

OPERATIONS AND ACCOMPLISHMENTS

Supervise Program

This program encompasses the supervision of national banks and their subsidiaries, federal branches and agencies of foreign banks,² national trust companies, bank data software vendors, and data processing service providers. This program also consists of activities to identify, analyze, and respond to emerging systemic risks and trends that could affect an individual national bank or the entire national banking system. The Committee on Bank Supervision establishes and oversees areas of emphasis for the OCC's supervisory activities. The committee is made up of the Chief National Bank Examiner and the senior deputy comptrollers for Large Bank Supervision and Mid-size/Community Bank Supervision. The supervise program supports the OCC's strategic goals of a safe and sound national banking system, fair access to financial services, and fair treatment of bank customers.

The supervise program, by far the largest program, constitutes the core for accomplishing the OCC's mission. In FY 2005, the OCC devoted 2,236 full-time equivalent (FTEs), or 83.4 percent of its total workforce, to the

supervise program. The cost of the supervise program was \$420.3 million in FY 2005.

Two business lines reside within the supervise program: large banks and mid-size/community banks. This approach reflects the recognition that institutions of varying sizes and complexity present different risks and require unique supervision philosophies.

The OCC's large bank program is responsible for supervising the 23 largest and most complex national banking companies, using teams of dedicated onsite examiners. During FY 2005, areas of supervisory emphasis for the large bank program included BSA/AML/USAPA compliance, corporate governance, credit quality and credit risk management, allowance for loan and lease losses (ALLL) procedures and adequacy, the integrity of banks' financial statements, ensuring adherence to accepted accounting practices, operational vulnerabilities, operational risk measurement and management practices, corporate structured transactions, compliance with anti-tying and covered transaction rules, and the implementation of Basel II at mandatory and opt-in banks.³

²Federal branches and agencies are branches licensed by the OCC and operated by foreign banking organizations. Federal agencies are offices that engage in the business of banking but do not accept deposits or exercise fiduciary powers.

³See the Partnership and Outreach section of this report for more information on activities related to Basel II. In August 2003, the OCC, FDIC, FRB, and OTS issued an Advance Notice of Proposed Rulemaking, which explained how the agencies might implement Basel II in the U.S. and proposed criteria for determining whether a bank would be required to adopt the Basel II framework.

There are 26 banking companies in OCC's mid-size bank program and 30 companies in the credit card bank program. During FY 2005, areas of supervisory emphasis for the mid-size and credit card bank programs included BSA/AML/USAPA compliance, early identification and resolution of supervisory issues, the effectiveness of risk management practices and controls, the integrity of banks' financial statements, ensuring adherence to accepted accounting practices, banks' increased reliance on noninterest income, outsourcing and vendor activities, interest rate risk models and controls, investment portfolio practices and holdings, and concentration risk.

The OCC's community bank program generally covers national banks with less than \$1 billion in total assets. Banks are assigned to an OCC portfolio manager who oversees the supervisory strategy for each bank. These strategies combine onsite examinations and off-site analysis to monitor bank performance. During FY 2005, areas of supervisory emphasis for the community bank program included BSA/AML/USAPA compliance, early identification and resolution of supervisory issues, banks' risk management practices and controls, banks' expanded use of outsourcing, interest rate risk monitoring and controls, concentration risk, and investment portfolio practices and holdings.

The supervise program is further divided into three subprograms: examining, enforcing, and ensuring fair access and fair treatment.

Examining

The OCC continuously supervises banks in the community bank, large bank, mid-size bank, and credit card bank programs. A supervisory strategy is developed based on each banking institution's risk profile and condition. The strategy includes a variety of supervisory activities, including examinations and off-site analyses, to be completed during a supervisory cycle. Examination activities focus on safety and soundness, consumer compliance, BSA/AML/USAPA, fair lending, asset management, bank information technology, and the CRA. The supervisory cycle conforms to either a 12- or 18-month time frame, depending on the size, complexity, and condition of the bank. All large banks and mid-size banks, and federal branches are on a 12-month supervisory cycle. At the end of each bank's cycle, OCC examiners certify the completion of the supervisory strategy and onsite activities, assign CAMELS ratings, and communicate their findings to the bank.

The OCC completed and certified 1,287 supervisory strategies during FY 2005. Included in this number are strategy certifications for all large, mid-size, and credit card banks; all federal branches and agencies; and more than 57 percent of community banks. In addition to strategy certification activities, the OCC conducted 427 CRA examinations, which are on either an 18- or 36-month cycle.

The supervisory strategy certifications completed during FY 2005 show that national banks continue to operate in a safe and sound

manner as evidenced by assigned CAMELS ratings and assessments of capital levels. The results of OCC's supervisory activities indicated that 94 percent of all national banks earned the highest composite CAMELS ratings of 1 or 2, and 99 percent were well capitalized relative to their risks. For the 119 national banks with CAMELS ratings of 3, 4, or 5 on September 30, 2004, 35 had improved their composite CAMELS rating to either 1 or 2 by the end of FY 2005. Another 18 banks were sold, merged, or left the national banking system during the year without loss to the Bank Insurance Fund. The OCC achieved a 44 percent rehabilitation rate, exceeding the target

of 40 percent, and an improvement from the 40 percent in FY 2004 and 32 percent in FY 2003. The OCC also exceeded its customer service standard for examination activities as rated by bank officials. The customer service results were based on 665 examination surveys completed by banks for the period July 2004 through June 2005, representing a 43 percent response rate. The survey is based on a five-point scale, in which 1 indicates complete agreement and 5 indicates complete disagreement with the survey statements. The results of the examining performance measures are shown in Table 1.

Table 1: Examining Performance Measures, FY 2005

| Performance Measures | Target | Actual ¹ |
|--|--------|---------------------|
| Percentage of national banks that are well capitalized | 95% | 99% |
| Percentage of national banks with composite CAMELS rating of 1 or 2 | 90% | 94% |
| Rehabilitated problem national banks as a percentage of the problem national banks one year ago (CAMELS 3, 4 or 5) | 40% | 44% |
| Average survey response that the report of examination clearly communicated examination findings, significant issues, and the corrective actions (including time frames) management needed to take | ≤ 1.75 | 1.28 |

¹ Performance numbers shown in bold italics are estimates. Some performance data is obtained from quarterly call reports from banks. The September 30, 2005 Reports of Condition and Income ("call reports") are not due until 30 or 45 days after the end of the period. Additionally, examinations concluded late in the fiscal year are not finalized for another 30 to 60 days. As a result, complete fiscal year data is not yet available, so estimates have been reported.

Horizontal Reviews

A horizontal review is an examination tool used to address significant, systemic concerns by examining across a portfolio of banks with similar characteristics. Horizontal reviews offer many benefits, notably the opportunity for exchange of best practices and a mechanism to ensure consistent expectations and supervision practices across all the banks. Typically conducted by experts in the area of focus, horizontal reviews provide an independent assessment. These reviews provide invaluable insights during the supervision process and give a quick assessment of how the banks are complying with laws, regulations, and other regulatory guidance. They allow the OCC to focus on higher-risk banks and make adjustments to supervision strategies and staffing as needed. During FY 2005, Large Bank Supervision restructured its senior management to bring the horizontal, systemic review, and analytic activities under a single deputy comptroller. The goal of this restructuring is to achieve greater consistency in the supervision of the large institutions.

The Mid-size Bank Supervision program conducted the following horizontal reviews in FY 2005:

- Automated Clearing House (ACH) activity
- ALLL methodology
- Appraisal programs and appraisal review programs
- Retail credit risk management

Two of these reviews (ALLL methodology and appraisal programs) were conducted at all of OCC's mid-size banks, while the rest focused on particular banks in the portfolio based on selection criteria.

Large Bank Supervision conducted a review focusing on staff monitoring and supervision processes to ensure each large bank's compliance with OCC guidance for ALLL methodology. The review was performed to determine the completeness and timeliness of Large Bank Supervision's efforts regarding ALLL, as supported by specific documentation provided by each large bank examination team.

Bank Secrecy Act, Anti-Money Laundering, and the USA PATRIOT Act

Money laundering and terrorist financing pose significant risks to the national banking system. The OCC responded to these risks in FY 2005 by conducting in-depth reviews across all lines of business for compliance with the requirements of the BSA/AML/USAPA.

All large banks received examinations, transaction testing, and compliance reviews regarding BSA/AML/USAPA for high-risk areas and activities. Using a risk-focused approach, the OCC completed similar reviews at high-risk mid-size banks and community banks. Concurrent with these reviews, OCC communicated with bank managers to make them aware of OCC expectations amid the heightened supervisory attention to this area.

On the international front, the OCC continued to provide foreign supervisors with technical assistance and training on BSA/AML techniques used in the OCC's supervision process. The OCC trained more than 50 supervisors from several countries at its

headquarters; provided the same training to the Latin American regional bank supervisors group; and completed with the World Bank a video of its BSA/AML training courses. The video will be available to bank supervisors worldwide.

OCC Bolsters BSA/AML Compliance Program

The OCC took an array of actions in FY 2005 to improve its BSA/AML compliance program, many of which address findings and recommendations in a final report emanating from an internal review of the agency's BSA/AML supervision. The agency has:

- Enhanced its BSA/AML expertise by creating and filling a new position, director for Bank Secrecy Act and Anti-money Laundering Compliance, to consolidate anti-money laundering activities within the agency; increasing the number of BSA policy staff in its Washington headquarters; establishing BSA/AML as a focal point for the OCC's Examiner Specialized Skills Program; and augmenting staff dedicated to BSA/AML compliance by expanding the contract examiner pool to include BSA skills.
- Conducted 1,123 BSA/AML/USAPA examinations through June 30, 2005.
- Published enforcement policy to provide additional guidance about situations in which formal actions should be taken.
- Worked with the other federal banking agencies and the Financial Crimes Enforcement Network (FinCEN) to develop and issue guidance on providing banking services to money services businesses.
- Issued, jointly with the other federal financial regulators and FinCEN, a new and comprehensive FFIEC BSA/AML Examination Manual that establishes minimum core procedures that will be used at every examination to review and verify that a bank has an adequate BSA/AML compliance program and include mandatory transaction testing in each examination.
- Conducted a teleconference for almost 5,000 participants from national banks to ask questions about BSA and participated in interagency teleconferences and outreach sessions to examiners and bankers on the new BSA/AML Manual.
- Created a money laundering risk assessment system to help examiners identify potentially high-risk bank activities that may warrant increased scrutiny.
- Enhanced internal tracking systems to ensure timely follow-up on BSA/AML compliance deficiencies cited in examination reports.

Continued

OCC Bolsters BSA/AML Compliance Program *continued*

- Worked with FinCEN and other agencies to improve information sharing and data analysis.

The OCC investigates and brings enforcement actions against national banks that fail to meet BSA/AML requirements to implement adequate BSA compliance programs in accordance with OCC regulations, establish procedures to identify and monitor high-risk accounts, and report suspicious transactions. The OCC coordinates with other regulators and law enforcement authorities to ensure compliance with BSA/AML provisions and detect, track, and prevent attempts by terrorists and other criminals to use the national banking system for their activities.

The OCC brought enforcement actions against several banks for inadequate BSA/AML compliance programs. Among other requirements, banks were ordered to develop and implement internal controls, conduct audits, designate BSA compliance officers, and conduct employee training programs.

- The OCC issued two cease-and-desist orders by consent against a federal branch of a foreign bank to preserve asset levels, restrict its wire transfer activities, pay off depositors, and convert to an uninsured agency office with limited banking activities. In addition, the OCC, jointly with FinCEN, assessed a \$24 million civil monetary penalty (CMP) against a federal branch for failure to comply with BSA/AML requirements. The agencies took these actions after determining that the branch failed to implement an adequate anti-money laundering program to manage the risks of money laundering and terrorist financing associated with its dollar clearing transactions, and that the branch violated BSA's suspicious activity reporting requirements.
- The OCC issued a cease-and-desist order by consent and assessed a \$750,000 CMP against a bank for multiple and continuing violations of BSA and the USAPA, including failure to classify and monitor accounts of senior foreign officials.
- The OCC issued a cease-and-desist order by consent against a federal branch for deficiencies in the branch's internal controls, particularly in BSA/AML compliance. The OCC also issued a prohibition order by consent and assessed a \$200,000 CMP against the branch's former general manager.
- The OCC issued a cease-and-desist order by consent that required a bank to shut down one of its lending departments, after the OCC determined that the bank permitted the department to engage in unsafe or unsound banking practices. The OCC also required the bank to address deficiencies in the bank's compliance with BSA and the USAPA; to increase capital levels, in view of increased risks; and to correct problems with the bank's books and records.

The OCC will also implement a Money Laundering Risk (MLR) system in early FY 2006. This system will provide collective information that will formulate the first step in assessing overall BSA/AML quantity of risk for each bank and enhance the OCC's ability to better measure the level of risk, evaluate risks within banks, and assess a bank's relative BSA/AML risk. This effort will not only enhance the quality of risk analysis by providing a more consistent methodology for measuring BSA/AML risks, but will allow for a larger scale of analysis because of the amount of data that will be systematically processed.

Shared National Credit Review

In the spring of 2005, the OCC completed the annual shared national credit review in coordination with the FRB, FDIC, and the OTS. This year's review covered 6,817 credits with commitments totaling \$1.6 trillion. Additional information on this program is provided in the Partnership and Outreach section.

National Resource Planning Tool

The National Resource Planning Tool (NRPT) is a centralized and integrated Web-based database that shows resource needs and opportunities throughout the OCC. It facilitates the National Resource Planning Process, which uses an agreed-upon timeline and common data elements for requesting and scheduling resources from the other lines of business. In FY 2005 the large bank, mid-size bank and credit card bank lines of business piloted a uniform national process for requesting examination staff resources. The pilot involved standardizing the processes for staffing and scheduling for better communication and accountability. The pilot resulted in better examination planning and led to the creation of the NRPT.

Entry-Level Bank Examiner Training

In FY 2005, the OCC continued its recruitment program for entry-level bank examiners. Given the number of projected examiner retirements over the next five years, this program is critical for maintaining the OCC's high level of examiner expertise. In this program, newly hired bank examiners join training teams led

by experienced examiners who provide on-the-job training examining banks during their first six to eight months with the OCC. During the year, 21 training teams consisting of 96 entry-level bank examiners hired in June 2004 and January 2005 completed their training team assignments and were placed in permanent field office locations in the community bank line of business. In June 2005, 21 new training teams began their on-the-job examiner training, and this group of 100 examiners is expected to join community bank field offices in the first half of FY 2006.

Risk Committees

The OCC National Risk Committee (NRC) identifies primary and emerging risks to the national banking system, stays abreast of evolving business practices and financial market issues, advises the OCC's Executive Committee of material risks facing the national banking system, and recommends OCC supervisory responses. The District Risk Committees (DRCs) operate in each district. The deputy comptroller for Risk Evaluation chairs the NRC. Its members include senior managers from key areas across the OCC as well as DRC chairpersons. The NRC identifies resource and training needs and provides specialized support and examiner guidance. The NRC also offers examiner training in such areas as bank technology, asset management, retail credit, compliance, mortgage banking, derivatives, and interest rate risk management. These efforts ensure consistent and efficient responses to emerging risk issues by precluding redundancies, encouraging the sharing of ideas

throughout the OCC, and assisting with the work of the DRCs.

National Bank Appeals

The national bank appeals process resolves individual appeals and inquiries from national banks. The ombudsman, with the consent of the Comptroller, has the discretion to stay any agency decision or action during the resolution of an appealable matter. The Office of the Ombudsman processed more than 150 substantive inquiries, including formal and informal appeals, during FY 2005.

Some of the issues considered by the ombudsman in 2005 include:

- The downgrade in the safety and soundness examination of the bank's composite rating from 2 to 4.
- The OCC's right to retain the full semiannual assessment fee for the period of January 1 through June 30 for a bank that converted to a state chartered commercial bank on January 1.
- The downgrade to a 3 of a bank's overall composite rating and component ratings for asset quality, management, and consumer compliance. The bank's board also appealed the violations of law of the legal lending limit.
- The restoration to a 2 of a 3 composite CAMELSI (capital, asset quality, management, earnings, liquidity, sensitivity to market risk, and information technology) rating assigned at the most recent examination.

An appeal summary is prepared for each formal appeal received in the ombudsman's office.

Enforcing

Enforcement actions ensure that corrective actions are taken to address violations of laws, rules, and regulations, unsafe or unsound banking practices, and non-compliance with policies or procedures by national banks, their insiders, and other affiliated parties. The OCC takes formal as well as informal actions to support prompt detection and mitigation of problems before they affect a bank's viability, and to require resolution of troubled banks in an orderly manner. The OCC's Enforcement and Compliance Division conducts investigations, takes administrative actions, and litigates those actions.

During FY 2005, the OCC took formal and informal enforcement actions against national banks and institution-affiliated parties who engaged in violations of laws and regulations or unsafe or unsound banking practices. The actions included temporary cease-and-desist orders, final cease-and-desist orders, removal or prohibition orders, CMPs, and formal agreements. The OCC's Fast Track Enforcement Program helps ensure that bank insiders and employees who committed criminal acts involving banks, but who are not being criminally prosecuted, are prohibited from working in the banking system. This program resulted in several prohibitions and personal cease-and-desist orders during FY

2005. Table 2 summarizes all enforcement actions completed in FY 2005.

- The OCC issued orders by consent for prohibition and restitution in the amount of \$5,550 against a former bank teller for making unauthorized and fraudulent withdrawals from a bank customer's account for his own benefit.
- Following the OCC's issuance of a Notice of Charges, the FRB issued a prohibition order and the OCC issued an order for restitution in the amount of \$2,400 against a former bank employee for altering bank records to inflate the amount of deposits into customers' accounts and depositing the surplus into his own account, and for diverting for his own use a cash overage that resulted when he conducted an improper transaction.
- The OCC issued a prohibition order by consent and assessed a \$5,000 CMP against a former bank employee who made unauthorized transfers from her relatives' accounts into her business account; made unauthorized loans to, and withdrawals from, accounts of unrelated bank customers; and provided falsified bank documents to another bank to obtain a business loan.
- The OCC assessed a \$180,000 CMP by consent against a bank's operating subsidiary for failing to dispose of confidential customer information in a secure fashion, in violation of bank regulations governing the security of customer information.

Table 2: Enforcement Actions, FY 2005

| Type of Enforcement Action | FY 2005 | |
|--|------------------------|--|
| | Against National Banks | Against Institution-Affiliated Parties |
| Cease-and-Desist Orders | 23 | 21 |
| Temporary Cease-and-Desist Orders | 1 | 0 |
| Civil Money Penalties | 11 | 52 |
| Civil Money Penalties Amount Assessed | \$25,587,700 | \$6,146,750 |
| Formal Agreements | 27 | 0 |
| Memoranda of Understanding | 14 | 0 |
| Commitment Letters | 5 | 0 |
| Suspension Orders | 0 | 4 |
| Letters of Reprimand | 0 | 15 |
| 12 USC 1818 Removal/Prohibition Orders | 0 | 24 |
| 12 USC 1829 Prohibitions | 0 | 410 |
| Total Enforcement Actions | 81 | 526 |

Other Enforcement Actions

The OCC continued to review the compliance of national banks with federal regulations requiring flood insurance for certain properties located in special flood hazard areas that secure loans made by national banks. The OCC assessed CMPs totaling \$272,700 against nine banks for violations of flood insurance requirements in FY 2005.

The OCC also initiated and litigated enforcement actions against bank insiders and other institution-affiliated parties who engaged in unsafe or unsound practices, unlawful conduct, or breaches of duty. The OCC acted when such practices, conduct, or breaches could have caused or did cause harm to a national bank, or other banks, or resulted in financial gain or other benefit for the insider. Several cases resulted in prohibitions, CMPs, restitution, or other personal cease-and-desist orders.

The OCC also brought enforcement actions against banks and bank insiders to support prompt detection and mitigation of problems before they affected a bank's viability and against persons or companies who, while serving as agents or independent contractors of national banks, engaged in allegedly reckless acts causing losses to the banks.

Ensuring Fair Access and Fair Treatment

During FY 2005, the OCC's efforts to ensure fair access and fair treatment focused on integrating compliance risk supervision into the on-going supervision activities for national banks.

This subprogram included:

- Conducting risk-based fair lending examinations.
- Conducting outreach to national banks to assist them in meeting their responsibilities under the recently revised CRA and the new Home Mortgage Disclosure Act (HMDA) requirements.
- Researching new opportunities for community development activities by national banks and publishing best practices.
- Meeting with persons and groups that protest banks' corporate applications.
- Facilitating the community and consumer groups' interactions with the OCC, such as helping them inform their constituents about the OCC's customer assistance group (CAG).
- Reviewing or approving individual bank community development activities.

The OCC met two of the three FY 2005 performance targets for ensuring fair access and fair treatment of bank customers as depicted in the following table.

Table 3: Ensuring Fair Access and Fair Treatment Performance Measures, FY 2005

| Performance Measures | Target | Actual |
|--|--------|------------|
| Percentage of national banks with consumer compliance rating of 1 or 2 | 94% | 94% |
| Percentage of qualified intermediate small institutions to which the OCC offers to provide consultation on the CRA and community development opportunities | 100% | 100% |
| Percentage of consumer complaints closed within 60 calendar days of receipt | 80% | 72% |

Unfair and Deceptive Acts or Practices

On February 2, 2005, OCC issued residential real estate lending standards to assist national banks in their efforts to avoid becoming involved in predatory, abusive, unfair, or deceptive residential mortgage lending practices. The OCC also continues to respond vigorously to abusive, unfair, or deceptive business practices by national banks, thereby promoting fair treatment of bank customers and fair access to financial services for all Americans.

- The OCC issued prohibition and cease-and-desist orders by consent and assessed a \$20,000 CMP against a former bank vice president and loan officer for making tax lien loans that violated the Home Ownership Equity Protection Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, and the Federal Trade Commission Act; and for receiving a large portion of excessive and duplicative fees collected by the bank from customers, including fees for services that were never performed. Earlier the OCC required

the bank to make restitution to affected customers and issued a cease-and-desist order by consent against the company that marketed, originated, serviced, and collected the tax lien loans for the purpose of restricting its conduct of business with insured depository institutions.

Actions to Combat Identity Theft

The OCC investigates and brings enforcement actions against individual bank employees as well as against bank service providers who misuse bank customer information to engage in identity theft and other illegal activities.

Consumer Complaints

The CAG (Customer Assistance Group) assists consumers who have questions or complaints about national banks and their operating subsidiaries. The CAG implements a wide range of initiatives each year to further improve the way it conducts its business and responds to its constituents' needs. Through these efforts, CAG strives to make a positive impact on the lives of many consumers, a considerable

contribution to the OCC supervisory process, and a significant difference to the nation's banking industry.

The CAG serves three constituents:

- Customers of national banks and their subsidiaries — by providing a venue to resolve complaints;
- OCC bank supervision — by alerting supervisory staff members to emerging problems that may potentially result in the development of policy guidance or enforcement action; and
- National bank management — by providing a comprehensive analysis of complaint volumes and trends.

The CAG is not an advocate for banks or consumers, but remains neutral in answering questions and offering guidance on applicable banking laws, regulations, and practices. The CAG encourages customers to contact their banks first to try to resolve their concerns. If these efforts are unsuccessful, CAG may serve as a liaison between the consumer and the bank. If a CAG specialist is unable to help over the phone, the consumer may be asked to submit a signed, written complaint. The CAG is not always able to resolve complaints of a factual or contractual dispute nature; these more appropriately may be decided by a court of law. Additionally, federal laws and regulations might not govern service issues or complaints related to the bank's internal policies and procedures. The CAG cannot give legal advice or personal opinions about consumer complaints and/or the bank's position

in a case, but it can offer informal education to the consumer on banking and the use of credit.

The CAG is staffed with highly trained compliance professionals equipped to deliver responsive customer service. The operation employs state-of-the-art call center technology with bilingual call routing (English and Spanish), a Web-based complaint resolution process, and Internet and facsimile access 365 days a year.

During FY 2005, the CAG received 67,839 calls, opened 73,519 cases and closed 72,203 cases. Of the cases closed, 72 percent were completed within 60 calendar days of receipt, falling short of the target of 80 percent and less than the 74 percent achieved in FY 2004. Although the Houston call center was closed for days due to Hurricane Rita, there was still a 1 percent increase in calls from FY 2004. Additionally, the OCC opened 8 percent and closed 6 percent more cases than in FY 2004. The risks and complexity of consumer complaints continue to increase, requiring additional time for analysis and in many instances, additional information from the consumer or the bank. This has lengthened the average response time.

Community Affairs

Revisions to the CRA regulations in 2005 added a new category of banks to include "Intermediate Small Bank," a bank with assets between \$250 million and \$1 billion. The OCC identified national banks in this category and offered CRA consultative services to each of them. During FY 2005 the

OCC conducted 273 bank consultations. The consultations covered strategies for national banks' responsibilities under CRA, including local and regional investment opportunities, the OCC's investment authority for community development investments, federal low-income housing tax credits, new markets tax credits, individual development accounts, bank-owned community development corporations, and small business administration programs.

The OCC published two *Community Developments Insights* papers on "Payroll Cards: An Innovative Product for Reaching

the Unbanked and Underbanked," and "Individual Development Accounts: An Asset Building Product for Lower Income Consumers." It also published four *Community Developments* newsletters: "The Power of Plastic: How Banks Are Using Technology to Reach the Unbanked," "Growing Markets with Bank-Owned Community Development Corporations," "Investment Intermediaries: Helping Banks Achieve a Double Bottom Line," and "Using the New HMDA Data to Expand Home Mortgage Lending Opportunities."

OCC, Banks, and Other Agencies Team Up to Help Katrina Victims

In the days and hours leading up to Hurricane Katrina's landfall along the Gulf Coast on August 29, 2005, the OCC was already coordinating with other federal agencies, state officials, and national bankers on efforts to weather the storm and begin recovery for what would turn out to be the most costly natural disaster in U.S. history.

After the storm, the OCC joined with other federal and state banking officials and industry trade groups in a coordinated response to the crisis. Of immediate importance was restoring financial services to the people dealing with Katrina's aftermath — ensuring that individuals and businesses had access to cash and that financial institutions could continue to receive and process payments, including Social Security, veterans, and disability payments. As part of these efforts, the OCC and other agencies encouraged banks to consider actions to assist storm victims, including:

- Waiving ATM fees for customers and non-customers.
- Increasing ATM daily cash withdrawal limits.
- Easing restrictions on cashing out-of-state and non-customer checks.
- Waiving overdraft fees resulting from paycheck interruption.
- Waiving early withdrawal penalties on time deposits.
- Waiving availability restrictions on insurance checks.
- Allowing customers to defer or skip some loan payments.

Continued

OCC, Banks, and Other Agencies Team Up to Help Katrina Victims *continued*

- Waiving late fees for credit cards and other loans due to interruption of mail and billing statements, or the customer's inability to access funds.
- Easing credit card limits and credit terms on new loans.
- Delaying delinquency notices to credit bureaus.
- Using non-documentary customer verification methods for customers who could not provide standard identification documents.

In addition, the OCC assisted banks in establishing temporary branches and sharing branch facilities and employees. The OCC also established a special section on its Web site where bankers and consumers could obtain additional Katrina-related information. Beyond addressing these immediate needs, the OCC has remained committed to working with national banks and the industry in addressing longer term concerns and issues. In September 2005, the federal financial regulatory agencies announced the formation of a working group to foster the regulatory agencies' coordination, communication, and financial supervisory responses to the issues facing the industry in Katrina's wake.

The response to Katrina showed the resiliency and strength of the nation's banking system. It showed the pride and professionalism of the federal and state regulators and banking trade groups who recognized the essential role banks play in responding to such crises and rebuilding communities. The response also showed the willingness of competing financial institutions to act in the interests of their communities and customers by sharing space, resources, and support. Lastly it showed the importance of sound disaster recovery planning.

Although hurricanes like Katrina do not come ashore every year, other natural disasters and incidents regularly affect the lives, communities, and businesses they touch. The safety and soundness of America's national banking system requires vigilance for responding to these crises, maintaining plans for disaster recovery and continuity of operations, and reviewing those plans to ensure they protect against foreseeable risks.

Regulate Program

The regulate program establishes regulations, policies, operating guidance, and interpretations of general applicability to national banks. These regulations, policies, and interpretations may set system-wide standards, define acceptable banking practices, provide guidance on risks and responsibilities facing national banks, or prohibit (or restrict) banking practices deemed to be imprudent or unsafe. This program

includes the establishment of examination policies, handbooks, and interpretations for examiners. It also includes representing and defending the OCC's regulatory authorities and interpretations in administrative, judicial, and congressional hearings.

The OCC devoted 358 FTEs or 13.4 percent of the OCC workforce, to the regulate program in FY 2005. The cost of the regulate program was \$65.9 million. The OCC issued 131 legal

opinions. Of the 120 legal opinions subject to the processing time frames, 86 percent were completed on time, meeting the FY 2005 goal.

The OCC issued seven final rules, one interim rule, and two notices of proposed rulemaking. The OCC also issued two notices, pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), inviting comment on ways to improve current regulations, and two notices seeking comment on substantive guidance that OCC proposed to provide to national banks.

Among the most significant rulemakings completed this year were:

- *Rules, Policies, and Procedures for Corporate Activities; Annual Report on Operating Subsidiaries (12 CFR5) 69 FR 64478 (November 5, 2004).* This final rule revised OCC's rules governing national bank operating subsidiaries. It requires a national bank to file an annual report with the OCC that identifies its operating subsidiaries that do business directly with consumers and are not otherwise "functionally regulated" subsidiaries within the meaning of section 5(c)(5) of the Bank Holding Company Act of 1956, as amended. The annual filing contains the name of each reportable operating subsidiary, its state of incorporation, and a brief description of its activities. The OCC makes this information available to the public on its Internet Web site.
- *Proper Disposal of Consumer Information under the Fair and Accurate Credit*

Transactions Act of 2003 (12 CFR 30 and 41) 69 FR 77610 (December 28, 2004).

The OCC, together with the FRB, FDIC, and the OTS issued a joint rulemaking to implement section 216 of the Fair and Accurate Credit Transactions Act of 2003. Section 216 requires the banking agencies, the National Credit Union Administration (NCUA), the Securities and Exchange Commission (SEC), and the Federal Trade Commission (FTC) to adopt consistent and comparable regulations, to the extent possible, requiring entities subject to their jurisdictions to dispose of consumer information properly to reduce the risk of identity theft.

- *OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices (12 CFR 30) 70 FR 6329 (February 7, 2005).* OCC issued final guidelines concerning the residential mortgage lending practices of national banks and their operating subsidiaries as a further step to protect against national bank involvement in predatory, abusive, unfair, or deceptive residential mortgage lending practices. The guidelines identify practices that are consistent with sound residential mortgage lending practices and describe terms and practices that may lead to predatory, abusive, unfair, or deceptive lending practices. They also address steps banks should take to mitigate risks associated with their purchase of residential mortgage loans and use of mortgage brokers to originate loans.

- *Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice (12 CFR 30) 70 FR 15736 (March 29, 2005)*. The OCC, the FRB, the FDIC, and the OTS issued an interpretation of section 501(b) of the Gramm-Leach-Bliley Act and the Interagency Guidelines Establishing Standards for Safeguarding Customer Information. The interpretation describes the agencies' expectations regarding the response programs, including customer notification procedures, that a financial institution should develop and implement to address the unauthorized access to, or use of, customer information that could result in substantial harm or inconvenience to a customer.
- *Fair Credit Reporting Medical Information Regulations (12 CFR 41) 70 FR 33958 (June 10, 2005)*. This interim final rule implements section 411 of the Fair and Accurate Credit Transactions Act of 2003. The interim final rule creates exceptions to the statute's general prohibition on creditors obtaining or using medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit for all creditors. The exception permits creditors to obtain or use medical information in connection with credit eligibility determinations when necessary and appropriate for legitimate purposes, consistent with the congressional intent to restrict the use of medical information for inappropriate purposes. The interim final rule also creates limited exceptions to permit affiliates to share medical information with each other without becoming consumer reporting agencies.
- *CRA Regulations (12 CFR 25) 70 FR 44256 (August 2, 2005)*. The OCC, together with the FRB and the FDIC, issued a final rule to revise certain provisions of its rules implementing the CRA. This rulemaking addresses the regulatory burden imposed on smaller banks by revising the eligibility requirements for CRA evaluation under the lending, investment, and service tests. The rulemaking adds a new community development test for banks with at least \$250 million and less than \$1 billion in assets (Intermediate Small Bank). This rulemaking also revises the definition of the term "community development" to include affordable housing and revitalization and stabilization in underserved rural areas and designated disaster areas and revises the regulation to address the impact on a bank's CRA rating of evidence of discrimination or other illegal credit practices.

Legal Opinions

Significant legal opinions issued in FY 2005 included:

- *Directors' Qualifying Shares.* National bank directors may meet the qualifying shares requirement under 12 USC 72 by purchasing trust preferred stock. This offers bank directors a new means of obtaining a financial stake in the bank in addition to purchasing bank stock. Interpretive Letter No. 1020 (February 8, 2005).
- *Equity Derivative Transactions with Affiliates and Subsidiaries.* A bank may enter into equity derivatives transactions with certain of its affiliates and subsidiaries that mirror the affiliates' and subsidiaries' transactions with their customers, and the bank may hedge the risks of those transactions in the same manner as it hedges the risks of its existing derivatives business, provided the OCC has no supervisory objection. Interpretive Letter No. 1018 (February 10, 2005).
- *Agricultural Loans.* A bank may offer agricultural loans with payments that vary based on changes in commodity prices. The proposed activities are permissible as incidental to an existing agricultural lending business. The bank first must satisfy itself concerning possible application of commodity laws to the program and must also establish that the bank has an appropriate risk measurement and management process. Interpretive letter No. 1019 (February 10, 2005).
- *Financial Intermediation Transactions Involving Electricity.* A bank may engage in electricity derivative transactions and hedges, settled in cash and by transitory title transfer, as part of, or incidental to, its existing financial intermediation business in energy-related commodities derivatives, provided the bank has established an appropriate risk measurement and management process for those activities to which the OCC expresses no supervisory objection. Interpretive Letter No. 1025 (April 6, 2005).
- *Branching.* The OCC concluded that a remote check-scanning terminal at a customer's location, which permits the customer to deposit checks electronically, is not a branch. This was the first letter to discuss such terminals. Interpretive Letter No. 1036 (August 10, 2005).
- *Workers' Compensation Self-Insurance.* The OCC issued a legal opinion confirming that it is permissible for national banks to participate in a group to self-insure group members' workers' compensation obligations. This opinion opens the way for community banks to reduce their costs significantly in this area. Interpretive Letter No. 1022 (February 15, 2005).

Supervisory Guidance, Policies, and Examination Handbooks

During FY 2005, the OCC issued supervisory guidance, policies, and examination handbooks on various issues and risks affecting national banks.

- *Clarifications to the OCC's Enforcement Guidelines.* Under 12 CFR 21.21, all national banks must establish and maintain adequate internal controls, independent testing, responsible personnel, and training to comply with the BSA. This guidance clarifies and provides a consistent approach for examiners to use when citing violations and taking enforcement actions with respect to this rule. The OCC also issued an appendix to its Enforcement Action Policy to identify those violations (including BSA) or other supervisory findings that, as a result of a statutory or other legal requirement, require the OCC to take a specific action. (OCC Bulletins 2004-50 and 2004-51).
- *Interim Examination Procedures for Retail Credit.* In recent years, the mix and complexity of products that banks offer and the availability of credit to consumers has expanded. Concurrent with this growth have been changes in the ways that banks manage their retail portfolios. In response to these trends, the OCC issued updated examination procedures that address the various risk management and control functions that banks need to manage more diverse and complex portfolios. The OCC plans to incorporate these procedures in a subsequent update to the Comptroller's Handbook. (OCC Bulletin 2004-59).
- *Guidance on Risk Mitigation and Response to Web-Site Spoofing Incidents.* Web-site spoofing is a method of creating fraudulent Web sites that look similar, if not identical to an actual site, such as that of a bank, with the goal of enticing customers to reveal information that would enable a criminal to use customers' accounts to commit fraud or steal the customers' identities. In response to the growing incidents of Web-site spoofing, the OCC issued guidance to banks on how to respond to such incidents and steps that they can take to mitigate the risks to themselves and their customers from such incidents. (OCC Bulletin 2005-24).
- *Advisory Letter on Electronic Disclosures and Notices.* Increasingly, banks are replacing their paper-based consumer notices or disclosures with electronic disclosures. However, the failure to provide such electronic disclosures in a proper manner can expose a bank to significant compliance, transaction, and reputation risk. This advisory letter provides background and highlights issues that should be considered by national banks that provide electronic consumer disclosures. (OCC AL-2004-11).
- *Additions and Updates to the Comptroller's Handbook series.* The OCC published two updates to the Comptroller's Compliance Handbook.

- “Other Consumer Protection Laws and Regulations” incorporates interagency examination procedures for the Homeowners Protection Act, the Disclosure and Reporting of CRA-Related Agreements, and the Prohibition Against Use of Interstate Branches Primarily for Deposit Production. It replaces the OCC’s 1996 booklet.
- “Home Mortgage Disclosure Act Examination Procedures” incorporates FRB changes to Regulation C, the majority of which relate to additional information requirements lenders must include on their HMDA Loan Application Register and replaces the OCC’s August 1996 booklet.

Consumer Advisories

Consumer Advisories issued in FY 2005 included:

- *Gift Cards: OCC Provides Holiday Tips for Consumers, OCC News Release 2004-108 (December 7, 2004).* The OCC issued this consumer advisory to provide important information to holiday shoppers about the terms and conditions that apply to gift cards. The OCC advised consumers to make sure they have received disclosures on significant terms and conditions of gift cards, including any applicable fees, such as those that apply after the purchase of the card and thereby reduce its value; any expiration date for the card; procedures

to follow in the event the card is lost or stolen; the locations at which the gift card can be used; and the procedures to follow in the event there are problems with the card. If these disclosures are not stated on the gift card itself, or its packaging, the OCC recommended that consumers determine if there is a toll-free number or Web site that would provide this information.

- *Check 21: Q’s and A’s, <http://www.occ.treas.gov/consumer/check21/htm>.* The OCC posted on its public Web site these questions and answers for consumers about the Check Clearing for the 21st Century Act, commonly referred to as the “Check 21 Act.” The questions and answers provide basic information to consumers on various aspects of this new federal law. The document focuses on what consumers most need to know about the Check 21 Act, including the importance of ensuring that there are sufficient funds in the account to cover checks that are written; the possibility that original checks will not be returned; the availability and significance of substitute checks created pursuant to the Check 21 Act; and special procedures to correct errors involving substitute checks.
- *Writing a Check: Understanding Your Rights, OCC News Release 2005-75 (August 2, 2005).* The OCC issued this consumer advisory to provide consumers with important information about their rights when they use checks to make payments. The advisory outlines the

different ways that checks can be processed and the significance for consumers of those differences. For example, the advisory informs consumers that various methods for electronic check processing may mean that funds are taken from consumers' bank accounts more quickly than before. As a result, it is even more important for consumers to ensure that they have enough money in their accounts to cover checks at the time they write them. The advisory also discusses the different laws and regulations governing check transactions, how consumers' rights may vary depending on how a check is processed, and how consumers may resolve problems in connection with their checks.

In addition to these OCC issuances, the OCC participated in and issued supervisory guidance and examination procedures in conjunction with other federal financial regulators. These initiatives are discussed in the Partnership and Outreach section of this report.

Litigation Activities

The OCC was a party to, or prepared, "friend of the court" briefs in several cases related to bank powers, federal preemption of state law, enforcement actions, problem banks, and Title VII actions. Some examples follow:

- *Decisions that federal law preempts state law restrictions on the activities of national bank mortgage operating subsidiaries.* Four U.S. district courts in California, Connecticut, Maryland, and Michigan have

granted national banks declaratory and injunctive relief in suits challenging states' efforts to license and exercise visitorial powers over the operating subsidiaries of national banks. In each case, the district court held that the National Bank Act and OCC regulations preempt state licensing and enforcement authority over the real estate lending activities of national bank operating subsidiaries. Both the Second and Ninth Circuit Courts of Appeals have affirmed the decisions of the district courts in California and Connecticut. *Wells Fargo Bank, N.A. v. Boutris*, — F.3d —, 2005 WL 1924713 (9th Cir. August 12, 2005), *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305 (2nd Cir. 2005). The decisions of district courts in Maryland and Michigan are pending appeal before the Fourth and the Sixth Circuit Courts of Appeals, respectively. *Nat'l City Bank of Ind. v. Turnbaugh*, 367 F.Supp.2d 805 (D.Md.2005), appeal docketed, No. 05-1647 (4th Cir. June 13, 2005); *Wachovia Bank, N.A. v. Watters*, 334 F.Supp.2d 957 (W.D.Mich.2004) appeal docketed, No. 04-2257 (6th Cir. October 14, 2004).

- *Challenge to federal diversity jurisdiction ruling of the Court of Appeals for the Fourth Circuit.* The Supreme Court granted certiorari to review a decision of the Court of Appeals for the Fourth Circuit that held, based upon its interpretation of 28 USC 1348, that a national bank is a citizen of any state in which it maintains a branch office or other physical presence for federal

diversity jurisdictional purposes. *Wachovia Bank, Nat. Ass'n v. Schmidt*, 388 F.3d 414 (4th Cir. 2004), *cert. granted*, 73 USLW 3540, 73 USLW 3713, 73 USLW 3718 (U.S. June 13, 2005) (No. 04-1186). The Fourth Circuit Court of Appeals decision created a conflict within the United States courts of appeals when it rejected a contrary interpretation of 28 USC 1348 adopted by the Fifth, Seventh and Ninth Circuits. *See Horton v. Bank One, N.A.*, 387 F.3d 426 (5th Cir. 2004).

- *Section 104 of the Gramm-Leach-Bliley Act preempts state law that restricts the sale of insurance by national banks.* A U.S. District Court granted summary judgment to plaintiffs who challenged as preempted state statutory provisions that restrict national bank insurance sales, solicitation, and cross-marketing. The court held that section 104 of the Gramm-Leach-Bliley Act, 15 USC 6701, preempts state laws that restrict the insurance sales activities of national banks. *Massachusetts Banking Ass'n v. Bowler*, 2005 WL 61458 (D.Mass. 2005).
- *Highest state court holds that state law authorizes a national bank to charge document preparation fees.* In an unanimous opinion, the Illinois Supreme Court affirmed two decisions of the Illinois Court of Appeals that dismissed complaints in 38 lawsuits, consolidated for appeal, where the plaintiffs alleged that various lenders, including a national bank operating subsidiary, engaged in the unauthorized practice of law by charging a fee for preparing real estate mortgage loan documents. The court concluded that a company engages in the practice of law by preparing loan documents, such as the note and the mortgage. Under Illinois law, however, a party to a transaction is permitted to prepare the documents memorializing that transaction. Thus, the court held that state law permits lenders, including national bank subsidiaries, to charge fees for preparing loan documents. *King v. First Capital Financial Service Corp.*, 828 N.E.2d 1155 (2005).
- *Fair Credit Reporting Act preempts California statute that restricts information sharing among affiliates.* The Ninth Circuit Court of Appeals held that the clause of the Fair Credit Reporting Act preempting state laws regulating the exchange of information among affiliates invalidates the requirements and prohibitions imposed by the California Financial Information Privacy Act (commonly known as SB1) for affiliates sharing information bearing on a consumer's creditworthiness, credit standing, credit capacity, character, or other factor used to establish the consumer's eligibility for credit or insurance. *American Bankers Ass'n v. Gould*, 412 F.3d 1081 (9th Cir. 2005).
- *Federal court upholds OCC decision denying a request for suspicious activity reports.* The U.S. District Court for the Northern District of Ohio held that the OCC's decision denying a request for

suspicious activity reports (SARs) was reasonable because the BSA’s prohibition on the disclosure of a SAR and the OCC’s implementing regulation declaring a SAR to be confidential prohibits the disclosure of a SAR to anyone. The court also sustained the constitutionality of the BSA’s confidentiality provision and the OCC’s implementing regulation. *Wuliger v. OCC*, — F.Supp. —, 2005 WL 2217039 (N.D. Ohio).

- *United States Court of Federal Claims rejects banker’s Tucker Act claim to recover compensation for a Fifth Amendment taking.* The U.S. Court of Federal Claims ruled that the OCC did not prohibit a former banker from selling shares of stock he owned in a national bank following his suspension from participation in the affairs of the bank and, thus, did not violate his constitutional rights. *Hedrick v. United States*, No. 95-684C, slip op. (Fed. Cl. September 29, 2004).

Charter Program

The charter program relates to chartering national banks as well as evaluating the permissibility of structures and activities

of those banks and their subsidiaries. The program includes the review and approval of new national bank charters, federal branches and agencies, mergers, conversions, corporate reorganizations, changes in control, operating subsidiaries, branches, relocations, and subordinated debt issues. The charter process incorporates conditions and agreements as needed to support the safe and sound operation of the resulting entities.

In FY 2005, the OCC devoted \$15.5 million and 86 FTEs or 3.2 percent of its workforce, to the charter program. The OCC exceeded all of its FY 2005 performance targets and customer service standards for licensing operations. The customer service results were based on 645 licensing surveys completed by banks during the year, for a 37 percent response rate. The survey is based on a five-point scale, in which 1 indicates outstanding and 5 indicates significantly deficient. The OCC follows up with every applicant that rates the overall licensing process 3 or worse. This follow-up helps agency employees understand the applicants’ concerns, so that the OCC can make appropriate modifications to its licensing process. The FY 2005 licensing and customer service performance measures and results are presented in Table 4.

Table 4: Licensing and Customer Service Performance Measures, FY 2005

| Performance Measures | Target | Actual |
|---|--------|--------|
| Percentage licensing applications and notices filed electronically | 35% | 38% |
| Percentage of licensing applications and notices completed within established time frames | 95% | 96% |
| Average survey rating of the overall licensing services provided by OCC | ≤ 1.5 | 1.19 |

Licensing Decisions

A responsive and efficient licensing operation is essential to meet the needs of banks that are part of, or seek to become part of, the national banking system. The OCC received 2,341 applications and 991 notices during FY 2005. The volume of corporate applications and notices decreased by 239 (6.7 percent) from FY 2004. Table 5 shows the corporate applications received in FY 2004 and FY 2005. Of the 2,128 decisions issued on applications during FY 2005, 96 percent were completed

within the established time frames, the same as in FY 2004. Table 6 shows the timeliness of the OCC's actions by type of application for FY 2004 and FY 2005. The OCC met its goal while providing a consistently high level of services as rated by applicants. In addition, the OCC received 1,256 applications and notices electronically, an increase of 64 percent over the 875 received in FY 2004. Electronic filing reached 38 percent of all applications and notices received and increased from 34 percent in FY 2004.

Table 5: Corporate Application Activity, FY 2004 and 2005

| | Applications Received | | FY 2005 Decisions | | | |
|------------------------------|-----------------------|--------------|-------------------|-------------------------------------|----------|--------------|
| | FY 2004 | FY 2005 | Approved | Conditionally Approved ⁴ | Denied | Total |
| | | | | | | |
| Branches | 1,765 | 1,645 | 1,546 | 4 | 0 | 1,550 |
| Capital / sub debt | 136 | 141 | 49 | 8 | 0 | 57 |
| Change in Bank Control | 16 | 17 | 17 | 0 | 0 | 17 |
| Charters | 31 | 26 | 3 | 17 | 0 | 20 |
| Conversions ¹ | 21 | 15 | 7 | 9 | 0 | 16 |
| Federal Branches | 4 | 2 | 0 | 0 | 0 | 0 |
| Fiduciary Powers | 22 | 22 | 5 | 6 | 0 | 11 |
| Mergers ² | 90 | 69 | 59 | 4 | 0 | 63 |
| Relocations | 288 | 259 | 241 | 1 | 0 | 242 |
| Reorganizations | 137 | 116 | 98 | 9 | 0 | 107 |
| Stock appraisals | 1 | 2 | 0 | 0 | 0 | 0 |
| Subsidiaries ³ | 81 | 23 | 39 | 4 | 0 | 43 |
| 12 CFR 5.53 Change in Assets | NA | 4 | 0 | 2 | 0 | 2 |
| Total | 2,592 | 2,341 | 2,064 | 64 | 0 | 2,128 |

¹ Conversions are conversions to national bank charters.

² Mergers include failure transactions when the national bank is the resulting institution.

³ This count does not include 70 After-the-Fact notices received in FY 2004 and 128 After-the-Fact notices received in FY 2005.

⁴ On April 14, 2000, the Licensing department issued guidance imposing special conditional approval for all bank charters requiring the OCC to be notified before a significant deviation or change in the operating plan during the first three years of operation.

Table 6: OCC Licensing Actions and Timeliness, FY 2004 and 2005

| Application Type | Target time frames in days ¹ | FY 2004 | | | FY 2005 | | |
|------------------------------|---|---------------------|---------------|-----------|---------------------|---------------|-----------|
| | | Number of Decisions | Within Target | | Number of Decisions | Within Target | |
| | | | Number | % | | Number | % |
| Branches | 45 / 60 | 1,798 | 1,769 | 98 | 1,550 | 1,519 | 98 |
| Capital / sub debt | 30 / 45 | 48 | 46 | 96 | 57 | 48 | 84 |
| Change in Bank Control | NA / 60 | 14 | 14 | 100 | 17 | 17 | 100 |
| Charters ² | | 38 | 22 | 58 | 20 | 17 | 85 |
| Conversions | 30 / 90 | 18 | 14 | 78 | 16 | 7 | 44 |
| Federal Branches | NA / 120 | 2 | 2 | 100 | 0 | 0 | NA |
| Fiduciary Powers | 30 / 45 | 13 | 7 | 54 | 11 | 6 | 55 |
| Mergers | 45 / 60 | 96 | 86 | 90 | 63 | 53 | 84 |
| Relocations | 45 / 60 | 283 | 278 | 98 | 242 | 237 | 98 |
| Reorganizations | 45 / 60 | 123 | 100 | 81 | 107 | 88 | 82 |
| Stock appraisals | NA / 90 | 0 | 0 | NA | 0 | 0 | NA |
| Subsidiaries | NA | 44 | 44 | 100 | 43 | 43 | 100 |
| 12 CFR 5.53 Change in Assets | | 0 | 0 | NA | 2 | 1 | 50 |
| Total | | 2,477 | 2,382 | 96 | 2,128 | 2,036 | 96 |

Note: Most decisions (99 percent in 2004 and 98 percent 2005) were decided in the district offices and Large Bank Licensing under delegated authority. Decisions include approvals, conditional approvals, and denials.

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

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

The OCC made several significant charter decisions, including:

- OCC issued, for the first time, an approval under its new regulation (12 CFR 5.53) requiring prior OCC approval for a fundamental change in a bank’s asset composition. Conditional Approval 662 (October 28, 2004).
- As part of an OCC approval of the acquisition of a corporation as an operating subsidiary of a national bank, the agency found that a number of international trade-related services were either part of, or incidental to, the business of banking. Corporate Decision 2005-02 (March 24, 2005).

- The OCC affirmed that a state bank organized as a limited liability company may convert to a national bank under 12 USC 35. Corporate Decision 2005-10 (June 30, 2005).

Other Licensing Accomplishments

The OCC publishes electronically the 22-booklet *Comptroller's Licensing Manual*. During FY 2005, several manual booklets were revised and posted to the OCC's Web site and made available on compact disc (CD) for examiners and the public. In addition, the OCC revised guidance on the national banking system in the manual's companion publication, "A Guide to the National Banking System," which is distributed at OCC's outreach meetings and recruitment efforts.

Change in Bank Control

The OCC's objective in administering the Change in Bank Control Act (CBCA) is to enhance and maintain public confidence in the national banking system by preventing identifiable adverse effects resulting from anti-competitive combinations or inadequate financial support and unsuitable management of national banks. The OCC reviews each CBCA notice and disapproves transactions that could have serious harmful effects.

During FY 2005, the OCC continued to review and determine whether the CBCA standards warrant a CBCA filer to execute an enforceable agreement with the OCC. In certain circumstances, the OCC may require an agreement that imposes substantive requirements equivalent to conditions and pre-opening requirements that apply to a de novo

Table 7: Change in Bank Control Act,¹ 2001–9/30/2005

| Year | Received | Acted On | Not Disapproved | Disapproved | Withdrawn |
|--------|----------|-----------------|-----------------|-------------|-----------|
| 2005 * | 17 | 17 | 17 | 0 | 0 |
| 2004 * | 16 | 14 ² | 13 | 0 | 0 |
| 2003 * | 16 | 10 | 9 | 1 | 0 |
| 2002 | 10 | 10 | 9 | 1 | 0 |
| 2001 | 18 | 17 | 17 | 0 | 0 |

* Reported by fiscal year, starting in fiscal year 2003.

¹ Notices processed with disposition.

² Includes one notice with no activity. The OCC considered it abandoned.

charter. When the notice raises fundamental supervisory or other issues that cannot be mitigated through agreements, the OCC will disapprove the proposal.

The OCC's CBCA activity is reflected in Table 7. The OCC received 17 CBCA notices in FY 2005. During this period, the OCC acted on 17 notices, none of which was disapproved.

Community Reinvestment Act

Consistent with 12 CFR 5, the "Public Notice and Comments" booklet (February 2004) details the OCC's procedures for handling CRA issues in applications, including the treatment of adverse comments from the public. During FY 2005, the OCC received adverse comments from the public on three CRA-covered applications. Table 8 lists those decisions rendered during FY 2005 on applications

presenting CRA issues that were published in the OCC's monthly *Interpretations and Actions*. This publication is available on the OCC's Web site.

Licensing Reviews

The OCC has several initiatives under way to evaluate and enhance its licensing programs. During the year, the OCC continued with the development of its new processing database, Licensing Information Systems (LIS). Also work continued to ensure the OCC and Federal Reserve Banks work together on change in bank control applications at the holding company level, where the OCC seeks certain safeguards from the acquiring holding company of a national bank. Initial efforts began during 2005 on a Quality Assurance Program (QAP) for licensing. The Licensing Department plans an early calendar year 2006 launch of the program.

Table 8: List of Applications Presenting Community Reinvestment Act Issues Decided, FY 2005

| Bank, City, State | Interpretations and Actions | Document Number |
|---|------------------------------------|--------------------------------|
| Community Bank, NA, Canton, NY | December 2004 | CRA Decision No. 124 |
| Wachovia Bank, NA, Charlotte, NC | January 2005 | CRA Decision No. 125 |
| First American Bank, SSB, Bryant, TX | March 2005 | Conditional Approval No. 676 |
| PNC Bank, NA, Pittsburgh, PA | May 2005 | Conditional Approval No. 687 |
| Pacific Capital Bank, NA, Santa Barbara, CA | August 2005 | Corporate Decision No. 2005-11 |

Partnership and Outreach

The OCC works with other regulators, industry, and community and consumer organizations to accomplish its mission and meet its strategic goals and objectives in an effective and efficient manner.

Financial Regulators

Primarily through the FFIEC, the OCC works closely with the other federal banking agencies (FRB, FDIC, OTS) and the NCUA to coordinate on issues that cut across the banking system, such as supervisory policies, regulations, regulatory reporting requirements, and examiner training. These efforts reduce regulatory burden by promoting greater uniformity, consistency, and efficiency in the supervision of insured depository institutions.

The OCC also works with other state, federal, and international regulators and supervisors, such as the SEC on securities, brokerage, and accounting and disclosure issues, and the FTC on consumer protection and privacy issues.

The OCC has entered into information-sharing agreements with 48 state insurance departments and the District of Columbia, and meets with the National Association of Insurance Commissioners (NAIC) at the NAIC's national quarterly meetings. The OCC also assisted the NAIC in drafting a model bulletin that will inform insurers that supervisory information, such as a financial institution's supervisory rating, is confidential information and may not be disclosed to, or used by, a third party unless

pursuant to federal banking agency regulations.

The OCC is a member of the administration's Financial and Banking Infrastructure Information Committee (FBIIC) and is working with other federal regulators to combat money laundering and terrorist financing. As noted elsewhere in this report, the OCC is collaborating with the other FFIEC-member agencies and FinCEN to coordinate BSA/AML activities and provide guidance to the industry in this critical area. In June 2005 the FFIEC agencies published a BSA/AML Examination Manual that provides bankers and bank examiners with comprehensive guidance and resources on the BSA requirements and the agencies' supervisory expectations. Following its publication, the agencies hosted training and outreach sessions for examiners and bankers to discuss the new manual. The OCC also worked with the other FFIEC-member agencies and FinCEN to provide additional guidance on providing banking services to money services businesses and to respond to questions regarding customer identification requirements for consumers affected by Hurricane Katrina.

The OCC continued its participation with the Basel Committee on Banking Supervision to update and revise the Basel Capital Accord to make the capital standards for internationally active banks more comprehensive, risk sensitive, and reflective of advances in banks' risk measurement and management practices (Basel II). These efforts included the Basel Committee's publication of a proposal for the application of Basel II to certain trading activities and the treatment of double default

risk when the risk of both a borrower and a guarantor defaulting on the same obligation may be substantially lower than the risk of only one of the parties defaulting.

The OCC worked closely with other regulators during FY 2005 on projects to enhance consumer protection, address emerging risks facing the industry, reduce regulatory burden, and enhance regulatory efficiency. These efforts included:

- *Initiatives to Enhance Consumer Protections and Disclosures.* During FY 2005, the OCC worked with other regulatory agencies to strengthen regulations, policies, and disclosures that assist consumers in making financial decisions and in safeguarding their confidential financial and personal information.

The OCC, FDIC, FRB, NCUA, FTC, and the SEC continued efforts to simplify consumer privacy notices to make them more understandable and useful for consumers and less burdensome for banks to provide. The OCC and the other agencies have engaged experts in plain language disclosures and consumer testing to assist in conducting focus groups and consumer interviews to find out what information consumers find most meaningful, and the most effective way to disclose that information. The agencies expect this consumer testing to be completed by the end of CY 2005; it may form the basis for a proposal to revise the current privacy notice rules.

In October 2004, the FFIEC-member agencies published a new consumer resource, *Protecting Yourself from Overdraft and Bounced-Check Fees*. In February 2005, the agencies published *Overdraft Protection Programs* guidance to assist insured depository institutions in the responsible disclosure and administration of overdraft protection services. The guidance describes federal consumer compliance laws that may apply to such programs, and industry best practices for the marketing and communications of these programs. Such practices include clearly disclosing fees, explaining the impact of transaction-clearing policies on the overdraft fees consumers may incur, disclosing the types of consumer banking transactions covered by the program, and monitoring program usage. The agencies also advised financial institutions to alert consumers before a transaction triggers any fees; to provide consumers the opportunity either to opt-in or opt-out of the program; and to notify consumers promptly each time overdraft protection is used.

Identity theft is a growing problem and concern for many Americans. As discussed in the Regulate Program section of this report, in December 2004 the OCC, FRB, FDIC, and OTS issued interagency final rules to require financial institutions to adopt measures for properly disposing of consumer information derived from credit reports. In March 2005, the agencies issued guidance on programs that banks should have in place to respond to unauthorized access to sensitive customer information. In early October 2005, the agencies

issued updated guidance for the industry on effective methods that they can use to authenticate the identity of customers who use Internet-based banking services to help deter account fraud and identity theft.

- *Initiatives to Reduce Unnecessary Regulatory Burden and Enhance Efficiency.* The OCC continues to work with the other FFIEC-member agencies on a multi-year project to review their regulations to identify outdated, unnecessary, or burdensome regulatory requirements for insured depository institutions. During FY 2005, the agencies requested public comment about possible burden reduction in six categories: money laundering; safety and soundness; securities banking operations; directors, officers and employees; and rules of procedures. The agencies also continued their outreach meetings with bankers and community groups with outreach meetings for bankers held in March 2005 in Phoenix, June 2005 in New Orleans, and August 2005 in Los Angeles. Two outreach meetings for consumer groups took place in Washington, D.C., and Kansas in August and September 2005.

As discussed in the Regulate Program section, in July 2005 the OCC, the FRB, and the FDIC issued a final amendment to their CRA regulations to reduce regulatory burden on community banks while making CRA evaluations more effective in encouraging banks to meet community development needs. The new rules reduce data collection and reporting burden for

Intermediate Small Banks and, at the same time, encourage meaningful community development lending, investment, and services by these banks.

In September 2005, the OCC, FDIC, and FRB implemented the agencies' Web-based Central Data Repository (CDR), which was created to modernize and streamline how the agencies collect, validate, manage, and distribute financial data submitted by banks in quarterly call reports. Through the use of new open data exchange standards the CDR system will facilitate faster delivery of accurate call report data for supervisors, bankers, and the public. Banks will use the system beginning with the submission of their September 30th call report data.

The OCC along with other federal banking agencies testified before Congress on the challenge of reducing unnecessary regulatory burden and on suggestions for reforms to reduce such burdens.

- *Basel II Implementation and Revisions to Risk-Based Capital Standards.* In June 2004, the Basel Committee issued its "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Framework). This Framework forms the basis for the U.S. banking agencies and representatives of the other Basel Committee member countries to develop proposed revisions to existing capital adequacy regulations and standards. Throughout FY 2005, the OCC worked closely with the other federal banking agencies (FDIC, FRB, and OTS) on implementation issues associated

with the proposed Basel II Framework. This work included a fourth quantitative impact study (QIS), designed to provide the agencies with a better understanding of how the implementation of the Basel II Framework might affect minimum required risk-based capital within the U.S. banking industry overall, at consolidated U.S. institutions, and for specific portfolios. In April 2005, the agencies announced they would undertake additional analysis of the QIS results before proceeding with a planned notice of proposed rulemaking and on September 30, 2005, announced their revised plan for implementation of the Basel II framework. Concurrent with this effort, the agencies continued work on supervisory guidance that outlines the key components of the measurement and management structures that banks subject to the revised Framework will need to meet; benchmarking exercises to assess banks' progress in developing and implementing operational risk measurement techniques consistent with the Framework's requirements; and examiner training initiatives. The agency also developed and provided training to more than 160 examiners on the Basel II Corporate and Retail AIRB quantitative guidance. The abbreviation "AIRB" stands for the advanced internal ratings-based approach to determining credit risk.

The agencies also developed and, in early October 2005, issued for comment an advance notice of proposed rulemaking outlining potential changes to the agencies'

risk-based capital rules for banks that would not be subject to Basel II.

- *Joint Examination Programs.* During 2005, the banking agencies continued their joint supervisory programs, including the Shared National Credit (SNC) Program, the Interagency Country Exposure Review Committee, and the interagency examination program for multi-regional data processing servicers (MDPS).

The interagency SNC program, governed by an interagency agreement between the FRB, FDIC, OTS, and OCC, provides uniformity and efficiency in analyzing and rating large, complex credits. A SNC is defined as any loan or formal loan commitment extended to a borrower by a supervised institution or any of its subsidiaries and affiliates that aggregates \$20 million or more and is shared by three or more institutions under a formal lending agreement. The program benefits the regulatory agencies and the banks by: 1) eliminating the redundancy of reviewing the same credit in multiple institutions; 2) ensuring that credits are reviewed in a uniform and consistent manner; 3) maximizing resources; and 4) limiting disruptions to banks' operations. The FY 2005 SNC review covered about 6,817 loan facilities with commitments totaling \$1.6 trillion. The review found that the quality of large syndicated bank loans continued to improve in 2005. Adversely rated loans, and loss loans in particular, declined significantly from the peak levels experienced in 2001 through 2003. This favorable trend is attributed to general

improvement in the economy and liquidity in the secondary market for lower quality assets.

In December 2004, the agencies released for public comment a proposal to revise the scope, depth, and manner in which data is collected for the SNC program. The changes are designed to improve the effectiveness of the agencies' SNC program; support other agency supervisory goals by developing a standardized repository for SNC related documents that would support exchanging SNC data electronically; and use and apply advanced risk analytics to SNC data to benefit participating banks and supervisors.

- *Updated Supervisory Guidance.* The OCC and other federal banking agencies, issued supervisory guidance throughout the year to bankers on risks posed by bank activities, and methods banks can use to manage those risks.

In addition to items previously cited, supervisory guidance to bankers was issued on:

- The risks and controls associated with the use of free and open source software (OCC Bulletin 2004-47).
- The purchase and risk management of bank-owned life insurance products (OCC Bulletin 2004-56).
- The risk-based capital treatment for certain types of direct credit substitutes extended to asset-backed commercial

paper programs (ABCP) (OCC Bulletin 2005-12) and clarification of the asset quality test that banks can use to determine the eligibility of an ABCP liquidity facility for certain risk-based capital treatments (OCC Bulletin 2005-26).

- Accounting and reporting requirements for transactions involving commitments to originate and sell mortgage loans (OCC Bulletin 2005-10).
- The confidentiality of supervisory ratings (OCC Bulletin 2005-4).
- Sound credit risk management practices for institutions engaged in home equity lending (OCC Bulletin 2005-22).

Training materials and examination procedures were issued for the implementation of the Check Clearing for the 21st Century Act (OCC Bulletin 2004-49); and interim examination procedures were issued for revised CRA rules for Intermediate Small Banks (OCC Bulletin 2005-22).

Frequently asked questions and answers were issued on:

- Independent appraisal and evaluation functions for real estate lending transactions (OCC Bulletin 2005-6) and appraisal and real estate lending requirements for residential tract developments (OCC Bulletin 2005-32).

- The USA PATRIOT Act’s requirements for customer identification programs (OCC Bulletin 2005-16).
- The new Home Mortgage Disclosure Act (HMDA) data (OCC Bulletin 2005-17).

The agencies also sought comment on:

- Proposed changes to the agencies’ classification system for commercial credit exposures (OCC Bulletin 2005-8).
- Proposed supervisory guidance on internal ratings-based systems for retail credit risk for regulatory risk-based capital under Basel II (OCC Bulletin 2004-48).
- Proposed advisory on the unsafe and unsound use of limitation of liability provisions and certain alternative dispute resolution provisions in external audit engagement letters (OCC Bulletin 2005-21).

Industry and Community Outreach

The OCC maintains open communications with key constituents affected by, and interested in, the OCC’s mission. The Comptroller and senior managers seek comments on issues facing the banking industry through outreach meetings with industry and trade associations. One creative response to the need for continuing dialogue between bankers and senior OCC

officials was the “Meet the Comptroller” roundtables.

The OCC participated in or conducted a variety of outreach activities during FY 2005. In addition to the interagency seminars and regional outreach meetings on the new FFIEC BSA/AML Examination Manual, the OCC continued its series of Web- and telephone-based seminars for bankers on selected topics. These convenient and cost-effective seminars allow bankers to listen to agency experts discuss their experiences and policy imperatives, and interact with them during question-and-answer sessions. The topics of the three FY 2005 seminars were, “Bank Secrecy Act/Anti-Money Laundering,” “The Home Mortgage Disclosure Act,” and “Corporate Governance and the Community Bank.” Approximately 9,000 listeners participated in these seminars from 1,630 sites.

The OCC met with community and consumer organizations on policy matters relating to credit card fees and disclosures, home equity lending, electronic check cashing processes, financial literacy, predatory appraisals, and other consumer issues. These meetings provided the OCC with information about the challenges and opportunities for increased access to financial services for consumers in disadvantaged communities.

The OCC also continued and expanded its workshops for community bank directors. The OCC’s workshop on “Understanding OCC’s Risk Assessment Process” enhanced directors’ understanding of risk-based supervision; increased familiarity with major risks in

commercial banking; highlighted the types of questions to ask managers, auditors, and examiners; and reviewed common ways to identify, measure, monitor, and control risk. The workshop, “Credit Risk: A Director’s Focus,” increased directors’ knowledge of effective credit risk management processes, taught them to assess and control their banks’ risk profiles and improved their abilities to evaluate the quality of their banks’ management information systems. The OCC added a new workshop in 2005, “Compliance Risk: What Directors Need to Know.” This workshop focused on increasing a director’s knowledge of major compliance risks, critical regulations, and the elements of an effective compliance risk management program. In all, approximately 500 directors attended these three workshops.



To ensure a safe and sound national banking system for all Americans, OCC must have an expert, highly motivated and diverse workforce that makes effective use of its resources. During FY 2005, OCC pursued management initiatives to achieve those goals.

