	**8**	**90**	**432**	**4,557**	**6,366**
Credit cards	3,998	1	55	340	3,602	4,895
Installment loans and other plans	1,089	7	35	93	955	1,472
All other loans and leases	**386**	**2**	**5**	**9**	**370**	**532**
Charge-offs to loan and lease reserve	**9,477**	**28**	**188**	**724**	**8,536**	**12,917**
Loans secured by real estate	**570**	**4**	**27**	**69**	**470**	**805**
1–4 family residential mortgages	255	1	12	22	219	335
Home equity loans	75	0	1	6	68	92
Multifamily residential mortgages	4	0	0	1	3	9
Commercial RE loans	144	2	13	22	108	236
Construction RE loans	46	0	1	17	27	78
Farmland loans	5	0	0	1	3	11
RE loans from foreign offices	41	0	0	0	41	46
Commercial and industrial loans	**2,656**	**8**	**38**	**134**	**2,476**	**4,070**
Loans to individuals	**5,784**	**12**	**114**	**509**	**5,148**	**7,383**
Credit cards	4,364	2	63	381	3,918	5,429
Installment loans and other plans	1,420	11	51	128	1,230	1,953
All other loans and leases	**467**	**3**	**9**	**13**	**442**	**658**
Recoveries credited to loan and lease reserve	**1,238**	**9**	**47**	**119**	**1,064**	**1,803**
Loans secured by real estate	**73**	**1**	**5**	**10**	**58**	**121**
1–4 family residential mortgages	40	0	3	4	33	58
Home equity loans	6	0	0	1	5	9
Multifamily residential mortgages	1	0	0	0	1	2
Commercial RE loans	15	0	1	2	12	32
Construction RE loans	5	0	1	2	2	12
Farmland loans	1	0	0	0	0	3
RE loans from foreign offices	5	0	0	0	5	5
Commercial and industrial loans	**388**	**3**	**14**	**28**	**343**	**540**
Loans to individuals	**697**	**4**	**24**	**77**	**591**	**1,016**
Credit cards	366	0	8	41	316	535
Installment loans and other plans	331	4	16	36	275	482
All other loans and leases	**81**	**1**	**3**	**4**	**72**	**126**

Year-to-date net loan and lease losses of national banks by asset size
Through March 31, 2002

(Dollar figures in millions)

	All national banks	National banks				Memoranda:
		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	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Net charge-offs to loan and lease reserve	**8,238**	**19**	**142**	**605**	**7,472**	**11,113**
Loans secured by real estate	**497**	**4**	**23**	**59**	**412**	**684**
1–4 family residential mortgages	214	1	9	18	186	277
Home equity loans	69	0	1	5	64	82
Multifamily residential mortgages	3	(0)	0	0	2	6
Commercial RE loans	130	2	12	20	96	204
Construction RE loans	41	0	1	15	25	66
Farmland loans	4	0	0	1	3	8
RE loans from foreign offices	36	0	0	0	36	41
Commercial and industrial loans	**2,268**	**6**	**24**	**106**	**2,133**	**3,531**
Loans to individuals	**5,088**	**8**	**90**	**432**	**4,557**	**6,366**
Credit cards	3,998	1	55	340	3,602	4,895
Installment loans and other plans	1,089	7	35	93	955	1,472
All other loans and leases	**386**	**2**	**5**	**9**	**370**	**532**
Charge-offs to loan and lease reserve	**9,477**	**28**	**188**	**724**	**8,536**	**12,917**
Loans secured by real estate	**570**	**4**	**27**	**69**	**470**	**805**
1–4 family residential mortgages	255	1	12	22	219	335
Home equity loans	75	0	1	6	68	92
Multifamily residential mortgages	4	0	0	1	3	9
Commercial RE loans	144	2	13	22	108	236
Construction RE loans	46	0	1	17	27	78
Farmland loans	5	0	0	1	3	11
RE loans from foreign offices	41	0	0	0	41	46
Commercial and industrial loans	**2,656**	**8**	**38**	**134**	**2,476**	**4,070**
Loans to individuals	**5,784**	**12**	**114**	**509**	**5,148**	**7,383**
Credit cards	4,364	2	63	381	3,918	5,429
Installment loans and other plans	1,420	11	51	128	1,230	1,953
All other loans and leases	**467**	**3**	**9**	**13**	**442**	**658**
Recoveries credited to loan and lease reserve	**1,238**	**9**	**47**	**119**	**1,064**	**1,803**
Loans secured by real estate	**73**	**1**	**5**	**10**	**58**	**121**
1–4 family residential mortgages	40	0	3	4	33	58
Home equity loans	6	0	0	1	5	9
Multifamily residential mortgages	1	0	0	0	1	2
Commercial RE loans	15	0	1	2	12	32
Construction RE loans	5	0	1	2	2	12
Farmland loans	1	0	0	0	0	3
RE loans from foreign offices	5	0	0	0	5	5
Commercial and industrial loans	**388**	**3**	**14**	**28**	**343**	**540**
Loans to individuals	**697**	**4**	**24**	**77**	**591**	**1,016**
Credit cards	366	0	8	41	316	535
Installment loans and other plans	331	4	16	36	275	482
All other loans and leases	**81**	**1**	**3**	**4**	**72**	**126**

Number of national banks by state and asset size
March 31, 2002

	All national banks	National banks				Memoranda:
		Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
All institutions	**2,118**	**999**	**951**	**126**	**42**	**8,005**
Alabama	22	13	8	1	0	157
Alaska	3	1	0	2	0	6
Arizona	16	7	4	3	2	41
Arkansas	40	11	28	1	0	173
California	81	34	37	7	3	294
Colorado	52	27	22	2	1	175
Connecticut	8	3	5	0	0	25
Delaware	14	2	7	2	3	31
District of Columbia	4	2	2	0	0	4
Florida	72	25	40	7	0	257
Georgia	61	31	28	2	0	326
Hawaii	1	0	1	0	0	8
Idaho	1	0	1	0	0	17
Illinois	179	73	95	7	4	690
Indiana	32	8	16	6	2	154
Iowa	48	26	20	2	0	413
Kansas	104	75	26	3	0	369
Kentucky	51	24	24	3	0	229
Louisiana	16	5	9	1	1	142
Maine	6	1	4	0	1	15
Maryland	13	5	8	0	0	73
Massachusetts	12	4	7	1	0	40
Michigan	27	10	16	0	1	161
Minnesota	126	79	43	2	2	479
Mississippi	20	9	9	2	0	99
Missouri	46	24	19	2	1	350
Montana	16	13	2	1	0	80
Nebraska	77	55	20	2	0	274
Nevada	8	1	3	4	0	35
New Hampshire	5	2	2	0	1	14
New Jersey	24	2	15	7	0	81
New Mexico	16	6	7	3	0	53
New York	58	11	39	7	1	139
North Carolina	8	0	5	0	3	74
North Dakota	15	6	6	3	0	104
Ohio	86	35	38	7	6	199
Oklahoma	96	56	36	4	0	282
Oregon	3	0	2	1	0	32
Pennsylvania	80	22	48	7	3	177
Rhode Island	4	2	0	1	1	8
South Carolina	25	15	9	1	0	77
South Dakota	19	9	7	2	1	93
Tennessee	28	6	19	0	3	190
Texas	340	202	128	9	1	678
Utah	7	2	3	1	1	55
Vermont	8	2	6	0	0	15
Virginia	35	6	26	3	0	128
Washington	14	10	4	0	0	77
West Virginia	22	9	10	3	0	70
Wisconsin	49	18	28	3	0	279
Wyoming	20	10	9	1	0	45
U.S. territories	0	0	0	0	0	18

Total assets of national banks by state and asset size
March 31, 2002

(Dollar figures in millions)

	All national banks	National banks				Memoranda:
		Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
All institutions	**$3,574,174**	**$52,489**	**$250,751**	**$407,212**	**$2,863,723**	**$6,504,593**
Alabama	3,685	799	1,801	1,086	0	188,098
Alaska	5,141	58	0	5,083	0	6,171
Arizona	39,807	187	1,163	5,963	32,493	42,321
Arkansas	8,198	650	6,524	1,024	0	28,429
California	219,301	1,761	12,021	17,431	188,089	365,360
Colorado	30,106	1,351	5,676	4,665	18,415	50,429
Connecticut	1,557	270	1,287	0	0	3,932
Delaware	101,585	70	1,791	4,317	95,407	143,043
District of Columbia	448	95	353	0	0	448
Florida	27,772	1,702	10,452	15,619	0	64,705
Georgia	18,869	1,679	6,289	10,900	0	168,883
Hawaii	332	0	332	0	0	22,910
Idaho	258	0	258	0	0	2,887
Illinois	292,546	3,838	23,631	18,542	246,535	429,912
Indiana	71,920	426	6,331	19,086	46,077	109,403
Iowa	15,456	1,406	5,074	8,975	0	46,462
Kansas	15,905	3,756	7,469	4,680	0	36,656
Kentucky	22,560	1,565	4,944	16,050	0	54,175
Louisiana	25,244	233	1,628	7,061	16,322	42,615
Maine	22,455	17	1,665	0	20,773	24,477
Maryland	2,603	297	2,306	0	0	48,312
Massachusetts	3,305	224	1,665	1,417	0	112,835
Michigan	45,318	410	4,538	0	40,370	162,004
Minnesota	82,933	3,996	10,872	3,737	64,329	107,191
Mississippi	10,265	545	2,076	7,643	0	36,035
Missouri	27,296	1,324	5,685	9,994	10,293	70,631
Montana	2,564	556	512	1,496	0	12,745
Nebraska	16,056	2,568	4,736	8,752	0	30,351
Nevada	24,722	40	870	23,811	0	37,836
New Hampshire	16,669	61	392	0	16,216	19,041
New Jersey	33,813	89	4,607	29,117	0	74,926
New Mexico	10,726	365	2,158	8,203	0	15,114
New York	485,553	750	11,748	18,188	454,867	1,350,524
North Carolina	841,143	0	1,519	0	839,624	940,630
North Dakota	11,789	280	1,731	9,777	0	18,106
Ohio	380,989	1,807	10,655	18,675	349,852	460,414
Oklahoma	26,046	2,875	7,331	15,840	0	46,123
Oregon	9,984	0	500	9,484	0	18,058
Pennsylvania	126,299	1,315	15,045	13,858	96,081	185,037
Rhode Island	185,120	20	0	6,876	178,224	195,747
South Carolina	5,854	877	2,656	2,321	0	26,887
South Dakota	54,486	346	2,624	12,707	38,810	63,217
Tennessee	77,234	453	6,431	0	70,349	99,775
Texas	85,503	10,368	31,157	22,832	21,147	144,204
Utah	29,424	67	774	9,133	19,450	127,400
Vermont	1,309	101	1,208	0	0	5,705
Virginia	17,220	309	6,872	10,039	0	73,278
Washington	1,834	568	1,265	0	0	22,244
West Virginia	10,111	503	2,045	7,563	0	18,560
Wisconsin	20,484	1,043	6,463	12,979	0	81,779
Wyoming	4,379	470	1,623	2,285	0	6,791
U.S. territories	0	0	0	0	0	61,777

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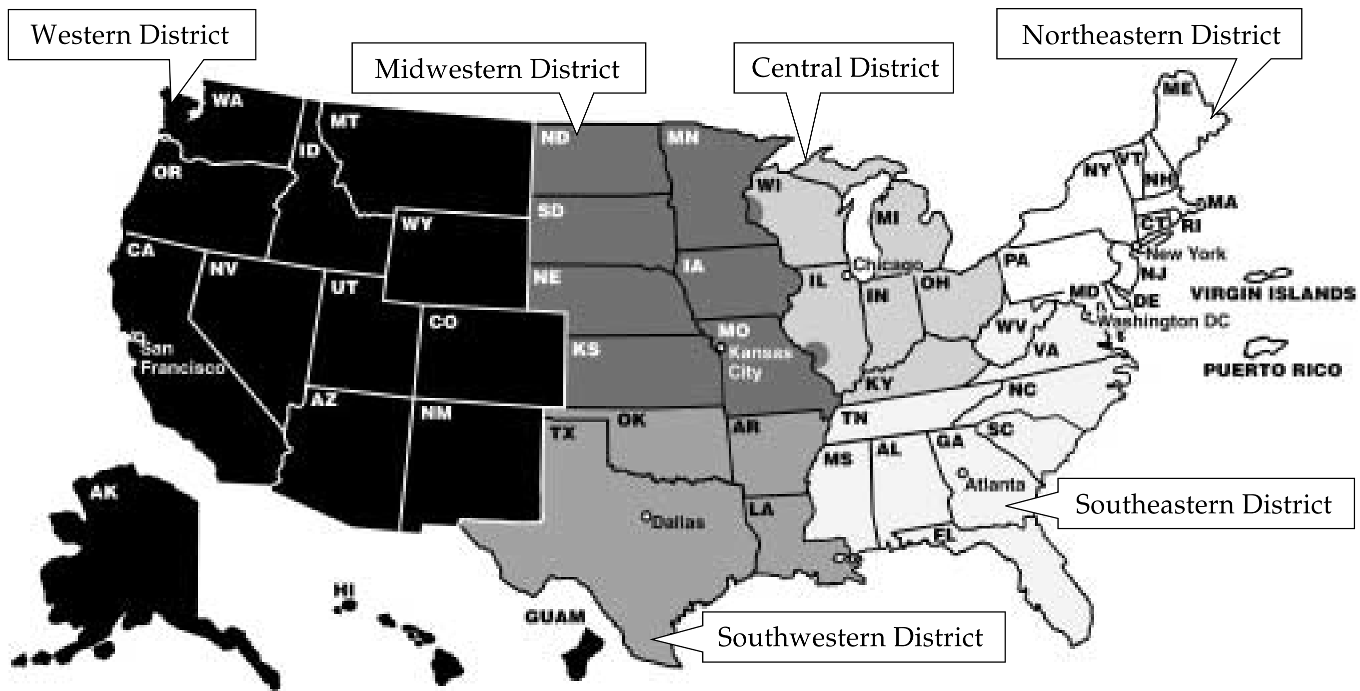

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