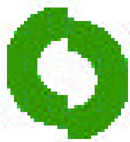
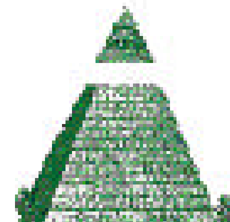


Comptroller of the Currency
Administrator of National Banks

VOLUME SEVENTEEN

Quarterly Journal

No. 2



Office of the Comptroller of the Currency
June 1998

Comptroller (Acting) . . . . Julie L. Williams

Executive Committee

Chief of Staff . . . . Mark P. Jacobsen
Chief Counsel (Acting) . . . . Raymond Natter
Senior Deputy Comptroller for Administration . . . . Edward J. Hanley
Senior Deputy Comptroller for Bank Supervision Operations . . . . Leann G. Britton
Senior Deputy Comptroller for Bank Supervision Policy . . . . Emory Wayne Rushton
Senior Deputy Comptroller for Economic and Policy Analysis . . . . James D. Kamihachi
Senior Deputy Comptroller for International Affairs . . . . Susan F. Krause
Senior Deputy Comptroller for Public Affairs (Acting) . . . . Leonora S. Cross
Ombudsman . . . . Samuel P. Golden

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

Julie L. Williams became acting Comptroller of the Currency on April 6, 1998, succeeding Eugene A. Ludwig whose term of office had ended. She had been chief counsel since 1994 with responsibilities for all of the agency's legal activities. As the Comptroller's top legal advisor, Ms. Williams served as a member of the Executive Committee, providing advice and guidance on major issues and actions. Ms. Williams joined the OCC in 1993 as deputy chief counsel, with responsibility for special legislative and regulatory projects.

Before joining the OCC in 1993, Ms. Williams served in a variety of positions at the Office of Thrift Supervision and its predecessor agency, the Federal Home Loan Bank Board. From 1991 to 1993, she was senior deputy chief counsel, responsible for regulations and legislation, corporate and securities law and general legal issues. She previously served as deputy chief counsel for securities and corporate analysis. In 1983 she joined the Bank Board, after working as an attorney since 1975 with the law firm of Fried, Frank, Harris, Shriver & Kampelman in Washington, D.C.

Ms. Williams is the author of *Savings Institutions: Mergers, Acquisitions and Conversions* (Law Journal Seminars-Press, 1988) and has published numerous articles on the regulation of depository institutions, financial services, securities and corporate law matters. She was awarded a B.A. from Goddard College, Plainfield, Vermont, in 1971, and a J.D. in 1975 from Antioch School of Law, Washington, D.C., where she was first in her class.

The *Quarterly Journal* is the journal of record for the most significant actions and policies of the Office of the Comptroller of the Currency. It is published four times a year in March, June, September, and December. The *Quarterly Journal* includes policy statements, decisions on banking structure, selected speeches and congressional testimony, material released in the interpretive letters series, statistical data, and other information of interest to the administration of national banks. Suggestions, comments, or questions on content may be sent to Rebecca W. Miller, Senior Writer-Editor, Communications Division, Comptroller of the Currency, Washington, DC 20219–0001. Subscriptions are available for $100 a year by writing to Publications—QJ, Comptroller of the Currency, P.O. Box 70004, Chicago, IL 60673–0004.

Quarterly Journal

Office of the Comptroller of the Currency

Julie L. Williams

Acting Comptroller of the Currency

The Administrator of National Banks

Contents

	Page
Condition and Performance of Commercial Banks	1
Recent Corporate Decisions	13
Appeals Process	15
Speeches and Congressional Testimony	23
Interpretations—January 1 to March 31, 1998	79
Mergers—January 1 to March 31, 1998	129
Tables on the Financial Performance of National Banks	141
1997 Chief Financial Officer's Annual Report	157
Index	191

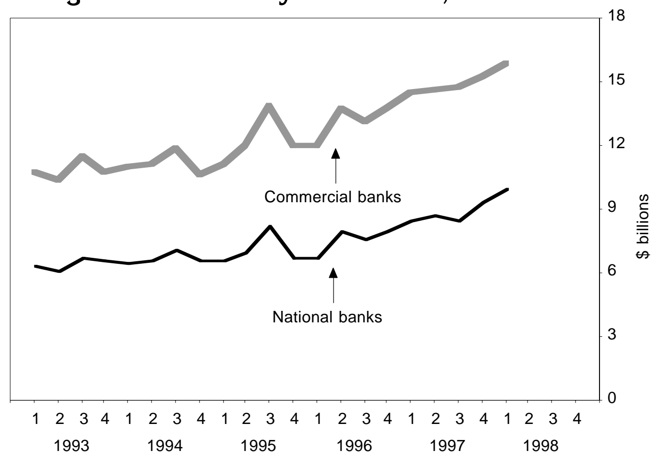
Condition and Performance of Commercial Banks

In the first quarter of 1998, U.S. economic growth remained strong, the national unemployment rate improved to its lowest level since 1970, inflation remained in check, and U.S. interest rates were relatively low and stable. Not surprisingly, commercial banks continued their record-setting earnings performance of the last six years. The strength in bank performance was widespread across the industry; contributing to earnings growth were high noninterest income and an historically low proportion of noncurrent loans.

Earnings

Reflecting the strong U.S. economy, commercial banks earned a record $15.9 billion in the first quarter of 1998 (see Figure 1). Industry earnings were 4 percent higher than in the fourth quarter of 1997, and 10 percent higher than the first quarter of 1997. National banks also set an earnings record in the first quarter with net income of $10.0 billion.

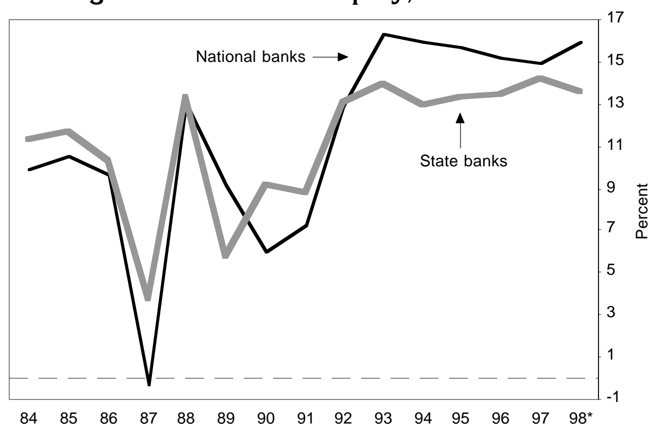
Figure 1—Quarterly net income, 1993–1998



Source: Integrated Banking Information System

The annualized return on average assets (ROA) for all commercial banks was 1.26 percent, a slight improvement from both the fourth and first quarter of 1997. The industry's annualized return on average equity (ROE) was 15.02 percent, up 36 basis points from the fourth quarter of 1997, but down 8 basis points from the first quarter a year ago. National banks, however, registered previous-quarter and year-ago increases in both ROA and ROE, to 1.36 percent and 15.98 percent respectively. Moreover, national banks have out-performed state-chartered banks on ROA and ROE in every year since 1992 (see Figure 2). Even after accounting for asset size, national banks generally had higher profitability rates over this period.

Figure 2—Return on equity, 1984–1998

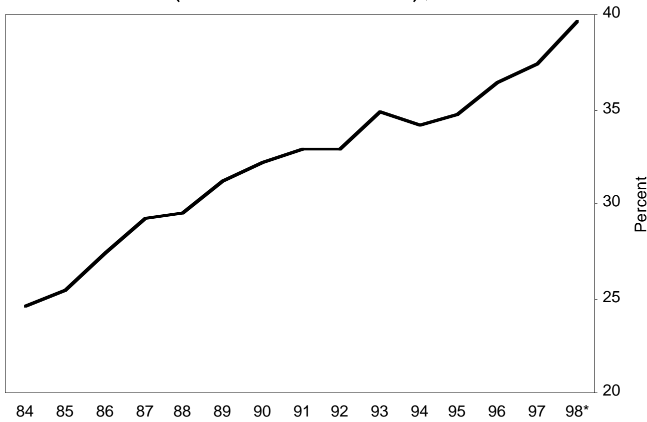


* 1998 data as of March 31, 1998. All other data as of year end.
Source: Integrated Banking Information System

Strong profitability and earnings gains were registered by large segments of the industry. Sixty-eight percent of all banks earned an ROA over 1 percent, and 63 percent of the industry had higher earnings than in the first quarter a year ago. One modest negative earnings trend from the first quarter was that the share of all banks reporting losses increased to 4.5 percent compared to 4.0 percent in the first quarter of 1997.

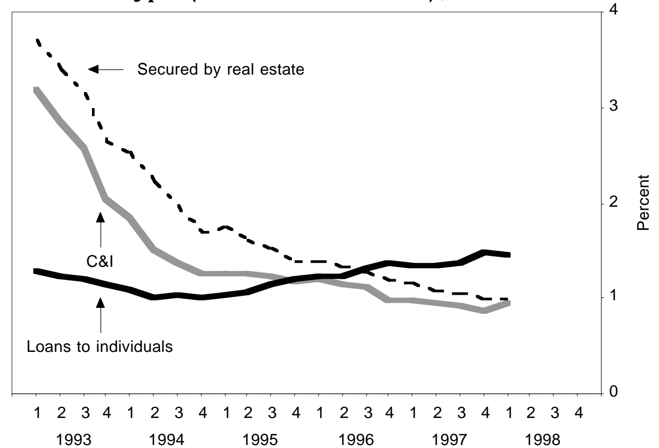
Noninterest income was the primary source of the growth in industry earnings in the first quarter, increasing 19 percent from a year ago. Fee income (from fiduciary activities, deposit service charges, and other) rather than trading revenue was the driving force in this growth. Net interest income, on the other hand, rose only 5 percent as net interest margins declined and loan growth was moderate. Consequently, the share of industry revenues from noninterest income rose to 40 percent in the first quarter, compared to 37 percent a year ago and 25 percent in 1984 (see Figure 3). Although big banks are more dependent on noninterest income than small banks, this long-term industry trend towards greater reliance on fee and other non-traditional sources of revenue is not just a big bank phenomenon. For commercial banks with less than $100 million in assets, noninterest income represented 23 percent of revenues in the first quarter of 1998, compared to 22 percent a year ago, and 15 percent in 1984.

Figure 3—Noninterest income to net operating revenue (commercial banks), 1984–1998



* 1998 data as of March 31, 1998. All other data as of year end.
Source: Integrated Banking Information System

Figure 4—Noncurrent loan ratios by loan type (commercial banks), 1993–1998



C&I—commercial and industrial loans
Source: Integrated Banking Information System

Credit Quality

Overall loan quality indicators for commercial banks remained strong in the first quarter. The noncurrent loan ratio for the industry rose slightly in the quarter, but remained below 1 percent for the third consecutive quarter. Moreover, two-thirds of all banks reported a noncurrent loan ratio below 1 percent. The net charge-off rate for loan and leases also remained historically low at an annualized 0.69 percent. The net charge-off rate was unchanged from the fourth quarter, and up only slightly from the first quarter a year ago.

Looking at noncurrent loans by loan type, two issues—one old and one new—warrant mention. First, loans to individuals continue to have the highest noncurrent rate by loan type despite a slight improvement in the rate during the first quarter (see Figure 4). This issue, however, remains primarily concentrated in the largest credit card issuers. Second, the noncurrent rate for commercial and industrial loans showed the first signs of slippage in the quarter, increasing 11 basis points to 0.96 percent. For the last two years, bank regulators have warned of an impending turning point in commercial credit quality based on several underwriting surveys that indicated a loosening of commercial lending standards. While the change in the noncurrent rate for commercial and industrial loans in the first quarter was small, and one quarter does not make a long-term trend, it is the first indication from bank call reports that the credit quality cycle for commercial lending may be turning.

On-Balance-Sheet and Off-Balance-Sheet Activity

Loans outstanding at commercial banks grew at a 7 percent annual rate in the first quarter and exceeded $3 trillion for the first time. Over the last year, loan growth, which was 9 percent for all loans, varied widely by loan type. Over this period, commercial and industrial loans grew 12 percent, real estate loans expanded by 10 percent, and loans to individuals declined by 0.3 percent.

The growth pattern by loan type over the last year is consistent with the realignment in portfolio distribution that has been under way for over two years. Commercial and industrial lending experienced the largest increase in loan share over the last two years, followed by real estate loans, while the share of loans to individuals decreased (see Figure 5).

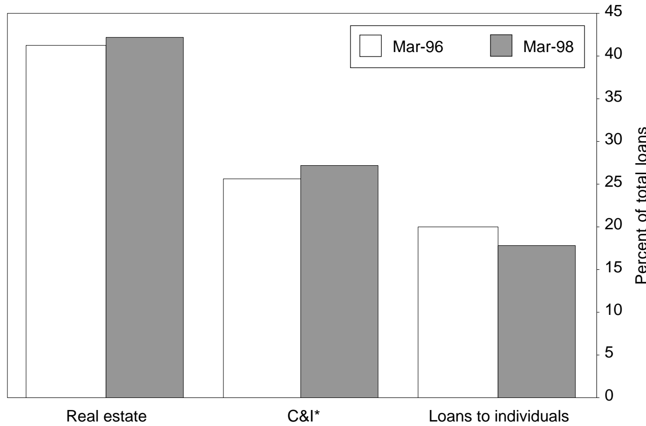
Although banks reduced their on-balance-sheet exposure to individuals over the last two years, their off-balance-sheet exposure increased. Credit card loans securitized and sold off-balance- sheet grew 28 percent over the last four quarters, compared to 20 percent growth over the previous four quarters. Two years ago, credit card loans securitized by banks were two-thirds of their on-balance-sheet credit card loans. As of the first quarter, the level of securitized credit cards loans were nearly equal to the on-balance-sheet level.

Banks' exposure to unused credit card commitments have also grown significantly. Unused credit card commitments grew by 20 percent over the last four quarters, compared to 23 percent growth over the previous four quarters. Two years ago commercial banks' unused credit card commitments were six times their credit card loans; today they are eight times their loans.

Structural Change

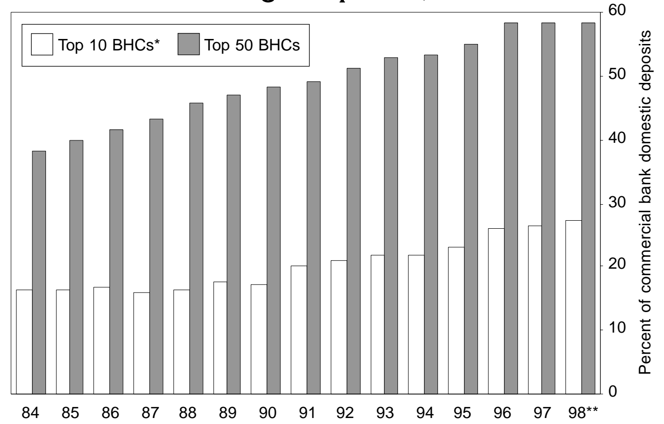
The major development on the structure of the banking system in the first quarter was the announcement of three mega-mergers. Two of the announced deals involved

Figure 5—Portfolio share by loan type (commercial banks), 1996 and 1998



* C&I—commercial and industrial loans
Source: Integrated Banking Information System

Figure 6—Nationwide domestic deposit share for bank holding companies, 1984–1998



* BHC—bank holding company
** 1998 data as of March 31, 1998. All other data as of year end.
Source: Integrated Banking Information System

companies within the top 10 banking companies, and the other involved the second largest banking company with a major insurance company. The first set of deals will further the long-term trend of consolidating deposits nationally within the largest banking companies.

At the national level, domestic deposit share for the top 50 U.S. bank holding companies (BHCs) (ranked by assets) has been increasing steadily over the past 10 years. In the first quarter of 1998, the top 50 held 59 percent of total commercial bank domestic deposits compared to 46 percent in 1988 (see Figure 6). The top 10 BHCs have almost doubled their domestic deposit share, growing to 27 percent from 16 percent over the same time period. Mergers and acquisitions, rather than internal growth, are the chief sources of this nationwide consolidation in deposits. NationsBank personifies this merger trend. NationsBank's national deposit share has grown to 6 percent in 1998 from 1 percent in 1988.

Focusing on the national level, however, provides a misleading impression about the effects of industry consolidation on competitive conditions in *local* banking markets. Over the past 10 years, the concentration of banks in the typical metropolitan statistical area (MSA) has remained stable. The three-firm concentration ratio (the share of local market deposits held by the largest three banks in an MSA) averaged 65.4 percent in 1997 and 67.7 percent in 1987.[1] These figures suggest that competitive rivalry *has not* diminished in local markets, despite the increase in nationwide concentration.

Another sign that competition remains healthy within the banking industry is the changing makeup of the top 10 BHCs. Over the 10 years leading up to the first quarter of 1998, only five BHCs remained in the top 10 in terms of nationwide deposit share (Chase Manhattan, Citicorp, BankAmerica, J.P. Morgan, and Bankers Trust). Several of the five newcomers (NationsBank, First Union, Banc One, Fleet, and First Chicago NBD) were relatively small banks only 15 or 20 years ago.

[1] Based on Federal Deposit Insurance Corporation, Summary of Deposits data for 1987 and 1997.

Key indicators, FDIC-insured national banks
Annual 1994–1997, year-to-date through March 31, 1998, first quarter 1997, and first quarter 1998
(Dollar figures in millions)

	1994	1995	1996	1997	Preliminary 1998 YTD	1997Q1	Preliminary 1998Q1
Number of institutions reporting	3,075	2,858	2,726	2,597	2,549	2,722	2,549
Total employees (FTEs)	851,311	840,699	850,737	911,433	928,914	869,917	928,914
Selected income data ($)							
Net income	$26,803	$28,584	$30,497	$35,792	$9,983	$8,512	$9,983
Net interest income	83,958	87,080	94,564	106,641	26,896	25,083	26,896
Provision for loan losses	5,500	6,335	9,598	13,057	3,311	2,710	3,311
Noninterest income	45,906	51,079	56,100	65,429	18,470	15,000	18,470
Noninterest expense	83,941	87,591	93,690	104,676	27,983	24,259	27,983
Net operating income	27,027	28,541	30,096	35,002	9,047	8,361	9,047
Cash dividends declared	17,669	20,516	25,279	28,572	7,671	5,423	7,671
Net charge-offs to loan and lease reserve	5,994	6,459	9,968	12,660	3,325	2,726	3,325
Selected condition data ($)							
Total assets	2,256,008	2,401,017	2,528,057	2,893,910	2,971,961	2,611,566	2,971,961
Total loans and leases	1,382,855	1,522,677	1,641,464	1,840,477	1,880,502	1,673,755	1,880,502
Reserve for losses	30,990	31,142	31,992	34,859	35,300	32,977	35,300
Securities	414,264	390,549	380,615	452,114	479,693	396,771	479,693
Other real estate owned	5,709	3,396	2,761	2,111	2,059	2,669	2,059
Noncurrent loans and leases	17,852	17,595	17,223	17,877	18,270	17,582	18,270
Total deposits	1,630,171	1,695,817	1,801,043	2,004,855	2,032,092	1,819,875	2,032,092
Domestic deposits	1,350,658	1,406,312	1,525,565	1,685,304	1,715,983	1,543,314	1,715,983
Equity capital	172,655	189,714	207,167	244,972	253,695	223,540	253,695
Off-balance-sheet derivatives	7,570,283	7,914,818	7,488,663	8,704,481	9,003,564	7,881,377	9,003,564
Performance ratios (annualized %)							
Return on equity	15.99	15.76	15.28	15.00	15.98	15.64	15.98
Return on assets	1.24	1.24	1.25	1.29	1.36	1.31	1.36
Net interest income to assets	3.87	3.78	3.88	3.83	3.66	3.86	3.66
Loss provision to assets	0.25	0.27	0.39	0.47	0.45	0.42	0.45
Net operating income to assets	1.25	1.24	1.24	1.26	1.23	1.29	1.23
Noninterest income to assets	2.12	2.22	2.30	2.35	2.51	2.31	2.51
Noninterest expense to assets	3.87	3.80	3.85	3.76	3.81	3.73	3.81
Loss provision to loans and leases	0.42	0.44	0.61	0.73	0.71	0.65	0.71
Net charge-offs to loans and leases	0.46	0.45	0.63	0.71	0.71	0.65	0.71
Loss provision to net charge-offs	91.75	98.09	96.29	103.14	99.53	99.39	99.53
Performance ratios (%)							
Percent of institutions unprofitable	4.13	3.32	4.77	4.74	4.59	4.26	4.59
Percent of institutions with earnings gains	52.59	66.83	67.83	68.23	64.06	61.24	63.36
Noninterest income to net operating revenue	35.35	36.97	37.24	38.02	40.71	37.42	40.71
Noninterest expense to net operating revenue	64.64	63.40	62.18	60.83	61.68	60.52	61.68
Condition ratios (%)							
Nonperforming assets to assets	1.05	0.88	0.80	0.70	0.69	0.78	0.69
Noncurrent loans to loans	1.29	1.16	1.05	0.97	0.97	1.05	0.97
Loss reserve to noncurrent loans	173.59	176.99	185.75	194.99	193.21	187.56	193.21
Loss reserve to loans	2.24	2.05	1.95	1.89	1.88	1.97	1.88
Equity capital to assets	7.65	7.90	8.19	8.47	8.54	8.56	8.54
Leverage ratio	7.39	7.31	7.40	7.42	7.39	7.62	7.39
Risk-based capital ratio	12.47	12.09	11.97	11.87	11.97	12.16	11.97
Net loans and leases to assets	59.92	62.12	63.66	62.39	62.09	62.83	62.09
Securities to assets	18.36	16.27	15.06	15.62	16.14	15.19	16.14
Appreciation in securities (% of par)	–3.84	0.86	0.50	1.11	1.00	–0.42	1.00
Residential mortgage assets to assets	20.43	20.13	19.81	20.10	20.43	19.74	20.43
Total deposits to assets	72.26	70.63	71.24	69.28	68.38	69.69	68.38
Core deposits to assets	55.16	53.28	54.08	51.59	50.88	53.17	50.88
Volatile liabilities to assets	29.90	30.29	29.83	31.42	31.86	30.24	31.86

Loan performance, FDIC-insured national banks
Annual 1994–1997, year-to-date through March 31, 1998, first quarter 1997, and first quarter 1998

(Dollar figures in millions)

	1994	1995	1996	1997	Preliminary 1998 YTD	1997Q1	Preliminary 1998Q1
Percent of loans past due 30–89 days							
Total loans and leases	1.14	1.26	1.39	1.32	1.26	1.35	1.26
Loans secured by real estate (RE)	1.28	1.38	1.45	1.39	1.30	1.37	1.30
1–4 family residential mortgages	1.28	1.44	1.63	1.65	1.45	1.51	1.45
Home equity loans	0.87	1.19	1.04	0.93	0.83	0.91	0.83
Multifamily residential mortgage	1.45	1.15	1.28	1.34	0.97	0.94	0.97
Commercial RE loans	1.26	1.26	1.25	0.95	1.08	1.17	1.08
Construction RE loans	1.67	1.42	1.63	1.63	1.57	1.95	1.57
Commercial and industrial loans*	0.76	0.77	0.89	0.76	0.82	0.94	0.82
Loans to individuals	1.77	2.16	2.46	2.52	2.28	2.32	2.28
Credit cards	2.08	2.35	2.70	2.75	2.57	2.63	2.57
Installment loans	1.59	2.04	2.26	2.33	2.05	2.08	2.05
All other loans and leases	0.34	0.40	0.41	0.46	0.62	0.50	0.62
Percent of loans noncurrent							
Total loans and leases	1.29	1.16	1.05	0.97	0.97	1.05	0.97
Loans secured by real estate (RE)	1.83	1.46	1.27	1.07	1.04	1.24	1.04
1–4 family residential mortgages	0.96	0.90	1.10	1.01	0.98	1.07	0.98
Home equity loans	0.56	0.52	0.47	0.43	0.43	0.48	0.43
Multifamily residential mortgage	3.19	2.21	1.47	1.01	0.93	1.37	0.93
Commercial RE loans	2.81	2.18	1.71	1.27	1.20	1.63	1.20
Construction RE loans	4.93	3.17	1.31	1.00	1.06	1.23	1.06
Commercial and industrial loans*	1.04	1.06	0.87	0.78	0.88	0.88	0.88
Loans to individuals	1.01	1.18	1.34	1.49	1.43	1.36	1.43
Credit cards	1.09	1.34	1.70	2.03	1.96	1.86	1.96
Installment loans	0.97	1.06	1.04	1.04	1.03	0.99	1.03
All other loans and leases	0.47	0.32	0.25	0.27	0.29	0.29	0.29
Percent of loans charged-off, net							
Total loans and leases	0.46	0.45	0.63	0.71	0.71	0.65	0.71
Loans secured by real estate (RE)	0.29	0.13	0.09	0.06	0.05	0.03	0.05
1–4 family residential mortgages	0.14	0.10	0.08	0.08	0.07	0.08	0.07
Home equity loans	0.25	0.23	0.24	0.18	0.21	0.19	0.21
Multifamily residential mortgage	0.39	0.20	0.09	0.01	–0.02	0.10	–0.02
Commercial RE loans	0.47	0.18	0.02	–0.01	–0.02	–0.07	–0.02
Construction RE loans	0.82	–0.01	0.16	–0.10	0.00	–0.09	0.00
Commercial and industrial loans*	0.16	0.10	0.22	0.27	0.23	0.18	0.23
Loans to individuals	1.49	1.80	2.45	2.86	3.10	2.76	3.10
Credit cards	3.06	3.40	4.25	4.95	5.42	4.81	5.42
Installment loans	0.59	0.76	1.04	1.20	1.27	1.16	1.27
All other loans and leases	–0.31	–0.28	0.34	0.30	0.16	0.01	0.16
Loans outstanding ($)							
Total loans and leases	$1,382,855	$1,522,677	$1,641,464	$1,840,477	$1,880,502	$1,673,755	$1,880,502
Loans secured by real estate (RE)	562,005	610,405	646,570	725,280	743,435	664,988	743,435
1–4 family residential mortgages	282,000	317,521	329,031	363,328	374,457	335,732	374,457
Home equity loans	46,044	48,836	55,022	67,680	67,033	57,830	67,033
Multifamily residential mortgage	17,081	18,161	20,480	23,346	23,979	21,662	23,979
Commercial RE loans	151,514	157,638	170,359	190,055	193,792	175,313	193,792
Construction RE loans	33,571	34,736	38,839	47,388	49,424	40,887	49,424
Farmland loans	8,310	8,734	9,046	10,177	10,366	9,368	10,366
RE loans from foreign offices	23,484	24,779	23,794	23,306	24,384	24,196	24,384
Commercial and industrial loans	370,094	405,630	425,148	508,568	528,080	446,929	528,080
Loans to individuals	291,799	320,009	356,067	371,513	358,647	351,388	358,647
Credit cards	111,109	131,228	161,104	168,257	154,267	152,122	154,267
Installment loans	180,690	188,781	194,963	203,256	204,380	199,265	204,380
All other loans and leases	162,135	189,490	216,194	237,327	252,475	212,984	252,475
Less: Unearned income	3,178	2,857	2,515	2,211	2,135	2,534	2,135

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

Key indicators, FDIC-insured national banks by asset size
First quarter 1997 and first quarter 1998
(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	1997Q1	1998Q1	1997Q1	1998Q1	1997Q1	1998Q1	1997Q1	1998Q1
Number of institutions reporting	1,456	1,349	1,045	1,016	172	143	49	41
Total employees (FTEs)	38,339	34,515	116,058	113,544	180,564	154,403	534,956	626,452
Selected income data ($)								
Net income	$217	$202	$905	$923	$1,788	$2,342	$5,602	$6,517
Net interest income	762	716	2,860	2,733	5,966	5,069	15,495	18,278
Provision for loan losses	25	36	228	185	1,198	1,128	1,258	1,962
Noninterest income	335	366	1,230	1,406	2,986	3,487	10,449	13,211
Noninterest expense	758	768	2,543	2,592	4,961	4,732	15,998	19,891
Net operating income	216	200	882	913	1,778	1,781	5,485	6,153
Cash dividends declared	113	198	423	482	1,242	921	3,645	6,071
Net charge-offs to loan and lease reserve	16	19	197	132	1,089	1,291	1,424	1,883
Selected condition data ($)								
Total assets	71,893	67,561	268,036	268,590	556,556	485,563	1,715,081	2,160,247
Total loans and leases	40,277	38,628	162,215	161,834	371,334	312,347	1,099,928	1,367,693
Reserve for losses	550	534	2,538	2,360	7,917	7,888	21,972	24,519
Securities	21,632	18,389	71,499	71,459	100,427	93,063	203,213	296,782
Other real estate owned	113	92	285	257	411	241	1,860	1,496
Noncurrent loans and leases	474	423	1,536	1,355	3,924	3,285	11,647	13,207
Total deposits	62,149	58,037	218,613	220,158	385,178	316,688	1,152,936	1,437,209
Domestic deposits	62,149	58,037	218,081	219,664	377,339	311,151	885,745	1,127,131
Equity capital	7,559	7,216	26,246	25,685	50,616	47,051	139,118	173,744
Off-balance-sheet derivatives	733	557	6,986	3,733	66,124	67,749	8,027,124	9,201,905
Performance ratios (annualized %)								
Return on equity	11.54	11.21	14.14	14.61	14.50	20.45	16.56	15.18
Return on assets	1.21	1.20	1.36	1.39	1.28	1.97	1.32	1.22
Net interest income to assets	4.25	4.26	4.29	4.11	4.28	4.35	3.64	3.43
Loss provision to assets	0.14	0.21	0.34	0.28	0.86	0.95	0.30	0.37
Net operating income to assets	1.20	1.19	1.32	1.37	1.27	1.50	1.29	1.15
Noninterest income to assets	1.87	2.18	1.85	2.12	2.14	2.94	2.46	2.48
Noninterest expense to assets	4.22	4.57	3.81	3.90	3.56	3.99	3.76	3.73
Loss provision to loans and leases	0.25	0.37	0.56	0.46	1.29	1.43	0.46	0.58
Net charge-offs to loans and leases	0.16	0.20	0.49	0.33	1.17	1.64	0.52	0.56
Loss provision to net charge-offs	152.32	190.19	115.45	140.52	110.05	87.37	88.39	104.08
Performance ratios (%)								
Percent of institutions unprofitable	6.46	7.04	1.53	1.77	3.49	2.10	0.00	2.44
Percent of institutions with earnings	58.38	57.45	63.54	69.69	67.44	70.63	75.51	75.61
Noninterest income to net operating revenue	30.56	33.85	30.08	3.39	33.36	40.28	40.27	41.96
Noninterest expense to net operating revenue	69.06	70.96	62.16	62.63	55.42	54.67	61.66	63.17
Condition ratios (%)								
Nonperforming assets to assets	0.82	0.76	0.68	0.60	0.78	0.74	0.80	0.69
Noncurrent loans to loans	1.18	1.10	0.95	0.84	1.06	1.05	1.06	0.97
Loss reserve to noncurrent loans	116.13	126.10	165.20	174.16	201.73	240.10	188.64	185.66
Loss reserve to loans	1.37	1.38	1.56	1.46	2.13	2.53	2.00	1.79
Equity capital to assets	10.51	10.68	9.79	9.56	9.09	9.89	8.11	8.04
Leverage ratio	10.45	10.45	9.31	9.15	8.00	8.60	7.11	6.81
Risk-based capital ratio	18.22	17.91	15.26	15.10	12.43	13.40	11.51	11.24
Net loans and leases to assets	55.26	56.38	59.57	59.37	65.30	64.02	62.85	62.18
Securities to assets	30.09	27.22	26.68	26.61	18.04	19.57	11.85	13.74
Appreciation in securities (% of par)	–0.50	0.71	–0.52	0.89	–0.59	0.98	–0.29	1.06
Residential mortgage assets to assets	22.40	22.08	25.50	25.99	22.54	22.68	19.83	19.19
Total deposits to assets	86.45	85.90	81.56	81.97	69.21	66.59	67.28	66.83
Core deposits to assets	76.03	74.77	71.45	70.92	60.49	57.37	46.99	46.22
Volatile liabilities to assets	11.96	12.52	16.21	16.43	25.81	25.92	34.64	35.69

Loan performance, FDIC-insured national banks by asset size
First quarter 1997 and first quarter 1998

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	1997Q1	1998Q1	1997Q1	1998Q1	1997Q1	1998Q1	1997Q1	1998Q1
Percent of loans past due 30–89 days								
Total loans and leases	1.81	1.74	1.49	1.35	1.63	1.66	1.21	1.14
Loans secured by real estate (RE)	1.57	1.48	1.24	1.14	1.29	1.24	1.43	1.34
1–4 family residential mortgages	1.85	1.80	1.45	1.30	1.29	1.21	1.59	1.52
Home equity loans	0.84	0.83	0.84	0.88	0.94	0.97	0.92	0.80
Multifamily residential mortgage	0.97	0.70	0.73	0.88	0.68	1.10	1.11	0.97
Commercial RE loans	1.26	1.17	0.98	0.91	1.17	1.15	1.23	1.10
Construction RE loans	1.49	1.13	1.44	1.27	2.34	1.93	1.93	1.54
Commercial and industrial loans*	3.25	3.30	1.94	1.83	1.37	1.34	0.71	0.63
Loans to individuals	2.27	2.18	2.05	1.87	2.44	2.40	2.29	2.27
Credit cards	2.55	2.73	2.59	2.56	2.73	2.54	2.57	2.60
Installment loans	2.25	2.13	1.89	1.72	2.10	2.18	2.10	2.06
All other loans and leases	N/A	N/A	N/A	N/A	0.90	1.36	0.44	0.56
Percent of loans noncurrent								
Total loans and leases	1.18	1.10	0.95	0.84	1.06	1.05	1.06	0.97
Loans secured by real estate (RE)	0.99	0.92	0.83	0.71	1.02	0.84	1.43	1.17
1–4 family residential mortgages	0.76	0.77	0.72	0.65	1.17	0.73	1.14	1.11
Home equity loans	0.47	0.29	0.37	0.37	0.44	0.51	0.50	0.43
Multifamily residential mortgage	0.99	0.54	1.06	0.70	0.68	0.81	1.76	1.03
Commercial RE loans	1.23	1.00	1.00	0.78	1.03	1.06	2.18	1.36
Construction RE loans	1.00	1.00	0.78	0.85	0.75	0.92	1.63	1.15
Commercial and industrial loans*	2.88	2.59	1.61	1.46	0.88	0.84	0.78	0.82
Loans to individuals	0.75	0.81	0.82	0.77	1.33	1.52	1.48	1.48
Credit cards	1.73	1.68	1.87	2.06	1.93	2.02	1.80	1.92
Installment loans	0.69	0.74	0.49	0.48	0.63	0.71	1.26	1.22
All other loans and leases	N/A	N/A	N/A	N/A	0.57	0.50	0.25	0.27
Percent of loans charged-off, net								
Total loans and leases	0.16	0.20	0.49	0.33	1.17	1.64	0.52	0.56
Loans secured by real estate (RE)	0.02	0.01	0.06	0.03	0.02	0.04	0.03	0.06
1–4 family residential mortgages	0.02	0.02	0.10	0.03	0.04	0.05	0.09	0.08
Home equity loans	0.01	0.06	0.07	0.07	0.15	0.30	0.23	0.20
Multifamily residential mortgage	0.00	–0.10	0.05	0.04	0.04	0.00	0.14	–0.04
Commercial RE loans	0.03	0.00	0.02	0.03	–0.02	–0.04	–0.12	–0.03
Construction RE loans	0.08	0.05	0.02	0.04	–0.02	–0.01	–0.17	0.00
Commercial and industrial loans*	0.30	0.28	0.30	0.22	0.23	0.05	0.16	0.26
Loans to individuals	0.62	0.90	1.99	1.62	3.51	4.56	2.51	2.61
Credit cards	2.20	3.35	5.44	5.84	5.51	6.60	4.22	4.47
Installment loans	0.49	0.64	0.75	0.64	1.08	1.15	1.31	1.43
All other loans and leases	N/A	N/A	N/A	N/A	0.15	0.27	–0.02	0.16
Loans outstanding ($)								
Total loans and leases	$40,277	$38,628	$162,215	$161,834	$371,334	$312,347	$1,099,928	$1,367,693
Loans secured by real estate (RE)	22,742	21,658	94,001	97,338	152,733	124,425	395,511	500,014
1–4 family residential mortgages	11,421	10,830	46,310	46,878	72,948	60,704	205,053	256,045
Home equity loans	550	505	4,881	4,552	12,963	10,712	39,437	51,262
Multifamily residential mortgage	516	493	3,022	3,362	5,545	4,528	12,579	15,596
Commercial RE loans	6,310	6,015	30,005	31,794	48,117	36,853	90,880	119,129
Construction RE loans	1,566	1,479	6,509	7,132	11,199	9,788	21,614	31,025
Farmland loans	2,378	2,336	3,266	3,603	1,854	1,701	1,870	2,726
RE loans from foreign offices	0	0	9	16	108	139	24,080	24,230
Commercial and industrial loans	6,912	6,637	28,348	28,961	78,803	62,859	332,866	429,623
Loans to individuals	6,356	5,925	31,326	26,269	114,143	106,272	199,563	220,182
Credit cards	395	443	7,547	4,727	61,961	65,823	82,220	83,274
Installment loans	5,961	5,482	23,779	21,542	52,182	40,449	117,343	136,908
All other loans and leases	4,467	4,567	8,979	9,648	25,896	18,969	173,642	219,291
Less: Unearned income	200	159	439	382	241	178	1,654	1,416

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

Key indicators, FDIC-insured national banks by region
First quarter 1998
(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All Institutions
Number of institutions reporting	291	331	533	495	635	264	2,549
Total employees (FTEs)	258,036	197,060	150,774	70,182	98,537	154,325	928,914
Selected income data ($)							
Net income	$3,376	$1,759	$1,601	$814	$746	$1,688	$9,983
Net interest income	7,514	5,737	4,313	2,214	2,199	4,919	26,896
Provision for loan losses	1,299	348	366	352	130	817	3,311
Noninterest income	6,439	3,314	2,249	1,590	1,420	3,458	18,470
Noninterest expense	8,467	6,174	3,861	2,177	2,389	4,914	27,983
Net operating income	2,683	1,638	1,567	810	735	1,613	9,047
Cash dividends declared	1,697	3,011	783	520	227	1,433	7,671
Net charge-offs to loan and lease rese	1,409	360	357	339	125	735	3,325
Selected condition data ($)							
Total assets	845,785	687,344	480,167	211,414	258,271	488,979	2,971,961
Total loans and leases	523,012	430,816	317,427	146,537	135,900	326,810	1,880,502
Reserve for losses	11,895	6,278	5,149	2,755	1,909	7,314	35,300
Securities	128,039	128,268	87,583	33,473	55,281	47,048	479,693
Other real estate owned	755	461	207	79	129	427	2,059
Noncurrent loans and leases	6,946	3,441	2,815	1,239	1,180	2,649	18,270
Total deposits	570,219	425,858	332,018	148,609	206,414	348,974	2,032,092
Domestic deposits	363,389	403,970	307,498	144,498	200,981	295,647	1,715,983
Equity capital	67,151	57,724	40,708	18,349	21,560	48,203	253,695
Off-balance-sheet derivatives	3,635,962	2,235,589	1,285,685	33,936	60,810	1,751,582	9,003,564
Performance ratios (annualized %)							
Return on equity	20.53	12.31	16.18	17.89	14.06	14.05	15.98
Return on assets	1.62	1.05	1.34	1.55	1.17	1.38	1.36
Net interest income to assets	3.60	3.41	3.61	4.21	3.45	4.03	3.66
Loss provision to assets	0.62	0.21	0.31	0.67	0.20	0.67	0.45
Net operating income to assets	1.29	0.97	1.31	1.54	1.15	1.32	1.23
Noninterest income to assets	3.09	1.97	1.88	3.02	2.23	2.83	2.51
Noninterest expense to assets	4.06	3.67	3.23	4.14	3.74	4.03	3.81
Loss provision to loans and leases	1.00	0.33	0.46	0.97	0.38	0.99	0.71
Net charge-offs to loans and leases	1.09	0.34	0.45	0.93	0.37	0.89	0.71
Loss provision to net charge-offs	92.03	96.84	102.60	103.59	103.39	111.20	99.53
Performance ratios (%)							
Percent of institutions unprofitable	1.37	5.14	2.81	5.05	5.51	7.95	4.59
Percent of institutions with earnings gains	68.73	69.18	64.92	59.60	57.64	67.80	63.36
Noninterest income to net operating revenue	46.15	36.61	34.28	41.79	39.24	41.28	40.71
Noninterest expense to net operating revenue	60.69	68.22	58.84	57.23	66.01	58.67	61.68
Condition ratios (%)							
Nonperforming assets to assets	0.93	0.57	0.63	0.62	0.51	0.63	0.69
Noncurrent loans to loans	1.33	0.80	0.89	0.85	0.87	0.81	0.97
Loss reserve to noncurrent loans	171.24	182.44	182.91	222.32	161.83	276.12	193.21
Loss reserve to loans	2.27	1.46	1.62	1.88	1.40	2.24	1.88
Equity capital to assets	7.94	8.40	8.48	8.68	8.35	9.86	8.54
Leverage ratio	7.35	6.79	7.65	8.10	7.42	7.76	7.39
Risk-based capital ratio	11.85	11.59	11.91	12.76	12.73	12.04	11.97
Net loans and leases to assets	60.43	61.76	65.04	68.01	51.88	65.34	62.09
Securities to assets	15.14	18.66	18.24	15.83	21.40	9.62	16.14
Appreciation in securities (% of par)	1.13	1.05	0.97	1.17	0.82	0.72	1.00
Residential mortgage assets to assets	15.72	28.18	22.13	20.60	20.41	15.94	20.43
Total deposits to assets	67.42	61.96	69.15	70.29	79.92	71.37	68.38
Core deposits to assets	37.27	52.70	56.25	62.40	63.71	54.84	50.88
Volatile liabilities to assets	43.46	32.35	27.12	19.52	24.36	25.06	31.86

Loan performance, FDIC-insured national banks by region
First quarter 1998
(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All Institutions
Percent of loans past due 30–89 days							
Total loans and leases	1.31	1.07	1.50	1.52	1.38	1.03	1.26
Loans secured by real estate (RE)	1.45	1.17	1.49	1.02	1.50	1.18	1.30
1–4 family residential mortgages	1.55	1.37	1.52	1.00	1.64	1.56	1.45
Home equity loans	1.03	0.82	0.80	0.59	0.83	0.77	0.83
Multifamily residential mortgage	0.59	0.74	1.50	1.71	1.06	0.78	0.97
Commercial RE loans	1.23	0.80	1.55	0.79	1.23	0.85	1.08
Construction RE loans	1.04	1.39	2.25	1.41	1.87	1.26	1.57
Commercial and industrial loans*	0.56	0.63	1.17	1.77	1.19	0.62	0.82
Loans to individuals	2.53	2.18	2.25	2.20	1.76	2.15	2.28
Credit cards	2.45	3.35	2.85	2.23	2.48	2.56	2.57
Installment loans	2.66	1.73	2.11	2.16	1.68	1.72	2.05
All other loans and leases	0.70	0.28	1.12	1.28	0.72	0.33	0.62
Percent of loans noncurrent							
Total loans and leases	1.33	0.80	0.89	0.85	0.87	0.81	0.97
Loans secured by real estate (RE)	1.57	0.95	0.85	0.62	1.02	0.95	1.04
1–4 family residential mortgages	1.19	1.02	0.84	0.56	0.92	1.00	0.98
Home equity loans	0.59	0.44	0.34	0.20	0.37	0.46	0.43
Multifamily residential mortgage	1.54	0.78	0.92	0.44	0.57	0.72	0.93
Commercial RE loans	2.08	0.97	1.02	0.61	1.18	1.13	1.20
Construction RE loans	2.27	0.90	0.92	0.93	1.04	0.83	1.06
Commercial and industrial loans*	0.94	0.64	1.02	0.97	1.02	0.80	0.88
Loans to individuals	2.16	1.15	1.00	1.22	0.60	1.14	1.43
Credit cards	1.89	2.64	2.22	1.69	1.99	1.86	1.96
Installment loans	2.58	0.57	0.71	0.61	0.46	0.37	1.03
All other loans and leases	0.29	0.15	0.51	0.56	0.28	0.24	0.29
Percent of loans charged-off, net							
Total loans and leases	1.09	0.34	0.45	0.93	0.37	0.89	0.71
Loans secured by real estate (RE)	0.13	0.03	0.05	0.03	0.03	0.01	0.05
1–4 family residential mortgages	0.11	0.05	0.06	0.06	0.06	0.05	0.07
Home equity loans	0.35	0.11	0.16	0.09	0.74	0.24	0.21
Multifamily residential mortgage	0.11	0.03	–0.01	0.00	0.04	–0.33	–0.02
Commercial RE loans	0.06	–0.03	0.01	–0.10	–0.01	–0.11	–0.02
Construction RE loans	–0.03	–0.05	0.01	0.20	–0.04	0.04	0.00
Commercial and industrial loans*	0.34	0.11	0.24	0.27	0.07	0.20	0.23
Loans to individuals	3.90	1.91	1.87	3.18	1.64	4.60	3.10
Credit cards	5.23	4.25	5.30	4.76	4.87	7.23	5.42
Installment loans	1.73	0.93	0.97	1.05	1.29	1.62	1.27
All other loans and leases	0.07	0.11	0.25	0.38	0.04	0.25	0.16
Loans outstanding ($)							
Total loans and leases	$523,012	$430,816	$317,427	$146,537	$135,900	$326,810	$1,880,502
Loans secured by real estate (RE)	161,065	212,365	138,992	58,720	52,550	119,743	743,435
1–4 family residential mortgages	80,170	120,247	64,455	29,858	26,317	53,410	374,457
Home equity loans	13,257	17,659	16,128	3,445	649	15,894	67,033
Multifamily residential mortgage	5,516	5,793	4,987	2,110	1,520	4,053	23,979
Commercial RE loans	34,779	51,394	40,860	15,951	16,606	34,202	193,792
Construction RE loans	5,200	15,203	10,053	4,659	5,967	8,342	49,424
Farmland loans	639	1,916	2,491	2,697	1,490	1,133	10,366
RE loans from foreign offices	21,504	152	18	0	0	2,709	24,384
Commercial and industrial loans	168,704	100,415	87,594	35,073	43,219	93,075	528,080
Loans to individuals	121,779	61,506	56,641	36,303	27,520	54,898	358,647
Credit cards	74,437	17,191	11,153	20,515	2,596	28,375	154,267
Installment loans	47,341	44,314	45,489	15,788	24,925	26,523	204,380
All other loans and leases	72,613	56,789	34,433	16,467	12,867	59,306	252,475
Less: Unearned income	1,148	259	233	26	257	212	2,135

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

Glossary

Data Sources

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

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

Computation Methodology

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

Definitions

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

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

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

IBIS—OCC's Integrated Banking Information System

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Recent Corporate Decisions

The Washington-Directed Licensing Division contributes summaries of selected corporate decisions to every issue of the *Quarterly Journal.* In addition, decisions that represent a new or changed policy, or present issues of general interest to the public or the banking industry, are published monthly in the OCC publication, *Interpretations and Actions.* In the first quarter of 1998, the following corporate decisions were of particular importance because they were precedent-setting or otherwise represented issues of importance. The decision documents for these approvals were or will be published in *Interpretations and Actions* (log numbers are noted in brackets—if the decision has not been published yet, the application control number is given).

Interstate Transactions

On January 15, 1998, the OCC granted approval for NationsBank Corporation to merge Sun World, National Association, Santa Teresa, New Mexico, into its affiliate, NationsBank, National Association, Charlotte, North Carolina, pursuant to 12 USC 215a–1, 1828(c) and 1831u(a). NationsBank operated branches in 13 states and the District of Columbia, and Sun World operated branches across the New Mexico border in El Paso, Texas. NationsBank, as the resulting bank in the merger, was authorized to retain and operate the branches of both merging banks, including Sun World's branches in Texas, under 12 USC 36(d) and 1831u(d)(1), preempting any Texas state laws that would prohibit or limit the exercise of these federally granted powers. This was the first Riegle–Neal merger decision involving Texas as the host state. [Corporate Decision No. 98–07]

On March 4, 1998, the OCC granted approval for NationsBank Corporation to merge Boatmen's Trust Company, St. Louis, Missouri, into its affiliate, NationsBank, National Association, Charlotte, North Carolina, pursuant to 12 USC 215a. NationsBank was also authorized to exercise fiduciary powers in Missouri under 12 USC 92a, 36(f)(2) and 215a(e), and the OCC concluded that the Missouri statutes that would prohibit NationsBank from exercising fiduciary powers and appointments in Missouri were preempted by federal law. [Corporate Decision No. 98–16]

Charters

On March 5, 1998, the OCC granted conditional approval for The Agua Caliente Band of Cahuilla Indians ("tribe") to establish a national bank in Palm Springs, California, with the title of "Canyon National Bank." The approval was conditioned on compliance by the tribe with its commitment letter, which addresses federal banking agency jurisdiction over and the applicability of federal banking laws to the tribe and activities and transactions between the tribe and the bank, and which included an irrevocable waiver of sovereign immunity signed by the tribe and its affiliates. [Conditional Approval No. 272]

On March 20, 1998, the OCC granted conditional approval for Stage Stores, Inc., Houston, Texas, to establish a new national credit card bank in Bowling Green, Ohio, under the provisions of the Competitive Equality Banking Act (CEBA). The bank is to be entitled "Granite National Bank." The approval was subject to the conditions normally imposed on national CEBA credit card banks. [Application Control No. 97–CE–01–0032]

Mergers

On February 3, 1998, the OCC granted approval for Fleet National Bank, Providence, Rhode Island, to purchase approximately $3 billion of credit card receivables and related assets and assume approximately $3.5 billion in deposits and other liabilities from Advanta National Bank, Wilmington, Delaware. Fleet proposed to house the credit card receivables in a newly established limited liability company, which will be a subsidiary of the bank's credit card bank. [Corporate Decision No. 98–12]

Reinsurance Operating Subsidiaries

On January 28, 1998, the OCC granted approval for Mellon Bank, National Association, Pittsburgh, Pennsylvania, to establish an operating subsidiary to reinsure a portion of the mortgage insurance on loans originated or purchased by the bank or its lending affiliates. The approval relied on OCC Interpretive Letter No. 743 (October 17, 1996), which concluded that the activity is generally permissible under the National Bank Act because this activity is part of, or incidental to, the business of banking. Similar approvals were granted to six other national banks in 1997. [Corporate Decision No. 98–10]

On February 19, 1998, the OCC granted approval for LaSalle National Bank, Chicago, Illinois, to establish an operating subsidiary to reinsure a portion of the mortgage insurance on loans originated or purchased by the bank or its lending affiliates. The approval also relied on

OCC Interpretive Letter No. 743 (October 17, 1996), which concluded that the activity is generally permissible under the National Bank Act because this activity is part of, or incidental to, the business of banking. [Corporate Decision No. 98–15]

Expanded Activities

On January 12, 1998, the OCC granted the first approval for a bank, Zions First National Bank, Salt Lake City, Utah, to establish an operating subsidiary to act as a certification authority to enable subscribers to generate digital signatures that verify the identity of a sender of an electronic message. The certification process will also enable subscribers to be certain that communications received have not been altered during transmission. As part of ongoing supervision of the activity, the OCC expects the bank to implement and maintain a risk management system that identifies, measures, monitors, and controls the material risk of the activity. Accordingly, the OCC's approval was conditioned on the bank's submission of a final blueprint of its information system. The OCC also expects the bank, which is well capitalized and well managed, to maintain adequate capital to support the activity. [Conditional Approval No. 267]

Other

On March 23, 1998, the OCC granted approval for Girard National Bank, Girard, Kansas, to establish an operating subsidiary to hold a working interest in natural gas interests and to receive certain tax credits under 26 USC 29, which would be used in part to repay the bank's extension of credit to the owners and operators of the gas reserves. The OCC concluded that in substance the proposed activity for the operating subsidiary is the extension of credit, which is a permissible activity for national banks. [Application Control No. 97–MW–08–0048]

On March 27, 1998, the OCC issued notice of its intent not to disapprove filings by Citibank, National Association, New York, New York, to acquire AT&T Universal Card Services Corporation and its subsidiaries, including Universal Bank, National Association, Columbus, Georgia (a CEBA credit card bank), from AT&T Corp. Citibank proposed to acquire approximately 19 million accounts and $15 billion in receivables. With this acquisition, Citibank, which is the largest issuer of Visa cards, would also become the largest issuer of MasterCards and would have a 20 percent interest in both Visa and MasterCard. [Application Control No. 98–WO–11–0001]

Appeals Process

Case One: Appeal of "Satisfactory" CRA Rating

Background

A formal appeal was filed concerning a bank's Community Reinvestment Act (CRA) rating of "Satisfactory Record of Meeting Community Credit Needs." The bank's final rating was determined based on the examiner's assignment of the following individual ratings for each of the three test areas:

Lending Test:	High Satisfactory
Investment Test:	Low Satisfactory
Service Test:	Outstanding

Management appealed the rating of "High Satisfactory" on the lending test. They stated in the appeal that their performance under this test should have been rated "Outstanding," which would have then resulted in an overall "Outstanding" CRA performance rating. The bank's previous CRA rating had been "Outstanding" and management felt that they continued to warrant the higher rating.

While management understood the methodology used for analyzing performance under the lending test, they believe that an adjusted median family income (MFI) figure should be used that is more representative of the bank's individual assessment area. In particular, they did not understand why state-wide nonmetropolitan MFI level was used to test their performance, instead of their county specific MFI level.

Management feels that county-wide MFI information is a more appropriate measure to evaluate their performance under the lending test for the following reasons:

- The bank's assessment area is much different from other parts of the state because of the city's low unemployment rates and higher housing costs; and
- The county-wide MFI number specifically includes their city (the capital of the state), where local income levels are positively affected by state government.

Management said that if the county-wide MFI figure was used, their mortgage loan penetration level to low- and moderate-income (LMI) borrowers would have equaled the level of LMI families in the bank's assessment area. Based on this fact, management argued that the bank's performance under the lending test should have been rated "Outstanding."

Notwithstanding the bank's confusion on the MFI evaluation criteria, management was also concerned about the fairness and consistency among other bank regulators of using state-wide or county-wide MFI numbers when evaluating performance under the service test. In particular, they provided examples of other competing financial institutions who were given overall "Outstanding" CRA ratings because another federal bank regulator used an "adjusted" MFI (instead of state-wide numbers) to support the bank's penetration figures.

Discussion

The basis for using MFI to measure lending to LMI individuals is contained within 12 CFR 25.12 (b) of the CRA regulation:

(b) *Area median income* means:

(1) The median family income [MFI] for the MSA [metropolitan statistical area], if a person or geography is located in an MSA; or

(2) The statewide nonmetropolitan median family income, if a person or geography is located outside an MSA.

To reduce burdens on the industry, the agencies chose to use the MSA MFI level in metropolitan areas or the state-wide nonmetropolitan MFI level in rural areas, to measure lending to individuals of various income levels. Since the bank's assessment area is not part of an MSA, the standard used to measure the bank's lending activity to LMI individuals is the state-wide nonmetropolitan MFI, as required by the regulation.

Conclusion

While it is clearly understandable why bank management believed that use of the state-wide MFI level is not appropriate for the bank's assessment area, there is not a sufficient basis for making this type of adjustment within the CRA regulation. However, the regulation does give examiners guidance to include specific information about a bank or its assessment area into the Performance Context section of the CRA Public Disclosure, and to use this information to more accurately and fairly evaluate a bank's overall performance.

During our examination, examiners used the regulation's guidance to analyze the bank's lending performance giving consideration to the differences between county-wide and state-wide MFI levels. Using the state-wide nonmetropolitan MFI level, the bank's performance was not representative of the community's demographics. To mitigate this finding, the examiners analyzed the bank's performance using county-wide MFI data. When considering county-wide MFI, the bank's lending practices to LMI individuals improved to a level more comparable to community demographics. While improved penetration resulted from the use of county-wide MFI information, the level of the bank's lending to LMI individuals never exceeded the community's demographics. The examiners incorporated this analysis into the Performance Context and used the results of the county-wide MFI levels to support a "High Satisfactory" rating.

While bank management was correct that another federal banking agency did in fact, use an adjusted county-wide MFI, that particular examination was performed very early in the regulatory transition from the *old* to the *new* CRA regulation. Unfortunately during that transitional period, some inconsistencies in the application of the regulation occurred between federal agencies. Since that examination, all of the federal banking agencies have attended joint CRA training and have worked diligently to ensure consistent application of the regulation.

After careful review of the information submitted in the appeal, the ombudsman decided that a "Satisfactory" rating accurately reflected the bank's CRA performance during the time period covered in the Public Disclosure. Although the examiners appropriately incorporated the differences in lending performance based on county- and state-wide MFI levels into the Performance Context, and used the analysis to support the "High Satisfactory" rating, additional detail was included in the Performance Context in the CRA Public Disclosure to support their analysis. At the request of the ombudsman, representatives of the OCC contacted bank management in order to discuss with them what opportunities are available to enhance the bank's overall performance.

Case Two: Appeal of Potential Violation of the Fair Housing Act

Background

An institution filed a formal appeal with the ombudsman's office concerning a potential violation of the Fair Housing Act (FHA). The potential violation involved possible discrimination against applicants for mortgage loans on the basis of familial status. The institution received correspondence stating the Office of the Comptroller of the Currency (OCC) had determined that it has reason to believe the bank engaged in a pattern or practice of violating the FHA by applying different appraisal criteria to property located in family developments than it did to property located in developments restricted to adults only or carefully separated adult/family sections. At the time of the potential violation the bank was operating under written residential appraisal report guidelines that set forth mobile home park rating criteria. The criteria contained 11 quality rating categories ranging from "exclusive" to "negative influences." Contained within the criteria was descriptive language which differentiated between "adult" and "family" occupancy and specified that "adult" parks would be rated higher than "family" parks. The guidelines specified that an appraisal should include a designated park rating and a statement referring to the criteria on which the rating was based.

A third-party fee appraiser was engaged to provide appraisals for loan applications originating from a family oriented mobile home park. The appraiser had earlier signed a bank statement confirming that he would comply with the guidelines to the best of his ability. While the record is unclear as to whether he actually applied the guidelines in conducting the appraisals, it is clear that he compared lots in nearby "adult" mobile home parks to the applicant lots located in the "family" mobile home park. Consequently, the appraiser applied a substantial discount to each of the proposed collateral lots. At a later date, the bank revised the guidelines eliminating differentiating language between adult and family occupancy.

The OCC conducted a review of the mobile home application documents and informed the bank that the agency found there was reason to believe the bank had violated the FHA when its fee appraiser discounted the value of lots in the family park at least, in part, on the basis of familial status. The OCC determined there remained reason to believe the bank had engaged in a pattern or practice of violating the FHA by applying different appraisal criteria to property located in family developments than it did to property located in developments restricted to adults only or carefully separated adult/family sections. The supervisory office concluded that it was therefore obligated to refer this matter to the U.S. Department of Justice (DOJ) and to notify the U.S. Department of Housing and Urban Development (HUD).

The bank appealed this decision to the ombudsman.

Discussion

The FHA, 42 USC 3605, prohibits a lender from discriminating on a prohibited basis in a residential real estate related transaction (including the making of loans) or in the terms or conditions of the transaction. The implementing regulation, 24 CFR 100.130, describes unlawful conduct as using different policies, practices, or proce-

dures for any loan which is secured by residential real estate because of, among other factors, familial status.

The appraiser exemption, 42 USC 3605(c), states that nothing in the FHA prohibits an appraiser from considering factors other than prohibited criteria (e.g., familial status). The implementing regulation 24 CFR 100.135(d) further describes unlawful practices as using an appraisal for financing any dwelling where the person knows or reasonably should know that the appraisal improperly contained familial status consideration. 42 USC 3607(b) establishes specific criteria for housing to qualify for the "housing for older persons" exemption. It states that the FHA provisions that protect familial status do not apply to "housing for older persons" as housing (i) intended for, and solely occupied by, persons 62 year of age or older; and (ii) intended for and operated for occupancy by at least one person 55 or older per unit.

The Interagency Policy Statement on Discrimination in Lending offers guidance on the meaning of a pattern or practice. The Policy Statement states that "repeated, intentional, regular, usual, deliberate, or institutionalized practices will almost always constitute a pattern or practice" of lending discrimination but "isolated, unrelated, or accidental occurrences will not." In assessing whether a pattern or practice exists, the OCC considers the totality of circumstances, including the following factors:

- Whether the conduct appears to be grounded in a written or unwritten policy or established practice that is discriminatory in purpose or effect.
- Whether there is evidence of similar conduct by a bank toward more than one applicant.
- Whether the conduct has some common source or cause within the bank's control.
- The relationship of the instances of conduct to one another.
- The relationship of the number of instances of conduct to the bank's total lending activity.

This list of factors is not exhaustive and whether the OCC finds evidence of a pattern or practice depends on the egregiousness of the facts and circumstances involved. Each inquiry is intensively fact-specific and there is no minimum number of violations that will trigger a finding of a pattern or practice of discrimination.

The term "pattern or practice" is not defined in the FHA but has generally been interpreted to mean that the discrimination must not be isolated, sporadic, or accidental. Also, while there is no minimum number of incidents that must be proven as a prerequisite to finding a pattern or practice of discrimination, a party does not have to discriminate consistently to be engaging in a pattern or practice.

What the facts in the judicial decisions and the examples in the Policy Statement indicate, however, is that a "pattern or practice" involves some degree of *action* or *conduct* toward a protected person. In particular, the Policy Statement specifically refers to a lender's "conduct" in describing relevant factors to a "pattern or practice" determination.

Even in the absence of a discriminatory policy, evidence of a contractor's discriminatory actions may still affect the bank when the bank hires the contractor to act as the bank's agent. According to agency law, a principal generally is liable for the acts of its agents. Thus, if the contractor's actions constitute a pattern or practice of discrimination (even if the contractor alleged that he or she followed nondiscriminatory criteria), the bank may be liable as principal for those actions. The fact that a single agent acted without express direction by the principal should not preclude a finding a liability.

Under the FHA, which protects persons from discriminatory housing treatment that *is about to occur*, a discriminatory policy (even if not acted on) could nevertheless signal the likelihood of imminent discriminatory treatment and could provide a basis for a charge by the Secretary of HUD. In accordance with Executive Order 12892, the OCC must notify HUD whenever it has received information "suggesting a violation" of the FHA and the OCC must forward such information to the DOJ if it "indicates a possible pattern or practice."

Where there is an openly declared or otherwise manifested policy that discriminates on a prohibited basis, it is not necessary to prove that the policy was consistently followed in order to believe that a pattern or practice existed. The written appraisal report guidelines of the bank did contain discriminatory familial status considerations. Moreover, under the FHA, any consideration by a lender or appraiser of a prohibitive factor such as familial status constitutes discrimination. Although the appraiser failed to provide a designated park quality rating as detailed by the guidelines, this does not alter the fact that he applied familial status considerations as one of the stated reasons for discounting the properties. While the appraiser had the latitude under the law to consider legitimate market and economic factors in appraising particular properties, any consideration of a prohibited factor such as familial status (rather than fair market value derived from comparable sales) is sufficient reason to believe that discrimination occurred.

Conclusion

The ombudsman concluded that there was sufficient reason to believe that a violation of the FHA occurred

and as such, remanded to the OCC's supervisory office the matter of notification to the U.S. Department of Housing and Urban Development and a referral to the U.S. Department of Justice.

Case Three: Appeal of Component and Composite CAMELS Rating

A bank formally appealed five of its six individual component ratings (all but Sensitivity to Market Risk), as well as its overall composite rating of 3. All component ratings were rated a 3 except for the Earnings component, which was rated a 2. Management believed that the Report of Examination's (ROE) numerical ratings were not adequately supported by the examiners' written narrative, and did not accurately reflect the bank's operations, management, earnings, capitalization, and overall state of affairs.

The appeal highlighted the bank's position on each of its individual component ratings as well as the board of directors' belief that the bank was not receiving objective and balanced treatment from the OCC's supervisory and field office personnel. In this appeal summary, we will discuss and opine on each component individually, followed by an overall discussion and opinion on the composite rating.

Capital

Background

The bank appealed the capital rating of 3 based on their capital levels and objective capital ratios—total risk-based capital/risk-weighted assets have been in excess of 10 percent every quarter in 1997. Also, the bank was deemed "well capitalized" for prompt corrective action purposes. The bank denoted that their capital strength was competitive to the average ratios of their principal correspondent banks, and that unlike their correspondent banks, they had no off-balance-sheet exposure to exotic swaps or risky derivatives. All of their investments were in U.S. Treasury bills.

The bank believed that the examiners completely ignored the objective capital ratios, choosing instead to focus on the subjective elements. The bank disagreed with the ROE's comments that the wholesale funding strategy and relatively high appetite for credit risk had elevated the overall risk profile of the bank.

Discussion

The ROE stated that although capital ratios exceeded regulatory minimums, they did not support the bank's risk profile. As of March 31, 1997, total risk-based capital was marginally above 10 percent. A further concern was that failure to maintain total risk-based capital of at least 10 percent would restrict access to the brokered funds market further elevating liquidity risk. The bank had experienced significant growth over the last year, approximating 80 percent. Execution of the 1995 through 1998 strategic and capital plans was accelerated. The total asset projections contained in the plan had been exceeded, while total capital projections had not, despite successful capital raising efforts. As a result, the present capital levels were below projections. The OCC did recognize the demonstrated ability of management and the board to raise capital on three separate occasions.

Conclusion

The Office of the Ombudsman (ombudsman) reviewed and noted that the bank's capital levels/ratios over the last two years had remained at slightly above the minimum requirements, and at times, had been slightly below. Since the examination, the bank's capital posture had strengthened through the continued retention of earnings and a small capital injection in December 1997.

The ombudsman reviewed the capital levels in relation to the bank's overall risk profile and risk management controls/processes, and agreed with the ROE conclusion that at the time of the examination, although the capital ratios exceeded regulatory minimums, a rating of 3 was appropriate. Per OCC Bulletin 97–1 (attachment, 61 FR p. 67026), a rating of 3 indicates "a less than satisfactory level of capital that does not fully support the institution's risk profile. The rating indicates a need for improvement, even if the institution's capital level exceeds minimum regulatory and statutory requirements."

Asset Quality

Background

The bank appealed the rating based on the improved asset quality indicators, the quality of the investment portfolio, the adequacy of the allowance for loan and lease losses, and the decline of past-due and nonperforming loans. Also, adversely classified assets as a percent of Tier 1 capital were reduced in half from the prior exam. The bank also pointed out that of the 29 lending relationships reviewed during the examination, only two loans were reclassified. In response to a ROE comment regarding the bank's shift toward larger commercial credits, the bank indicated that it is trying to fill in a vacuum left by large commercial banks exiting the small business market lending arena in their service territories.

The bank did implement several of the recommendations made in the ROE.

Discussion

The examination rating of 3 was based on the loan and overall asset quality which remained less than satisfac-

tory. Most loan quality indicators had improved since the last asset quality review. However, while the improvement was encouraging, all qualitative indicators remained much worse than average, and the aggregate level of loans with one or more negative underwriting characteristics remained high. Particularly of concern, was that these negative underwriting characteristics were present in new loans made by the bank since the previous examination. Past dues had been high and averaged approximately 7 percent during 1997. Classified assets were above 30 percent. Investment quality was good; however, the investment portfolio comprised a very small percentage of assets, while the loan and lease portfolio comprised over 80 percent.

The level of credit risk remained high and increasing. The aggregate credit risk was not limited, managed, or controlled. Management and the board continued to focus on individual credit relationships while ignoring the aggregate risk presented by a portfolio of sub-prime credits. Furthermore, the tolerance for credit risk limits had not been established. Credit risk continued to increase as the percentage of assets comprised of loans with one or more negative underwriting characteristics increased and the loan mix shifted toward larger commercial credits.

Credit administration practices needed improvement. Areas where weaknesses were noted included the following: loan policy exceptions, problem loan identification reliant on past due status, lack of a system for tracking financial statements, lack of a system for monitoring concentrations of credit, and lack of a system for monitoring expired UCC filing.

Also, although the allowance for loan and leases losses balance was adequate, the methodology was not reflective of the inherent risk in the portfolio.

Conclusion

The ombudsman acknowledged the bank's comments regarding the improvement in the qualitative factors of the loan portfolio. However, as noted in the ROE, the indicators still reflected an increased level of concern, particularly given the significant growth over the last few years, the more aggressive underwriting characteristics present in loans made since the previous examination, and credit administration that warranted improvement. Furthermore, although the credit administration issues noted in the ROE might have been individually mitigated, collectively they presented an increased level of concern. Per OCC Bulletin 97–1 (attachment, FR 61 p. 67027), a rating of 3 is assigned "when asset quality or credit administration practices are less than satisfactory. Trends may be stable or indicate . . . an increase in risk exposure. The level and severity of classified assets, other weaknesses, and risks require an elevated level of supervisory concern. There is generally a need to improve credit administration and risk management practices."

The ombudsman agreed that at the time of the examination, a rating of 3 was appropriate. He acknowledged that since the examination date, management had implemented several of the recommendations made during the examination. These included approval of loan limits/parameters, and a revised loan committee infrastructure whereby the loan committee will approve loans greater than $200,000 and loans with policy exceptions.

Management

Background

The bank appealed this rating based on the knowledge and experience level of their officers. The individuals averaged more than 20 years of banking experience in their specialized areas of operations. The bank also indicated that they were actively involved in executing the board's strategic initiatives on a daily basis. As an example, a particular loan officer personally called on the majority of all past-due accounts and talked directly to the customers regardless of the size of the loan. Also, the chairman had successfully raised capital on three separate occasions. Management and employees demonstrated their commitment to the bank and its customers by using principally their own personal funds to acquire more than 25 percent of the bank's outstanding stock. Management's extensive equity investment, and coinciding representation on the board of directors was a benefit, not a detriment to the bank's customers, shareholders, and overall safety and soundness.

Discussion

The examination team based the 3 rating on management and board supervision, which was deemed less than satisfactory. This resulted primarily from continuing increases in the quantity of risk inherent in the bank's operations and strategies combined with risk management systems that were not adequate in relation to the quantity of risk. The ROE acknowledged management's positive accomplishments, such as their experience levels, success at raising capital on three occasions, improvement in the asset quality indicators, and improvement in the bank's earnings posture. The ROE stated that although bank management concurred with some of the recommendations and/or weaknesses noted in the examination, and in fact had implemented some of these recommendations, overall, management had not been timely or proactive in improving risk management systems, particularly, in higher risk areas.

Also, independent risk control systems (i.e., loan review, internal audit, compliance management) needed improvement. On different occasions, management and the

board have attempted to compensate for this by retaining consultants to provide the services. The success of these attempts has been sporadic because of unanticipated events affecting the service providers, to which management and the board have been slow to make alternative arrangements.

Conclusion

The ombudsman recognized, respected, and appreciated management's depth and tenure of experience, the positive efforts in raising new capital and the steps taken to implement corrective measures recommended during the examination. However, as noted in OCC Bulletin 97–1, a rating of 3 may be assigned when risk management practices are less than satisfactory given the nature of the institution's activities. At the time of the examination, the management team had not implemented risk management processes that adequately identify, monitor, and control risk in various key areas of the bank. Also independent risk control systems (i.e., loan review, internal audit, compliance management) needed improvement. Therefore, a rating of 3 was appropriate. The rating should not be viewed as a reflection of management or the board's abilities or skills, but rather of risk management practices that needed improvement.

Earnings

Background

The bank appealed the 2 rating. Management believed the bank's earnings were outstanding and should have been rated a 1 based on the objective numbers, primarily, the net interest margin above 7 percent, the annualized return on average equity in excess of 20 percent, and the annualized return on average assets above 1 percent. The bank indicated that earnings had more than doubled in each of the last three years, and that this pattern was likely to repeat again in 1997.

Discussion

During the examination, the bank's earnings performance was considered good. Performance had improved as a result of continued strength in the net interest margin and improved efficiency. Earnings performance was fee sensitive, with fees relating to lending and leasing activities approximating 20 percent of total interest and fees. Also, despite the noted improvement, efficiency and overhead expense ratios remained very high.

The ability to sustain the trend in earnings performance was somewhat questionable in view of the need to manage the risks associated with present business strategies more effectively, and potential earnings exposure to interest rate, credit and liquidity risks. Budgeting and forecasting processes have stalled; thus no budget and earnings forecasts were prepared for 1997. Also, the ROE recommended a review of the officer compensation practices. Commissions were paid for originating and/or purchasing loans and leases with no qualitative controls such as independent reviews of the assets and/or performance benchmarks, which precede commission awards.

Conclusion

A rating of 2 indicates earnings that are satisfactory and sufficient to support operations and maintain adequate capital and allowance levels after consideration is given to asset quality, growth, and other factors affecting the quality, quantity, and trend of earnings. The rating was appropriate given the bank's earnings posture and the budgeting and forecasting processes that have stalled.

The bank informed the ombudsman that the bank had revised the compensation practices, and that the board of directors' executive committee will review officer compensation practices at least annually. Thus far, they are satisfied that current compensation levels are in relation with the return to shareholders, capital, and overall risk profile of the bank.

Liquidity

Background

The bank appealed the 3 rating based on growth of approximately $15 million in assets since 1994 which they indicated had been well-managed and prudent. They also stated that the growth had come within their geographical market in conservative products (residential mortgages, commercial loans, and equipment leases). They did not have any exotic investments, hedges, swaps, or other derivatives. They do not pay above-market rates for brokered deposits and have retained more than 20 percent of these customers and cross-sold them on other bank products. Certificates of Deposit and Federal Home Loan Bank Board advances are only two of the five primary sources of funding; others include local customer deposits, credit union direct purchases, and loan sales and participations. The bank had taken steps to improve the overall risk management.

Discussion

Liquidity was rated a 3 based on a high and increasing level of liquidity risk combined with ineffective liquidity risk management practices. Rapid asset growth since 1994 was funded without a defined contingency funding plan. Also, the loan-to-deposit ratios were very high with the loan-to-deposit ratio in excess of 95 percent, and the loan-to-core-deposit ratio slightly above 100 percent. The $2 million investment portfolio, which was 76 percent of that pledged on March 31, 1997, provided nominal secondary liquidity.

The elevated risk profile had not been accompanied by an increase in the quality of liquidity risk management. There were no liquidity risk limits and no contingency funding plans. While management had enjoyed recent success in selling loans and developing relationships with the financial institutions that had purchased the loans, the potential risk associated with this strategy of employing wholesale funding sources to originate, purchase, and then sell loans had not been well-identified, monitored, managed, or controlled.

Conclusion

The ombudsman concurred with the 3 rating based on the funds management practices, discussed above, which are in need of improvement. Per OCC Bulletin 97–1 (attachment, FR 61 p. 67029), institutions rated a 3 "evidence significant weaknesses in funds management practices."

Composite

Background

The bank appealed the composite rating primarily on their appeal of the above component ratings. The board of directors believed that supervisory and examination personnel had lost their ability to provide impartial, balanced supervisory oversight over the bank's operations. The bank further indicated that they felt they were suffering from retribution for its successful appeal of its examination ratings in early 1995.

Discussion

As mentioned throughout the discussion of the component ratings, the bank was rated a 3 primarily as a result of a continued increase in the quantity of risk inherent in the bank's operations and strategies, combined with risk management systems that needed improvement. The ROE did acknowledge management's success in increasing fee income resulting in an improved earnings performance, the successful cultivation of relationships with institutions eager to purchase different types of loans, and management's ability to raise additional capital when needed. However, the bank had not implemented effective risk management systems commensurate with the increased risk. Effective risk management includes established limits on the level of acceptable risk, controls systems, and adequate management information systems.

Conclusion

In January 1997, the OCC in conjunction with the other federal supervisory agencies issued a revised rating system that reflects an increased emphasis on risk management practices. The issuance, OCC Bulletin 97–1, "Uniform Financial Institutions Rating System and Disclosure of Component Ratings," contains explicit language emphasizing management's ability to identify, measure, monitor, and control risks. The federal agencies recognize that management practices, particularly as they relate to risk management, will vary considerably among financial institutions depending on their size and sophistication, the nature and complexity of their business activities, and their risk profile. However, each institution may properly manage its risks and have appropriate policies, processes, or practices in place that management follows and uses.

The fundamental issue during any examination, and in particular this examination, is the accurate assessment of the bank's risk profile and the processes and controls in place to manage that risk. The ombudsman carefully reviewed the issues highlighted in the bank's appeal letter, the Report of Examination, and supporting documentation. Also, lengthy discussions were held with bank management, OCC supervisory personnel, and with key managers from the core policy unit of the OCC's Bank Supervision Policy group. The ombudsman concurred that at the time of the examination, the risk management processes in place in key areas of the bank were in need of improvement, particularly, in loan portfolio management, liquidity, and sensitivity to market risk. The growth in the bank over the last two years coupled with the strategy of purchasing and selling loans necessitated a more comprehensive risk management system. As the risk profile of the bank increased, management did not sufficiently enhance the bank's processes and controls. Since the examination, management had implemented several of the recommendations made in the ROE.

The ombudsman's opinion on the various issues of this appeal were as follows:

- The ombudsman concurred with the individual component ratings assigned during the examination as discussed above.
- The ombudsman concurred with the assigned composite rating based on the bank's risk profile and lack of adequate risk management processes and controls.
- The ombudsman recommended a prompt examination to review the bank's progress in implementing corrective action and strengthening the bank's risk management processes.
- The ombudsman concluded that the supervision of the bank had not been unfairly affected as a result of previous use of the national bank appeals process.

Speeches and Congressional Testimony

Page

Of the Comptroller of the Currency:

Statement of Eugene A. Ludwig, Comptroller of the Currency, before U.S. Congresswoman Maxine Waters' "Forum on Community Reinvestment and Access to Credit: California's Challenge," on the community reinvestment and development activities of commercial banks in California, Los Angeles, California, January 12, 1998 25

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Small Business Banking Issues Forum, on current issues in small business banking, Washington, D.C., February 5, 1998 45

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Exchequer Club, on tightening loan underwriting standards, Washington, D.C., February 18, 1998 48

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Institute of International Bankers, on international banking, Washington, D.C., March 2, 1998 51

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Independent Bankers Association of America, on the future of banking, Honolulu, Hawaii, March 4, 1998 54

Statement of Eugene A. Ludwig, Comptroller of the Currency, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, on the issue of regulatory burden reduction, Washington, D.C., March 10, 1998 59

Of the Chief Counsel:

Remarks by Julie Williams, Chief Counsel, Office of the Comptroller of the Currency, before the Third National CDFI Institute, on the implications of financial modernization for community development, Washington, D.C., January 29, 1998 75

Statement of Eugene A. Ludwig, Comptroller of the Currency, before U.S. Congresswoman Maxine Waters' "Forum on Community Reinvestment and Access to Credit: California's Challenge," on the community reinvestment and development activities of commercial banks in California, Los Angeles, California, January 12, 1998

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

Congresswoman Waters, I appreciate the opportunity to appear before this forum to discuss the community reinvestment and development activities of commercial banks in California. In my tenure as Comptroller of the Currency, I have made access to credit and financial services a top priority of the Office of the Comptroller of the Currency (OCC). I welcome this opportunity to share with you my thoughts on this important issue and to describe the various actions that the OCC has taken over the last five years to promote community reinvestment and fair access to credit and other financial services.

Few, though, in public service can match your sustained leadership in this area. You have long asked the hard questions about many of the most difficult issues facing our nation. Convening today's forum is only the latest example of your long effort to seek expanded economic opportunity for distressed communities and citizens here in Los Angeles and across the nation.

During my tenure as Comptroller I have visited scores of community development projects, programs, and lenders. This is, in fact, my third personal visit as Comptroller to the South-Central community to learn first-hand of reinvestment opportunities and accomplishments. I have conducted outreach sessions all across the country in diverse markets with many of our nation's leading bank and non-bank practitioners of community development finance and investment. All of this has improved my understanding of what can be achieved and assisted the OCC in supporting innovative and sustainable community development bank lending and investment programs.

Over the last five years, the OCC has pursued a broad strategy to support and promote sound and innovative national bank community development lending and investment. We have worked toward this goal by revising regulations and policies (including licensing policies), issuing formal legal decisions and opinions, approving specific national bank community development or public welfare investment proposals and improving the capacity of our staff to effectively supervise and assist national bank community reinvestment activities.

From 1993 to 1996, the OCC conducted a top-to-bottom review of its regulations to remove unnecessary burden, promote national bank competitiveness, and allow for industry innovation and improve the effectiveness of our supervision of national banks. Many revisions, such as those of the Community Reinvestment Act (CRA) and national bank community development, or "public welfare," investment rules, directly impacted bank community reinvestment and development activities. Our regulatory reform program has been backed by new and more effective supervisory procedures and techniques in both the CRA and fair lending areas.

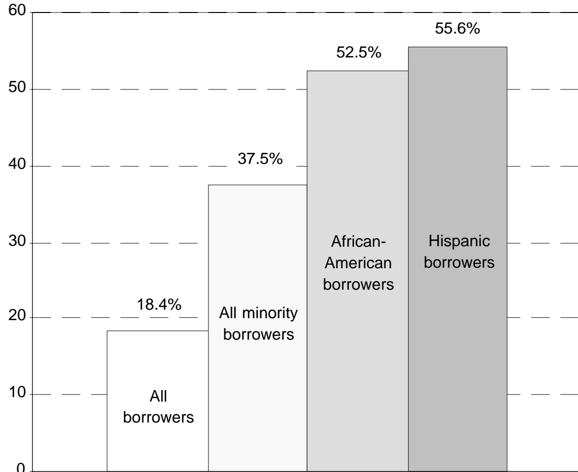
We have supported innovation in the field of community development lending and investment by approval of creative and sometimes legally novel national bank activities. In the licensing area, we have made it easier for banks to offer services in low- and moderate-income communities by waiving fees for applications for new national bank charters and new branches in low- and moderate-income areas not currently served by depository institutions. All of these efforts have been supported by a vigorous program of outreach to promote sound community development among national banks and their development partners.

The increased attention given to the CRA and community development has had concrete results, providing new opportunities for many to participate in the American dream of home ownership and asset accumulation: home mortgage loans to African-Americans and Hispanics increased dramatically—by 52.5 percent and 55.6 percent, respectively—from 1993 to 1996, as shown below in Figure 1.[1] Overall, the growth in mortgage lending to minorities was more than twice the growth rate for all borrowers during this time period.

This encouraging trend is reflected in the mortgage lending figures for your district, Congresswoman Waters, where loans to African-Americans and Hispanics increased by 56.2 percent and 64.5 percent, respectively, in the 1993 to 1996 time period.

[1] Source: Home Mortgage Disclosure Act (HMDA) data.

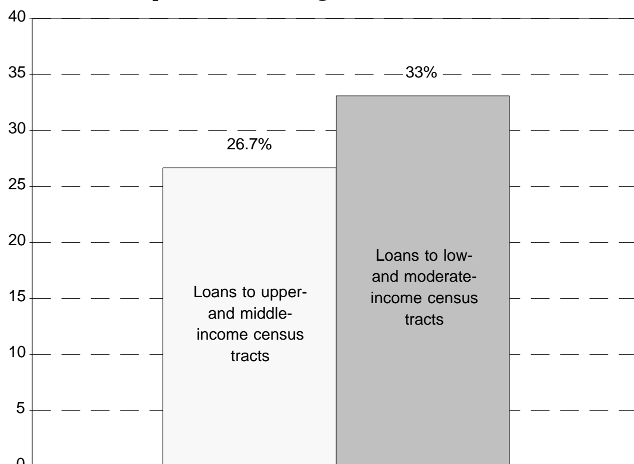
Figure 1—Increased loans to minorities, percent change, 1993–1996



Source: HMDA Data

Moreover, mortgage loans for homes in low- to moderate-income census tracts increased 33 percent nationwide from 1993 to 1996, notably more than the 26.7 percent increase in middle- and upper-income census tracts, as shown below in Figure 2.[2]

Figure 2—Increased home purchase loans percent change, 1993–1996



Source: HMDA Data

Recently released figures on small business lending are also encouraging. Under the U.S. Small Business Administration's largest lending program, known as the 7(a) program, loans to African-Americans increased by 171 percent between 1992 and 1997 in the Los Angeles area, and 154 percent nationwide.[3] Loans to Hispanics increased even more—by 526 percent in the Los Angeles area and 144 percent nationwide during the same time period.[4] Moreover, in the Los Angeles area, small business loans were distributed relatively evenly across all census tracts. Specifically, in 1996, low- and moderate-income census tracts—which are 32.9 percent of the total—received a proportional share of small business loans—27.6 percent of the total.

Other CRA and community development-related bank activities have also increased. In the past four years, bank and thrift CRA and low- and moderate-income lending commitments have totaled $270 billion, representing 86 percent of all reinvestment commitments since the enactment of the CRA.

Since I became Comptroller in 1993, national banks and their community development partners have increased their community development or public welfare investments fourfold over their investments in the previous three decades. These special equity investments have provided new capital for community development corporations, individual housing and commercial development projects and the growing industry of specialized community development financial institutions, or CDFIs. These institutions include new OCC-chartered national banks—two here in California[5]—that focus explicitly on providing community development loans and services to traditionally underserved communities.

While we can take pride in our accomplishments to date, many challenges remain. I commend you, Congresswoman Waters, for your sustained leadership on behalf of your constituency in attracting community reinvestment funds and promoting access to credit and other

---

[2] Source: HMDA data.

[3] Source: U.S. Small Business Administration, "Loan Approval Activity," FY1992–FY1997.

[4] *Ibid.*

[5] *Neighborhood National Bank, San Diego, California.* The OCC approved the application for this new, full service bank with a community development focus. Wells Fargo sold a branch to the bank for its use as the main office, and transferred to it approximately $10 million in deposits and loans. The bank applied for and received financial support from the CDFI fund. It opened for business on September 19, 1997.

Mission Community Bank, NA, San Luis Obispo, California. The OCC approved the application for this new bank with a local business and community development focus. The bank proposed to open with two operating subsidiaries, Mission Community Development Corporation and Mission Community Services Corporation. The main purpose of the subsidiaries is to focus on low- and moderate-income areas and small businesses, and they will offer micro-enterprise loans, community development loan products, small business technical assistance and training, special project funding, and Small Business Administration loan packaging. The bank opened for business on December 18, 1997.

financial services. These needs still exist in this community. The benefits of our strong economy will not serve all of our citizens if the credit and financial service needs of some sectors go unmet. Forums like this one are essential to an improved understanding of weaknesses in our credit and financial service delivery systems and developing practical and effective strategies to overcome access barriers. We must do all that we can to ensure that more and more Americans have the tools necessary to build better lives for themselves and their families.

I have structured my statement today to respond to the issues you raised in your invitation letter. First, I elaborate on the interagency CRA reform effort and OCC organizational changes to improve bank understanding of and involvement in community development activities. Next, I discuss the significance of increases in CRA-related bank activities for distressed communities. In particular, I provide this forum with my assessment of the community impact of the large CRA commitments made by banks over the past few years, stressing that it is not commitments, but results, that the OCC evaluates in the CRA examination process.

I then discuss some fundamental principles and strategies for sustainable community development. This section includes a discussion of additional OCC actions to foster community development, as well as innovative bank strategies that are helping to provide credit and other financial services to underserved low-income and minority communities throughout the nation. In the next section, I briefly summarize the economic situation in California, and, in particular, Los Angeles and South-Central Los Angeles. Finally, I outline some of the remaining challenges that regulators and financial institutions face in continuing to expand the provision of credit and other financial services to those in need. The statement includes two appendices as well. Appendix 1 outlines significant OCC actions since 1993 ensuring fair access to financial services while appendix 2 describes the types of permissible small business-related investments and activities for national banks.

Increased Focus on CRA

One of the accomplishments of which I am most proud in my tenure as Comptroller is how the OCC, community leaders, and bankers have worked together to improve access to credit for all Americans. As I mentioned above, we have revised our regulations to encourage community development activities. We also have improved the effectiveness of our fair lending examinations and made organizational changes to support the added focus on community development. Let me discuss these initiatives in greater detail.

Community Reinvestment Act (CRA.) Congress reaffirmed the important responsibility that banks have to help serve their local communities when it passed the CRA in 1977. However, the regulations to implement the CRA that were in place when I became Comptroller were not as effective as they could have been. Though well-intentioned, they were in many respects counterproductive, primarily because they focused on activities other than the bank's performance in providing loans, services and investments. More importantly, no one was satisfied with how the agencies implemented CRA—not the banks, not the public, not our examiners. As you know, there were many who preferred that the regulators simply do away with CRA. I strongly believed that CRA could and should work for all of us. When President Clinton challenged the federal banking regulators to make fundamental changes in the way we administer CRA, I led an interagency effort to improve its effectiveness.

To revise the CRA regulations so they would better achieve their intended purpose, and to ensure they focused on performance, rather than process, we traveled across the country to hear from everyone with a stake in the new CRA, and we put out two proposals for public comment. In 1993, we held seven public hearings on CRA reform—including one here in Los Angeles—and we received thousands of comment letters from the public. This process enabled us to move beyond confrontation. Although the process of reforming the regulation was difficult, our efforts are being rewarded by the creation of effective partnerships—partnerships that are, today, growing in strength and helping to rebuild communities.

Importantly, we have revised the regulation in a way that both eases the industry's compliance burden and improves its performance. For example, the CRA regulations provide for different evaluation methods to respond to basic differences in institutions' structures and operations.[6] This type of flexibility and customizing permits institutions to be evaluated more fairly and accurately in conformance with their business approach. Finally, and most importantly, the revised regulation focuses CRA examination on a bank's performance and not on documentation of its process for compliance. To support the examination emphasis on performance, the revised rule includes requirements for large banks and thrifts to geographically code and report their small business lending activities.

[6] The regulations provide an assessment method for large, retail institutions that focuses on lending, investment, and service performance; a streamlined assessment method for small institutions that emphasizes lending performance; an assessment method for wholesale and limited-purpose institutions based on community development activities; and, an option for any institution, regardless of size or business strategy, to be evaluated under a strategic plan.

Community development. Recent changes to our regulations have helped to spur rapid growth in national bank equity capital investments to promote public welfare—investment activities that would otherwise be prohibited by law. Today, national banks throughout the country are making capital investments in a variety of community-based development efforts that provide special financing and tax credit investment for low-income housing, small business development, neighborhood and commercial revitalization, and industrial development. Since I became Comptroller in 1993, national banks and their community development partners have made targeted investments of over $4 billion in these public welfare investments alone. In 1996 alone, we approved 187 national bank community development corporations and projects, with investments for the year totaling $1.4 billion.

Our efforts to ease regulatory requirements and promote greater flexibility for national bank investment in community development have contributed to the increase in bank capital investment in this area. In 1996, we revised the OCC's Part 24 regulation, the governing provisions for national bank equity investments in community development corporations and community development projects. The revised Part 24 facilitates bank community development investments by eliminating application requirements in favor of a self-certification process in many instances and streamlining application procedures in some other circumstances. Part 24 was also revised to relax restrictions on the reinvestment of these funds in an effort to attract new capital.

Fair lending. Over the past four years, the OCC has also taken a number of actions to improve our enforcement of fair lending laws. We issued new comparative file fair lending examination procedures in 1993, and the OCC has conducted 4,000 examinations using these new procedures. Last year, we further revised our fair lending examination procedures to cover all credit products and stages of the lending process. Our improved fair lending enforcement resulted in 25 referrals of national bank violations of fair lending law to the Department of Justice and the Department of Housing and Urban Development.

In 1995, the OCC became the first depository institution regulator to incorporate into its enforcement program the use of mystery shoppers to test for the presence of discriminatory lending behavior. In September of 1995, the OCC published a bulletin detailing the agency's interim policy guidelines regarding the disclosure of the results of fair lending self-assessments by national banks.

Additionally, we are bringing critical new technical skills to fair lending examinations. OCC economists have begun to participate in fair lending examinations, employing statistical models to supplement judgmental evaluations in checking for the presence of discriminatory behavior. These models increase the efficiency of our examination effort, both by pre-screening banks to find possible discriminatory behavior and then to guide us in completing our actual examinations in a highly efficient, objective manner.

Organizational commitment. To solidify the OCC's commitment to fair access, we have made a number of significant organizational changes and undertaken other key initiatives. We created the Community and Consumer Law Division in 1994 to provide a focal point for legal advice and interpretations with regard to consumer and community development laws and regulations and associated policy issues. We also created the Community Relations Division in 1995, which is responsible for the OCC's relations with consumer and community organizations, particularly national public interest organizations. The division provides analysis and advice to me and other senior policy makers on consumer and community organization interests and activities that affect the OCC and the National Banking System.

In November of 1995 the OCC established the Community Reinvestment & Development Specialist program. There are two Community Reinvestment & Development Specialists in each of the OCC's six districts. These individuals work as a team to improve our CRA examinations and to foster community development in low- and moderate-income neighborhoods, rural communities, and inner cities throughout the country. They have diverse backgrounds and specialties including non-profit housing development, small business lending, banking, community organizing, advocacy, and bank examination. Educating bankers and their community partners and acting as consultants to bank examiners and national banks are key aspects of their jobs.

In addition, we continue to help banks identify effective and innovative community development strategies through the efforts of our Community Development Division. This division oversees national bank community development investment activity and develops special initiatives, which I describe later in my statement.

In sum, actions taken by the OCC in recent years to improve access to credit and other financial services have yielded positive results. The contrast between what we have accomplished since 1993 and the relatively slow pace of progress that preceded these efforts underscores the importance of maintaining a vigorous, focused approach to community development and fair lending programs. Let me now turn to a discussion of the growing level of community development commitments that banks have made, particularly over the past few years.

Significance of Bank CRA Commitments

In your letter of invitation, you asked for my assessment of the community impact of large CRA commitments made in recent years, particularly commitments made by banks or thrifts in the context of acquisitions or mergers. As you state, these are important financial commitments that have the potential to bring renewed capital investment and economic development and affordable housing finance to distressed communities.

As I mentioned before, the CRA evaluation process doesn't look at promises, it analyzes results. Our assessment of banks' CRA-related activities focuses on accomplishments by the banks: the effective provision of credit and other financial services to low- and moderate-income families and communities. Commitments only represent a first step in bringing needed funds and expertise to underserved communities.

Definition. Let me first discuss what is commonly meant by the term "CRA commitments." The CRA regulation does not incorporate an explicit definition of a bank or thrift "CRA commitment." Consequently, banks, community advocates, and the media often use the term differently. There are two distinct types of CRA commitments. The first are public statements by a bank or thrift of future lending and investment goals in low- and moderate-income communities or to low- and moderate-income consumers. A second category of more formal written commitments, sometimes called CRA agreements, are direct agreements between a bank or thrift and a community organization or other members of the institution's community.

As you note in your letter of invitation, many institutions announce these commitments in the context of a bank or thrift merger. In some instances, commitments may be written agreements that reflect the outcome of negotiations between a lender and a community organization who may have protested a merger application. It would be wrong, however, to believe that CRA commitments arise only from protested mergers. Both informal and formal CRA commitments are entered into by all parties completely outside of a merger context.

CRA commitments also vary considerably in time period covered and the scope and depth of the discussion of lending and investment goals. Some may refer only to lending and investment in a single market and a narrow product area. Others, particularly the significant commitments large institutions sometimes make, outline lending and investment goals across a broad range of credit and investment products and financial services lines and incorporate an institution's goals across its entire, sometimes multi-state, lending territory.

Notwithstanding these differences, there is one important common thread to CRA commitments, particularly more formal written commitments: they are most often the outgrowth of discussions between a lender and community organizations and other local or regional community development leaders on unmet community credit and investment needs. Whether or not these discussions lead to formal agreements, they help lenders to better understand the community development lending and investment needs, to recognize new business opportunities in traditionally underserved communities, and to identify local community development resources and partners that they may not have recognized previously.

OCC review under the Bank Merger Act. Let me turn to how the OCC considers formal commitments and agreements in our review of national bank mergers. The OCC's review process for merger applications is quite comprehensive and, in some ways, unique.

When we revised our policies and procedures for processing national bank corporate applications during late 1996 and in the early part of last year, I instituted a major policy change at the OCC to preserve the recent gains made by traditionally underserved communities. In particular, I wanted to make certain that these gains were not lost in the course of the ongoing consolidation and restructuring of the national banking system. It is now OCC policy to require the surviving bank in a merger to indicate in their application—on the public record—whether it will honor the commitments made by the target bank to community organizations (or similar entities) and if not, to explain the reasons and the impact on the affected communities. If an acquiror indicates it does not plan to honor the commitments made by the target bank, we will consider that to be a significant issue. This will result in a removal of the application from our expedited review procedures and we will investigate the situation as part of the application process. Currently, the OCC is the only federal bank regulator to have such a requirement of bank merger applicants, although I understand OTS is considering adopting this standard. Since we began this procedure, we have never had an acquiring bank indicate it would not honor CRA commitments made by a target bank.

When the OCC reviews a merger application, we look at the CRA performance of both of the merging parties. We review their most recent CRA evaluations and more recent information. We consider not just the current overall CRA ratings, but also whether the evaluations identified any weaknesses. In particular, we review actions taken by the bank in response to our examiners' recommendations. We require the applicants, if they have received any CRA examination rating of "less than

satisfactory," to describe in the application—on the public record—what actions they have taken to address the deficiencies.

Our Community Reinvestment and Development Specialists inform us whether their community contacts have revealed any relevant information about the parties to the transaction. If one of the parties to the merger is not regulated by the OCC, we contact the staff at the Federal Reserve Board, the Federal Deposit Insurance Corporation, or Office of Thrift Supervision and ask for any relevant information. The OCC expects to issue new public involvement guidelines in the near future that will reiterate the seriousness with which we consider public comments and requests for meetings.

In addition to this retrospective CRA review, we also conduct a prospective convenience-and-needs analysis to ensure that the proposed merger will not have an adverse impact on any given community. We require the applicants to identify in the application—on the public record—any branches that they know will be closed as a result of the merger. We also require the applicants to describe in the application—again on the public record—whether they will discontinue or significantly reduce services to any customers of either applicant and, if so, to explain the reasons.

When we reach a decision on a merger application, we address the CRA issues in the OCC's decision documents and publish them in our monthly Interpretations and Actions so that the public can see how we have handled these issues and taken them into account in our decision. Our decisions may include requirements on the banks before the transaction can be consummated, or they may include conditions that the acquirer must comply with after the transaction is consummated.

Compliance review. Let me now discuss our CRA compliance examination process. Since we began implementing the CRA, the banking regulators have jointly taken the position that examiners should not consider an institution's commitments for future action as part of the CRA record of performance of a bank or thrift.[7] A financial institution's good words do not necessarily translate into CRA performance. Until recently, there was one unfortunate exception to this rule: examiners could point to commitments as evidence of potential for improvement in addressing specific problems in an institution's otherwise satisfactory CRA performance.[8] In these circumstances, institutions were sometimes given credit for commitments that addressed specific weaknesses identified by the examiners, although this provision was never used to raise a CRA examination rating from unsatisfactory to satisfactory. I am pleased to say that the new performance-based CRA regulation eliminated this consideration in CRA examinations.

In the case of written commitments or agreements, the agencies have maintained a policy of neither approving nor enforcing agreements between lenders and community organizations or other members of the institution's community. This is based on the premise that written agreements are entered into freely by a lender and external parties. Thus, they are generally outside of the CRA supervisory process, and often cover activities and practices well beyond the scope of the CRA statute and the authority of the CRA regulation. While not formally enforcing written agreements, however, the agencies have evidence of a lender's compliance with provisions of an agreement when examiners assess the CRA record of the institution in helping to meet its local credit needs. Consideration of a financial institution's lending or investment activity that may adhere to the provisions of a written CRA agreement, however, is relevant only to the examiner's assessment of the performance record of the financial institution on the basis of standards set forth in the CRA regulation and its examination procedures.

The OCC and the other banking agencies believe this is the right approach for treatment of CRA commitments in the context of the CRA examination process. No matter their origin, size, or depth of detail, commitments are no more than expressions of intent. Our focus must be on what banks do, not what they promise. Under the revised CRA regulation, OCC examiners now focus their assessment of a bank on the basis of the number, amount, distribution, and innovative nature of the loans and investments made and the services offered.

While it is certainly not the only factor, I am confident that the performance-based reform of the CRA regulation has helped to spur the recent dramatic growth in CRA commitment levels, and more importantly, these commitments are being translated into actual increases in community development lending and investment.

Community impact. Banks have achieved an increased level of expertise, sophistication, and capacity in the field of community development lending and investment. The evolution of community development finance and investment now involves the rapidly increasing availability of, and diffusion of knowledge about, the tools and techniques to recognize and successfully exploit genuine business opportunities in previously underserved and overlooked markets. Providers of community development finance and investment have now had much more experience with identifying risks in underserved markets.

---

[7] Banking Bulletin 89–12, "Joint Statement on Community Reinvestment Act," March 22, 1989, FFIEC, and Banking Circular 149, "FFIEC's Community Reinvestment Act Statement," September 30, 1980, FFIEC.

[8] *Ibid.*

Thus, they are more confident about their ability to manage these risks and to identify appropriate development partners with whom they can successfully pursue these newly discovered business opportunities.

An assessment of the potential impact of CRA commitments on local communities is, thus, greatly influenced by the availability of local development capacity to absorb new sources of investment capital and credit. At this stage, what may most require our focus is assuring that local communities have available the know-how, expertise and leadership to assist lenders in the identification and pursuit of genuine business opportunities. Where that development capacity is found to be lacking, nurturing it must become the priority of economic development efforts involving banks, community development partners and government at all levels.

The increase in the level of bank CRA commitments and tangible community development lending and investment indicates that banks are finding these activities to be profitable and sound. In the next section, I discuss my views on the relationship between expanding community development lending and investment opportunities and bank safety and soundness.

A Foundation for Long-Term Success

Sustaining and expanding recent gains in community development lending and investment poses difficult challenges for financial institutions and their public and private economic development partners. One of these challenges is that many lenders lack adequate information on prospective borrowers and market conditions. Thus, profit-making opportunities for lenders can go unmet in distressed markets because lenders are unable to make both rational and optimal credit decisions. Another challenge for financial institutions is the limited means of many borrowers in low- and moderate-income communities. In many instances, particularly in the real estate area, borrowers must rely on public subsidies, often from multiple sources, in order to meet standards of creditworthiness. Although they can sometimes obtain collateral or equity through innovative public and private equity investment vehicles and publicly funded sources of credit enhancements, many borrowers in distressed communities lack access to these vehicles. Occasionally, lenders' willingness to innovate can overcome the financial limits of these types of programs.

The balance of funding sources and project financing requirements represents a particular challenge to community development finance. As financial intermediaries, commercial banks' traditional function is to provide shorter-term credit than that often necessary for many community development projects. To overcome these challenges, lenders must find alternative matched funding sources, rely on secondary markets to help manage interest rate and liquidity risks, or identify specialized investment intermediaries for securitizing community development assets.[9]

Clearly, then, successful community development lenders must address the complexities of these emerging markets by following a strategy that combines flexible, innovative delivery practices and sound risk management principles. Let me turn to a more thorough discussion of that now.

Managing Risks in Community Development Lending

In your invitation letter, you asked me to address the way in which regulators can best balance safety and soundness concerns with the need to make credit more readily available to all segments of the communities served by banks. Let me now discuss how banks should approach the management of risk in this area.

Over the past four years, the national banking industry has come a long way in expanding its community development lending, achieving some impressive results and demonstrating that community development lending is good, sound business. Nonetheless, some observers have asserted that the goals of CRA—lending to low- and moderate-income individuals and communities—conflict with the goal of ensuring that we have strong, safe and sound banking institutions. I disagree. As in every other stage in the history of the democratization of credit—the ongoing expansion of credit and other financial services to unserved or underserved populations—we are finding that in the vast majority of cases, lending to low- and moderate-income Americans and other community development lending and investment is also safe and sound. The recent increase by commercial banks in their lending and investment activities in traditionally underserved markets does not represent charitable investment, rather, it represents an improved bank understanding of the nature of the financial risk of these activities and acknowledgment of business opportunities in these markets—markets that banks may have left unexplored only a few years ago.

---

[9] In February 1997, the OCC issued an advisory letter noting that a bank's investment in CD securities is considered a "qualified investment"—and therefore one that can receive positive consideration under the CRA regulation—if it benefits the bank's assessment area(s) or a larger statewide or regional area that includes its assessment area(s). CD securities are securities that are backed by interests in pools of community development loans, such as loans to borrowers in low- and moderate-income areas, or to small businesses. These securities typically are not rated by a nationally recognized statistical rating agency. Nonetheless, the OCC determined that national banks may invest in those securities if the bank documents that the issuer of the security will perform.

Lenders can increase their community development lending and investment in a safe and sound manner by following good risk management strategies. The OCC believes that national banks should view the risks of making community development loans and investments in the same way as they view the granting of traditional loans and investments.[10]

An effective risk management strategy for community development lending and investment requires an understanding of what is actually happening in the marketplace. Depository institutions and regulators need to get the facts, face up to the challenges they pose, and respond to those challenges with creativity and innovation. For example, a few affordable housing lending programs are experiencing higher than normal delinquency rates. Some have said that the higher delinquency rates indicate that aggressive lending programs for low- and moderate-income individuals are potentially unsafe and unsound, while others suggest that we should disregard those delinquencies for the sake of expanding home ownership. Neither position is entirely accurate. By carefully examining programs with higher delinquency rates, as well as programs with lower delinquency rates, we have an opportunity to learn a number of important lessons, two of which are readily apparent.

One of the lessons we have learned is that there are prudent steps—risk management strategies—that banks can pursue to lower delinquency rates for these programs. For example, in the July 1997 OCC advisory letter on affordable mortgage portfolios,[11] we highlighted that banks with lower delinquency rates on affordable mortgage programs had common characteristics: requirements for borrowers to participate in credit counseling programs; rapid response delinquency intervention programs; and a limited layering of risk factors such as high debt-to-income ratios and minimal borrower reserves.

The second critical lesson that emerges from our analysis is that even in those programs with the highest delinquency rates, more than nine out of ten borrowers are paying in full and on time. The vast majority of borrowers using these programs have proven to be good credit risks because they have been able to access credit through innovative programs.

One way for depository institutions to mitigate the risks of community development lending, and ensure that it is safe and sound lending, is the formation of community development partnerships with, for example, public, nonprofit, and other community organizations. Community partners provide additional knowledge about the community and the borrowers, knowledge needed to create a successful project. Other partners may provide a guarantee that makes the project viable or provide technical assistance or expertise necessary to structure a transaction. Often, nonprofit development partners can help lenders leverage their funds with public sources of financing and equity capital.

As I mentioned before, successful community development lenders' strategies incorporate not just risk management, but also other actions that help support these investments. In the section that follows, I discuss the OCC's efforts to gather and disseminate information on additional strategies used by successful community development lenders.

Effective Practices of Community Development Leaders

To underscore our commitment to safety and soundness in the areas of community development lending and investment, bank and thrift regulators should provide examiners and regulated institutions with information about specific techniques and strategies that lenders have used to enhance the credit quality or the profitability of these loans and investments. In 1997 the OCC conducted a detailed analysis of affordable single-family and multifamily housing and small business lending programs at 10 national banks to determine common strategies and effective practices of successful bank community development programs.

The OCC focused on a group of national banks that do an outstanding job of meeting the credit needs of their communities by financing affordable single-family and multifamily housing or small businesses. Many of the institutions we interviewed have been operating community development programs for almost a decade and have encountered challenges along the way. Their willingness to share experiences and strategies in support of activities that benefit low- and moderate-income families and small businesses is consistent with their approach: successful banks are open to new ideas and go back to the drawing board to develop something new when an approach does not work.

The OCC will publish the results of this analysis soon, but let me mention the main community development themes that emerged from our analysis:

- *Strong bank commitment:* Bank leadership supports community development activities by dedicating resources and establishing strong goals and objectives. They apply their knowledge of the local

[10] To promote supervisory consistency in the review and analysis of these loans and investments, the OCC developed special training for our examiners. Last year, for example, our Community Development Division prepared a Community Development Lending Training manual for safety and soundness examiners.

[11] OCC Advisory Letter 97–7, "Affordable Mortgage Portfolios," July 23, 1997.

market to design programs that address the credit needs of local residents.[12]

- *Integrated business strategy:* Banks integrate community development financing with their broader business strategies, thereby promoting the community development products as a way to generate revenue and profits and expand their customer base. They often design affordable multifamily programs that address the differences between financing conventional and affordable rental housing. Banks actively solicit potential small business customers. Some banks have an extensive branch network, and others rely on advanced technology or obtain referrals from community development intermediaries and government agencies to generate small business loans.
- *Partnerships:* Banks often seek out other banks, government agencies, and other resources in the community to help address credit and other needs, establishing the partnerships so essential to effective community development lending and investment. These partnerships help to create a sustainable, comprehensive economic base in underserved neighborhoods, rather than the fragmented, piecemeal economic development approaches that are prone to failure.

Although many banks that have developed effective strategies indicate there is no single successful approach to building strong communities—since local economies differ from neighborhood to neighborhood and from state to state—the OCC believes that developing and maintaining viable community development products involves banks learning as much as they can from the best in the business and replicating appropriate strategies in local markets.

Economic Situation in Los Angeles and South-Central

Let me now describe the unique economic environment in California, Los Angeles, and South-Central Los Angeles. I will also respond in this section to the request made in your invitation letter to highlight some innovative bank activities and initiatives approved or promoted by the OCC that could be useful in improving access to credit and other financial services in this community.

As I discussed before, successful lenders establish and maintain a variety of ties to the communities they serve. These relationships serve as a mechanism for banks to acquire knowledge about local economic conditions, information that is critical to effectively serve any community. As you know so well, Congresswoman Waters, Los Angeles is a large, complex city full of both opportunities and challenges for its governing officials, financial institutions, and citizens. Los Angeles is the second largest city[13] in the United States, with nearly 3.5 million residents and 470 square miles.[14] Los Angeles has experienced tremendous change in its economic infrastructure and its demographic profile in the last twenty years. In the early 1980s, manufacturing accounted for over one quarter of the area's nonfarm jobs. That figure is currently 17 percent, which, while still above the national metropolitan area average of 13.7, is clearly far below its peak level.

Many of the manufacturing job losses that occurred during the most recent recession, which started in the late 1980s, were the result of corporate downsizing and consolidation in the defense and aerospace industries. Specifically, manufacturing employment declined by 253,000 between 1988 and 1995.

These job losses had a devastating impact on the region, affecting other sectors of the economy. Overall, Los Angeles lost nearly half a million jobs in the 1990–1993 period alone.[15] Residential real estate markets were particularly hard hit, mainly because this recession followed a period of such significant growth that the supply of housing could not keep pace with demand, driving prices up. By 1996, housing prices had dropped by an

[12] For example, in the area of affordable mortgage lending, these banks often hire specialized loan officers who understand how to handle borrowers with irregular credit histories and have knowledge of government and nonprofit programs that can help them. Many of them also implement enhanced servicing programs to identify and assist borrowers early in the nonpayment cycle at a time when repayment problems can be resolved more readily.

In their small business lending activities, these banks invest the capital, staff, and organizational resources to develop and manage the portfolio in a way that differentiates small business credit and service needs from middle market or large corporate customers. Banks also develop internal processes that emphasize quick, convenient, and efficient loan processing by using consistent underwriting and centralized loan processing. They may use credit scoring models, stay open extended hours on Saturdays and evenings, have on-line services that give quick access to small credit advances, and prepare written materials in various languages. They often offer a variety of business-related services and products, such as savings accounts, overdraft protection, payroll, retirement, insurance and equipment lease products. Banks develop internal processes that provide innovative and flexible loan underwriting and referrals for technical assistance and equity capital, when needed. Often they rely on lending officers to obtain additional information from the borrower and to provide input on borderline cases.

[13] U.S. Census Bureau, "Census Counts for Cities with 1990 Population Greater than 100,000."

[14] U.S. Department of Housing and Urban Development, "Los Angeles, California Consolidated Plan, 1994."

[15] DRI/McGraw-Hill, "U.S. Markets Review, Metro Focus (Los Angeles), Third Quarter 1997," p. W–81.

average of 20 to 25 percent. As you well know, some communities were so severely affected that, to this day, they have yet to recover.

In the past five years, many of us have been made painfully aware of how difficult it can be to revitalize a community afflicted with tremendous job losses, social unrest, and all the difficulties inherent in a restructuring economy. For example, there are fewer high-paying jobs in the Los Angeles economy today than before the recession. Many jobs in high-paying industries were lost during the recession, nearly 100,000 in aerospace alone, and an additional 12,000 aerospace jobs were lost through 1996. Many of the jobs that have been added over the past couple of years are in low-paying industries such as women's outerwear manufacturing and personnel supply services.[16]

Recent statistics. Nineteen ninety-seven marked the third consecutive year of recovery for Los Angeles County. The unemployment rate fell to 6.5 percent in October of 1997, down from 8.0 percent in October of 1996. The migration from the area in the early 1990s has ceased and population growth has recently increased in conjunction with the economic recovery. Los Angeles County and City both posted 1.2 percent growth rates in 1996, compared to only 0.3 percent in 1995.

Los Angeles' housing market is only recently beginning to recover from the devastation of the early 1990's. Between 1989 and 1994, new housing construction dropped by nearly 85 percent and sales plummeted by 40 percent. As stated earlier, home prices declined 20 to 25 percent between 1990 and 1996. Currently, the county's housing market is stabilizing: median resale prices are up 6.6 percent in October from one year ago and new home permits increased by 18 percent in the first three quarters of 1997. However, home foreclosures continue to run at high levels. In the first half of 1997, the county recorded a total of 17,000 foreclosures, a 7.0 percent increase from the same period in 1996. In fact, home foreclosures have increased each year since 1990.

In addition, the Los Angeles housing market has other difficulties. For example, a research paper published by the Lewis Center for Regional Policy Studies at the University of California found that the housing in South Los Angeles is notoriously expensive, overcrowded, and in poor physical condition.[17] According to the California Association of Realtors in discussing the housing market for the Department of Housing and Urban Development's (HUD) 1994 California Consolidated Plan for Los Angeles, "80 percent of Los Angeles households could not afford a median-priced home in 1991. Although that figure declined to 64 percent by 1995, most households are still priced out of ownership."[18] HUD's Consolidated Plan for Los Angeles also reports the following about the area: "[o]ver 119,000 extremely low-income households (0–30 percent of median family income) are severely cost- burdened, paying more than 50 percent of their income for housing expenses, and three quarters of them are renters."[19] The need for affordable housing, particularly affordable multifamily housing, remains high.[20]

Commercial real estate vacancy rates remain relatively high. The metropolitan area office vacancy rate reached 18 percent in the second quarter of 1997, down only modestly from the 18.8 rate of one year ago. This is the highest rate among the 53 markets we track.[21] The region's industrial vacancy rate, at 8.1 percent in the second quarter of 1997, is the same as the national average. Rents are rising for all commercial property types, but, as with home prices, they have yet to return to pre-recession levels.

Small businesses. Small businesses have traditionally been an engine of job growth, creating approximately 65 percent of new jobs nationwide in the 1970–1990 time period, and projections from the Bureau of Labor Statistics and the Small Business Administration suggest that industries dominated by small businesses may generate 68 percent of new, nonfarm jobs through 2005.[22] Small

---

[16] Bank of America, *Economic & Business Outlook,* "Los Angeles on the Mend," May 1997 [available online at http://www.bankamerica.com/econ_indicator/ebo_la9703.html].

[17] *South-Central Los Angeles: Anatomy of an Urban Crisis,* Allen J. Scott and E. Richard Brown, eds., Working Paper No. 6, Los Angeles: UCLA Lewis Center for Regional Policy Studies, June 1993, p. 22.

[18] U.S. Department of Housing and Urban Development, "Los Angeles, California Consolidated Plan, 1994."

[19] U.S. Department of Housing and Urban Development, "Los Angeles, California Consolidated Plan, 1994."

[20] See *Life in the City*, a report by the Urban Neighborhoods Task Force, 1997, and U.S. Department of Housing and Urban Development, "Los Angeles, California Consolidated Plan, 1994." To address these needs, the OCC recently approved national bank requests to make equity investments in the California Equity Fund (CEF). The CEF is a limited partnership managed by the National Equity Fund, Inc., a non-profit corporation controlled by the Local Initiatives Support Corporation (LISC). The CEF invests in partnerships with non-profit community development corporations that are developing low- and moderate-income housing that qualifies for low-income housing credits. In 1995, the OCC approved a request from Bank of America, San Francisco, to make a $25 million equity investment in the CEF; in 1996, we approved a $1.7 million equity investment by City National Bank, Beverly Hills. These investments support community development by providing affordable housing to low- and moderate-income households.

[21] CB Commercial/Torto Wheaton Research, "Office Vacancy Index of the United States, Second Quarter 1997 (Ending June 30, 1997)."

[22] *Community Development: A Profitable Market Opportunity,* September 1997, OCC, page 13.

Table 1: Number and percent distribution of small business loans in the greater Los Angeles area by census tract

Census tract income level	Number of tracts	Number of small businesses	Small business loans
Low or moderate	522 (32.9%)	108,388 (31.4%)	19,793 (27.6%)
Middle or upper	1047 (65.9%)	235,793 (68.3%)	51,680 (72.1%)
Undefined	19 (1.2%)	844 (0.2%)	213 (0.3%)
Total	1588 (100%)	345,025 (100%)	71,686 (100%)

businesses also serve as a signal of the vitality of a community—they are present and prospering in vibrant communities, absent or failing in communities in distress.

Small businesses sometimes have difficulty obtaining credit because of factors such as insufficient credit histories and relatively small loan sizes. The geographic location of business borrowers has long been cited as a barrier to credit as well. However, recent statistics are encouraging. For example, under the U.S. Small Business Administration's 7(a) loan program, loans to African-Americans increased by 171 percent between 1992 and 1997 in the Los Angeles area, and 154 percent nationwide.[23] Loans to Hispanics increased even more—by 526 percent in the Los Angeles area and 144 percent nationwide during the same time period.[24]

As noted earlier, the revised CRA regulation requires large banks and thrifts to geographically code and report their small business loans. Recently released CRA data on lending to small business show that, for the greater Los Angeles area, banks are making small business loans relatively evenly across all census tracts. The distribution of loans across tract income levels closely mirrors the distribution of small businesses. In 1996, 28 percent of small business loans[25] were made to businesses in low- or moderate-income census tracts, compared with 31 percent of small businesses[26] which were located in low- or moderate-income census tracts.

Notwithstanding these encouraging figures, I recognize that many small businesses are unable to obtain the financing needed to grow and prosper. I believe this may be particularly true for minority-owned businesses. Over the last year, the OCC sponsored a number of "Banking on Minority Business" forums[27]—including one here in Los Angeles—to bring together minority small business entrepreneurs and national bankers to discuss how to break down barriers to minority small business lending. All start-up businesses—whether minority-owned or not—sometimes find it difficult to obtain bank financing due to the size of loan requested, a lack of a formal business plan, or failure to maintain adequate accounting records. Similarly, young firms or firms in certain business sectors, like the service or retail industries, may be unable to pledge collateral or have inadequate borrower equity invested in the enterprise. Because minority business borrowers often have fewer personal assets to invest or pledge and, on average, are more likely to seek loans for collateral-deficient service sector enterprises, these common challenges loom larger and become more difficult to overcome. Let me point out two innovative bank programs that focus on helping fill equity gaps in small business lending: the California Economic Development Lending Initiative[28] and the First National Bank of Boston.[29]

[23] Source: U.S. Small Business Administration, "Loan Approval Activity, FY1992–FY1997."

[24] *Ibid.*

[25] Federal Financial Institutions Examination Council, 1996 CRA Aggregate and Disclosure Software.

[26] PCI Services, CRA WIZ. Small businesses are defined as those with less than 20 employees.

[27] This initiative has helped participating bankers, businesses, and the OCC to better understand common barriers minority-owned firms share with other small businesses and to identify unique challenges minority-owned firms may face.

Our "Banking on Minority Business" forums also identified bank programs that have proven successful in serving the minority small business market. Some of these practices include innovative cash flow underwriting and receivables financing by lenders who look less to secondary sources of repayment, like collateral, and more to the demonstration of the borrower's ability to repay. These kinds of programs are often tied to the availability of hands-on, non-bank technical assistance providers who help borrowers lacking experience in demonstrating their creditworthiness develop business plans and meet application documentation requirements.

[28] The California Economic Development Lending Initiative (CEDLI) has provided several loans, training, and screening services to groups located in or servicing South-Central. CEDLI was founded in July 1995 as a multibank community development corporation to make loans to small businesses and community organizations throughout California.

CEDLI offers three major loan programs focused on assisting small businesses and local community development. The Co-Lending Program for Small Business was established to aid in financing businesses that are likely to succeed, but cannot obtain traditional bank financing. This program gives preference to women- and minority-owned businesses. The Loans to Lenders Program extends credit to intermediaries, such as local community development organizations, from which financing is extended to local small businesses or micro-enterprises unable to qualify for conventional loans. Finally, the Direct Real Estate Lending Program gives permanent financing to community organizations for the development or

Table 2—1990 census demographic characteristics for the 35th district, the greater Los Angeles area, and the state of California

	California	Greater Los Angeles area	35th congressional district
Median family income (weighted average)	$43,283	$42,209	$28,610
Low-income tracts as a percent of area tracts	6	9	30
Moderate-income tracts as a percent of area tracts	22	24	36
Middle-income tracts as a percent of area tracts	41	33	26
Upper-income tracts as a percent of area tracts	27	33	8
Owner occupied units (percent)	51	44	34
Households on public assistance (percent)	9	10	17
Households below poverty level (percent)	10	12	20

In other efforts to make it easier for these firms to access capital, the OCC has also approved bank applications to make a variety of equity or equity-equivalent investments—investments otherwise prohibited for national banks—in community development and nonprofit organizations.[30] These regulatory decisions[31] and informational exchanges have facilitated increased levels of small business and affordable housing finance in underserved communities.

The 35th congressional district. The 35th congressional district is an ethnically diverse community with a large proportion of both African-American and Hispanic residents. Figures from the 1990 census show that, compared to the greater Los Angeles area[32] and the state of California, this community has relatively lower income, more low- and moderate-income census tracts, fewer

purchase of community service facilities. To date, CEDLI has made three loans in South-Central. Willing Workers, Inc., a nonprofit corporation that provides transportation services to disabled people, received a loan from CEDLI. The purpose of the loan was to purchase additional buses. In a joint lending arrangement, Willing Workers, Inc. loaned $50,000, while Founders National Bank loaned an additional $50,000. Community Counseling Service also received a CEDLI loan. This $500,000 real estate loan helped the organization acquire an old building in South-Central to set up a boys' home for at-risk youth. Pacific Coast Regional Corporation received a $300,000 line of credit under CEDLI's Loans to Lenders program. The organization is re-lending the funds in South-Central and other parts of Los Angeles, in loan amounts ranging from $5,000 to about $25,000.

[29] *Bank of Boston Community Development Investment Bank.* The First National Bank of Boston received OCC approval in January 1997 to make an equity investment of $300,000 in a for-profit limited liability company (LLC) structured as a community development corporation. The LLC's total capitalization was projected to be $5.2 million. The purpose of the investment is to stimulate economic development by financing small businesses, including minority-owned small businesses, particularly those that create jobs for low- and moderate-income persons in disadvantaged communities in the bank's market areas. Specifically, the LLC is planning on doing the following: 1) provide loans, equity financing, and technical assistance to low- and moderate-income persons in the bank's market areas; 2) offer equity and mezzanine financing consisting of non-traditional loans including variable repayment terms and gap financing; 3) assist small businesses in the bank's market areas in Connecticut, Massachusetts, Rhode Island, and Florida by providing technical assistance and business management training; and 4) provide affordable housing for low- and moderate-income persons and families.

In its first venture, the LLC invested in an affordable housing rehabilitation project. The LLC made an equity investment of $6.5 million in the 227–unit housing project. The entire project is expected to cost $15 million.

[30] Following revision of the CRA regulations, the OCC advised a community development lender that investments in nonprofit organizations would allow a bank to take advantage of the community development loan "pass-through" provision, thus fostering investments in nonprofit organizations and leading to greater credit and investment in low- and moderate-income areas. Under the CRA regulations, if a bank has made an equity investment in a third party, the bank may ask its examiners to consider its pro-rata share (based on its equity investment) of community development loans made by that third party. Because nonprofit organizations cannot sell stock, equity investments are not possible. We opined, however, that banks' "equity-equivalent" investments in nonprofit organizations, i.e., investments having attributes similar to those of equity investments, would trigger the "pass-through" provision.

In 1997, the OCC issued an interagency interpretation stating that an investment in a community development real estate investment trust (REIT) would be favorably considered as a qualified investment. The properties in the proposed REIT consisted primarily of shopping centers in underserved, primarily minority areas of a city. We opined that banks' investment in the REIT would help to revitalize and stabilize these low-income geographies.

[31] One area in which I think regulation currently hinders our efforts to identify illegal discrimination in the lending process is in the implementation of the Equal Credit Opportunity Act (ECOA). For example, existing prohibitions on creditors from inquiring about the race, color, sex, religion, or national origin of the applicant hampers our efforts to examine for disparate treatment in non-mortgage lending.

The OCC's position is that creditors should be allowed to collect—on a voluntary basis—monitoring information about all loan applicants. Permitting monitoring information to be voluntarily recorded by creditors in loan categories besides home purchase and mortgage refinancing transactions would help creditors and the government in the fight against discrimination. Indeed, without such monitoring information, self-testing in other loan categories is virtually impossible and government monitoring is difficult at best.

[32] The greater Los Angeles area is defined as the Los Angeles/Long Beach MSA (4480) minus the towns of Calabasas, North and South Antelope Valley, Newhall, and the islands of Palos Verdes.

owner-occupied housing units, a much higher proportion of households on public assistance, and nearly twice the proportion of households below the poverty level. It is also an area of high unemployment.

Housing market. As in the rest of the greater Los Angeles area, 35th district residents devote a significant proportion of their income to housing expenses. In fact, almost one in five residents in the 35th district spends over 30 percent of his or her income on rent, and given the local prices, many are probably priced out of home ownership. The district's lower median family income is reflected in lower home ownership rates. In fact, only 34 percent of housing units in the district are owner-occupied, compared to 44 percent for the greater Los Angeles area and 51 percent for the state.

In spite of the socioeconomic disparities evident in the figures in Table 2, the most recent Home Mortgage Disclosure Act (HMDA) numbers for this congressional district are encouraging. In the 1993 to 1996 time period, the number of home purchase loans for properties located in the 35th district increased by 52.9 percent, versus increases of 30.7 percent for the greater Los Angeles area and 22.9 percent nationwide. African-American and Hispanic borrowers received many of these mortgage loans, with growth rates for these groups at 56.2 percent and 64.5 percent, respectively. In the greater Los Angeles area, home purchase loans to African-Americans increased by 43.5 percent and loans to Hispanics increased by 49.4 percent; nationwide, loans to these groups increased by 52.5 percent and 55.6 percent, respectively. Moreover, there was a 63.4 percent increase in mortgage loans to low-income census tracts in the 35th district, compared to a 50.2 percent increase for the greater Los Angeles area and a 33.0 percent increase nationwide.

Although conditions appear to be improving, partly because of the dedicated efforts of individuals such as yourself, Congresswoman Waters, it is important that we keep our attention focused on the remaining needs of the community. Continued improvement depends, to some degree, on financial institutions' ability to implement effective strategies and partnerships that maximize the impact of their community development loans and investments.

Challenges to Continued Expansion of Community Development Activities

In your invitation letter, you asked me to express my views about the remaining challenges the regulators face in helping financial institutions meet the credit needs of their communities. In determining how to meet these challenges, we can draw useful lessons from our experience in meeting similar kinds of challenges in the past. To build on the progress we have achieved to date, I believe we must do five things:

1) government, including regulators, must work with financial institutions to establish partnerships;
2) innovation must be rewarded;
3) we must work to continue to elicit the facts and analyze what these facts mean;
4) we must secure government commitments at all levels; and
5) we must assure that banks remain competitive.

Let me discuss these issues in more detail.

Partnerships. Strengthening neighborhoods and expanding economic opportunity requires the collective strengths of community development organizations, government, business leaders, religious and social organizations and committed members of the financial service industries. Vibrant partnerships are the key to successful and lasting community development and we are all challenged to assure their continued growth and formation.

Development partnerships aid lenders in identifying new business opportunities and managing credit risks. Community-based partners may also refer borrowers to revolving loan funds and other bank-supported community development intermediaries that are effective at developing business plans and correcting operating deficiencies of local small businesses. In addition, banks can partner with other banks through loan consortia and multi-bank community development corporations to make very small loans, equity capital investments, develop expertise, and test more flexible debt financing terms and instruments. Government and community organization partners can also be sources of gap financing for closing costs and down payments.

Frankly, there are limits to what banks can do alone. All the confrontation in the world will not solve our community development problems. To take a big step forward from where we are today, we need many more strong community-based partnerships.

Innovation. One of the things that stands out in the history of banking and bank regulation is the extent to which traditionally held views about the creditworthiness—or lack thereof—of a particular group of Americans have been proven wrong. At one time, virtually all working class Americans were deemed unworthy of credit. It took experience to prove that this view was

mistaken. Most of all, it took initiative and innovation to revise the old approaches and to begin to assume that most Americans would know how to use credit responsibly if they were only given the chance.

While innovation has characterized the retail credit market,[33] at least in recent years, until very recently there had been relatively little innovation in retail service delivery. For much of this century, the banking industry has faced legal and regulatory limits on its ability to innovate in this area. However, Congress and the regulatory community have taken a number of steps in the last several years to remove restrictions on banks' ability to open branches and provide alternative delivery vehicles for financial services. As a result of these changes in the law and other operational innovations by banks, alternative retail service delivery systems such as automated teller machines (ATMs), point of sale terminals, electronic banking, and supermarket branches are spreading rapidly. In addition, the OCC has clarified the ability of national banks to provide telephone and other electronic banking services to their customers by not considering these services as constituting branches subject to regulatory and legal requirements. The OCC will continue to review and update its regulations to ensure that we do not unnecessarily restrict banks from being creative in their offering of financial services to underbanked populations.

The bottom line is that to increase credit and services to underserved populations, innovation is essential. We should encourage it aggressively but within the limits of safety and soundness.

Reliance on analysis. Increased partnerships and continued innovation, though, will only advance the cause of community development if they are based on sound factual analysis of the needs and capacities of underserved borrowers and communities. Take the example of what many often refer to as the "nonbanked."

Despite the numerous accomplishments of U.S. depository institutions to date, we know that millions of American households do not have deposit accounts. What we do not know well is why so many households conduct their financial service needs outside of the mainstream banking system. One thing I am certain of in this area: this is a very heterogeneous population and no one solution will work for all. To develop innovative products that reach these underserved populations, it is important for regulators and financial institutions to work hard to elicit the facts and to carefully analyze the needs and preferences of these potential customers.

The OCC is aware of—and applauds—the pioneering research in this area by banks and other financial institutions, consumer organizations, and academics. Some of the key research is presented in the recent OCC publication, *Financial Access in the 21st Century,* which represents the proceedings of a forum convened by the OCC earlier in 1997. The findings reported in this volume indicate that many organizations around the country have already begun the process of learning about the nonbanked and underserved. The OCC will also be conducting a survey of the needs of the nonbanked population during 1998.

I encourage banks, consumer organizations, and others to continue this process of learning by pooling the information they may already have on the credit, savings, insurance, transaction, and other financial needs of the nonbanked and underserved. Even better, they might consider working (together or separately) on market research on local area needs—certainly an essential part of the process of designing and introducing new, more appropriately designed products for this emerging market. Of course, financial regulators also need to be aware of this information in order to assess the new, innovative practices of banks and other financial institutions seeking to better meet these financial needs.

Government commitment. As you have often reminded us, Congresswoman Waters, government, at all levels, cannot shy away from its responsibility to dedicate the resources necessary to attract private sector investment for economic development. Obviously, public sector resources are, and are likely to remain, scarce. The delivery mechanisms and channels of these available resources are also undergoing change. These facts make urgent the need to better leverage public resources for community development and assure that available funds help support the ongoing innovation of private sector lenders.

Continued government provision of project-based equity investment and credit enhancement is needed. In addition, I believe the community development efforts of banks will have greater impact in particularly distressed communities if government, at all levels, maintains a focus on the need to support traditional and innovative community development intermediaries including CDFIs and the growing field of small business technical assistance and equity investment providers.

Keeping banks competitive. The plain fact is that traditional banking activity—taking deposits and making loans—has declined in this country relative to other countries. If, in the future, we limit banks to only engag-

[33] The credit card, adjustable rate mortgage, home equity loans, asset securitization, targeted community development lending, microfinance, and support group lending—these are all innovations that have helped to propel that market.

ing in these traditional activities, or only have these traditional activities of banking covered by CRA, the CRA program will decline in impact almost immediately. We must, in my view, rather, allow banks to grow and expand their activities and allow these new bank activities to support CRA into the future. That is why I think the OCC's bank operating subsidiary rule is so important to the future of community reinvestment.

To compete in the market for financial services, and thus continue to serve their communities, banks must have the flexibility to engage in a broader range of financial and financially related activities, to the same extent as other financial providers. Product diversification not only enhances the safety and soundness of the banking system, it enables banks to serve their customers and their communities with the broad, integrated range of financial products and services that, as I have earlier pointed out, is so crucial to bringing more Americans successfully into the economic mainstream. In contrast, unnecessary restrictions on bank activities not only hinder their ability to compete, but also diminish their ability to serve the inner city.

CRA is only as strong as the institutions that are subject to it. Stronger institutions, with diversified sources of income and potential for growth, are better positioned to help meet the credit needs of their communities and support the economy as a whole than deflated institutions that have been deprived of new growth businesses. Congress must keep these issues in mind as it continues to debate proposals for financial modernization legislation. I feel strongly that certain provisions in H.R. 10 would shift new and expanding activities to holding company affiliates, instead of keeping them in the bank's affiliates, namely, its subsidiaries. Such rules, I am convinced, would not only make the bank a less stable enterprise, but also one less able to meet its obligations to its customers and community.

Conclusion

In conclusion, banks are a critical element in supporting and sustaining economic development for our underserved communities. Effective regulation that permits innovative bank practices also fosters the revitalization of these communities. In recent years, the OCC has taken a number of steps to facilitate the CRA-related activities of banks, and recent figures suggest that banks are increasingly recognizing and taking advantage of these market opportunities.

While I am encouraged by the progress we have made thus far, I also recognize that we can and must accomplish even more. Although significant challenges remain, I commit to you that the OCC, working together with national banks and our fellow regulators, will continue to do everything we can to advance the gains already made in providing our neediest citizens with improved access to credit and other financial services.

Appendix 1

Significant OCC actions ensuring fair access to financial services, 1993–1997

Date	Event and impact
March 10, 1993	*OCC Credit Availability Initiative Results in Formation of Interagency Program on Credit Availability*. Program addresses: loans to small and medium sized businesses; real estate lending and appraisals; agency procedures for handling appeals by bankers and consumer complaints; examination procedures; and paperwork and regulatory burden on banks. (I/A)[1]
March 30, 1993	*Credit Availability Program Initiates Reforms* aimed at eliminating unnecessary documentation of loans to small and medium-sized businesses and farms, and reducing costs to lending institutions and the time it takes to respond to credit applications. (I/A)
May 4, 1993	*OCC Issues New Procedures to Detect Lending Discrimination*. New approach involving comparative reviews of bank lending decisions results in more effective and efficient examinations. Previously, OCC did not review bank files—relying only on reviews of bank audit results and bank representations. Since implementation, OCC has conducted over 3,000 fair lending examinations under the new procedures.
May 18, 1993	*OCC/Housing and Urban Development (HUD)/Justice (DOJ) Form Working Group on Lending Discrimination,* undertaking a comprehensive review of fair lending enforcement.
May 26, 1993	*OCC Issues New Real Estate Appraisal Rules to reduce costs that can restrict the availability of credit,* by increasing the threshold level for required appraisals from $100,000 to $250,000, expanding exemptions, and identifying additional circumstances when appraisals are not required. (I/A)
May 27, 1993	*Banking Agencies Issue Interagency Letter on Discrimination Concerns*, announcing a strengthening and refining of fair lending enforcement activities and transmitting a list of 11 suggested measures by which banks could prevent illegal discrimination and improve access to credit by underserved groups. (I/A)
June 10, 1993	*OCC Announces Additional Credit Availability Initiatives that improve the availability of credit to businesses and individuals,* by changing regulatory reporting requirements, issuing joint policy statements on the valuation of real estate collateral, using the "special mention" category in reviewing loans, and improving the coordination of examinations. (I/A)
July 15, 1993	*OCC Acts to Facilitate Community Development Investments,* by issuing new rule utilizing increased statutory authority permitting such investments.
August 2, 1993	*OCC Announces CRA Reform Hearings*, seeking input from financial services industry, social scientists, and consumer and community representatives.
August 31, 1993	*OCC Issues New Regulation on Disposal of OREO (Other real estate owned),* easing bank restrictions and making OREO more available.
December 8, 1993	*OCC Proposes New CRA Regulation*. OCC at the forefront of moving to performance based assessments and a streamlined assessment method for small banks.
January 21, 1994	*OCC/DOJ Settle the First National Bank of Vicksburg, Mississippi Lending Discrimination Case,* the first settlement for violations under the Equal Credit Opportunity Act for a national bank.
March 8, 1994	*Bank Agencies Adopt Joint Policy Statement on Lending Discrimination*, joint statement by OCC, DOJ, HUD, Federal Trade Commission (FTC), and the other banking regulators that interpreted the fair lending laws, stated policies related to enforcement of those laws, and advised lenders on self-compliance measures. (I/A)

[1] I/A indicates event was part of an interagency effort.

Significant OCC actions ensuring fair access to financial services, 1993–1997 (continued)

Date	Event and impact
April 1994	*OCC Forms Native American Working Group,* aimed at improving the delivery of banking services to native Americans.
June 1994	*Comptroller Initiates Community Outreach Program* to directly learn of credit access concerns, holding over 15 forums with over 300 regional and local community development leaders across the country.
June 2, 1994	*OCC Creates Community and Consumer Law Division,* as a step to help implement community, consumer, and fair lending laws.
February 9, 1995	*OCC Grants First Community Development Financial Institution Charter.*
April 19, 1995	*OCC Adopts Final CRA Regulation*, creating performance-based standards.
December 14, 1995	*OCC Issues Risk-Based Capital Guidelines for Sales of Small Business Obligations with Recourse,* expanding bank lending capabilities to small businesses.
February 20, 1996	*OCC Names District Community Reinvestment and Development Specialists*, creating specialists in all OCC district offices to help foster national bank involvement in community development.
February 22, 1996	*OCC Holds Community Development Conference*, convening the largest conference of its kind in OCC history, with over 500 attendees.
June 3, 1996	*OCC Establishes CRA Web Site*, to give the public broader access to information about the national banking industry.
September 17, 1996	*Comptroller Announces Changes to Part 24*, launching major initiative to stimulate investment in low- and moderate-income housing, including empowerment zones.
September 20, 1996	*Secretary Rubin Announces the Creation of the Consumer Electronic Payments Task Force, Chaired by Comptroller Ludwig*, to study how emerging electronic payment products will affect consumers and whether these products will be available and beneficial to low- and moderate-income persons.
September 30, 1996	*OCC Waives Application Fees for New Charter and Branch Applications in Low- and Moderate-Income Areas,* acting to improve access to financial services for low- and moderate-income consumers.
October 1, 1996	*OCC Sponsors Seminars on Federal Low Income Housing Tax Credits,* actively marketing tax incentives for low- and moderate-income housing.
November 1996	*OCC Announces it is Conducting Community Development Best Practices Study,* a study of national banks' loans and investments that benefit their communities. The purpose of the study is to provide banks and other financial institutions, agency personnel, community development organizations and the public with information about successful strategies that promote affordable single- and multifamily developments and small business growth.
November 20, 1996	*OCC Issues Revised Part 5,* expanding activities that may benefit underserved communities, and enhancing the availability of assets and income for community reinvestment purposes.
January 9, 1997	*OCC Publishes Community Development Finance: Tools and Techniques for National Banks,* a reference work designed to continue stimulating creative and profitable community development lending and investment opportunities.
January 22, 1997	*OCC Publishes "New Opportunities to Excel: Outstanding CRA Actions for Community Banks,"* spotlighting Community Reinvestment Act performance of small national banks. The pamphlet is intended to recognize the efforts of some of the community bankers who have made the revised CRA work for them, and most importantly, to provide examples, inspiration, and ideas to other small banks throughout the country.

Significant OCC actions ensuring fair access to financial services, 1993–1997

Date	Event and impact
February 12, 1997	*OCC Holds Industry Forum on Financial Access in the 21st Century*, convening leaders from a variety of sectors—banking, bank vendor, non-bank financial institution, check cashing, community development, academic, and government—who would not otherwise meet in substantive discussions.
February 20, 1997	*OCC Announces the Availability of its New Online Community and Consumer Organizations Database*. The database, available through the Internet, will function as a registry to help identify local contacts for CRA examinations and for community and consumer input to the agency's supervisory and regulatory processes.
February 25, 1997	*OCC Issues Advisory on Community Development Securities* that informs national banks of the standards that community development securities must meet to qualify under the authority granted by the investment securities regulation, 12 CFR Section 1. It also explains the treatment of these investments under the CRA regulation, 12 CFR Section 25.
March 14, 1997	*OCC Forms National Access Committee,* to conduct research on access to financial services, oversee an initiative to extend the frontiers of banking to households who are not now bank customers, conduct research on the impact of credit scoring on access to banking services, and analyze how on-line banking may be used to facilitate access to financial services.
May 29, 1997	*OCC Releases Videotape and Workbook Set on the Low-Income Housing Tax Credit,* showing how national banks can participate in this program to provide affordable rental housing in their communities.
June 5, 1997	*OCC Hosts "Banking on Minority Business" Forum,* bringing together bankers, representatives of the minority small business community, and leaders of minority business and community organizations to discuss how to overcome barriers to small business lending and build mutually profitable relationships.
July 23, 1997	*OCC Sponsors Affordable Housing Symposium,* to promote broader discussion among lenders and their community development partners about the performance of single family affordable mortgages and effective practices in managing risks in banks' affordable mortgage portfolios.
July 24, 1997	*OCC and Department of Justice Sponsor "Banking in Indian Country: Expanding the Horizons,"* a conference on effectively providing financial products and services to Native Americans living in Indian country. OCC also publishes *A Guide to Mortgage Lending in Indian Country,* designed to help banks deal with the challenges of lending to native Americans, including some unique legal challenges.
September 18, 1997	*OCC Releases "Financial Access in the 21st Century: Proceedings of a Forum.*" The booklet reports the discussion at an all-day meeting held in February 1997 to explore ways to improve access to financial services for the 12 million households—about 12.5 percent of the U.S. population—that do not have deposit account relationships with banks or other depository institutions.
September 30, 1997	*OCC Releases "Community Development: A Profitable Market Opportunity."* The publication reports the proceedings of a two-day conference held in February 1996 to encourage national bank involvement in community development activities.

Appendix 2

Types of Permissible Small Business-Related Investments and Activities by National Banks

1. Investments in SBICs:

15 USC 682(b): Permits a national bank to invest in small business investment corporations (SBICs) subject to a 5 percent of capital and surplus limitation. SBICs are SBA-regulated vehicles for providing debt and equity financing and loans with equity features to small businesses, including small businesses that are owned or controlled by minorities.

12 CFR Part 25: Provides that a national bank's investment in a SBIC may receive positive consideration in assessing the bank's performance under the Community Reinvestment Act (CRA) if the conditions of the CRA statute and regulations are met.

2. Investments in Community Development Corporations:

12 USC 24(Eleventh): Authorizes a national bank to make investments designed primarily to promote the public welfare, including the welfare or low- or moderate-income communities or families (such as providing housing, services, or jobs) subject to a maximum limit of 10 percent of the bank's capital and surplus. The investments may be made directly or through a community development corporation or project.

12 CFR Part 24: Clarifies that providing or supporting equity or debt financing for small businesses that are located in low- or moderate-income areas (or other areas that are targeted for redevelopment by a government) or that provide permanent jobs for low- or moderate-income individuals is promoting the public welfare for purposes of 12 USC 24(Eleventh).

12 CFR Part 25: Provides that a national bank's investment in a community development corporation or project may receive positive consideration in assessing the bank's performance under CRA if the conditions of the CRA statute and regulations are met.

3. Investments in Small Business-Related Securities/Securitization:

12 USC 24(Seventh): Subject to certain limitations and restrictions, authorizes a national bank to purchase, sell, deal in, underwrite, and invest in certain securities, including the authority to invest in small business-related securities (as defined in the securities laws).

- For purposes of 12 USC 24(Seventh), a small business-related security includes a security that is rated in one of the four highest rating categories by a nationally recognized statistical rating organization (NRSRO) and is backed by the obligations of a small business concern and sold by a bank in the secondary market.

12 CFR Part 1:

- Provides that a national bank may purchase and sell small business-related securities (classified as Type IV securities under the regulation) for its own account without limitation except if the small business-related securities are rated in the third or fourth highest investment grade rating categories. If the securities are rated in the third or fourth highest rating categories, a national bank only may hold the small business-related securities of any one issuer up to an aggregate par value of 25 percent of the bank's capital and surplus. National banks may also deal in Type IV securities that are fully secured by Type I securities, such as U.S. government securities and State general obligation bonds.
- Authorizes a national bank to treat any debt security as an investment security under Part 1 notwithstanding that it is unrated by a NRSRO if, on the basis of reliable estimates, the bank concludes that the obligor will be able to satisfy its obligations under the security and the bank believes that the security may be sold with reasonable promptness at a price that corresponds reasonably to its fair value. Banks may invest up to an aggregate of 5 percent of the bank's capital and surplus in securities acquired on the basis of reliable estimates.

Advisory Letter 97–2 (February 25, 1997): Clarifies that securities backed by interests in pools of community development loans, such as loans to borrowers in low- and moderate-income areas or to small businesses (CD securities), also may qualify as investment securities under Part 1. A national bank also may purchase CD securities as an investment under the authority in 12 USC 24(Eleventh) and 12 CFR Part 24 (described above) if the CD securities meet the public welfare requirements of that statute and regulation. In addition, this Advisory Letter clarifies that a national bank's investment in CD securities may receive positive consideration for purposes of CRA if the conditions of the CRA statute and regulations are met.

4. Lease Financing Transactions:

12 USC 24(Seventh) and (Tenth): Authorizes a national bank to engage in lease financing transactions

that may assist small businesses in obtaining equipment but, in some cases, the investment is subject to a 10 percent of assets limitation.

62 Fed. Reg. 52105, 52127 (October. 6, 1997): Interprets CRA to provide that a bank may receive positive consideration for purposes of CRA for leasing transactions that benefit small businesses if the conditions of the CRA statute and regulations are met.

5. Investments in Bank Service Companies:

12 USC 1861, et seq.: Authorizes insured banks to invest in bank service companies (BSC). Activities of BSCs in which national banks are shareholders are limited to those permissible for national banks or, subject to Federal Reserve Board approval, activities that are closely related to banking under the Bank Holding Company Act. A bank may invest 10 percent of its capital and surplus but no more than 5 percent of its total assets in a BSC. If approved by the Federal Reserve Board under the closely related to banking test, a BSC may, for example, be able to engage in additional lease financing transactions or other transactions that a national bank could not conduct directly that could assist small businesses. A bank may receive positive consideration under CRA for this investment or for the lending or other activities of the BSC if the conditions of the CRA statute and regulations are met.

6. Other Provisions That May Provide Incentives for Small Business Lending and Investments:

12 USC 1835: Provides for alternative capital calculations that apply to a qualified insured depository institution with respect to the transfer of certain small business loans or leases of personal property with recourse. These rules are implemented for national banks in 12 CFR Part 3, App. A, Sec. 3(c).

12 CFR Section 7.1006: Permits a national bank to take a share of profits, income, or earnings from a business enterprise of a borrower in lieu of or in addition to interest on a loan. These so-called "equity kickers" only may be used to repay interest and would not affect the obligation to repay principal.

12 CFR Section 7.1015: Permits a national bank shareholder in a SBIC to retain stock dividends. These stock dividends are not purchases of stock for purposes of the investment limitations and, therefore, the stock dividends are an additional investment in the SBIC.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Small Business Banking Issues Forum, on current issues in small business banking, Washington, D.C., February 5, 1998

It is a genuine pleasure to welcome you all to our meeting on small business banking—a subject that is crucial to our nation's continued economic vitality and opportunity.

To understand *how* crucial, just look at the facts and figures. By Small Business Administration standards, more than 99 percent of our nation's businesses qualify as "small." The vast majority are very small—two-thirds of them employ fewer than five people. But they make an outsized contribution to our nation's well-being. Small businesses employ more than half of the private nonfarm workforce and, combined, generate 51 percent of our private gross domestic product. Today they produce almost two-thirds of all new jobs.

The small business community is a big part of the reason why we have enjoyed an unparalleled economic expansion of the past five years—an expansion driven very largely by small business people like yourselves, especially in the service and technology areas.

Small business men and women, in short, are the vehicles for the nation's initiative and creative imagination. We count on all of you here to support that initiative and imagination and to put it to work—as you always have. Small firms produce twice as many product innovations per employee as larger firms. From small businesses have come innovations as complex as the artificial heart valve and the optical scanner and as prosaic as the zipper. From small businesses will undoubtedly come the product breakthroughs of the future. That will enhance the American standard of living and ensure the nation's continued economic success.

Notwithstanding the strength and ingenuity of the small business sector, we live in turbulent times. The financial turmoil that today besets so many of the nations of Asia—nations which not many months ago were hailed for their economic successes—reminds us that the future is essentially unknowable. And yet, I believe that we have much reason for optimism. The reason is sitting right in this room. Our forum today shows that we are not resting on our laurels. We came here today because we recognize that there remains a rich mother lode of ideas and enterprise in our people—ideas and enterprise waiting to be recognized and waiting to be financed. We came here today because, despite all that many of our financial institutions have done already, lack of credit or capital is still an obstacle that may prevent tomorrow's small business success stories from being written. And we are here—all of us together—because we understand that through partnerships between financial providers and small entrepreneurs, all things are possible for ourselves and for our people.

I believe we have proved that over the past five years. Five years ago, we were in the midst of a credit crunch. Many in the small business community were unable to get the loans they needed and deserved. Some firms undoubtedly failed as a result. Yet, as painful as it was for many, the credit crunch experience reminded us of something terribly important: that financial institutions and small business need one another—and so does the national economy.

That lesson was on everyone's mind when I became Comptroller of the Currency, and it led us immediately to develop and implement a four-point plan to restore the flow of credit into the small business community. First, we went over our regulatory rule book with a fine-toothed comb, weeding out or modifying those rules that seemed to unduly complicate fair access to small business credit. Second, we developed innovative new programs to encourage financial institutions to make those loans. Third, we conducted research into the systemic problems that interfere with the whole process of small business lending. Finally—and the one that made all the others possible—we sought to stabilize and strengthen the national banking system, so that banks were once again in position to lend.

Let me give you some specific examples.

- We liberalized the rules requiring a small business owner to obtain a real estate appraisal from a licensed appraiser whenever personal real estate was used as collateral for a business loan—a change whose benefits, for those who qualify, can be measured not only in savings of dollars but also in savings of time—weeks sometimes, critical weeks when loans can be held up awaiting the completion of an appraisal.
- We adopted a low documentation loan program to allow highly rated and well-capitalized banks to make a portion of their loans to small and medium-sized businesses—loans that examiners would review solely on the basis of performance and not on the basis of the documentation in the file. These are loans made on the basis of character that may not necessarily meet standard requirements for collateral or detailed performance plans.

But nothing, I think, has done more to highlight and promote that constructive partnership between small business and financial institutions than our revisions in the Community Reinvestment Act. Much has been said, and rightly so, about the new CRA's emphasis on performance as opposed to paperwork. What is just as important, in my mind, is that the new CRA takes a far broader, more holistic view of what really constitutes community development. It recognizes that small business lending can be an important component of financial institutions' commitment to the communities they serve.

Stimulated by CRA and their own good business sense, financial institutions have lately demonstrated a renewed commitment to small business lending. One of the most auspicious developments in recent years has been the growth of small business finance intermediaries for institutions that lack the expertise or the resources to establish special small business lending programs of their own. Their variety is truly impressive—and encouraging. Lending consortia, loan pools, bank-owned or affiliated community development corporations, small business investment companies, community-based micro-enterprise loan funds—all these institutional devices are helping to fill the gaps in the small business lending market.

Thanks to constructive regulation and innovations by lenders and community development partners, we have made impressive progress over the past five years in small business finance. Our nation's banks have reaffirmed their traditional role as a major source of funding to the small business community. Small business lending dominates the loan portfolios of many community banks. As of late last year, more than 60 percent of all small business credit was originated by commercial banks. Commercial banks also provided more than half of all loans used to finance the purchase of equipment and vehicles by small firms. These days, fewer and fewer small business people are reporting difficulty in obtaining credit. And bankers, for their part, are finding that, as a rule, small business loans perform just as well, if not better, than other components of the loan portfolio.

And the evidence suggests that many of our bankers are not sitting back passively and waiting for small business customers to walk through the door. The recent Federal Reserve report to Congress on the availability of credit to small businesses shows a new aggressiveness on the bankers' part in seeking out small business customers, by offering better terms, additional products and services, and more direct marketing. Even while striving to meet their CRA obligations, bankers are moving beyond mere compliance to a recognition that partnerships with small business make good business sense.

Now the time has come to build on our successes and to consider new approaches where we have been less successful than we would like. Unfortunately, many of the gains I have just described have been distributed less evenly than we would like. For years we have heard anecdotes about the special obstacles facing minority small business people in obtaining credit. Considering the importance of small business as a engine for job creation and upward mobility, it is incumbent on us to ensure that small business does not face special handicaps just when small business's contributions are most needed.

To help us determine the nature and extent of the problems that minority small business people face—and to begin formulating workable remedies—we have moved aggressively on several fronts. First, as part of CRA reforms, we have begun to collect information—for the first time—on small business originations on a national basis from every large bank and thrift—information that we can use to determine where small business loans are going—and, just as important, where they are not going. This was an important breakthrough. But the data we have collected tells us nothing about the recipients of those loans—information that we need to determine whether illegal discrimination is preventing some potential small business borrowers from obtaining credit. In fact, lenders are forbidden by the Federal Reserve's Regulation B from inquiring about the race, color, sex, religion, or national origin of an applicant for a non-mortgage loan. If the Fed changed Reg. B so that creditors could collect such information—on a voluntary basis—it would materially assist us in the fight against discrimination. I would urge you to support such a change.

Fact-finding was an important part of the rationale for the OCC's Banking on Minority Business program, which we launched last year in Washington and took on the road to cities all over America. This cross-country dialogue brought together community leaders, minority small business entrepreneurs, and bankers, to discuss how to break down barriers and build mutually profitable relationships that will bring economic opportunity to our neglected and ignored communities. As I listened and learned during these visits, a number of points became clear—points whose relevance goes beyond minority small business to the small business community at large.

First, there is a need for improved communication between bankers and potential small business borrowers. In the home mortgage area, a field we have studied intensively, we have found again and again that simply making the loan to first-time borrowers may not be enough for the loan to work. In turns out that the best performing affordable mortgage loans are those which are accompanied by education and counseling—helping borrowers to negotiate the application process, helping them understand what lenders expect of them, helping them to manage a budget, and so forth.

The same thing appears to be true in the small business field. Based on what I have heard around the country, there continues to be considerable misunderstanding between lenders and small business borrowers on what is expected of both. Some would-be entrepreneurs have minimal experience with all the intricacies of running a financial operation. They need counseling and education almost as much as they need capital. For their part, some lenders have limited familiarity with small business markets generally and with market conditions that prevail in minority communities. If the relationship is to succeed, both parties need to think about their partnership in the broadest sense—as one that involves an investment of time and expertise as well as financial capital.

Second, what I heard in my discussions around the country convinces me that we regulators can do more to encourage banks to use those programs that are currently available. Take our low-documentation program. At last count, only about 200 national banks are using it, because, I am told, the others continue to believe that examiners will criticize them later for inadequate documentation. Let me assure those of you here today that you can take full advantage of that program without fear of adverse criticism.

The same thing is true of the public welfare investment authority embodied in the Part 24 of the OCC's regulations. Certainly the amount of Part 24 equity investments used by banks generally, and for small business lending and investing specifically, has increased in the last few years. But most national banks are not at their 5 percent of capital threshold for self-certification of qualifying investments, and only a handful are at their aggregate statutory 10 percent limit. It is in your interest—and in the small business community's interest—for banks to take fuller advantage of this program. I encourage you to do so.

Although we certainly have obstacles to overcome in the years ahead, the dominant impression I took away from my meetings across the country was one of energy, pride, and optimism. I met many lenders and small business people who, through creativity and perseverance, have became allies in common partnerships.

I learned about organizations like TELACU—the East Los Angeles Community Union—a one-stop resource for minority small business people which provides counseling and arranges loans—loans with some of the lowest delinquency rates in the entire industry.

I heard about innovations in lending such as second- and third-look programs, whose operative philosophy reflects a dogged determination to find ways to make loans to worthy borrowers who might not qualify by traditional standards.

I heard about encouraging developments in the use of credit scoring models to reduce the costs of reviewing and monitoring small business loans, while at the same time paying attention to the potential problems of inadvertent discrimination in theses models. The reduced costs from using these models should help lenders make more of them. And when they do, it may open to door for the development of a secondary market for these loans, with all that implies for increased availability and better pricing.

Most of all, I saw evidence of genuine long-term commitment to community development, broadly defined. In our discussions today, I expect to hear and learn more about these innovations and how we can use them to address the problems that persist.

When I became Comptroller of the Currency five years ago, I made a commitment to do everything in my power to promote fair access to credit and other financial services for all of our people. I think we have made significant progress to that end. One reason we are meeting here today is to help ensure that the momentum continues to build, so that, one year from now, we will have even more striking progress to report. Wherever the future takes me personally, let me assure you that the cause of financial democratization will always be special to me.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Exchequer Club, on tightening loan underwriting standards, Washington, D.C., February 18, 1998

It is a great pleasure to be with you again for what is undoubtedly my last opportunity to talk with you in my capacity as Comptroller. By periodically bringing together citizens from the private and public sectors to discuss the pressing issues of our day, the Exchequer Club and organizations like it around the country play a vital role in our democratic system. The Exchequer Club is particularly near and dear to my heart because it was here that I first discussed in public some of the important measures that our office has implemented, such as derivatives guidance and Part 5 of our rules.

The Exchequer Club provides a convivial setting for such discussions. It is the sort of environment in which a Thomas Jefferson would have felt at home. Jefferson was a giant in most respects, but a contradiction in at least one way. Seat him with guests around a luncheon table, and he was one of the great raconteurs of his day. But in public, he was virtually mute. During his entire eight years in the White House, he gave just two speeches—his two inaugural addresses. Even his State of the Union messages were sent up to the Hill for someone else to read for him—abandoning the practice of his predecessors and setting a precedent that lasted for over a hundred years.

You wouldn't expect this kind of tight-lipped reticence from one of the most prolific and brilliant statesmen in American history. But Jefferson considered himself a poor orator—and most of his contemporaries agreed. Here, at least, is one trait that he and I may have in common!

More to the point, though, Jefferson decried the tendency of politicians to play to the crowd and to clutter public forums with fulsome rhetoric that generated more heat than light. The affairs of state, Jefferson believed, required sober deliberation and rational discourse conducted behind the scenes—not public spectacle or propaganda.

Given the volume of words and images that assail us day in and day out, we might well feel nostalgia for the simpler world in which the Sage of Monticello lived. Yet, as historian Joseph Ellis makes clear in his recent biography, Jefferson's presidency and his reputation suffered because of his failure to use his office as a bully pulpit. He adopted policies that might have worked—his embargo, for example, designed to force England and France to stop attacking American merchant shipping. But those policies, which involved painful short-term sacrifice for the American people, never had a chance—in part because Jefferson chose not to take his case to the people.

Jefferson's experience has come to mind as I mulled over the proper course of action in dealing with the decline in lending standards unmistakably evident throughout the U.S. banking system. Beginning almost three years ago and at intervals ever since, the OCC has expressed its concerns to the industry, issued advisories, and taken what we believed to be the appropriate supervisory actions. In an April 1995 speech, I urged the industry not to compromise on asset quality goals. In a December 1996 speech, I called attention to the emerging warning signals of excessive relaxation of lending standards, especially in the syndicated loan market. In August of last year, we issued an advisory alerting national banks to the dangers of declining loan loss reserves, which we were seeing at some banks throughout the country. Just last October, in a speech before the American Bankers Association, I announced a series of supervisory actions that we were taking in response to an increase in credit risk in most lending categories.

Now, with the approach of the end of my five years in office, I have heard some suggest that we give it a rest. The economic expansion, they say, has not petered out; who can say with complete assurance that it won't go on indefinitely, in defiance of all historical experience?

To some degree, they say, our admonitions over the past three years appear to have had their intended effect: banks have indeed tightened underwriting standards in some areas, as in credit cards. Others urge me to stop pressing the point, because if our worst fears *were* to materialize and banks were again to suffer heavy losses due to imprudent lending and a deteriorating economy, bankers would have no one but themselves to blame. After all, these folks say, you warned them; you took supervisory action; you can lead a horse to water, but you can't make him drink.

So the advice from some quarters has been for me to stop worrying, to close out things out with a succession of feel-good, farewell speeches, and, above all, to avoid unpleasantness or controversy. It's bad enough to rain on someone else's parade—but to rain on your own? At this point in my term, as I begin to say my goodbyes, it seems almost churlish to continue hammering at an

issue that everyone by now has heard before and that, truth be told, some really did not want to hear even the first time.

But I just cannot sit silent. To do so, I believe, would be negligent.

For I have come away from five years at the OCC with an enhanced appreciation for the importance of a safe, sound, and competitive national banking system to the economic well-being of the American people. The extraordinary revival of commercial banking from the depths of the early nineties has been a big factor in the solid economic gains we have registered as a nation in recent years. A healthy, profitable banking system has helped fuel the growth of businesses large and small and has furthered the development and rehabilitation of our nation's communities. Many Americans are better housed than they were five years ago, in large part because banks have stretched the envelope and found ways to make housing finance available to segments of our population who would never have been able to qualify before.

We cannot afford to abandon these gains or leave future gains to chance. We have an important obligation not only to the banking system *per se,* but to all those who benefit from and depend on it.

This is one reason I feel compelled to raise these safety and soundness issues again. Moreover, raising these issues cannot wait. It is essential that we focus NOW—not 6 or 12 months from now—on the safety and soundness implications of underwriting standards that, in some areas, regrettably, continue to slip. If we care about a robust, dynamic banking system capable of supporting the people and the economy of the United States, it is essential from a safety and soundness perspective that we not only do what is necessary to allow the system to evolve into new areas of finance, but also take strong actions to ensure that banks continue to adhere to the fundamentals of traditional banking.

That's why I am speaking to you today and will speak out again on this subject several times in my remaining weeks as Comptroller.

The ironic fact of the matter is that some of the serious banking problems we have confronted in recent times stemmed from too much liquidity in the system rather than too little. During the 1970s, oil-producing nations flush with cash poured funds into U.S. and European banks, which in turn sank record sums into less-developed countries (LDC). Over time, many of these loans turned sour, and the result was the LDC debt crisis of the early 1980s. The same basic dynamic was at work in the U.S. Southwest 20 years ago. Energy prices skyrocketed in 1981, and the proceeds found an outlet in Southwestern real estate, which soon became overbuilt. When oil prices collapsed, it set off a chain reaction that led to major losses in energy and real estate loans, and the eventual failure of hundreds of banks, including 9 out of the 10 largest bank holding companies in the state of Texas.

Today the U.S. banking system is again awash in liquidity. Senior OCC examiners tell me that money is more widely available at more reasonable prices from a greater variety of sources than at any time in recent memory. Much of this liquidity is coming from abroad—including East Asia—as investors seek sanctuary in the superior safety and stability of the U.S. dollar and U.S. financial institutions.

This vote of confidence from the international investment community should be a source of pride to us. But with that trust comes responsibility. Long before the current Asian problems appeared on our screens, we were seeing too much money in the banking system chasing too few good deals—a point I have made again and again. Even before Asia, razor-thin margins, lengthening tenors, and highly leveraged transactions had become increasingly common in bank loan portfolios. Many bankers wondered aloud how they could possibly make money on some deals, but chose to do them nonetheless for fear that a customer might be lost to the competition. The OCC's 1997 survey of credit underwriting practices, which covered national banks in 80 of the country's largest bank holding companies, found that the level of inherent credit risk had increased in most parts of the loan portfolio, with especially significant easing of standards for commercial loans.

The problems in East Asia add weight to our concerns about liquidity and underwriting standards.

I alluded earlier to the speech I gave to the American Bankers Association last fall in which I announced a series of supervisory steps we would take in response to these observed weaknesses in underwriting. One of these steps required OCC examiners to sit down with the CEO of each national bank to discuss our underwriting survey, to review potential problem loans, and to evaluate the bank's capacity to deal with a potential increase in those loans. The idea was for examiners to explain how our systemic concerns related to each institution, and to do it in a way that would gain top-level attention and lead to quick remedial action when such action was warranted.

An interim survey of our examiners shows that this approach is beginning to show some results. Our examiners tell me that some community banks are revising their loan policies. Others are beefing up their collection capabilities as a contingency in case problem loans increase. In some cases, examiners have requested a

written plan of action that would be implemented if deterioration in the economy had an adverse impact on asset quality.

Among larger banks that have made strategic decisions to take on additional risk in specific product markets, some are enhancing workout units, despite the current low level of problem assets, to ensure they have the necessary expertise should problems arise. And in other banks, information systems are being upgraded to better identify and administer problem loans.

Unfortunately, not all banks are taking such prudent, proactive measures. OCC examiners report credit practices at some banks that I find worrisome. They have found banks entering new product lines for which they lack appropriate expertise—for example, a predominantly agricultural lender that, without careful study, enters the volatile subprime auto loan market. Some bankers are making a conscious decision to accept higher risk by granting structural concessions in existing product lines—for example, loosening repayment and recourse terms for commercial loans and funding 100 percent of a real estate developer's hard and soft costs.

Finally, examiners have called attention to undue concentrations in some lenders' portfolios where the product line is vulnerable to developing market trends or predictable business cycles—for example, agricultural loans based on rising land values where the cash flow does not support increased debt or a growing volume of unsecured loans.

Bringing our concerns about such practices to the attention of management is one way we help those banks willing to help themselves. Where we *do* bring those issues to management's attention, we expect management to respond positively. We have had considerable cooperation in this regard. However, let me be clear: in those instances—and I expect they would be few—where management does not follow through as we would expect, we will make certain that our admonitions are followed. This is clearly our responsibility and it is clearly what Congress intended in enacting the safety and soundness provisions of Federal Deposit Insurance Corporation Improvement Act.

An additional and very significant step we will be taking in the credit underwriting area will be the issuance in the next few weeks of guidance on loan portfolio management techniques. The need for such guidance was demonstrated recently with the release of a study conducted by Robert Morris Associates and First Manhattan Consulting Group. That study found that only four of the 64 largest North American banks practiced what the authors called advanced techniques of portfolio risk management. Let me say parenthetically that not all banks need to have state-of-the-art portfolio management capabilities. But certainly the institutions with the largest, most complex loan portfolios need to improve their risk management techniques. And all banks would benefit by adopting more proactive risk management and measurement practices. Clearly, this is an area in which banks have a need to improve.

The forthcoming release of the OCC's guidance on loan portfolio risk management should help them do just that. It will be the most comprehensive policy document on OCC expectations for loan management that we have ever issued. But it is more than that. This guidance will provide a full breakdown of the lending process, enabling bankers and examiners in effect to see both the forest AND the trees. It should serve as a primer for bankers seeking to better understand the concepts and application of loan portfolio risk management: the interrelationships among loans, the importance of analyzing risk across different boundaries, and how this process can aid in the management of overall risk before it jeopardizes bank solvency. Used properly, the practices outlined in the OCC's guidance will provide management with a more complete picture of the bank's credit risk profile and with more tools to analyze and control that risk. This vital guidance will be published and in the hands of national bankers by the time I leave office.

I spoke earlier of the challenges we face, challenges made even more pressing by the financial instability abroad. But the problems in Asia provide us with confirmation as well as challenge. During my recent Asian trip, I found it encouraging that, while the work goes on to stabilize financial systems and repair the damage to local economies, the leaders of that region are also taking a hard look at what went wrong and what they can do to ensure that the debacle does not recur. Many of the senior officials to whom I spoke pointed to shortcomings in their supervision of the financial sector as a significant factor in bringing on their problems. And, almost as one, they look to the United States as a model for the reforms that they know must be undertaken.

The OCC's innovations in the supervision of derivatives and supervision by risk have not only improved bank supervision worldwide, but have become symbols of what can be achieved in our field. If we are to continue to serve as a model of supervisory excellence, we have to be just as serious and farsighted in our approach to underwriting standards and loan portfolio management. I am confident that the fine men and women of the OCC, with whom it has been my honor to serve over the past five years, are up to this task.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Institute of International Bankers, on international banking, Washington, D.C., March 2, 1998

It is a great pleasure to be with you at your annual conference. Ever since its founding in 1966, the Institute of International Bankers (IIB) has been an organization dedicated to serious discussion of the issues in which all of us here—bankers, regulators, and other government officials—share a common interest. Under the distinguished leadership of Larry Uhlick, the IIB has helped us to better understand the benefits of a free global financial marketplace. I am proud to be with you, and proud to follow in the footsteps of the many distinguished speakers who have addressed your conferences in the past.

Of course, our Office, the Office of the Comptroller of the Currency has a keen interest in international banking. The OCC, which I have headed for the past five years, regulates and supervises some 2,600 nationally chartered banks, which together hold the greatest portion of the total banking assets of the United States. As a group, national banks are extremely active in the international arena. As of late 1997, they held foreign investments worth more than 225 billion dollars. National bank subsidiaries of foreign banks, which the OCC also supervises, held total assets of 131 billion dollars, while their foreign branches held almost $300 billion in assets. As these numbers show, the national banking system of the United States is a major force in the global banking picture.

As the supervisors of such globally active institutions, the Office of the Comptroller of the Currency is active internationally as well. For decades, the OCC has had an office in London, and has coordinated examinations all over the world. The OCC is a member of the Basle Committee on Banking Supervision. We have close and productive relationships with foreign financial supervisory agencies. We play an active role in advising foreign governments and supervisory agencies on issues of common concern. In the past year alone, bank supervisors from 29 countries around the world came to the United States to work with and learn from OCC staff, while OCC specialists visited 13 countries to provide technical assistance. And the number of governments with which we consult is growing.

Even if national bankers and this office were not so active internationally, we would still have to keep a close watch on financial developments around the world, recognizing that virtually every facet of domestic banking—indeed, virtually every facet of our nation's economic life—is influenced by what goes on abroad.

What a far cry from the circumstances that prevailed when the OCC was created 135 years ago, in 1863! Back then, cables had not yet been strung between the New World and the Old, so that international communications moved little faster than they had a hundred or even a thousand years earlier. Information between the continents traveled under sail and, much less often, under steam. The fastest ships afloat took seven and a half days between New York and Liverpool, and 120 days from New York to Hong Kong. Under these conditions, with news often outdated before it arrived at its destination, investing abroad was largely an act of faith, as many ruined investors could attest.

The numbers reflected this. In 1869, all U.S. investments overseas totaled less than $100 million—about what Citicorp now generates in revenues on a bad day. Even in the 1920s and 1930s, when air travel was still a novelty, our physical isolation from Europe and Asia was an article of faith for most Americans, and only the most farsighted members of the banking fraternity recognized that the future of finance was in the international arena.

Today, I need hardly tell you, the world is a radically different place. The information superhighway reaches into every corner of the globe. Sums that stagger the imagination travel tens of thousands of miles, instantaneously, with a single computer keystroke. Insomniacs can trade stocks or futures in real time at any hour of the day or night, for the markets never close. Where once there were only one or two financial nerve centers—London or New York—today there are many. The *Financial Times* tracks no fewer than 53 global stock exchanges, including bustling markets in China, Russia, Sri Lanka, and Zimbabwe. In the United States, global funds are one of the fastest growing segments of the mutual fund industry. In just one year, 1996, the assets of international equity and bond funds in the United States rose from $230 billion to $321 billion—a phenomenal 40 percent increase. The speed, the stakes, the unpredictability of it all, can be exhilarating—and intimidating.

Of course, with this greatly increased activity comes greatly increased risk. Technology and the sheer volume of global financial activity today have made multilateral supervisory concerns more important and more challenging than ever before.

Fortunately, the G–10 countries and international organizations such as the IMF and the World Bank are rising to the challenges of financial globalization. During my five years in office, we have seen exemplary intergovernmental cooperation at several levels—including at the very

highest level—all aimed at enhancing the stability of the global economy. And what is really significant is the growing recognition—again, at the highest level—that the stability of financial institutions and the quality of their supervision are a critical element in the whole global financial structure.

It was in recognition of the importance of financial institutions and their effective supervision that, beginning at their summit meeting at Halifax in 1995 and at every summit meeting since, the heads of state of the Group of Seven industrial countries have gone on record to advocate closer international cooperation in the regulation and supervision of financial institutions and markets. Financial supervision is again on the agenda of the 1998 G–7 Summit in Birmingham, England, as it was in Denver last year. Clearly, the international supervision of financial institutions has taken its place at or near the top of the world's economic priorities.

It is also encouraging that an international supervisory infrastructure is emerging that holds a great deal of promise for the financial world of the twenty-first century. In addition to expanded contacts on the bilateral level, there are three multinational organizations—the IMF, the World Bank, and the Basle Committee on Banking Supervision—that are playing and will continue to play a central role in improving international bank supervision.

Since its founding in 1974, the Basle Committee has taken the lead in formulating supervisory standards for supervising capital adequacy, derivatives activities, cross-border banking, and much more. Of considerable importance, the Basle Committee has endorsed a comprehensive set of core principles for adoption by bank supervisors globally.

As for the IMF, with its ready access to economic policymakers in host countries, it is particularly well positioned to assess the implementation of the Basle standards. And the World Bank, with its extensive on-the-ground development apparatus, is uniquely situated to assist in providing useful technical assistance—for example, the training and education of bank supervisory personnel in host nations.

This collaboration among the IMF, World Bank, and Basle Committee is to my mind a very important development and should be commended. Too often, institutions find themselves doing someone else's job, and we get duplication and complication instead of progress and insight.

Notwithstanding the important steps that have been taken to date, the recent problems in East Asia show that there is still a considerable amount of work to be done if we are to achieve a more stable financial world. But the problems in East Asia also provide us with some important lessons from which we can all learn. Certainly, as scholars and practitioners pore over the East Asian situation, more lessons will be learned, but I do not believe it is too early to start to draw some conclusions. Where financial stability is concerned, the sooner we start, the better.

Before I begin my remarks about lessons learned, I should note that my comments will focus on the banking sector. This is by far the largest part of the financial system in East Asia, and it is the part where we have the most expertise. However, in talking about lessons learned, I would be remiss in failing to point out that the virtual absence of supervision of non-bank financial intermediaries and the excessive loan-to-equity ratios of the business sectors in these countries certainly has played an important role in the problems.

Now for lessons learned in the banking area.

First, the Asian experience underscores the importance of greater transparency—by which I mean improving the quality, quantity, and consistency of the information that governments, financial institutions, and financial regulators make available in the marketplace. The market *can* play a crucial role in disciplining the banking system, but this requires reliable information about banks' financial condition. In Southeast Asia, banks' balance sheets were telling us one thing and the reality was another. Greater transparency and reliability in the financial information that came from the affected countries of Asia, I believe, would have strengthened market discipline, which I also believe would in turn have prompted earlier—and less onerous—remedial action before problems ballooned to the extent they did.

The second lesson relates to the need for clear, consistent accounting standards. In many Asian countries, such standards were lacking, which had the effect of concealing problems in Asian bank portfolios. For example, although several of the affected Asian countries subscribed to the Basle capital standards, their accounting systems tended to give a different picture of their capital position than would have been the case under generally accepted accounting principles, or GAAP, in the United States.

Third, Asia teaches us that directed and connected lending have a corrosive effect on financial institutions. In Southeast Asia, too much lending was based on borrowers' business or political connections, rather than on their creditworthiness and ability to repay the loan.

Fourth, Asia highlights the importance of the fundamental principles of supervision, especially regarding loan concentrations, leverage and capital, collection practices, and the integrity of underwriting standards. For

example, supervisory forbearance in some countries aggravated matters by inhibiting the identification of problems that might otherwise have been addressed in a comprehensive and timely manner.

Fifth, in addition to weaknesses in some relatively lax supervisory rules, supervisory services in those countries too often were hamstrung by too few examiners with too little training. In a number of cases, banks went four or five years without an on-site examination, and even when on-site examinations were conducted, they were less detailed and less thorough than is desirable.

Sixth, Asian developments speak volumes about the importance of risk-based supervision. Too little attention was paid to the inherent riskiness of the loans that banks were making, either in isolation or in the context of the entire loan portfolio. Recognizing that supervisory resources are limited makes it doubly imperative that supervisors focus on the systemic impact of risk factors in their subject institutions.

Finally, the Asian story shows how important it is that bank supervisors have the will and the political authority to carry out their responsibilities in a professional, dispassionate, and resolute manner.

These are the lessons that the Asian experience seems to offer. I believe that from these seven lessons emerge a set of seven prerequisites for greatly improved worldwide bank supervision and with it, greater international stability. I mention these in no particular order of importance.

First, we must move rapidly toward achieving worldwide accounting standards that are at least as rigorous as the generally accepted accounting principles in the United States. It is hardly possible to have a meaningful evaluation of institutional risk unless a reliable and readily understandable picture of the basic economics of the institution can be obtained.

Second, increased transparency is necessary. At a minimum, this transparency should reflect what is currently required by the U.S. Securities and Exchange Commission. For supervisors, the transparency should be still greater.

Third, every country needs a high-caliber supervisory rule set. In this regard, the recently announced Basle core principles, which I mentioned earlier, provide an important platform for quality supervision in any country. Their adoption by the Basle Committee represented an international endorsement of time-tested supervisory practice in G–7 countries. They should be adopted universally. They also should be elaborated upon by the Basle Committee.

Fourth, in adopting and implementing the Basle core principles, particular attention should be paid to the problem of connected and directed lending. When a loan arises because of connections, without independent credit evaluation, the likelihood that it is not an economically sound proposition for the bank and will result in some harm to the bank are significantly higher.

Fifth, bank supervisory services should have sufficient personnel to be able to provide an on-site, full-scope examination at least every 18 months. Sixth, supervision and examination should become even more risk focused. Examination and supervision are dramatically less effective when they focus on today's problems. They must focus on emerging risks before they become intractable problems. We at the OCC have spent a considerable amount of my five-year term developing a supervision-by-risk program, and although this program will be continually refined in the months to come, I am confident that it has already made a big contribution to a safer and sounder national banking system.

Finally, it is absolutely essential that bank supervisory bodies have the enforcement tools, the independence, and the political support to take tough enforcement measures when they are needed. Everything else—more uniform accounting standards, improved disclosure, and risk-based supervision—will count for little if supervisors lack effective powers of enforcement and the will to use them.

As you can see, much remains to be done. However, I am optimistic that we will be able to accomplish the changes we need to make the economic world of the twenty-first century a stable and prosperous place. The world of the next century holds great promise for us all. Through continued cooperation among international agencies and the private sector—and through organizations like the IIB that bring together people of talent and commitment—I believe it is a world of promise well within our reach.

Remarks by Eugene A. Ludwig, Comptroller of the Currency, before the Independent Bankers Association of America, on the future of banking, Honolulu, Hawaii, March 4, 1998

We are blessed in the banking world with many fine industry organizations, and over the past five years, I have had the honor of speaking to a number of these groups. But I have always particularly looked forward to speaking to the Independent Bankers Association of America (IBAA).

Your accomplishments are impressive. You have developed products that help keep community banks on the cutting edge of the financial services industry. You have lent your voice—clearly and forcefully—to our national debate over financial services modernization. You have worked tirelessly with me and others to minimize regulatory burden and to ensure that community banks have the organizational flexibility they need to serve their customers well into the next century. Ken, to you and your hard-working associates in the IBAA, let me say congratulations—and thanks.

What I would like to do this morning is to draw upon the experiences of my five years as Comptroller and talk about the future of banking generally and community banking particularly. I do so in full awareness of the perils of the enterprise. Predictions that go awry can become a source of acute mortification. In 1901, less than two years before their historic flight at Kitty Hawk, Wilbur Wright told his brother Orville that it would be 50 years before man would fly. "Ever since then," Wilbur said to an interviewer a decade later, "I have distrusted myself and avoided all predictions."

Wilbur evidently concluded that it was safer to go up on that first rickety flight than it was to go out on a limb about the future. I can understand that. As investor Warren Buffet is fond of noting, "in the business world, the rear-view mirror is always clearer than the windshield." Of course, Buffet would not have gotten where he is today without some sixth sense pointing him in the right direction. The rest of us who lack that instinct will have to work at it, using whatever acumen and insight we can muster in our efforts to identify the signposts to the future.

Though the task may be daunting, I will try today to look through the windshield and shine the headlights on some of the changes, pitfalls, and opportunities that I see for banking in the twenty-first century. I then want to suggest some steps that should be taken if bankers are going to avoid the pitfalls, seize the opportunities, and retain the important place they hold in supporting the people and the economy of the United States. Finally this morning, I will also take a look at the rear-view mirror and say a word about what I have tried to accomplish during my term as Comptroller.

Changes Shaping the Financial Environment

First, where are we now, and where are we going?

We are living through a particularly dynamic and innovative period in our financial history—the result, I believe, of the convergence of three important changes that have taken place in our lifetimes and will undoubtedly continue to shape the financial services environment for a long time to come.

The first is technological change. Finance is fundamentally an information-driven business, and the costs and speed of processing information have changed dramatically for the better. Over the past 20 years, computer costs have halved every 18 months—which means that every 18 months, you can buy twice the computing power for the same dollar. In the early days of the computer era, this doubling transformed what had been a little more than a high-tech calculator into a management and information storage tool. Today, the increase in computing power can make for fundamental changes in businesses themselves. And the future seems to hold still more rapid improvements in computer power, with the advent of copper silicone technology. This should have at least as dramatic an effect on future business—especially the information-driven financial services business—as it has on business in the past.

The second major change affecting the financial services industry is the rapid globalization of the financial marketplace. Where once there were only one or two financial nerve centers, today there are many. The *Financial Times* tracks no fewer than 53 global stock exchanges, including bustling markets in China and Russia, Sri Lanka and Zimbabwe. Insomniacs can trade stocks or futures at virtually any hour of the day or night, for the markets never close. Problems in one part of the world affect markets almost instantaneously worldwide.

The final ingredient in the brew is the change in the tastes and attitudes of consumers toward financial products. This is partly a function of our nation's changing demographic profile. By the year 2010, one-third of the U.S. population—and more than one-half of the population of some states, most notably California—will be made up of members of various minorities. This is a population group

that, for various reasons, has traditionally been poorly represented among the customers of financial institutions. At the same time, the U.S. population is growing older. By the middle of the next century, one out of every five Americans will be a senior citizen—more than 80 million strong. These older Americans will have financial needs and desires that are significantly different from those of their younger counterparts—for example, for new insurance products and greater safety in their investments. And by the time today's technologically savvy young people come of age in the first years of the twenty-first century, shopping and banking on the Internet will be as common for them as writing a check is for us today.

Impact on Banking

What do these changes mean in practical terms for the banker of the twenty-first century?

First, banking institutions will have to be more nimble and innovative in order to meet the demands of a fast changing financial marketplace. That means, on the retail side, developing new products, services and delivery systems that appeal to a more diverse customer base—a population that is older, more ethnically diverse, and technologically sophisticated. The financial consumer of the future will have a wider range of choices when it comes to spending, saving, and investing. For example, credit and debit cards will increase their already impressive penetration into the retail market, as will more sophisticated market-oriented savings vehicles, such as mutual funds and retail-oriented derivatives; electronic money and Internet finance will alter traditional modes of financial exchange. These changes pose both opportunity and challenge for financial institutions.

On the commercial side, with the continuing erosion of what once was the core business of banking—lending money directly to business—bankers will need to be even more innovative in finding ways to serve existing business customers, identify new business markets, control risk, and generate income. Already, bankers are relying increasingly on fee income as interest income declines. That trend will continue and accelerate; fewer and fewer loans will be held to maturity, as securitization, which increased five-fold between 1990 and 1997, becomes even more widespread. The increase in the volume and variety of derivatives, whose notional value increased by a phenomenal 158 percent between 1992 and 1997, to more than $25 trillion, is likely to continue into the next century.

Certainly the future banker will face greater competition for the customer's business on both the retail and the commercial sides. Some of this new competition will be the result of the technological changes I mentioned earlier. Because of advances in data processing, the information needed to make prudent and profitable loans is now more readily available, and less costly to access, than ever before. Increasingly, competition will come from companies that have not been traditional financial services providers, such as telecommunications companies and software development firms.

At the same time, we will see a continuation of the trend toward more fully integrated financial services providers offering more diverse menus of products and services, including those traditionally provided by banks. Before long, it will not be unusual for consumers to obtain, say, a home equity loan from the securities firm with whom they do their stock trading or from the finance company that issues their credit card. In short, the lines will continue to blur among the various categories of financial providers.

Furthermore, bankers will face greater volatility in more areas than ever before, especially in the funding arena. All the data I have seen points to a growing gap between traditional deposit sources of funding and loan growth. As a consequence, community banks will become more and more reliant on other funding sources, such as brokered deposits and securitization. And these nontraditional funding sources will expose bankers to competitive pressures and volatility on the liability side that they have not experienced before.

Challenges for Bankers and Regulators

All of these changes and future trends portend challenge for bankers and bank regulators. What must we do to ensure that our banking system remains a robust contributor to our nation's well-being into the twenty-first century?

First, you as bankers must have the ability to compete on a truly level playing field. It is critically important that banks have the freedom to respond to the changing market of the future. If banks are unable to offer the products and services their customers want and need, they will be marginalized at best. At worst, they will be forced to go further out on the risk curve in declining sectors of the financial business and their very survival will be threatened.

But the freedom to respond to the demands of the marketplace is no freedom at all if banks are loaded down with so many restrictions that they cannot compete fairly with other market players. With your thin margins, small staffs, and low overhead, community banks especially have a low tolerance for inefficiency—especially when inefficiency is the result of regulations that do not apply equally to your competitors. You have to be able to manage your business in the best way you know how, utilizing whatever corporate form best suits you. You

should not be imprisoned in the holding company form or the "op sub" form or any other form unless it is absolutely essential for safety and soundness reasons. Absent proven safety and soundness concerns, our laws should be based on consumer well-being and sound business, marketplace principles—not on regulatory convenience.

We simply cannot allow interest group politics and needlessly restrictive legislative language to deprive you of the right to operate *your* business *your* way. We must work to safeguard *your* basic right to operate productively in our free market economy. You cannot afford to take any steps backward where your organizational flexibility is concerned. To do so would jeopardize your very survival in the dynamic financial world of the future.

Second, and just as critical to the survival of banks in the twenty-first century, is a commitment to the fundamentals of safe and sound operation. Banks must focus resolutely on the measurement, management, and control of risk. You must never lose sight of the fundamentals of safety and soundness. You must never overreach for short-term profitability or growth. The markets of the future will be unforgiving to those who stumble. Second chances will be harder to come by. You simply cannot afford to be lax in your underwriting or in your management of risk.

In this regard, let me emphasize that I consider the slippage we have seen in underwriting standards around the country and that I have been speaking out about to be a very serious matter. For some time now, we have been identifying worrisome trends in virtually all phases of the lending process and across the whole gamut of loan products. We see razor-thin interest margins, lengthening tenors, highly leveraged transactions, and undue concentrations. Our examiners have heard too many bankers say that they were making loans that, in the best case, would yield little or no profit, but that they were making anyway out of fear a customer may be lost to the competition. And I am personally quite concerned about bankers going into new credit markets, such as subprime automobile finance or high loan-to-value home equity lending, before they have acquired the necessary expertise to control potential risk to the bank.

While we are on the subject of safety and soundness and future risk, let me take just a minute to remind you once again about the risk posed by the century date change. I know that some people think of the year-2000 problem as a technology issue, and, narrowly defined, it is. But for banks, it is first and foremost a safety and soundness issue. All the experts tell me the same thing: a failure to deal *now* and deal *aggressively* with the year-2000 problem could threaten the viability of your institution.

Especially among community bankers, our examiners are finding a worrisome reliance on the verbal assurances of outside contractors who service their information systems that all will be well when the new millennium arrives. To those who are tempted to rely on such assurances, let me say this: don't take anyone's word for it, any more than you would take the word of a borrower that a loan will be repaid on time. Get a plan and get it in writing. It's your responsibility to ensure that your systems are up and running to serve your customers when the calendar turns. If you fail to do this, the future of your bank is in jeopardy.

Third, for banks—and particularly community banks—to survive as robust players in the financial marketplace of the twenty-first century, they must stay connected with their customers and their communities. Even more than in the past, customer focus is the key to successful community banking. And that will not be easy in view of the changes in demographics and in customer needs and tastes that I have already discussed.

In this connection, let me make two points. Community bankers have a deserved reputation for individual personal service. Customers count on you for sound advice, a sympathetic ear, and products and services that meet their needs. But, in the light of the changes taking place in the financial world, you cannot afford to be complacent. The best way to ensure that your current customers will be your customers of the future is to build on the personal relationship that you have today. That might mean getting out from behind your desk and spending some time at your customers' workplace or business to learn first hand about the challenges he or she really faces and what your bank can do to help. It will take extra effort, but the payoff, in the form of a loyal lifelong customer, will be worth it.

The second point speaks to community outreach. Many of you do an outstanding job serving all segments of your community. But in many cases, there are opportunities to do more to serve the entire community—good business opportunities to provide credit and other banking services where such services have not been widely available in the past. This is not merely a matter of compliance with the law; it makes good business sense.

If all of this sounds like a tall order, it is. But you have resources at hand that can assist you—your innate abilities, your strong institutions, and—yes—technology. So far, I have spoken of the information revolution primarily in terms of challenge—as a source of new competition and as a clock ticking toward the year 2000. Let me suggest that technology might also hold some of the answers. There is a natural tendency to think of our information systems as labor-saving devices that enable bankers to cut costs and achieve administrative efficiencies. But we should also think of technology as a labor-enhancing rather than a labor-saving tool. Technology is

no substitute for personal service, but it can be an important adjunct to it. Contrary to conventional wisdom, the proliferation of technology can help bankers provide *more* personalized service by identifying changes in customers' personal or business situations and in reaching out to new customers in the broader community.

Lessons of the Last Five Years

Having described what I see through the windshield, let me close by looking into the rear-view mirror and reflecting on my five years in office, in the hope that what I've learned can be of value to you and to others.

The year before I took office in 1993, 50 banks failed. Banking had suffered through more than a decade of decline and failure. We were in the middle of a credit crunch so severe that it threatened the viability of the small business sector in some parts of the country and denied many low- and moderate-income Americans the dream of owning a home or starting a business.

Strong medicine was needed, and so we launched the four-part program that became known as the OCC's Four Pillars—a program to improve safety and soundness supervision, reduce regulatory burden, relieve restrictions that prevented banks from competing, and ensure that financial services were provided on a fair basis to all Americans, rich and poor alike. We have been able to achieve some successes in each of these areas. We have improved our safety and soundness supervision through supervision by risk and targeted guidance in such areas as derivatives and mutual funds. We restructured our supervisory program to better differentiate between the supervisory needs of community banks and those of larger banks. By rewriting all our rules, establishing an ombudsman, and reducing paperwork requirements and fees, we have achieved a significant reduction in regulatory burden that should help you succeed in the more competitive financial environment of the future. Through our legal interpretations, banks—including community banks—are in a better position to meet the needs of their customers by entering a variety of new business and taking new approaches to existing businesses. And we have worked to ensure that banks serve their *entire* communities, profitably and productively.

Certainly my five years as Comptroller have been busy and exciting ones. Many of the things we have done stirred controversy. That was never my intention—but it was probably unavoidable. When you try to make changes, you're bound to make some people unhappy. And I firmly believe that you cannot be deterred from doing what you believe is right by a fear of opposition or unpleasantness.

For many years before I came to this office, there was a common assumption about the OCC: that it could take the side of the bankers or the side of the people, but it could not take both sides at once. When I became Comptroller, people were interested in what *my* choice would be. But that dichotomy always struck me as a false and pernicious one. I viewed my role *not* in terms of serving any single constituency, but, instead, in serving the public interest, and in so doing, having an opportunity to advance the well-being of *all* relevant parties.

Let me explain. Too often, we look at a regulatory issue as if it were a football game in which one side inevitably wins and the other loses. I think this is a mistake. What we should doing instead—and what I have tried to do—is to look for ways to ensure that, without compromising basic principles—indeed, by holding on to basic principles for dear life—all legitimate parties to a problem can emerge as winners.

For example, safety and soundness has long been viewed as an either/or proposition. In order to achieve a safe and sound banking system, it was widely believed regulators had to impose detailed regulations and narrowly restrict innovations that might expose banks to new kinds of risk. In other words, either the bankers win or the regulators win.

In fact, handled properly, achieving a safe and sound banking system can be a win/win for both parties. By focusing on strategies like burden reduction and supervision by risk, both sides win, and safety and soundness is strengthened. Indeed, I would go further and say that by holding on to core principles and working to achieve a win/win, we have a much better chance to achieve our goal, and the public interest is better served, than if we pursued another strategy.

Although many things have taken place during my five years as Comptroller, I believe the win/win regulatory paradigm is worthy of particular note.

Of course, the idea that free market economics is a zero-sum game, with a loser for every winner, was not unique to banking and finance. For many years, unfortunately, this adversarial mentality characterized labor relations in this country. In the consumer marketplace, mutual distrust between big business and consumers was pervasive, and consumer protections of any sort were seen as almost inherently hostile to the interests of business. In this emotionally charged environment, those who spoke out in favor of cooperation—on either side—were denounced as traitors to their cause. The middle ground became a precarious place. And this partisan approach to solving problems inevitably spilled over into government, which competing interest groups held to the same uncompromising—and specious—standard of loyalty.

It has taken a long time for us to free ourselves from the mind-set of confrontation and polarization. Only of late

have we begun to appreciate that, to be truly successful in the competitive global economy, all parties to the social compact—business, government, interest groups, and individual Americans—can and must work together for the common good. Only of late have we come to recognize fully the virtue of bringing the parties together—helping everyone to recognize that what's good for one *can* be good for all.

That's especially true in banking and finance. When banks gained the ability to market mutual funds, everyone concluded it was a big setback for the securities industry, which would presumably lose customers to the banks. Instead, banks have attained a rather stable portion of the mutual fund business, but the mutual fund market has continued to grow, benefitting *all* sellers and buyers alike to a greater degree than might otherwise have been the case. Or, to cite another example, community groups, which long begrudged bankers their profits, discovered that a prosperous banking system is essential for socially desirable projects to be funded. Meanwhile, for their part, bankers are finding that such desirable projects—affordable mortgages, small business loans, redevelopment projects, and the like—are good business. In both of the instances I have cited, regulatory efforts have achieved results that are a win/win.

As I said at the outset, for all of our attempts to fathom it, the future is essentially unknowable. But I am convinced that the path on which we have set out together is one we can travel with confidence into the next century. It has been a very great honor for me to serve as Comptroller of the Currency. I have an enormous respect for the people I have tried to serve and for my colleagues in bank supervision. It is my hope that my efforts have helped to make things a bit better for you and for the people of this wonderful country.

Thank you.

Statement of Eugene A. Ludwig, Comptroller of the Currency, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, on the issue of regulatory burden reduction, Washington, D.C., March 10, 1998

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.

I. Introduction

Mr. Chairman and members of the committee, I appreciate this opportunity to discuss continuing regulatory burden reduction for the banking industry, and specifically to offer my views on S. 1405, the "Financial Regulatory Relief and Economic Efficiency Act of 1997." I commend you and Senators Shelby and Mack for your sustained focus on the issue of regulatory burden reduction, and for your leadership in proposing a bill that builds on prior successful efforts to provide prudent and effective regulatory relief for the banking industry.

When I became Comptroller almost five years ago, I sought to highlight the importance of regulatory burden reduction and increased supervisory effectiveness and efficiency for the economic health and well-being of the national banking industry. I made improving the efficiency of bank supervision by streamlining supervisory procedures and regulations one of the four pillars, or organizing principles, that have shaped my term as the Comptroller of the Currency. The Office of the Comptroller of the Currency (OCC) recognizes that effective bank supervision necessarily imposes a degree of regulatory burden to maintain the safety and soundness of the industry, ensure that the credit needs of the public are served, and protect the interests of banking customers. However, it is also our responsibility to identify and eliminate unnecessary regulatory and supervisory burden. Excess burden cannot be tolerated. It makes banking more costly and makes banks less safe and sound and less able to serve their customers.

Four factors motivate our efforts to eliminate unnecessary regulatory burden and to carry out our supervisory responsibilities more efficiently. First, unnecessary regulatory burden causes banks to devote precious resources to unproductive tasks. Those excess expenses ultimately force banks to assume more risk to maintain necessary levels of profitability. Second, unnecessary regulatory requirements divert bank management away from the critical steps that will most enhance safety and soundness toward policies and procedures that offer few or no safety and soundness gains. Third, a bank that is less safe and sound and less profitable is less able to provide critical services that customers demand.

Finally, the task of eliminating unnecessary burden and minimizing what is necessary for effective bank supervision is never finished. In our rapidly changing, global financial marketplace, there is bound to be a need for some new rules; at the same time, logic compels us to eliminate some rules that may have been appropriate for a bygone era, but now serve no purpose.

I support the committee's continuing efforts to provide regulatory relief and promote economic efficiency in the banking industry as proposed in S. 1405. Although we have achieved much, we can accomplish even more.

This next section of my statement provides a description of the OCC's actions taken since 1993 to reduce regulatory burden for the national banking industry. Section III comments on specific provisions of S. 1405. Finally, the appendix contains detailed comments on the bill.

II. OCC Actions to Reduce Regulatory Burden and Increase Supervisory Efficiency

Since 1993, the OCC has undertaken three significant initiatives aimed at reducing unnecessary regulatory burden and improving the efficiency of supervision: the Regulation Review Program, the supervision-by-risk approach, and the revision of our assessments and fees. We designed each of those programs to ensure that the OCC focuses its regulations and supervisory resources on those bank activities and products that present the greatest risks to safety and soundness. Through these programs, we are seeking to reduce regulatory costs in three ways:

(1) reductions in direct costs, such as fees and assessments;

(2) reductions in regulatory compliance costs, such as reporting and record keeping requirements; and

(3) reductions in the costs imposed by regulatory uncertainty, such as time spent by bank managers to determine what the bank has to do to meet regulatory and supervisory requirements.

Let me now briefly discuss each of these initiatives.

Regulation Review Program. I initiated the Regulation Review Program at the OCC in mid 1993. The program involved reviewing all 29 of the OCC's rules and eliminating or revising provisions that did not contribute significantly

to maintaining the safety and soundness of national banks, facilitate equitable access to banking services for all consumers, or accomplish the OCC's other statutory responsibilities. The regulation review effort—the first of its kind in OCC history—also included clarifying regulations to more effectively convey the OCC's standards. We designed the program to ensure that our rules are better tailored to the goals we seek to achieve. To guarantee that our regulations are less burdensome going forward, we also established standards for developing new regulations.

I believe that the Regulation Review Program has produced a more modern set of regulations that, without sacrificing safety and soundness, reduce unnecessary regulatory burden for banks and are clearer and more understandable. For example, our revised application processing regulation eliminated the need for banks to submit applications to engage in many routine and low-risk activities; accelerated processing for many of the remaining types of applications for qualified banks; and simplified the application process for those preparing applications. Another key regulatory change revised the lending limit calculation, which slashed the number of times a bank had to calculate its lending limit annually from as many as 365 to 4. Additionally, the OCC revised the provisions governing national bank equity investments in community development corporations and projects by streamlining or eliminating certain application requirements and relaxing restrictions on the reinvestment of these funds in efforts to attract new capital. We completed this Regulation Review Program in December 1996 by clarifying and modernizing the fiduciary activities permissible for national banks. As I stated earlier, however, regulatory review is an ongoing process, and we will continue to issue revised regulations and guidance as necessary.

Last year, the OCC sought to build on the principles we had articulated in the program by issuing a set of Standards for Developing Regulations that apply to any new rules that the agency may issue in the future. These standards are as follows:

- Effectively target the areas of bank activity that present the greatest risk to safety and soundness, the payments system, or the long-term vitality of the national banking system, or are required by statute;
- Eliminate unnecessary regulatory burden and minimize the burden resulting from requirements that are necessary for the effective supervision of national banks;
- Foster bank competitiveness and allow industry innovation;
- Adopt regulations that can be understood by a reasonably knowledgeable person;
- Maximize the opportunity for national bank and public participation in our rulemaking, including timing the effective dates of our regulations to facilitate national banks' planning processes; and
- Encourage continual re-evaluation of the OCC's rules.

Following completion of this Regulation Review Program, we took another unprecedented step by asking publicly whether this program had made a difference to those who are subject to or otherwise affected by our rules. For those who responded affirmatively, we asked whether the effect was, on balance, positive or negative. The OCC conducted this evaluation—called the Regulation Review Assessment Project to measure the results of our work—primarily by convening many focus groups across the country including bankers, private sector banking lawyers, community group representatives, and our own examiners and supervisory staff. The vast majority of those who participated in our evaluation effort thought the program was beneficial; they noted a reduction in regulatory burden and no discernible impact on the safety and soundness of the industry.

For example, many participants thought that the new streamlined application process cuts costs and produces quicker results. A number of bankers and banking lawyers agreed that the new Community Reinvestment Act (CRA) regulations shifted the emphasis from paperwork to performance. Community group representatives applauded the process used to revise the CRA regulations as a good example of how the OCC should obtain community input into the regulatory process. Others complimented the new suspicious activity reporting system—implemented jointly by the OCC and other agencies—because it dramatically reduces the number of required filings. Virtually all of those who evaluated the program could identify some tangible, quantifiable benefit arising from the changes that the OCC made.

Supervision by risk. To achieve our supervisory objectives in the most risk-focused manner possible, we initiated the Bank Supervision Review project in January 1994 to direct more of our supervisory resources to those banking activities and those banks that pose the most serious threats to the safety and soundness of the banking system. This review led to the implementation of our supervision by risk program in December 1995, which outlined supervisory policies and processes that tailor our oversight to the key characteristics of a bank, including size,[1] products offered, markets in which it

[1] The OCC's supervision by risk examination procedures differentiate between large banks and community banks. The OCC defines

competes, and management's tolerance for and control of risk. This program also provides an effective means for the OCC to alert senior bank management to problems they need to address so they do not worsen.

One of the major goals of the supervision by risk program is to provide the highest quality supervision of the banking industry in the most efficient manner possible. Supervision by risk requires examiners to determine how certain existing or emerging issues facing a bank or the banking industry affect the nature and extent of risks in that institution. Having identified the risks for an individual bank, we then evaluate and measure the quantity of risk and the quality of risk management to form an overall conclusion about the bank's risk profile. That profile serves as the basis on which our examiners structure supervisory plans and actions.

Just as our Regulation Review Program was designed to revise existing regulations to ensure that the OCC's rules focused on bank activities that presented the greatest risk to safety and soundness or the most significant threat to the long-term vitality of the national banking system, supervision by risk eliminated supervisory procedures unnecessary for maintaining the safety and soundness of the banking industry and refined the remaining procedures to be more risk-focused. This allows banks and the OCC to allocate more time and resources to the most significant sources of risk, increasing the overall quality of supervision.

For example, over the past couple of years, the OCC has expressed concerns about the trends in credit risk. Our *1997 Survey of Credit Underwriting Practices* demonstrated a continuing slide in underwriting standards and a trend toward increasing credit risk for most commercial and consumer loan products. The supervision by risk approach enables examiners to pay particularly close attention to credit quality and credit risk management in our current bank examinations.

Following the implementation of the initial stage of our supervision by risk procedures for community banks, we received positive feedback from bank management on the resulting reduction in burden. In response to our post-examination questionnaires that we ask banks to complete following an examination, a number of bankers noted that the community bank procedures reduced the level of supervisory burden during the examination. Moreover, the vast majority also stated that the streamlined approach did not compromise the quality of the examination. Rather, it better focused attention on the riskiest areas of the bank.

Assessments and fees. In 1993, we initiated a review of our assessments and corporate fees. This review resulted in a series of reductions beginning in 1995 that scaled back charges for national banks and ensured that fees and assessments more accurately reflected the actual costs of supervision. In 1995 we rolled back assessments to their 1992 levels and reduced certain corporate and trust fees by 50 percent. In September 1996, the OCC waived application fees for new charter and branch applications in low- and moderate-income areas to improve access to financial services for low- and moderate-income consumers. Another change made in 1996 lowered assessments for national banks that are not the lead—or largest—bank in multibank holding companies by 12 percent. The fee reduction reflects the fact that it takes fewer resources to supervise the smaller banks in a holding company structure. This revision more closely matched banks' fees to the actual costs of supervision and ensured that the assessment schedule did not favor one form of corporate organization over another. The total reduction in fees and assessments instituted by the OCC between 1995 and 1997 will save national banks $88 million annually.

The 1998 assessment schedule lowered the basic rates for all institutions (following similar steps in each of the three previous years), but imposed a 25 percent surcharge on banks rated 3, 4, or 5 on the five-point CAMELS scale. This change is intended to ensure that healthier banks do not subsidize the higher costs incurred by the OCC in supervising less healthy institutions. OCC analyses have demonstrated that lower-rated institutions cost more to supervise than those rated 1 or 2.

III. Comments on S. 1405, "The Financial Regulatory Relief and Economic Efficiency Act of 1997"

Mr. Chairman, you requested that the OCC provide comments on S. 1405. Let me state at the outset of these comments that your committee can be proud of the leadership it has shown over the last five years in the effort to reduce unnecessary regulatory burdens for the banking industry, while not compromising either the safety and soundness or the community and customer responsibilities of banks.

In 1994 and 1996 Congress passed two significant bills that, among other things, streamlined the legislative and regulatory infrastructure governing the banking industry.[2] Both bills increased the number of small banks

a large bank as a national bank with total assets of $1 billion or more or a national bank that is part of a multibank holding company that has a national bank with over $1 billion in assets. We define a community bank to be a national bank with total assets of less than $1 billion or one that is part of a holding company where none of the individual national bank's assets exceed $1 billion.

that may be subject to an 18-month (rather than a 12-month) examination cycle. In addition, these bills reduced unnecessary regulatory burden in many other areas such as the notice and applications process, corporate structure, and call report requirements. The current bill seeks to build on the successes of prior efforts to reduce unnecessary burden, and the OCC supports continued efforts to reduce that burden and improve supervisory efficiency.

Let me first discuss one of the bill's most significant provisions, which would lift the prohibition on depository institutions paying interest on demand deposits to business customers. As stated in a 1996 interagency report,[3] the OCC and other federal banking regulatory agencies concluded that the statutory prohibition against the payment of interest on demand deposits no longer serves a public purpose. The OCC continues to believe the prohibition is outdated in the modern financial services environment. Further, we do not believe that the repeal of this prohibition would result in any longer-term supervisory concerns. We recommend, however, that the legislation provide an appropriate transition period to allow financial institutions to make necessary changes in their funding sources and pricing.

The bill contains other important, burden-reducing provisions. I strongly support the provisions of the bill that enhance national banks' organizational flexibility. Section 110 expedites the procedure by which a national bank may reorganize to become a subsidiary of a holding company. Section 112 provides procedures by which a national bank could merge with nonbank subsidiaries or affiliates. Currently, to combine with a nonbank subsidiary or affiliate, a bank must use a more burdensome form of corporate transaction—a purchase of assets and assumption of liabilities of the subsidiary or affiliate. Sections 110 and 112 enhance the ability of banks to organize themselves in a manner that is less burdensome and enables them to better execute their business strategies.

Similarly, section 111 provides national banks with the flexibility to stagger the election process of members of their boards of directors. Currently, national bank directors may hold office for only one year and must be elected annually. Conducting an election process for an entire board every year can be disruptive to business operations. This section would provide banks with the flexibility to choose a staggered election process as a means of ensuring that a board will at all times include experienced members, enhancing the banks' safety and soundness.

This section also will permit the OCC to allow a national bank to have more than 25 directors. Current law does not necessarily provide banks with enough seats to accommodate directors from both institutions in the case of an acquisition or merger or adequate geographic representation in the case of larger interstate banks. Both of these changes provide banks with the flexibility to ensure the highest quality boards thereby enhancing the board's oversight of the bank's activities. These are examples of just a few of the provisions in S. 1405 that may benefit national banks.

I am concerned, however, about the effects on consumers of certain provisions in S. 1405. While simplifying disclosure requirements is a worthwhile objective when they provide superfluous or unnecessary information to consumers, we must be careful to ensure that consumers have sufficient information to effectively evaluate the financial products in the marketplace. Section 402 proposes amendments to the Truth in Lending Act (TILA) that eliminate certain of the current triggers for additional disclosures in closed-end credit ads and key credit terms in radio and television ads. As a result of these amendments, consumers would be deprived of information that is crucial to making informed credit decisions.

In addition, while I appreciate the benefits of reducing paperwork and compliance costs, I fear the proposed removal of anti-tying restrictions in section 204 and certain proposed revisions to the Fair Debt Collection Practices Act (FDCPA) in section 207 could also be somewhat detrimental to consumers. The OCC believes that the anti-tying provisions that prohibit the banks from conditioning the availability of one product on the purchase of another remain important. These provisions increase banks' awareness of their responsibilities to customers as they expand the array of products and services they offer.

With respect to section 207, the OCC has concerns about allowing a debt collector to initiate any communication with the consumer at any time or place if the communication is made pursuant to a "nonjudicial foreclosure proceeding." This is not a defined term and has the potential to be construed broadly to permit a debt collector to harass consumers by, for example, calling a consumer in the middle of the night or at work about foreclosing on any debt that can be characterized as a "nonjudicial foreclosure," the type of action which the Fair Debt Collection Practices Act is intended to prohibit.

[2] P.L. 103–325, the "Riegle Community Development and Regulatory Improvement Act of 1994" and Title II of P.L. 104–208, the "Economic Growth and Regulatory Paperwork Reduction Act of 1996."

[3] *Joint Report: Streamlining of Regulatory Requirements*, September 23, 1996, p. I–47.

Conclusion

The OCC remains committed to the reduction of regulatory and supervisory burden. We must promote an environment where risks are prudently managed by banks and appropriately monitored. But we must do so without imposing unnecessary regulatory burdens that undermine the ability of these institutions to operate efficiently, compete vigorously, and provide credit and other financial products and services to the public. We applaud the committee for its efforts, and support the provisions in S. 1405, with only a small number of exceptions.

Reducing regulatory burden is a cooperative effort. Continued reduction of regulatory burden, while maintaining safety and soundness, requires the type of ongoing, vigorous legislative effort on the part of Congress typified by this bill. It also demands the OCC and the other banking agencies continue to do their part in reducing burden as they carry out the mandates of Congress.

Appendix

S. 1405, The Financial Regulatory Relief and Economic Efficiency Act of 1997, as introduced*

Summary and Comments of the Office of the Comptroller of the Currency

Title I—Improving Monetary Policy and Financial Institution Management Practices

Sec. 101. Payment of Interest on Reserves at Federal Reserve Banks

Summary: In general, section 19(b) of the Federal Reserve Act (FRA) requires depository institutions to maintain reserves against their transaction accounts and nonpersonal time deposits ("sterile reserves"). This section amends section 19(b) to permit the Federal Reserve Board (Fed) to pay interest on sterile reserves on at least a quarterly basis at a rate not to exceed the general level of short term interest rates. The Fed would have authority to issue regulations regarding the payment, distribution, and crediting of interest pursuant to this section. In addition, this section permits depository institutions to place their reserves in either Federal Reserve Banks or banks that maintain reserves in a Federal Reserve Bank.

OCC Comments: The OCC defers to Treasury on this provision.

Sec. 102. Amendments Relating to Savings and Demand Deposit Accounts at Depository Institutions

Summary: Section 1832 of Title 12 prohibits depository institutions from offering interest-bearing NOW accounts to businesses. Section 19(i) of the FRA (12 USC 371a), section 5(b)(1)(B) of the Home Owners' Loan Act (HOLA) (12 USC 1464(b)(1)(B)) and section 18 of the Federal Deposit Insurance Act (FDI Act) (12 USC 1828) prohibit member banks, thrifts, and nonmember banks, respectively, from paying interest on demand deposits. Section 102 of this legislation removes these prohibitions.

OCC Comments: In a joint report submitted to the Congress in September, 1996, OCC, along with the other federal banking agencies, recommended removal of the prohibition against paying interest on demand deposits. *See Joint Report: Streamlining of Regulatory Requirements* (September 23, 1996). At that time, the OCC and the other agencies said that the prohibition "no longer serves a public purpose." The OCC continues to believe that the prohibition on paying interest on business checking accounts is outdated. In addition, we do not believe that the repeal of this prohibition would result in any supervisory concerns. However, we recommend linking removal of the prohibition to an appropriate transition period to allow financial institutions to make necessary changes in their funding sources and pricing.

Sec. 103 Repeal of Liquidity Provision

Summary: This section repeals section 6 of the HOLA (12 USC 1465) and makes "conforming" changes to other provisions of HOLA. Section 6 requires savings associations to maintain between 4 and 10 percent of their deposits in certain liquid assets in accordance with Office of Thrift Supervision (OTS) regulations. The Director of OTS is authorized to levy deficiency assessments for failure to satisfy the liquidity requirements and, under certain conditions, to reduce or temporarily suspend the requirements.

OCC Comments: The OCC takes no position on the repeal of section 6 of HOLA.*

Sec. 104. Repeal of Dividend Notice Requirement

Summary: Under current law, different statutory requirements on dividends apply to savings associations and

*An asterisk [in an OCC comments paragraph] indicates that a non-substantive technical problem exists with the amendment as drafted. (We would be happy to supply technical corrections to congressional staff.)

national banks. Section 10(f) of HOLA (12 USC 1467a(f)) requires savings association subsidiaries of savings and loan holding companies to give 30 days advance notice to the OTS before declaring any dividends. Under section 5199(b) of the Revised Statutes (12 USC 60(b)), national banks must obtain prior OCC approval if the dividends declared exceed a certain amount based on net income.

Section 104 of this legislation repeals the notice requirement in section 10(f) of HOLA, but leaves in place the dividend approval requirement for national banks.

OCC Comments: The OCC would support modification of the dividend requirements that apply to savings associations and to national banks so that both are subject to comparable standards. As drafted, the amendment deals only with savings association dividend approval requirements. The different treatment of thrifts and national banks is unwarranted since both are subject to the same system of prompt corrective action based on capital levels under section 38 of the FDI Act.*

Sec. 105. Thrift Service Companies

Summary: Subsection (a) of this section amends section 5(c)(4)(B) of HOLA (12 USC 1464(c)(4)(B)) concerning the activities of service corporations of federal savings associations. Under current law, a federal savings association may invest in the stock of *any* corporation organized under the laws of the state in which the association has its home office if the stock of the corporation is owned only by savings associations chartered by that state and federal savings associations having their home office in that state. The amendment repeals the geographic and ownership limitations but requires that the corporation must be engaged in activities "reasonably related" to the activities of financial institutions as approved by the Director of OTS. This activity-based restriction mirrors current OTS regulations providing that federal savings associations may apply to engage in activities through a service corporation, other than those that are preapproved, that are "reasonably related" to the activities of financial institutions subject to the geographic and ownership limitations in current law. 12 CFR 559.3(e)(2). This subsection also applies section 5(c)(4)(B) requirements to both corporations and limited liability companies.

Subsection (b) of this section amends section 5(d) of HOLA (12 USC 1464(d)) to provide the OTS with examination and regulatory authority over service providers performing services under contract for savings associations, their subsidiaries and their affiliates. The other federal banking agencies have the same authority under the Bank Service Company Act (BSCA) (12 USC 1861 *et. seq.*) over service providers that provide services under contract to insured banks, as well as authority over service companies in which an insured bank may invest. This provision seems intended to provide the OTS with statutory parity with respect to service providers only.

In addition, a confusing amendment in subsection (c) may be interpreted to limit the OTS's new authority to savings and loan holding companies and any subsidiaries thereof, except a bank or a subsidiary of a bank. Recently, the House Banking Committee ordered reported H.R. 3116, the Examination Parity and Year 2000 Readiness for Financial Institutions Act, that would amend HOLA to give the OTS statutory parity over thrift service providers and service corporations to that provided to the other federal banking agencies under the BSCA.

OCC Comments: The OCC takes no position on this amendment. We note that other legislation proposed by the OTS and the National Credit Union Administration (NCUA) would provide express enforcement authority over service corporations and other service providers, comparable to that possessed by the federal banking agencies.*

Sec. 106. Elimination of Thrift Multistate Multiple Holding Company Restrictions

Summary: This section amends section 10(e) of HOLA to delete the prohibition on a savings and loan holding company controlling savings associations in more than one state unless permitted under one of three exceptions. As a result, the Director of OTS could approve interstate acquisitions of savings associations in the same manner as intrastate acquisitions.

OCC Comments: The effect of the proposed amendment would be to allow thrift holding companies broader flexibility for interstate acquisitions of thrifts, with fewer regulatory standards, then apply to bank holding company interstate acquisitions of banks under the Riegle–Neal Interstate Banking and Branching Act of 1994. Under the amendment that is made by this section, out-of-state savings and loan holding companies could acquire savings associations in a host state and maintain their separate charters without complying with the same requirements that apply to bank holding companies. The OCC recommends that the acquisition of banks and savings associations by out-of-state holding companies be treated consistently. For example, under the Riegle–Neal Act, out-of-state bank holding companies acquiring banks in a host state must comply with state age and consumer protection laws. *See* 12 USC 1842(d).

---

*An asterisk [in an OCC comments paragraph] indicates that a non-substantive technical problem exists with the amendment as drafted. (We would be happy to supply technical corrections to congressional staff.)

The OCC also suggests including a provision that grandfathers those savings and loan holding companies that have contractual rights to acquire savings associations in a host state as negotiated under prior supervisory transactions.

Sec. 107. Noncontrolling Investments by Savings and Loan Holding Companies

Summary: This section amends section 10(e)(1)(A)(iii) of HOLA (12 USC 1467a(e)(1)(A)(iii)) to give the Director of OTS the discretion to permit a savings and loan holding company to acquire or retain more than 5 percent of the voting shares of a savings association or another savings and loan holding company that is not a subsidiary. Current law prohibits the acquisition unless the transaction is subject to an exception, *e.g.*, the shares are acquired in a fiduciary capacity or acquired pursuant to a debt previously contracted. While the Director has the discretion to permit a savings and loan holding company to acquire "control" of a savings association or another savings and loan holding company (control is generally triggered if 25 percent of the voting stock is acquired), the Director does not have the discretion under current law to permit noncontrolling ownership of stock of over 5 percent.

OCC Comments: The OCC takes no position on this provision.

Sec. 108. Repeal of Deposit Broker Notification and Recordkeeping Requirement

Summary: This section repeals section 29A of the FDI Act (12 USC 1831f–1), which requires a deposit broker to file a written notice with the Federal Deposit Insurance Corporation (FDIC) before soliciting or placing any deposit with an insured depository institution. The FDIC has no enforcement power over deposit brokers, who are part of a generally unregulated industry.

OCC Comments: The OCC takes no position on this provision.

Sec. 109. Uniform Regulation of Extensions of Credit to Executive Officers

Summary: Section 22(g)(4) of the FRA Act (12 USC 375a(4)) provides that the appropriate federal banking agency prescribe regulations governing the amount of a loan that an insured depository institution may make to its executive officers if the loan is not specifically authorized by statute. This section provides that the Fed, rather than the appropriate federal banking agency, promulgate these regulations. (The Fed has the authority under current law to promulgate regulations with respect to other provisions in § 375a.) The OCC recently amended its insider lending regulations to require national banks and their insiders to comply with the Fed's regulations. See 12 CFR Part 31. The FDIC has similar regulations to the Fed's, and the OTS already follows the Fed's regulations.

OCC Comments: We request that this provision be amended so that the appropriate federal banking agencies maintain the authority to impose limits that are more stringent than Fed rules when warranted, but not more liberal. This would permit all of the agencies to address situations in this limited area that may warrant stricter scrutiny for safety and soundness reasons, but would not permit us to loosen the Fed's rules.

Sec. 110. Expedited Procedures for Certain Reorganizations

Summary: This section amends the National Bank Consolidation and Merger Act (12 USC 215 *et seq.*) to expedite the procedure by which a national bank reorganizes to become a subsidiary of a holding company. Pursuant to regulations issued by the OCC, national banks would be permitted, with the approval of two-thirds of the shareholders of the bank and the approval of the OCC, to reorganize into a subsidiary of a bank holding company directly. Under this section, the shareholder approval requirements and dissenters' rights that apply under current law to these transaction would not change, and the requirements of the BHCA would still apply.

OCC Comments: The OCC supports this provision. Under current law, a national bank that wishes to reorganize into a subsidiary of a bank holding company must go through a cumbersome multi-step process because there are no provisions in current law that permit a national bank reorganization as a subsidiary of a bank holding company in one direct transaction. Under current law, the bank first forms a "phantom bank" that is owned by a bank holding company. The bank then merges into this phantom bank to become the subsidiary of the bank holding company. Upon the consummation of this transaction, shares of the existing bank are converted into shares of the holding company or other compensation is provided to the shareholders, and the holding company owns all of the shares of the resulting bank. The resulting bank typically is indistinguishable in name, location, and balance sheet from the preexisting bank, with the only difference being the ownership of its stock. However, because the "phantom bank" must be chartered as any other bank with its attendant procedures and costs, this procedure can be expensive and time-consuming, and imposes needless burdens.

We also note that this amendment does not affect the application of the Community Reinvestment Act (CRA), nor that of the Bank Holding Company Act (BHC Act), to these transactions.

Sec. 111. National Bank Directors

Summary: This section makes two changes to national banking law concerning national bank directors. First, this section permits national banks to elect their directors for terms of up to three years in length, and permits these directors to be elected on a staggered basis in accordance with regulations prescribed by the OCC, *e.g.*, so that only one third of the board of directors is elected each year. Currently, section 5145 of the Revised Statutes (12 USC 71) provides that directors of a national bank may hold office for only one year and must be elected on an annual basis.

Second, the section amends section 31 of the Banking Act of 1933 (12 USC 71a), which requires the board of directors of every national bank and state member bank to consist of at least 5 and no more than 25 members, to permit the OCC, by order or regulation, to allow a national bank to have more than 25 directors.

OCC Comments: The OCC supports both of these changes. The first amendment would provide national banks with flexibility in their corporate election process, and would ensure that the board of directors of banks that choose a staggered election process will at all times include experienced members, enhancing the bank's safety and soundness. This change is consistent with § 8.06 of the Model Business Corporation Act (1984, as amended in 1994) and with many state corporate codes, including Delaware's General Corporation Law, Del. Code Ann. Tit. 8, § 141 (1991, as amended in 1994). The second amendment would give the OCC the discretion to waive the 25-director maximum limitation for certain national banks if appropriate to accommodate special circumstances, such as certain mergers or consolidations or to permit greater geographic representation on the board of directors of interstate banks.

Sec. 112. Amendment to Bank Consolidation and Merger Act

Summary: This section adds a new section to the National Bank Consolidation and Merger Act (12 USC 215 *et seq.*) to permit a national bank to merge with subsidiaries or other nonbank affiliates upon the approval of the OCC and pursuant to regulations issued by the OCC. The section specifies that it does not in any manner increase the powers of a national bank nor affect the applicability of section 18(c)(1) of the FDI Act (the Bank Merger Act), which requires the approval of the FDIC for the merger, consolidation, or assumption of liabilities of noninsured banks or savings institutions.

OCC Comments: The OCC supports this provision. The National Bank Consolidation and Merger Act authorizes and establishes the procedures for the merger or consolidation of national banks with other national banks or with state banks. However, there is no express authority under federal law for national banks to merge with nonbank affiliates. As a result, in order to accomplish a corporate reorganization involving a combination of an uninsured subsidiary or affiliate with the bank, the bank must use a more burdensome form of corporate transaction—a purchase of assets and assumption of liabilities of the subsidiary or affiliate. While the substance of the transaction is the same as a merger, the purchase and assumption transaction can require extensive documentation of transfers of individual assets and can entail issues of corporate succession that do not arise in a merger. This amendment enhances the ability of banks to organize activities and assets within their banking organizations in the way that makes the best business sense and does not impose unnecessary burdens. The OCC also does not object to providing federal thrifts with authority similar to that provided to national banks by this amendment.*

Sec. 113. Loans On Or Purchases by Bank of Its Own Stock; Affiliations

Summary: Section 5201 of the Revised Statutes (12 USC 83) prohibits a national bank from making any loan or discount on, or owning or holding, its own stock unless the stock is acquired to prevent loss on a debt previously contracted (DPC) and sold or disposed of within six months. This section replaces § 5201 with a provision that prohibits a national bank from making any loan or discount on the security of the shares of its own capital stock if it acquires the stock DPC "before the date of the loan or discount transaction." This section also adds this prohibition to section 18 of the FDI Act so that it applies to all insured depository institutions, i.e. insured banks and savings associations.

Finally, subsection (c) of this section amends section 18(s)(1) of the FDI Act (12 USC 1828(s)(1)), as added by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, P.L. 104–208, which prohibits a bank or savings association from being an affiliate of, being sponsored by, or accepting financial support, directly or indirectly, from any Government-sponsored enterprise (GSE), except for routine business financings. For purposes of this prohibition, a GSE includes Fannie Mae, Freddie Mac, Farmer Mac, Sallie Mae, the Federal Home Loan Bank System, the Farm Credit Banks, the Banks for Cooperatives, the College Construction Loan Insurance Association, and any of their affiliated or member institutions. Subsection (c) removes the prohibition on affiliations.

---

*An asterisk [in an OCC comments paragraph] indicates that a non-substantive technical problem exists with the amendment as drafted. (We would be happy to supply technical corrections to congressional staff.)

OCC Comments: The OCC recommends simply deleting the prohibition in § 83 on a national bank owning or holding its own stock without the addition of the new language "before the date of the loan or discount transaction." This new language is confusing and its meaning is unclear. While the OCC has interpreted § 83 in light of other provisions in national banking law and has concluded that a national bank may acquire its own stock for certain legitimate corporate purposes but not for speculation (12 CFR 7.2020), deleting the prohibition in § 83 will eliminate any confusion about the authority of a national bank to purchase its own shares for legitimate corporate purposes, e.g., to reduce its capital when market conditions or internal operations indicate that doing so is in the best interest of the bank and is consistent with safety and soundness. Other examples of legitimate corporate purposes for which a bank may wish to acquire or hold its own stock include offering stock in connection with an officer or employee stock option or bonus plan, selling stock to a potential director in circumstances where a director is required to own qualifying shares, or reorganizing as a Subchapter S corporation, which may involve decreasing the number of shareholders of the bank.

In addition, to be consistent with the OCC's interpretations of § 83 and for safety and soundness reasons, we suggest that the legislative history accompanying this provision make clear that a bank's acquisition of its own stock may not be for speculative purposes.

The OCC would support a technical correction to P.L. 104–208 that would allow depository institutions to affiliate with depository institution members of GSEs. As currently drafted, subsection (c) of this provision, which removes the prohibition against depository institution affiliations with GSEs, is broader than necessary to accomplish this technical change.*

Sec. 114. Depository Institution Management Interlocks

Summary: Section 205(8) of the Depository Institution Management Interlocks Act of 1978 (DIMIA) (12 USC 3204(8)) permits a diversified savings and loan holding company to have director interlocks with a non-affiliated depository institution or holding company, if the OTS and other federal banking agency are notified 60 days before the dual service is to begin, and neither regulator disapproves this dual service within this time period. Section 114 amends this section so that this exception applies not only to directors, but to the dual service of "management officials" (defined, in general, as an employee or officer with management functions, a trustee, or a director).

OCC Comments: The OCC takes no position on this provision.*

Sec. 115. Purchased Mortgage Servicing Rights

Summary: This section amends section 475(a) of the FDI Act (12 USC 1828 note), which provides that purchased mortgage servicing rights (PMSR) may be included in calculating risk-based capital if, among other things, the servicing rights are valued at not more than 90 percent of their fair market value (10 percent haircut). Specifically, this section: (1) repeals the 10 percent haircut in current law and provide that PMSRs may be valued at 100 percent of their fair market value, (2) allows originated mortgage servicing rights (OMSR), as well as PMSRs, to be included in this calculation, and (3) makes a technical change in the law to conform with GAAP by replacing references to "mortgage servicing rights" with "mortgage servicing assets."

OCC Comments: We would support the federal banking agencies having the authority to modify by regulation the current 10 percent haircut, provided the agencies make a determination that such modification will not have an adverse effect on the deposit insurance funds and the safety or soundness of the depository institutions involved.

Sec. 116. Cross-Marketing Restriction; Limited Purpose Bank Relief

Summary: This section amends section 4(f) of the BHC Act (12 USC 1843(f)). Section 4(f) of the BHC Act grandfathers companies that control so-called nonbank banks (i.e., banks that were not defined as banks under the BHC Act until that definition was amended by the Competitive Equality Banking Act of 1987 (CEBA)). Under section 4(f)(3), certain restrictions are imposed on grandfathered nonbank banks' activities. Crossmarketing of products or services that a bank holding company could not provide under section 4(c)(8) of the BHC Act is prohibited. Overdrafts (including intra day overdrafts) on behalf of an affiliate are also prohibited except for those that are defined as "permissible overdrafts." Violations of the restrictions may result in mandated divestiture. CEBA also permitted bank holding companies to retain ownership of nonbank banks provided that the nonbank bank did not engage in any activity that would have caused the institution to be a bank before the enactment of CEBA or increase the number of locations from which the institution transacts business. (The 7 percent asset growth restriction was repealed by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.)

This section eliminates the crossmarketing restrictions and expands "permissible overdraft" to allow overdrafts

* An asterisk [in an OCC comments paragraph] indicates that a non-substantive technical problem exists with the amendment as drafted. (We would be happy to supply technical corrections to congressional staff.)

incurred by an affiliate engaged in activities that are incidental to banking and that do not violate section 23A or 23B of the FRA.

OCC Comments: The OCC takes no position on this provision.

Sec. 117. Divestiture Requirement

Summary: This section amends section 4(f)(4) of the BHC Act (12 USC 1843(f)(4)) requiring companies controlling a grandfathered nonbank bank to divest the nonbank bank if the company: (i) acquires control of an additional bank or an insured institution, (ii) acquires more than 5 percent of the shares of an additional bank or a savings association, or (iii) fails to comply with the restrictions contained in paragraph (3) of section 4(f). (*See* section 116, above, which amends section 4(f).) Under current law, it must divest control of the nonbank bank within 180 days or conform to the limitations in the BHC Act within that period. Section 117 provides that the company does not have to divest the nonbank bank if it corrects the condition or ceases the activity that violated the exemptions or submits a plan to the Fed to correct the condition or cease the activity within 1 year, and the company implements procedures that are reasonably adapted to avoid the reoccurrence of the offending condition or activity.

OCC Comments: The OCC takes no position on this provision.*

Sec. 118. Daylight Overdrafts Incurred by Federal Home Loan Banks

Summary: Federal Home Loan Banks utilize the Fed's payment system in providing banking and correspondent services to their member institutions. In a May 9, 1994 interpretation of its Payment System Risk Policy, the Fed imposed fees, and raised the possibility of imposing penalties, on daylight overdrafts incurred by Federal Home Loan Banks and other government-sponsored enterprises in the normal course of their daily business. The Fed has explained that the extension of intraday credit to organizations not subject to deposit reserves, such as Federal Home Loan Banks, is not allowable under the FRA and the Monetary Control Act.

This section adds a new section to the FRA to require the Fed's payment system risk or intraday credit regulations to either exempt Federal Home Loan Banks or include net debit caps appropriate to the credit quality of each Federal Home Loan Bank and impose daylight overdraft fees calculated in the same manner as fees for other users.

OCC Comments: The OCC takes no position on this proposal, and defers to the Treasury Department, which in the past has proposed comprehensive legislation relating to the Federal Home Loan Bank System.

Sec. 119. Federal Home Loan Bank Governance Amendments

Summary: This section makes a number of amendments to the Federal Home Loan Bank Act (FHLB Act) relating to the governance of Federal Home Loan Banks. Specifically, this section removes the requirement that a Federal Home Loan Bank obtain approval from the Federal Housing Finance Board when: (1) setting director compensation; (2) buying, building, or leasing for more than 10 years a building to house the Bank; (3) prescribing, repealing or amending rules and regulations relating to the administration of bank affairs;(4) establishing budget or business plans; (5) prescribing applications for, authorizing, or setting conditions for Federal Home Loan Bank advances; (6) selling Federal Home Loan Bank advances to other Federal Home Loan Banks; and (7) paying dividends.

OCC Comments: The OCC takes no position on this proposal, and defers to the Treasury Department, which has proposed comprehensive legislation relating to the Federal Home Loan Bank System.

Sec. 120. Collateralization of advances to members

Summary: This section amends section 10(a)(1) of the FHLB Act (12 USC 1430(a)(1)) to expand the categories of acceptable collateral upon which a Federal Home Loan Bank can make advances. The expanded categories include second mortgages on improved residential property insured or guaranteed by the U.S. government or any agency thereof. [NOTE: This section also amends paragraph (4) of 10(a). However, it appears that this is a drafting error and that paragraph (5) instead should be amended. If this technical correction is made, this section would repeal the provision that permits a Federal Home Loan Bank and the Federal Housing Finance Board to approve the renewal of advances existing on August 9, 1989 without fully secured collateral.]

OCC Comments: The OCC takes no position on this proposal, and defers to the Treasury Department, which in the past has proposed comprehensive legislation relating to the Federal Home Loan Bank System.*

*An asterisk [in an OCC comments paragraph] indicates that a non-substantive technical problem exists with the amendment as drafted. (We would be happy to supply technical corrections to congressional staff.)

Title II—Streamlining Activities of Institutions

Sec. 201. Updating the Authority for Thrift Community Development Investments

Summary: This section replaces outdated language in section 5(c)(3)(A) of HOLA (12 USC 1464(c)(3)(A)) that authorizes a federal savings association to invest in real estate (or loans secured by real estate) located in areas receiving "concentrated development assistance" under the Community Development Block Grant program, with the language that parallels the language that currently authorizes community development investments by national banks and state member banks. *See* 12 USC 24(Eleventh) and 338a.

OCC Comments: The OCC takes no position on this provision. This authority would parallel the community investment authority of national banks pursuant to paragraph (11) of section 24, United States Code.

Sec. 202. Acceptance of Brokered Deposits and Deposit Solicitations

Summary: This section amends section 29 of the FDI Act (12 USC 1831f) to extend the prohibition on *soliciting* deposits by offering significantly higher than normal rates of interest on insured deposits—a prohibition currently applicable only to undercapitalized institutions—to (1) insured depository institutions that are adequately capitalized (but not well capitalized), and (2) insured depository institutions for which the FDIC has been appointed conservator. This section also eliminates a provision that prohibits those same institutions from paying a higher than normal rate of interest on funds received from a deposit broker (to the extent that the FDIC allows them to accept brokered deposits). In addition, this section replaces the three different standards that define higher than normal interest rates—all of which are based, to some extent, on an institution's "normal market area"—with a single standard based on the "national rate of interest," as established by the FDIC.

OCC Comments: This section as drafted is unclear, but appears to restrict additional institutions from advertising high interest rates, while allowing all institutions to pay high interest rates to deposit brokers. The OCC understands that this provision is currently under review in light of its ambiguity.

Sec. 203. Repeal of Federal Reserve Act Lending Limit

Summary: This section repeals section 11(m) of the FRA (12 USC 248(m)), which prohibits a member bank from making loans secured by stocks or bonds to one borrower in excess of 15 percent of the bank's unimpaired capital and surplus.

OCC Comments: The OCC supports this provision. Section 11(m), as enacted, set a limit of 10 percent (raised to 15 percent in 1994), which once corresponded to the 10 percent lending limit applicable to national banks under 12 USC 84. In 1982, Congress raised the lending limit in section 84 to 25 percent of unimpaired capital and surplus (not more than 15 percent of which may correspond to loans not fully secured), but did not raise the corresponding limit in section 11(m). This produces anomalous results. For example, if a bank has loaned to one borrower an amount equal to 15 percent of its unimpaired capital and surplus, and those loans are secured by stocks or bonds, section 84 allows that bank to lend an additional 10 percent of its unimpaired capital and surplus to that borrower (secured or unsecured), but section 11(m) prohibits that bank from securing that loan with stocks or bonds, even though they may be the only or best collateral available. Section 11(m) thus hinders a bank's ability to collateralize its loans to the maximum extent possible and, thus, is inconsistent with safety and soundness.

Sec. 204. Eliminate Unnecessary Restrictions on Product Marketing (Anti-Tying)

Summary: This section repeals section 106(b)(1) of the Bank Holding Company Amendments of 1970 (12 USC 1972(1)), which prohibits a bank from engaging in certain tying arrangements. Currently, section 106(b)(1) prohibits a bank from conditioning (or varying the conditions of) an extension of credit, a lease or sale of property, or a service, or varying the conditions thereof, on the customer obtaining or providing additional credit, property, or service from or to the bank or any of its affiliates. The Fed also is authorized to grant exceptions to section 106(b)(1) by regulation or order.

OCC Comments: The OCC has strong concerns about the repeal of section 106(b)(1). Section 106(b)(1) provides important consumer protections with respect to sales of non-deposit products by banks and their subsidiaries. Moreover, because the Fed has exemptive authority, there is no need to repeal this section.

Sec. 205. Business Purpose Credit Extensions (Business Credit Cards)

Summary: This section adds a provision to section 4 of the BHC Act (12 USC 1843) authorizing CEBA credit card banks and nonbank banks to provide credit card accounts for business purposes.

OCC Comments: The OCC takes no position on this amendment.

Sec. 206. Affinity Groups

Summary: This section permits a payment to an "affinity group" for a written or oral endorsement of a settlement

service provider in an advertisement or mailing, provided that payment is clearly disclosed in the first written communication with the consumer. This section defines "affinity group" as a person (other than an individual) that is established for common objectives or purposes and is not established by a settlement service provider for the principal purpose of endorsing a settlement service provider or the conduct of settlement services, and does not consist of member organizations whose principal business is providing settlement services.

OCC Comments: The OCC has some concerns with this amendment. Under current law, affinity groups may enter into arrangements with settlement service providers to provide discounts on services directly to consumers. However, this amendment would permit referral fees to be paid directly to affinity groups. This could increase the cost of home ownership for consumers without ensuring any corresponding benefit to consumers, such as a lower interest rate, from the lender.

We also note that previous versions of this amendment were drafted as amendments to RESPA. If section 206 moves forward, we strongly recommend that this section continue to be an amendment to RESPA because of its direct relationship to settlement service providers, and in order to provide federal agency (HUD) implementation and oversight.

Sec. 207. Fair Debt Collection Practices

Summary: Section 207 makes several amendments to sections 803 and 809 of the Fair Debt Collection Practices Act (FDCPA) (15 USC 1692a and 1692g). The FDCPA generally prohibits a "debt collector" from using unfair practices, false or misleading representations, or harassment to collect a debt and, among other things, from communicating with a consumer concerning collection of a debt if the "communication" is at an unusual time or place. In addition, under certain circumstances, the debt collector is prohibited from communicating with the consumer at the consumer's place of employment. Under the FDCPA, there are two provisions that permit the consumer to terminate or suspend communications or collection efforts by debt collectors. First, if a consumer requests that the debt collector cease communications, all communications are required to cease except certain specific notices, e.g., a notice of specific remedies being invoked. Second, under the FDCPA, a consumer has 30 days in which to dispute a debt and, if disputed during that period, the debt collector must cease all collection efforts until verification information is provided to the consumer.

This section amends the definition of "communication" to exclude (1) any communication made pursuant to federal or state rules of civil procedure or a nonjudicial foreclosure proceeding; and (2) any communication made or action taken to collect on loans made, insured, or guaranteed under the Higher Education Act of 1965. (The sponsors note that this latter change in the definition is needed so that a debt collector can adhere to regulations issued pursuant to the Higher Education Act of 1965 without violating the FDCPA, as these two laws have conflicting debt collection provisions.) This section also amends the definition of "debt" to exclude a draft drawn on a bank for a sum certain, payable on demand and signed by the maker. Finally, subsection (b) of this section adds a provision allowing a debt collector to continue debt collection activities and communications during the 30-day period after providing the written notification required in 12 USC 1692g, unless the consumer requests the cessation of such activities.

OCC Comments: The OCC has serious concerns regarding the scope of the exclusion of federal or state civil rules of procedure from the definition of "communication" and the potential for abuse if the amendment as drafted is enacted. Under current law, the term "debt collector" does not include a person serving legal process in connection with the judicial enforcement of any debt. Therefore, service of process made in accordance with federal or state rules of civil procedure already is exempt from the restrictions in the FDCPA. The amendment would expand the exemption by amending the definition of "communication" to allow a debt collector to initiate any communication with the consumer at any time or place if the communication is made pursuant to a nonjudicial foreclosure proceeding, as well as communications made pursuant to federal or state rules of civil procedure. This exemption could be construed broadly to permit, for example, a debt collector to call a consumer in the middle of the night about foreclosing on a debt in a nonjudicial proceeding. Therefore, we recommend that this provision be redrafted to limit the exception to apply only to the transmittal of pleadings, legal documents, or other notices in connection with a court action or a nonjudicial foreclosure proceeding.

The OCC also has concerns with this section's the change to the definition of "debt." Consumers who have written checks that are returned for insufficient funds should be covered by the protections of the FDCPA. Recently, a number of federal appeals courts have ruled that the FDCPA covers checks written for consumer purposes. See, e.g. *Bath* v. *Stolper,* 111 F.3d 1322 (7th Cir. 1997, *Duffy* v. *Landberg,* 1998 US App Lexis 724 (8th Cir. 1998), and *Charles* v. *Check Rite Ltd., Inc.,* 119 F.3d 739 (9th Cir. 1997). This amendment is a legislative reversal of these decisions, and would constitute a rollback of consumer protections in this area.

The OCC notes that, as currently drafted, subsection (b) has two alternative interpretations. First, this amendment could be read to defeat the purpose of the FDCPA's written notice requirement. That requirement provides

the consumer with 30 days to dispute the validity of the debt (in which case the debt collector must verify the debt) or to request the identity of the original creditor. Under the FDCPA, a debt collector must suspend debt collection activities until after the debt collector mails verification of the debt if the debt is disputed by the consumer or the identity of the original creditor if requested by the consumer. The amendment made by subsection (b) could be broadly interpreted to mean that, in addition to requesting verification of the debt as provided under current law, a consumer must also specifically request that all debt collection efforts cease until verification is provided before a debt collector is required to suspend collection efforts. In the alternative, the amendment made by subsection (b) also could be construed to be a new basis under which a consumer could request a debt collector to cease communications, as well as all other debt collection activities during the 30-day dispute period. The amendment provides that a debt collector may continue debt collection activities or communications during the 30-day dispute period "unless the consumer requests the cessation of such activities." There is no requirement in the amendment that the request to cease debt collection or communications must be linked to the consumer's right to dispute the debt. Therefore, the amendment could be construed to be an independent basis under which a consumer could request cessation of all debt collection activities and communications for the 30 day period notwithstanding that the consumer does not dispute the validity of the debt. The OCC recommends that this provision be clarified to achieve the second interpretation.

Sec. 208. Restrictions on Acquisitions of Other Insured Depository Institutions

Summary: This section amends section 4(f)(12) of the BHC Act (12 USC 1843(f)(12)) to allow a company controlling a grandfathered nonbank bank to purchase an undercapitalized insured institution without losing its exemption from treatment as a bank holding company. Under current law, a company controlling a grandfathered bank can purchase insured institutions from the RTC, FDIC, or OTS, and insured institutions found to be in danger of default, without losing its exemption.

OCC Comments: The OCC takes no position on this provision.

Sec. 209. Mutual Holding Companies

Summary: This section amends section 10(o) of HOLA, which provides for the formation and regulation of mutual holding companies. Under current law, a mutual savings association may reorganize into stock form by first forming an interim savings associations. This section would allow mutual savings associations to reorganize into stock form without first forming this "phantom bank."

OCC Comments: The OCC takes no position on this section.

Sec. 210. Call Report Simplification

Summary: This section requires the federal banking agencies to jointly develop a system under which insured depository institutions and their affiliates may file call reports, savings association financial reports, and bank holding company consolidated and parent-only financial statements electronically, and make these reports and statements available to the public electronically. The agencies must report to Congress one year after enactment with legislative recommendations that would enhance efficiency for filers and users of these call reports and statements. In addition, the federal banking agencies would be required to jointly adopt a single form for the filing of core information that is required to be submitted to all federal banking agencies in these reports and statements, and to simplify, and establish an index for, instructions for these reports and statements. Finally, each federal banking agency would be required to review the information required by schedules supplementing this core information and eliminate requirements that are not necessary for safety and soundness or other public purposes.

OCC Comments: This section has already been enacted in full by Congress. *See* section 307 of P.L. 103–325, the Riegle Community Development and Regulatory Improvement Act of 1994.

Title III—Streamlining Agency Actions

Sec. 301. Scheduled Meetings of Affordable Housing Advisory Board

Summary: This section amends section 14(b)(6)(A) of the Resolution Trust Corporation Completion Act (12 USC 1831q note) to reduce the number of times that the Affordable Housing Advisory Board must meet each year from four times per year to twice a year. This section also repeals the requirement that the Advisory Board must meet in various regional locations each year.

OCC Comments: The OCC takes no position on this provision.

Sec. 302. Elimination of Duplicative Disclosure of Fair Market Value of Assets and Liabilities

Summary: This section repeals section 37(a)(3)(D) of FDI Act (12 USC 1831n(a)(3)(D)), a provision added by FDICIA, which requires the federal banking agencies, by December 19, 1992, to develop jointly a method for insured depository institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities in any financial report, "to the extent feasible and practicable."

OCC Comments: The OCC takes no position on this provision.

Sec. 303. Payment of Interest to Creditors in Receiverships with Surplus Funds

Summary: This section amends section 11(d)(10) of FDI Act (12 USC 1821(d)(10)) to provide the FDIC with express rulemaking authority, with respect to receivership estates of insured depository institutions, to pay post-insolvency interest to creditors and to establish an interest rate on those payments following satisfaction of the principal amount of all creditor claims.

OCC Comments: The OCC takes no position on this provision.

Sec. 304. Repeal of Reporting Requirement On Differences in Accounting Standards

Summary: This section repeals section 37(c) of the FDI Act (12 USC 1831n(c)), a requirement added by FDICIA, that each federal banking agency submit annually a report to the House and Senate Banking Committees explaining any differences among the federal banking agencies capital or accounting standards.

OCC Comments: The federal banking agencies have essentially accomplished the objectives of this section and have adopted uniform standards with respect to capital and accounting issues. The agencies are working jointly to eliminate the remaining differences, most of which are technical or interpretive in nature. Thus, the reporting requirement has served a valuable purpose of alerting or educating the agencies to substantive differences in their standards in this area, but it may no longer be necessary.

Sec. 305. Agency Review of Competitive Factors in Bank Merger Act Filings

Summary: Subsections (a) and (b) of this section eliminate the requirement in section 18(c)(4) of the FDI Act (12 USC 1828(c)(4)) that the responsible agency with respect to a Bank Merger Act transaction must request competitive factors reports from all other federal banking agencies. The requirement that the responsible agency and the Attorney General consider the competitive factors remains. Subsection (c) amends Section 3(c) of the BHC Act (12 USC 1842(c)) and section 18(c)(5) of FDI Act (12 USC 1828(c)(5)) to prohibit the responsible agency from disapproving a merger transaction unless it takes into account the following factors: (1) competition from non-depository institutions that provide financial services; (2) efficiencies and cost savings that the transaction may create; (3) deposits of the participants that are not derived from the relevant market; (4) the capacity of savings associations to make small business loans; (5) lending by institutions other than depository institutions to small businesses; and (6) such other factors as the Board deems relevant.

OCC Comments: The OCC supports this provision.

Sec. 306. Termination of the Thrift Depositor Protection Oversight Board (Oversight Board)

Summary: The Oversight Board was charged by Congress with the primary function of overseeing and monitoring Resolution Trust Corporation (RTC) operations. However, the RTC's operations terminated as of December 31, 1995, leaving the Oversight Board with only two remaining functions—oversight of the Resolution Funding Corporation (REFCorp) and, through FY 98, non-voting membership on the Affordable Housing Advisory Board.

Section 306 eliminates the Oversight Board three months after the enactment of this legislation, transferring its REFCorp responsibilities to the Secretary of the Treasury and restructuring the Affordable Housing Advisory Board to eliminate the non-voting seat held by the Oversight Board.

OCC Comments: The OCC takes no position on this provision. (This provision is similar to H.R. 2343, passed by the House on September 23, 1997 and section 13 of S. 318, the Homeowners' Protection Act of 1997, as passed by the Senate on November 9, 1997.)

Title IV—Disclosure Simplification

Sec. 401. Alternative Compliance Method for APR Disclosure

Summary: This section amends section 127A(a)(2) of the Truth in Lending Act (TILA) (15 USC 1637(a)(2)) to allow a creditor to provide a statement that "periodic payment may increase or decrease substantially" in lieu of the 15-year historical table currently required for a variable-rate, open-end, consumer credit plan secured by the consumer's principal dwelling. Section 127A(a)(2) continues to require a creditor to provide the maximum APR and the associated minimum payment. (Section 2105 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 amended TILA to provide a similar change for closed-end, variable-rate loans.)

OCC Comments: The OCC takes no position on this provision.

Sec. 402. Alternative Compliance Methods for Credit Terms

Summary: Subsection (a) of this section amends section 144(d) of TILA (15 USC 1664(d)) to eliminate (1) the number of installments, and (2) the period of repayment, as terms that trigger the disclosure of the down payment,

terms of repayment, and APR in closed-end credit advertisements.

Subsection (b) adds a new section 148 to TILA (15 USC 1661 *et seq.*) to provide an alternate disclosure method for radio and television advertisements. The disclosures that currently apply to radio and television advertisements under TILA are found in sections 143, 144(d), and 147(a) and (e) (15 USC 1663, 1664, and 1665b, respectively). Section 143, which applies to open-end plans, requires disclosure of any minimum or fixed amount, the periodic rates expressed as an APR (if periodic rates may be applied), and any other term required by the Fed's regulations (currently, 12 CFR 226.16(b)(3) requires disclosure of any membership or participation fee). As indicated above, section 144(d), which applies to closed-end plans, requires disclosure of the down payment, the terms of repayment, and the finance charge expressed as an APR if certain triggering terms are used in the advertisement. Section 147(a), which applies to open-end, home-secured plans, requires disclosure of loan fees and opening cost estimates, the periodic rates expressed as an APR (if periodic rates may be applied), the highest annual percentage, and any other information required by the Fed's regulations (currently none) if the advertisement states specific terms of the plan. Section 147(e) requires the disclosure of any required balloon payments in the case of open-end, home-secured loans if the advertisement mentions a minimum monthly payment.

Section 402 of this legislation provides that a radio or television advertisement meets the disclosure requirements of sections 143, 144(d) and 147(a) and (e) if it clearly and conspicuously discloses: (1) the APR of any finance charge (and, with respect to an open-end plan, the simple interest rate or the periodic rate); (2) whether the interest rate may vary; (3) if the advertisement states an introductory rate, the period during which any introductory rate is in effect and the APR that will be in effect after any introductory period, with equal prominence; (4) the annual fee, with respect to an open-end plan; (5) a toll-free telephone number from which a consumer may obtain additional information; and (6) a statement that the consumer may use the telephone number to obtain further details about the terms and cost of the credit. The telephone number must be available beginning not later than the date of first broadcast and ending no earlier than 10 days after the final broadcast, and the creditor must provide all information otherwise required by TILA orally by telephone or, if requested, in writing.

OCC Comments: The OCC is concerned that these changes to TILA may deprive consumers of material terms (such as the amount of any down payment, repayment terms, highest possible APR and balloon payment requirements) that are key to making informed credit decisions, particularly in the case of home equity loans.

Title V—Miscellaneous

Sec. 501. Positions of Board of Governors of the Federal Reserve System on the Executive Schedule

Summary: This section raises the pay of the Chairman of the Fed from Level II ($133,600) of the Executive schedule to Level I ($148,400) (an increase of approximately $14,800), and Fed board members from Level III ($123,100) to Level II (an increase of approximately $10,500.)

OCC Comments: The OCC takes no position on this provision.

Sec. 502. Coverage of Employee Health Plans at Federal Banking Agencies

Summary: Under current law, federal employees are required to be enrolled in the Federal Employees Health Benefits Program (FEHBP) for at least five years immediately prior to retirement in order to continue FEHBP coverage in retirement. At the end of 1997, the FDIC and the Fed will terminate their own health benefit plans which are separate from the FEHBP. This section permits FDIC and Fed retired employees, or employees within five years of retirement, who currently are enrolled in these FDIC or Fed plans to enroll in another federal health benefit plan. Without this provision, the FDIC and Fed would need to continue the operation of their non-FEHBPs in order to provide insurance coverage for these employees.

OCC Comments: The OCC notes that Congress adopted legislation in 1994 that provided OCC and OTS employees with similar rights (P.L. 103–409).

Sec. 503. Federal Housing Finance Board Positions

Summary: Section 2A of the FHLB Act (12 USC 1422a) establishes the Federal Housing Finance Board as the federal supervisor of Federal Home Loan Banks. The Board of Directors of the Finance Board consists of five members, one of which is the Secretary of HUD, with the four remaining members being persons with extensive experience or training in housing finance. In addition, at least one of these four directors must be chosen from an organization, which is at least two years old, that represents consumers or community interests on banking services, credit needs, housing, or financial consumer protection. Section 503 eliminates the requirement that one member of the board be a consumer representative.

OCC Comments: The OCC takes no position on this proposal, and defers to the Treasury Department, which in the past has proposed comprehensive legislation relating to the Federal Home Loan Bank System.

Title VI—Technical Corrections

Sec. 601. Technical Correction Relating to Deposit Insurance Funds

Summary: This section amends an incorrect citation in section 2707 of the Deposit Insurance Funds Act of 1996 (P.L. 104–208, 110 Stat. 3009).

OCC Comments: The OCC supports this technical correction. However, in order to fully correct the citation, this section should also strike from section 2707 the following: ", as redesignated by section 2704(d)(6) of this subtitle."*

Sec. 602. Rules for Continuation of Deposit Insurance for Member Banks Converting Charters (Technical Error in Section 8(o) of FDI Act)

Summary: This section amends an incorrect citation in section 8(o) of FDI Act (12 USC 1818(o)).

OCC Comments: The OCC supports this technical correction.

Sec. 603. Amendments to the Revised Statutes

Summary: Subsection (a) of this section amends section 5146 of the Revised Statutes (12 USC 72) to provide the OCC with authority to the waive the U.S. citizenship requirement for any national bank director for a minority of the total number of directors serving on the board. Subsection (b) amends section 329 of the Revised Statutes (12 USC 11) to update an obsolete reference to "any association issuing national currency under the laws of the United States" with "any national bank." Finally, subsection (c) repeals section 5138 of the Revised Statutes (12 USC 51), which imposes minimum capital requirements for national banks ranging from $50,000 to $200,000, depending on where the bank is located.

OCC Comments: The OCC supports all three changes to be made by this section. Section 2241 of the Esqconomic Growth and Regulatory Paperwork Reduction Act of 1996 (P.L.104–208) gave the OCC the authority to waive the requirement in 12 USC 72 that national bank directors must reside within the state in which the national bank is located or within 100 miles of the bank's location. As drafted, however, section 2241 inadvertently deleted the long-standing authority of the OCC to waive the citizenship requirement for not more than a minority of directors of national banks that are subsidiaries or affiliates of foreign banks. In a colloquy on the Senate floor at the time P.L. 104–208 was being considered for final passage, Senators Mack, D'Amato, and Graham stated that deleting the citizenship waiver authority was a technical drafting error and directed the OCC to treat the authority as unchanged until Congress could correct the error. This amendment corrects that technical error and, in addition, gives the OCC the authority to waive the citizenship requirement for up to a minority of directors for any national bank, whether or not affiliated with a foreign bank, in the same manner that the OCC may now waive the residency requirement for any national bank.

Subsection (b) of this section also would be a beneficial change. Section 329 currently prohibits the Comptroller and Deputy Comptroller from having an interest in any association issuing national currency. This amendment updates section 329 to reflect that national banks no longer issue national currency. The amendment, however, maintains the purpose of the original provision by prohibiting the Comptroller and Deputy Comptroller from owning interests in the national banks they regulate.

Finally, subsection (c) also provides a necessary update of federal banking law. Section 5138 was first enacted in 1864 and last amended in 1935 and does not reflect current minimum capital ratio requirements that have been adopted pursuant to the authority in section 38 of FDI Act (12 USC 1831o) and section 908 of the International Lending Supervision Act (ILSA) (12 USC 3907). Section 908 of ILSA was enacted by Congress in 1983 and expressly requires the federal banking agencies to establish adequate minimum capital requirements for banking institutions. Section 38 of FDI Act was enacted in 1991 and establishes a system of prompt corrective action based on capital levels. Section 5138 is outdated and unnecessary in light of current law and should be repealed to avoid any confusion.

Sec. 604. Conforming Change to the International Banking Act.

Summary: This section amends section 4(b) of the International Banking Act of 1978 (12 USC 3102(b)) to eliminate obsolete language stating that the requirements of 12 USC 481 are satisfied if the federal branch or agency is examined once in each calendar year.

OCC Comments: The OCC supports this provision. Section 2214 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 replaced the annual requirement for an on-site examination of a branch or agency of a foreign bank with a requirement that these branches and agencies be examined as frequently as would a comparable national or state bank. As a result, branches or agencies that satisfy the asset test imposed on domestic banks may be examined on an 18-month cycle rather than a 12-month cycle. However, that legislation did not make a conforming change to 12 USC 3102(b). This provision makes that conforming change.

*An asterisk [in an OCC comments paragraph] indicates that a non-substantive technical problem exists with the amendment as drafted. (We would be happy to supply technical corrections to congressional staff.)

Remarks by Julie Williams, Chief Counsel, Office of the Comptroller of the Currency, before the Third National CDFI Institute, on the implications of financial modernization for community development, Washington, D.C., January 29, 1998

Freedom and opportunity are at the heart of a healthy, vibrant democratic system. In particular, economic opportunity—the chance for all people to make the most of their lives, attain good jobs, live in decent homes and develop their own businesses—is essential to the strength and long-term vitality of our society. But, unfortunately, economic opportunity has not always been available to all on equal terms, and when and where it has been thwarted, as in the case of many disadvantaged communities across the nation, special efforts are needed to nurture economic opportunity and growth so that these communities may thrive. This is a vital role performed by the community development financial institutions that you lead and represent here today.

I am pleased that the CDFI Institute recognizes the link between ongoing changes in the financial services industry and the growth of the community development financial institution (CDFI) sector. Your success, and the success of others striving to foster economic opportunity through various community development initiatives, may be substantially affected by federal legislation that seems quite distant from your immediate goals. However, the course of so-called "financial modernization legislation" can have a profound impact on the avenues and incentives available for private sector financial institutions to support community development and economic revitalization.

For starters, what exactly *is* "financial modernization"? Generally that term today is understood to mean eliminating the existing restrictions that prevent banks, securities firms and insurance companies from owning, or freely affiliating with, each other.

The potential benefits of financial modernization have been variously described as increased competition, lower prices, increased product innovation and increased consumer access and convenience. On the other hand, critics of financial modernization express concern that it will produce an unhealthy concentration of economic power in gigantic financial conglomerates, to the detriment of community development, small businesses and the farm sector.

For purposes of our discussion here today, however, there is another, equally important perspective on financial modernization—whether it will have a meaningful positive or negative effect on low- and moderate-income communities and the poor.

What I will try to do here is frame several issues that, from the perspective of community development and economic revitalization, should be key considerations in constructing any new "modern" framework for financial institutions.

Role of Financial Institutions in Community Development

It is becoming increasingly clear that the marketplace is ignoring the artificial legal barriers that once separated the banking, securities, and insurance industries. Banks, securities firms, and insurance companies all perform many of the same financial functions, albeit sometimes in different ways. Is it important to pay particular attention to how "financial modernization" affects any one of these types of financial institutions? Should we care whether financial modernization enhances or undermines the relative role of *banks* in the financial services marketplace?

Banks are subject to standards—some would say regulatory burdens—that do not apply to other types of firms that perform the same types of financial activities as banks. For example, banks are comprehensively and frequently examined to assure their financial stability and their compliance with applicable laws. They are a safe place to store money. In fact, some have argued that the safety and soundness of them makes insured banks the preferred issuer of electronic money.

Banks are also subject to certain specific types of obligations, such as the consumer protection requirements under the Truth in Savings Act or the obligation to serve their entire community that arises under the Community Reinvestment Act. These obligations do not apply to other types of financial firms.

Banks shoulder these obligations, even though other financial services providers that are not subject to these obligations also enjoy significant public benefits. For example, "savings" accumulated in certain types of pension funds are guaranteed by the Pension Benefit Guaranty Corporation, and securities firms, like banks, have access to the Federal Reserve's "discount window."

Where banks and other financial firms are subject to the same standards—e.g., Truth in Lending, Fair Housing and Equal Credit Opportunity—other types of financial firms do not have assigned examiners that regularly

check to make sure they are in compliance with these standards.

Impact of Financial Modernization on Community Development

Financial modernization could diminish or enhance the extent to which these bank characteristics are present in the financial system. It can enhance the presence of these characteristics either by enabling banks to be robust players, or by causing other types of financial firms to assume the same characteristics of banks in these respects. It can diminish the presence of the characteristics, on the other hand, by limiting the business of banks and encouraging *current and future functions* of financial institutions to be performed in entities that do not have these characteristics.

In the current debate in Congress regarding financial modernization legislation, three factors are crucial to whether banks will emerge as robust financial service providers in the twenty-first century:

1) Whether banks and their *subsidiaries* are allowed to engage in a broader range of financial and financially related activities to the same extent as subsidiaries of holding companies;
2) The extent to which "wholesale financial institutions" are authorized in the legislation and the extent to which they are subject to the same prudential regulation and other obligations, such as CRA, that apply generally to insured banks; and
3) The degree to which activities that are currently permissible for banks to conduct directly are required or encouraged to be "pushed out" of the bank.

Corporate Structure of a "Modern" Financial Firm

Let me turn first to the question of whether bank subsidiaries and bank holding company subsidiaries should both be able to engage in a broader range of financial activities. This may seem to many to be an esoteric legal question. Let me assure you it is not. There is currently a vigorous debate about the extent to which banks and bank subsidiaries should be allowed to conduct the same range of newly authorized activities as holding company affiliates. Embedded in this debate is the issue of how broadly the obligations and regulatory oversight now applicable to banks will be applicable in the future financial services industry. If financial modernization limits the new business of banks, while encouraging new business in companies that are simply affiliated with banks, then the reach of bank regulatory standards will be reduced, and indeed, the bank itself will become a less stable enterprise.

For example, the activities conducted in bank subsidiaries can increase the resources a bank has available to perform its obligations under CRA; activities conducted in bank affiliates do not. It is true that a banking organization, at its option, can elect to have specific activities conducted in its affiliates or subsidiaries to be counted for CRA credit. But it does not have to. From the organization's perspective, therefore, it is something like a "heads I win, tails you lose" proposition because bank regulators have no leverage over the performance of affiliates of a bank that are not subject to any CRA obligations.

We must not lose sight of a fundamental point: *CRA is only as strong as the institutions that are subject to it.* Stronger institutions, with diversified sources of income and potential for growth are better positioned—and have more resources available—to help meet the financial services needs of their communities and support the economy as a whole, than are deflated institutions that have been deprived of new growth businesses.

In assessing the composition of the "modern" financial services industry, it is probably also important to pay attention to the *way* various financial services firms typically deliver their products and services, e.g., via telephone or now Internet, rather than through face-to-face customer contact. We should also care about the extent to which those delivery systems are accessible and readily useable by those who are economically disadvantaged.

"Woofies"

The second factor that will influence the extent of bank participation in the financial services industry—and their ability to continue supporting community and economic development—is the creation of "wholesale financial institutions," called "woofies." The authorization of "woofies" would allow investment banking firms as well as existing bank holding companies to have specialized wholesale banks. A "woofie" would be a new type of bank that (i) could not accept insured deposits; (ii) would not have to pay deposit insurance premiums; (iii) could accept uninsured wholesale deposits (i.e., those with an initial deposit over $100,000); (iv) would have direct access to the payments system; and (v) would generally be subject to a lower level of regulatory burden than insured banks. This could prove to be an attractive vehicle for financial firms to conduct wholesale lending and funding activities.

If woofies are not subject to CRA, a potentially huge amount of financial system assets will not be covered—

including assets that are today subject to CRA because they are part of a single insured bank. And even if woofies were not exempt from CRA, as "wholesale banks," they would be subject to a community development standard under the CRA regulations, rather than the general lending, services, and investment criteria applicable to insured banks. Thus, their CRA obligations could end up being satisfied through targeted investments rather than through community-oriented lending.

Deflating Banks by Activities "Push-Outs"

A third factor that will affect whether banks are robust participants in the financial services industry is the outcome of the debate about "functional regulation" of activities conducted by banks. Again, this debate may appear to be somewhat arcane, but it translates into the very practical question of whether certain types of activities—most notably securities activities—that are currently conducted directly by banks and are stable sources of bank revenues will be forced out of *the bank* into bank affiliates. The activities in question are not esoteric. They include loan participations, underwriting certain government securities, securitizing loans, acting as a custodian for managed accounts, offering self-directed IRAs, arranging private placements, engaging in certain financial contracts, and offering employee and shareholder benefit plan services.

Profits of activities that are forced out of a bank will not of course, be available to support the activities and obligations of the bank. Nor will the "pushed-out" activities be subject to the comprehensive preventive regulation and regular on-site supervision that is typical of the bank supervision process.

"Push-outs" are another means by which a bank is deflated, to the detriment of its safety and soundness as well as its ability to meet the credit needs of its community and support the economy as a whole.

Conclusion

I hope this overview has been helpful to flag key issues in the financial modernization debate that could significantly affect future private sector support for community development and economic revitalization initiatives. I thank you for the opportunity to spotlight these very important concerns.

Interpretations—January 1 to March 31, 1998

	Page
Interpretive Letters	81

Laws

	Letter No.	Page
12 USC 24(7)	811,	84
	812,	88
	813,	92
	815,	97
	819,	106
	824	123
12 USC 36	814	95
12 USC 36(j)	818,	102
	821	111
12 USC 60	816	100
12 USC 85	817,	101
	822	114
12 USC 92	823,	122
	824	123
12 USC 2901	809,	81
	810,	83
	820	109

Subjects

	Letter No.	Page
Data collection requirements and performance standards for small wholesale institutions under the Community Reinvestment Act regulations	809	81
Applicability of Community Reinvestment Act regulations to financial institutions' investments in a middle income housing down-payment assistance program	810	83
Permissibility of a bank to purchase a printing company to sell printing services to other financial institutions	811	84
Confirmation that a bank may offer, as agent, crop insurance in connection with loans to its farmer customers	812	88
Confirmation that a bank may acquire and hold a noncontrolling minority interest in a limited liability company	813	92
Whether offices of a wholly owned subsidiary of a national bank are branches of the bank	814	95
Confirmation that a bank may retain its minority noncontrolling interest in a state-chartered trust company	815	97

Determination of a bank's dividend-paying capacity 816 100

Clarification of whether certain fees charged by banks in connection with credit cards
constitute interest 817 101

Whether disbursing loan proceeds at a bank's loan production office would cause that office
to be considered a branch of the bank 818 102

Confirmation that a bank may acquire and hold a 50 percent noncontrolling interest in a
limited liability company, established as a general insurance agency 819 106

Whether financial institutions should collect and report the gross adjusted gross annual revenue
or income to use when making credit decisions under the Community Reinvestment Act 820 109

Whether Connecticut statute prohibits establishment and operation of out-of-state automated
teller machines of a national bank 821 111

Explanation of when an interstate national bank may charge home state interest rates 822 114

Definition of the term "place" by the United States Bureau of the Census as used by OCC 823 122

Participation by national banks in an insurance program with a separate corporation owned
by independent insurance agencies 824 123

Interpretive Letters

809—November 20, 1997

[Note: This OCC Interpretive Letter was released jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision.]

12 USC 2901

Dear [ ]:

This letter responds to your letter inquiring about the data collection requirements and performance standards for small wholesale institutions under the Community Reinvestment Act (CRA) regulations.

You explained in your letter and subsequent telephone conversation with agency staff that you represent a bank that is currently designated as a wholesale bank.[1] You state that the bank's assets remain under $250 million and that it is independent of a holding company. With respect to the record keeping and performance criteria for wholesale banks, you have asked the following:

- Whether a small bank subsequently designated as a wholesale bank needs to comply with the CRA regulations' data reporting requirements.
- What type of data is required for community development loans, and how this data would be interpreted for compliance with the act.
- Whether letters of credit and acceptances qualify for consideration under the community development lending test.
- Whether commitments for community development loans, made in a prior period and still outstanding in the bank's books, can be recognized for the CRA compliance evaluation.
- Whether an investment in county school board bonds or water and sewer department bonds would be considered a qualified investment.
- Whether qualified investments are considered only in the year purchased or whether they can be taken into consideration as long as the bank maintains them on its books.

As you know, the CRA regulations establish the framework and criteria by which the four bank and thrift regulatory agencies (agencies) assess an institution's record of helping to meet the credit needs of its community. The agencies have promulgated substantively identical CRA regulations.[2] Therefore, staff from all of the agencies (staff) have considered the issues you raise and concur with the opinions expressed in this letter.

Data Collection Requirements

The CRA regulations only require data collection by banks that are not "small institutions."[3] Small institutions are institutions that, as of December 31 of either of the prior two calendar years, had total assets of less than $250 million and were independent or were affiliates of a holding company that, as of December 31 of either of the prior two calendar years, had total banking and thrift assets of less than $1 billion.[4]

This exception to the data collection requirement applies to all small institutions (except those choosing to be evaluated under the lending, investment and service tests), including those that are designated as wholesale or limited purpose institutions.[5] The exception notwithstanding, small wholesale or limited purpose institutions must be prepared to identify those loans, investments, and services to be evaluated under the community development test.[6]

Community Development Loans

Under the community development test, wholesale and limited purpose banks are evaluated on, among other things, the number and amount of community development loans[7] (including originations and purchases of

---

[1] A wholesale institution is an institution that is not in the business of extending home mortgage, small business, small farm, or consumer loans to retail customers, and for which a designation as a wholesale bank is in effect, in accordance with Sec. 25.25(b). 12 CFR 25.12(w), 228.12(w), 345.12(w), and 563e.12(v). In order to receive a designation as a wholesale institution, the institution must file a request, in writing, with the appropriate financial institution regulatory agency and have the agency approve the designation. 12 CFR 25.25(b), 228.25(b), 345.25(b), and 563e.25(b). You have indicated that the institution in question has obtained agency approval for designation as a wholesale institution.

[2] 12 CFR parts 25, 228, 345, and 563e.

[3] 12 CFR 25.42, 228.42, 345.42, and 563e.42.

[4] 12 CFR 25.12(t), 223.12(t), 345.12(t), and 563e.12(s).

[5] Interagency Questions and Answers Regarding Community Reinvestment (hereinafter "Qs and As"), 62 Fed. Reg. 52105, 52124, Q/A 7, addressing section _____.42. Institutions that would otherwise be evaluated under the performance standards for small institutions may choose to be evaluated under the lending, investment and service performance standards used to evaluate large retail institutions. *See* 12 CFR 25.21(a)(3), 228.21(a)(3), 345.21(a)(3), and 563e.21(a)(3).

[6] *Id.*

[7] With respect to wholesale institutions, a community development loan is a loan that has as its primary purpose community development. 12 CFR 25.12(i)(1), 228.12(i)(1), 345.12(i)(1), and

loans and other community development loan data provided by the bank, relating to loans outstanding, commitments, and letters of credit).[8] Consequently, letters of credit, acceptances, and loans outstanding that have as their primary purpose community development would receive consideration under the CRA regulations. In addition, loan commitments must be legally binding between an institution and a borrower in order to be considered.[9] Again, although reporting of data on commitments, acceptances, letters of credit and loans outstanding is not required, the institution should be prepared to identify these transactions for examiner evaluation.

Please note that considerations beyond the number and dollar amount of such community development loans will affect the level of favorable consideration that examiners will accord them. The extent to which community development lending would receive favorable consideration also depends on the innovativeness and complexity of the lending activity.[10]

Qualified Investments

In addition to community development lending, a wholesale institution's performance is evaluated on the basis of the number and amount of its qualified investments. A qualified investment is a lawful investment, deposit, membership share, or grant that has as its primary purpose community development.[11] Qualified investments include investments in state and municipal obligations, such as revenue bonds, only if the bonds are primarily for affordable housing for low- and moderate-income individuals, community services targeted to low- and moderate-income persons, or revitalization of low- and moderate-income areas.[12] General purpose municipal bonds typically are not considered to have a community development purpose. An institution's investment in a bond to finance school services would be considered a qualified investment only if the services will be targeted primarily to low- and moderate-income individuals.[13] Similarly, an investment in a bond for water and sewer facilities that are part of a plan to revitalize a low- or moderate-income neighborhood could constitute a qualified investment.[14]

With respect to consideration given to qualified investments, although institutions may exercise a range of investment strategies, including short-term investments, long-term investments, investments that are immediately funded, and investments with a binding up front commitment that are funded over a period of time, institutions making the same dollar amount of investment over the same number of years, all else being equal, would receive the same level of consideration.[15] Generally, examiners will consider all qualified investments that are on an institution's books, including investments made since the preceding examination, and also will consider the investments' innovativeness or complexity, the extent to which they are not routinely provided by private investors, and their responsiveness to credit and community development needs.[16]

I trust this letter has been responsive to your inquiry. If you have any additional questions, please feel free to contact me or Yvonne McIntire of my staff at 202–874–5750.

Michael Bylsma
Director
Community and Consumer Law Division

[Enclosures omitted. OCC Interpretive Letters No. 800 and 802 may be found in the *Quarterly Journal,* Vol. 17, No. 1 (pp. 135 and 139) and on the World Wide Web at http://www.occ.treas.gov/interp/monthly.htm under October 1997. Unpublished letter available on request from OCC Public Information Room, Washington DC 20219–0001.]

563e.12(h)(1). Community development means: (1) Affordable housing (including multifamily rental housing) for low- or moderate-income individuals; (2) Community services targeted to low- or moderate-income individuals; (3) Activities that promote economic development by financing businesses or farms that meet the size eligibility standards of the Small Business Administration's Development Company or Small Business Investment Company programs (13 CFR 121.301) or have gross annual revenues of $1 million or less; or (4) Activities that revitalize or stabilize low- or moderate-income geographies. 12 CFR 25.12(h), 228.12(h), 345.12(h), and 563e.12(g).

[8] 12 CFR 25.25, 228.25, 345.25, and 563e.25.

[9] Qs and As, 62 Fed. Reg. at 52116 Q/A 1, addressing section _____.22(a)(2).

[10] 12 CFR 25.25(c)(2) and (3), 228.25(c)(2) and (3), 345.25(c)(2) and (3), and 563e.25(c)(2) and (3).

[11] 12 CFR 25.12(s), 228.12(s), 345.12(s), and 563e.12(r).

[12] *See* Qs and As, 62 Fed. Reg. at 52114–15 Q/A 4, addressing sections _____.12(s) and 563e.12(r).

[13] *See* Interagency Staff CRA Opinion Letter from Michael Bylsma (September 17, 1997) (designated as OCC Interpretive Letter No. 802) (copy enclosed). [Enclosure omitted.] *See also* Interagency Staff CRA Opinion Letter from Glenn E. Loney (August 29, 1997) (copy enclosed). [Enclosure omitted.]

[14] *See* Qs and As, 62 Fed. Reg. at 52,114, Q/A 2, addressing sections 12(s) and 563.12(r).

[15] *See* Interagency Staff CRA Opinion Letter from Michael Bylsma (September 11, 1997) (designated as OCC Interpretive Letter No. 800) (copy enclosed). [Enclosure omitted.]

[16] 12 CFR 25.25(c)(2) and (3), 228.25(c)(2) and (3), 345.25(c)(2) and (3), and 563e.25(c)(2) and (3).

810—December 12, 1997

[Note: This OCC Interpretive Letter was released jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision.]

12 USC 2901

Dear [ ]:

This letter responds to your inquiry about whether financial institutions that invest in the City of [ ] Middle Income Housing Down-Payment Assistance Initiative would receive favorable consideration when the institutions' Community Reinvestment Act (CRA) performance is evaluated by their regulators. As you may know, the four financial institution regulatory agencies issue interagency CRA interpretive letters for the purpose of providing consistent guidance to our examiners, financial institutions, and the public. The letters are intended to provide broadly applicable guidance and not to endorse any specific projects or products.

In order to provide broadly applicable guidance as described above, this letter will focus on how an examiner would determine whether an investment in the initiative or similar program would receive favorable consideration under the CRA regulations.

The four federal bank and thrift regulatory agencies promulgated substantially similar CRA regulations on May 4, 1995.[1] The regulations of the four agencies are substantively identical. Therefore, staff from all of the agencies have considered your inquiry and concur in the opinions expressed in this letter.

Background

In your letter, you state that the city of [ ] is introducing a new program to provide down payment assistance to middle-income families and individuals choosing to purchase homes in middle-income housing developments in targeted areas within the city of [ ]. The program is designed to provide approximately 400 loans at $10,000 per loan. The loans will be second mortgages on the property, the interest rate will be competitive with the market rate, and will be financed through the issuance of bonds by city agencies. These developments are in city-targeted areas located within and adjacent to low- and moderate-income areas in the city. According to the information included with your letter, the purpose of this program is to "cultivate middle income home ownership within the City. . . ."

[1] *See* 12 CFR parts 25, 228, 345, and 563e.

Discussion

As a general matter, the CRA regulations establish the framework and criteria by which the regulatory agencies assess an institution's record of helping to meet the credit needs of its community. The regulations set out a number of different evaluation methods for examiners to use, depending on the business strategy and size of the institution under examination. Regardless of the performance test used to evaluate a regulated financial institution,[2] an institution may receive positive consideration for making "qualified investments" that help meet the credit needs of the institution's assessment area(s) or a broader statewide or regional area(s).

The regulations define a "qualified investment" as "a lawful investment, deposit, membership share or grant that has as its primary purpose community development."[3] "Community development" includes "[a]ctivities that revitalize or stabilize low- or moderate-income geographies."[4] "Low income" means "an individual income that is less than 50 percent of the area median income, or a median family income that is less than 50 percent, in the case of a geography."[5] "Moderate income" means "an individual income that is at least 50 percent and less than 80 percent of the area median income or a median family income that is at least 50 and less than 80 percent, in the case of a geography."[6]

In determining whether investments in projects, such as the City of [ ] Initiative, are qualified investments,

[2] *See* 60 Fed. Reg. 22,156 (May 4, 1995). Examiners typically evaluate a large institution's CRA performance under the lending, investment, and service tests. Examiners consider a large institution's qualified investments under the investment test. *See* 12 CFR 25.26(a)(1), 228.26(a)(1), 345.26(a)(1) and 563e.26(a)(1); *see also* Interagency Questions and Answers Regarding Community Reinvestment [hereinafter Qs and As], 62 Fed. Reg. 52,119 (October 6, 1997) (Q and A 1 addressing section _____.26(a) (consideration of small institutions; lending-related activities)). Examiners may also consider qualified investments to determine if a small institution merits an outstanding CRA rating. *See* 12 CFR pt. 25 app. A(d)(2), pt. 228 app. A(d)(2), pt. 345 app. A(d)(2), and pt. 563e app. A(d)(2); *see also* Qs and As at 52,120 (Q and A 5 addressing section _____.26(a)). The community development test, which is appropriate for wholesale and limited purpose institutions, evaluates, *inter alia,* the number and amount of qualified investments. *See* 12 CFR 25.25(c)(1), 228.25(c)(1), 345.25(c)(1), and 563e.25(c)(1). Finally, institutions evaluated on the basis of a strategic plan must include in their plan how they intend to meet the credit needs of their assessment area(s). They may meet credit needs through lending, *investment,* and/or services, as appropriate. *See* 12 CFR 25.27(f)(1), 228.27(f)(1), 345.27(f)(1), and 563e.27(f)(1) (emphasis added).

[3] *See* 12 CFR 25.12(s), 228.12(s), 345.12(s), and 563e.12(r).

[4] *See* 12 CFR 25.12(h), 228.12(h), 345.12(h), and 563e.12(g).

[5] 12 CFR 25.12(n)(1), 228.12(n)(1), 345.12(n)(1), and 563e.12(m)(1).

[6] 12 CFR 25.12(n)(2), 228.12(n)(2), 345.12(n)(2), and 563e.12(m)(2).

examiners will look to see whether the initiative is part of a governmental plan to revitalize or stabilize a low- or moderate-income area, or otherwise evidences governmental support for revitalization or stabilization of low- or moderate-income geographies. Investments in higher- or middle-income housing programs in distressed areas would qualify as qualified investments if these loans or investments are part of a governmental plan, or there is other evidence of governmental support for revitalization or stabilization efforts, and the activity would not significantly disadvantage or primarily have the effect of displacing low- or moderate-income individuals and communities.

You stated in your letter that the targeted areas in the City of [ ] Middle Income Housing Down-Payment Assistance Initiative include low- to moderate-income areas and areas adjacent to low- and moderate-income areas. Examiners may give favorable CRA consideration to community development activities outside of low- and moderate-income areas that, among other things, stabilize or revitalize particular low- or moderate-income areas. Activities outside of low- or moderate-income areas also may receive favorable CRA consideration if, for example, those activities are part of a plan to revitalize or stabilize the low- and moderate-income areas.[7]

I trust that this letter is responsive to your request. If you have any additional questions, please feel free to contact me or Beth Knickerbocker, an attorney on my staff, at 202–874–5750 if you have further questions.

Michael S. Bylsma
Director
Community and Consumer Law Division

811—December 18, 1997

12 USC 24(7) *[file 18]*
12 USC 24(7) *[file 1]*

John W. Alderman, III
Vice President & Chief Legal Counsel
City Holding Company
P.O. Box 4168
Charleston, West Virginia 25364–4168

Dear Mr. Alderman:

This responds to your request that the Office of the Comptroller of the Currency (OCC) confirm that the proposed acquisition of [ ] ("Printing Company") by [ ], *[city, state]* ("bank") is permissible. Based on the information and representations provided, and for the reasons discussed below, we agree with your conclusion that the proposed acquisition and contemplated activities of the printing company would be permissible under the National Bank Act.

Background

The bank and its affiliates currently contract with the printing company and other third parties for bank printing and related design services which include the printing of checks, forms, marketing materials, and similar items. The printing company also offers similar services and supplies to other customers, some of whom are not financial institutions. The bank proposes to acquire the printing company and to operate it as a division of the bank. The bank's primary business objective in acquiring the printing company is to reduce its printing costs and achieve greater control over the production of its printed materials. The bank believes that the acquisition of an existing printing business, including its trained employees and assets, would achieve these objectives more efficiently and with less risk than acquiring printing capability *de novo.*

Following its acquisition, the printing company would continue to provide printing services to the bank and its affiliates as described. Additionally, the bank plans to use the printing company's "excess capacity" to provide printing services to third-parties, including nonfinancial entities. This excess capacity would exist in part because initially the bank and its affiliates will not consume all of the printing and design capacity of the printing company. Specifically, the bank expects that immediately after the acquisition approximately 80–85 percent of the printing company's printing and design capacity will be consumed by the businesses of the bank and its affiliates. However, the bank expects that this excess capacity in the printing company will decrease over time as the operations of the bank and its affiliates expand and as their need for printing services increase concomitantly. Although the precise amount and timing of this reduction in excess capacity cannot be predicted with certainty, based on current growth rates and assuming no increase in the printing company's capacity, the bank believes that the initial excess would be consumed by its operations and those of its affiliates within five years.[1]

The bank reports that the owners of the printing company will not sell to the bank less than 100 percent of the

[7] *See* Qs and As, 62 Fed. Reg. 52,111 (October 6, 1997) (Q and A 2 addressing section _____.12(h) & 563e.12(g) (definition of community development)).

[1] OCC recognizes that projections of future needs of printing services cannot be made with complete accuracy because, among other reasons, unforeseen changes in technology could change patterns of internal consumption of such services.

company, and the bank does not believe that it can cost-effectively acquire assets and attract employees *de novo* that would adequately substitute for the assets, employees and expertise that it could acquire through the printing company. The bank also states that, assuming it did not need the excess capacity for anticipated future internal growth, it would be unable following the acquisition of the printing company to segregate and divest the excess printing capacity since substantially all of the excess is represented by individual, indivisible assets *(e.g.,* presses, printers, copiers, and other fixed assets) and employees with special expertise. The bank represents that simply divesting or not using the excess capacity would result in substantial loss to the bank from increased overhead and reduced return on assets.

Discussion

The National Bank Act provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes. . . .

12 USC 24(Seventh).

The Supreme Court has expressly held that the "business of banking" is not limited to the enumerated powers in 12 USC 24(Seventh), but encompasses more broadly activities that are part of the business of banking. *See NationsBank of North Carolina, N.A.* v. *Variable Life Annuity Co.*, 115 S. Ct. 810, 814 n.2 (1995) *(VALIC).* The *VALIC* decision further established that banks may engage in the activities that are incidental to the enumerated powers as well as the broader "business of banking."

Prior to *VALIC,* the standard that was often considered in determining whether an activity was incidental to banking was the one advanced by the First Circuit Court of Appeals in *Arnold Tours, Inc.* v. *Camp,* 472 F.2d 427 (1st Cir. 1972) *("Arnold Tours").* The *Arnold Tours* standard defined an incidental power as one that is "convenient or useful in connection with the performance of one of the bank's established activities pursuant to its *express* powers under the National Bank Act." *Arnold Tours* at 432 (emphasis added). Even prior to *VALIC,* the *Arnold Tours* formula represented the narrow interpretation of the "incidental powers" provision of the National Bank Act. OCC Interpretive Letter No. 494 (December 20, 1989). The *VALIC* decision, however, has established that the *Arnold Tours* formula provides that an incidental power includes one that is convenient and useful to the "business of banking," as well as a power incidental to the express powers specifically enumerated in 12 USC 24(Seventh).

Printing Services for the bank and its Affiliates

The acquisition and operation of the printing company to provide printing services for the bank and its affiliates are permissible for a national bank under 12 USC 24(Seventh). With respect to printing services for the bank, the proposed activity is "convenient" and "useful" to the business of banking. Some printing operations will be used directly for banking services, *e.g.,* to provide forms used by the bank in its lending and deposit functions. Indeed, the OCC has previously concluded that the printing of checks, drafts, loan payment coupons, and similar documents for use in the national bank's business is a permissible incidental activity for a national bank. *See* Letter from Mary Wheat (April 7, 1988) (unpublished).

Other printing activities of the company will not be used directly for banking activities, but are permissible incidental activities because they facilitate, support and, hence, are "necessary to" the operation of the bank as a business. Examples of these would be the design and printing of internal personnel forms and telephone message pads for the bank. These printing services fall within the category of permissible incidental activities of national banks that are not incident to specific banking services or products, but rather to the operation of the bank as a business: they facilitate general operation of the bank as a business enterprise. Examples of these facilitating activities include hiring employees, issuing stock to raise capital, owning or renting equipment, borrowing money for operations, purchasing the assets and assuming the liabilities of other financial institutions. While no express grants of authority to conduct these activities exist, various federal statutes have implicitly recognized and regulated these business activities of national banks. For example, the statutes refer to limits on persons who can serve as bank employees.[2] In each case, the statutes have assumed the existence of the corporate power to conduct the activity. These powers are incidental to the general grant of power to conduct a "business" under 12 USC 24(Seventh) and do not need express enumeration.[3] Producing printed materials

---

[2] *See, e.g.,* 12 USC 78 (persons ineligible to be bank employees).

[3] Memorandum dated November 18, 1996, to Eugene A. Ludwig, Comptroller of the Currency, from Julie L. Williams, Chief Counsel, "Legal Authority for Revised Operating Subsidiary Regulation," *reprinted at* [1996–1997 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 90–464 ("Williams memo").

needed for the bank's internal administration as a business is, thus, a permissible incidental activity.

Finally, providing printing services for affiliated banks (and for nonaffiliated banks) is part of the business of banking because it is a valid correspondent banking function. National banks have traditionally performed for other financial institutions an array of activities called "correspondent services." *United States* v. *Citizens and Southern Nat'l Bank,* 422 U.S. 86, 114–15 (1975). These correspondent activities are part of the business of banking. OCC Interpretive Letter No. 754, *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–118 (November 6, 1996). Among the permissible correspondent activities are designing and producing banking related forms and documents. *See* OCC Interpretive Letter No. 513, *reprinted in* [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,215 (June 18, 1990).

Retained Excess Capacity

The bank notes that acquisition of the printing company will provide more printing capacity than can be consumed initially by the bank and its affiliates. Accordingly, it proposes to use this excess capacity to provide a limited amount of printing services for third parties. For the reasons below, this is a permissible use of retained excess capacity.

As noted above, a national bank may acquire a nonfinancial company where the company's nonfinancial operations are incidental to the production or distribution of banking products. In some cases the acquired company may have more productive capacity than can be currently used for banking operations. *See, e.g.,* OCC Interpretive Letter No. 677, *reprinted in* [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,625 (June 28, 1995) (acquisition of a financial services software company).

The OCC and the courts have long held that if a bank acquires excess capacity in good faith to meet the needs of the bank or its customers, the bank may use the excess capacity profitably even though the specific activities involving the excess capacity are not, themselves, part of or incidental to the business of banking. This doctrine has been applied to excess capacity in real estate,[4] electronic facilities,[5] and non-electronic facilities.[6] Further, this doctrine applies to the acquisitions of companies as well as equipment and facilities. OCC Interpretive Letter No. 677, *supra.*

The excess capacity doctrine recognizes that a bank acquiring an asset in good faith to conduct its banking business should, under its incidental powers, be permitted to make full economic use of the acquired property if use of the property for purely banking purposes would leave the property under-utilized. The underlying rationale is essentially that of avoidance of economic waste. The market price of the acquired property necessarily reflects its potential full economic use and if a bank cannot obtain that full economic value from owning the property, the bank would incur economic waste and could be unable to purchase the property it needs for its banking business. Thus, in the leading case of *Brown* v. *Schleier, supra,* the court observed:

> Nor do we perceive any reason why a national bank, when it purchases or leases property for the erection of a banking house, should be compelled to use it exclusively for banking purposes. If the land which it purchases or leases for the accommodation of its business is very valuable, it should be accorded the same rights that belong to other land owners of improving it in a way that will yield the largest income, lessen its own rent, and render that part of its funds which are invested in realty most productive.

Similarly, the OCC has said regarding excess computer capacity:

> If a bank . . . has legitimately acquired data processing equipment with excess capacity, it need not allow the excess capacity to go unused. Thus, the bank . . . may, incident to its legitimate acquisition of that equipment, sell the excess time even where the data processing services thus sold will not be data processing functions which are, of themselves, part of the business of banking. This allows a bank . . . to lower its costs of performing those data processing services which part of the banking business more profitable and competitive.

Unpublished letter from Peter Liebesman, dated December 13, 1983 (hereinafter: the "Liebesman letter").

---

[4] *See Brown* v. *Schleier,* 118 F. 981, 984 (8th Cir. 1902), aff'd, 194 U.S. 18 (1904); *Wingert* v. *First National Bank,* 175 F. 739 (4th Cir. 1909); *Perth Amboy National Bank* v. *Brodsky,* 207 F. Supp. 785, 788 (S.D.N.Y. 1962); and Unpublished letter from Comptroller James J. Saxon dated February 16, 1965.

[5] OCC Interpretive Letter No. 742, *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–106 (August 19, 1996) (excess capacity in Internet access); OCC Interpretive Letter No. 677, *supra* (excess capacity in software production and distribution); Unpublished letter from William Glidden dated June 6, 1986 (excess capacity in electronic security system); Unpublished letter from Stephen Brown dated December 20, 1989 (excess capacity in long line communications); and 12 CFR 7.1019.

[6] Unpublished letter from Mary Wheat dated April 7, 1988 (excess capacity in acquired printing equipment); unpublished letter from William Glidden dated July 11, 1989 (excess capacity in messenger services); and unpublished letter from Peter Liebesman dated December 13, 1983 (excess capacity in mail sorting machine).

In its excess capacity letters, OCC recognizes that good faith excess capacity can arise for several reasons. For example, the excess may be unavoidable where "due to the characteristics of the [desired equipment or facilities] available on the market, the capacity of the most practical optimal equipment [or facilities] available to meet the bank's needs may also exceed its precise needs." OCC Interpretive Letter No. 742, *supra. See also,* Liebesman letter, *supra;* unpublished letter from Mary Wheat dated April 7, 1988; and unpublished letter from William Glidden dated June 6, 1986. With equipment, this can occur because the equipment is not marketed in a size that meets the specific needs of the bank. With a company, this can occur in good faith because, for example, (1) the acquisition of an existing company is more economical than acquiring or developing needed capability *de novo;* (2) the seller refuses to sell just the portion of the company the bank needs; and (3) as a practical matter, the purchasing bank is unable to divest the excess portion of the company without loss or injury because purchasers for that portion of the company cannot realistically be found at a price that would fully compensate the bank for its investment in the excess portion of the company.[7]

Retention of excess capacity may also be necessary for future expansion or to meet the expected future needs of the bank. OCC Interpretive Letter No. 677, *supra;* and unpublished letter from Stephen Brown dated December 20, 1989. By way of analogy, national banks are permitted to acquire and to sell excess space in real property that they hold in good faith for future banking use. *See, e.g.,* unpublished letter from Comptroller James J. Saxon dated February 16, 1965 and unpublished letter from Wallace Nathan dated July 22, 1986. Property acquired for future use can be retained if there is a "reasonable expectation that, in the foreseeable future, the property will be useful" for banking purposes. Unpublished letter from Thomas DeShazo dated August 6, 1975; unpublished letter from Peter C. Kraft dated February 13, 1986; unpublished letter from John Powers dated December 23, 1986.[8]

Finally, good faith excess capacity can also arise after the initial acquisition of capacity thought to be fully needed for banking operations. This can occur due to a decline in level of banking operations using the capacity[9] or because banking operations become more efficient in their use of the capacity.[10]

The underlying reason for the acquisition or retention of excess capacity in any particular case is significant because, among other things, it can affect the analysis of whether the retention of the specific quantity of excess capacity is permissible in that particular case. For example, the rationale permitting retention of excess capacity acquired in reasonable anticipation of future growth might reasonably support fairly large amounts of initial excess capacity that will decline quickly. On the other hand, excess capacity that is acquired due to the "market availability" rationale will not necessarily decline over time and the likelihood that such excess will persist indefinitely may be considered in assessing the amount of permissible retained excess. Therefore, one cannot develop fixed rules on what specific quantity of excess capacity will meet the good faith standard in all retention cases.

Here, the bank proposes to retain the excess capacity in the printing company in good faith for two reasons. First, the bank has demonstrated a reasonable expectation that it will need the excess printing capacity for future expansion within the foreseeable future. The bank has attested that it believes that, based upon projected growth, it will probably consume the entire printing capacity of the company for banking purposes within five years. Second, the bank also justifies retention of the excess capacity due to the necessities of market availability. The bank credibly represents that it could not acquire *de novo* the needed printing capacity more economically, that the company cannot be acquired without the excess, and that the excess cannot be divested without undue economic loss. Under either rationale, since the excess printing capacity will have been acquired and retained in good faith, it follows that the bank may acquire the printing company and make full economic use of its excess capacity, including for nonbanking functions.

I trust the foregoing is responsive to your inquiry. If you have any questions concerning this opinion, please contact Assistant Chief Counsel James Gillespie at 202–874–5200.

Julie L. Williams
Chief Counsel

[7] Merely ceasing the operations of the "excess" portion without a sale, even though it would save on variable costs, will frequently result in a loss where the "excess" portion produces net revenues. The purchasing bank will usually have paid a premium for the company based in part upon the net present value of that expected revenue stream which will be lost if the operation is simply ceased without sale.

[8] In light of the express statutory limitation on national bank holding of realty under 12 USC 29, the OCC expects that a national bank will normally use real estate acquired for future expansion within five years. *See* 12 CFR 34.84. However, the appropriate period of time for expected consumption of non-realty excess capacity should depend upon the nature of the specific asset and its use.

[9] *See, e.g.,* unpublished letter from William Glidden dated June 6, 1986.

[10] *See, e.g.,* unpublished letter from William Glidden dated July 11, 1989.

812—December 29, 1997

12 USC 24(7) *[file 41]*

Mr. John K. Sorenson
President
Iowa Bankers Insurance and Services, Inc.
418 Sixth Avenue, Suite 430
Des Moines, Iowa 50309–2438

Dear Mr. Sorenson:

This responds to your request that the Office of the Comptroller of the Currency (OCC) confirm that a national bank may offer, as agent, multiple peril crop insurance[1] and hail/fire insurance[2] (collectively, "crop insurance") in connection with loans to its farmer customers. Your request is on behalf of the Iowa Bankers Insurance and Services, Inc. ("IBI"). For the reasons discussed below, it is our opinion that the proposed activity would be permissible for national banks because the sale of such credit-related insurance is part of, or incidental to, the business of banking.

I. Background

The IBI is a cooperative formed in 1972 to provide insurance services to customer banks and bank insurance agencies in Iowa, including life and health insurance, financial institution bonds, professional errors and omissions coverage, and directors and officers liability coverage. The IBI is jointly owned (99.6 percent) by the Iowa Bankers Association, a trade association representing the majority of commercial banks in Iowa, and by individual commercial banks (0.4 percent). The IBI provides training to banks and loan officers in connection with banks' sales of credit-related insurance, including crop insurance programs in Iowa. The IBI's training programs would be available for national banks interested in selling crop insurance.

Agricultural lenders frequently make loans to farm borrowers for the purpose of paying for operational expenses associated with farming, e.g., expenses for seeds, fertilizer, fuel, etc.[3] According to the IBI, in assessing agricultural loans to crop producers, the projected cash flow of the producer is the critical element in a bank's assessment of the ability of a crop producer to repay the loan. Banks' loans to crop producing borrowers are not always collateralized by the borrowers' crops. If the farmer has crop insurance, crop insurance payments may be assigned to the banks that financed the planting of the farmer's crops.[4] Even if crop insurance proceeds are not specifically assigned to a bank, these proceeds are taken into account in judging a borrower's ability to make repayments on a loan.

Crop insurance provides farmers with a financial risk management tool to protect against excessive losses resulting from crop failures or low yields. Historically, the federal government provided subsidies and price supports to the agriculture industry as a "safety net" to reduce some of the production and price risk inherent to the producer. Some minimal catastrophic insurance coverage was required to participate in these programs. However, those programs were phased out under the Federal Agricultural Improvement and Reform Act of 1996 (the "1996 Farm Bill"). Due to the repeal of the federal farm price guarantees on a host of crops, according to the IBI, farmers can no longer rely on the federal government for help in repaying a debt if their crops are destroyed in a natural disaster, and must look to the private sector to purchase crop insurance to provide the "safety net" once provided by government programs. Because of the elimination of traditional price support and crop subsidy programs, the degree of risk to banks from loans to agricultural producers has increased. Accordingly, both farmers and lenders have a heightened need to identify appropriate risk management approaches, including insurance coverage, that manages the risks of crop production. Crop insurance both protects a crop producer from loss of income due to damage or destruction of the producer's growing crops, and reduces lenders' agricultural credit risk.

The IBI has represented that farmers frequently inquire whether national banks can provide crop insurance coverage due to the lack of crop insurance agents in

---

[1] Multiple peril crop insurance (MPCI), covers unavoidable losses on crops, including losses due to drought, excess moisture, insects, disease, flood, hail, wind, and frost. MPCI guarantees a minimum average yield per acre for the insured crop. The deductible is determined by the insured level of production. If the producer's average yield falls below the insured level, the insurance company pays the difference. According to the IBI, farmers can purchase up to a 75 percent guarantee of their past production. The rates payable to an insured farmer are determined by market analysis. For example, in 1996, the rates payable on corn were $2.65 per bushel and the rates payable on soybeans were $6.75 per bushel. Thus, if a farmer produced less than 75 percent of his/her average, the farmer was paid an amount that provided for $2.65 or $6.75 for each bushel short of the 75 percent guarantee.

[2] According to the IBI, hail/fire insurance is normally purchased in $100 increments and pays a farmer a predetermined percentage of loss to the insured crop caused by hail or fire.

[3] The IBI represents that operational expenses do not include expenses for farm machines or real estate.

[4] The coverage amount of crop insurance selected by the crop producer may not necessarily be the same amount as the borrower's outstanding loans from the bank. The term of the crop insurance also may be different from the term of the loan, because the term of the crop insurance generally is tied to the growing season, according to the IBI.

their area. Agricultural borrowers want to purchase crop insurance from their national bank lenders, because of their sense of familiarity with the bank and the confidence they have in the ability of the bank to identify appropriate crop insurance products for its customers.

II. Discussion

A. The "Business of Banking"

The National Bank Act provides that national banks shall have the power:

> [t]o exercise . . . all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes. . . .

12 USC 24(Seventh).

The Supreme Court has held that this powers clause is a broad grant of the power to engage in the business of banking, including, but not limited to, the five specifically recited powers and the business of banking as a whole. *See NationsBank of North Carolina, N.A.* v. *Variable Life Annuity Co.,* 115 S.Ct. 810 (1995) *(VALIC).* Many activities that are not included in the enumerated powers are also part of the business of banking. Judicial cases reflect three general principles used to determine whether an activity is within the scope of the "business of banking": (1) is the activity functionally equivalent to or a logical outgrowth of a recognized banking activity; (2) would the activity respond to customer needs or otherwise benefit the bank or its customers; and (3) does the activity involve risks similar in nature to those already assumed by banks. *See, e.g., Merchants' Bank* v. *State Bank,* 77 U.S. 604 (1871); *M & M Leasing Corp.* v. *Seattle First National Bank,* 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied,* 436 U.S. 956 (1978); *American Insurance Association* v. *Clarke,* 865 F.2d 278, 282 (2d Cir. 1988).

Further, as the Supreme Court established in the *VALIC* decision, national banks are also authorized to engage in an activity if that activity is incidental to the performance of the five specified powers in 12 USC 24(Seventh) *or* incidental to the performance of an activity that is part of the business of banking.

1. Functionally Equivalent to or a Logical Outgrowth of Recognized Banking Functions

Crop insurance enhances or facilitates a bank's lending activity by protecting the bank's loans, and is therefore functionally part of, or a logical outgrowth of, a bank's lending operations. Banks make loans to farmers to cover operational expenses related to producing crops and expect to be repaid from proceeds from the sale of the farmer's crops. Crop insurance protects a bank's ability to recover on farm loans when farmers are unable to repay their loans because of their loss of income resulting from crop failure. Farm customers are interested in obtaining crop insurance to ensure that their farm loans are repaid in the event that they do not receive expected income from crop sales due to the destruction of their crops. Thus, crop insurance can be an integral part of the lending relationship that insures sources of repayment relied on by both the bank and the borrower. The proceeds of this insurance enhance borrowers' ability to fulfill their debt obligations to the bank, and protects the bank's loans even in cases where the borrower's crops are not collateral securing the borrower's loan, or where the crop insurance proceeds are not specifically assigned to a lending bank. Crop insurance sales that mitigate risks assumed by borrowers and lenders, and enhance a bank's ability to recover on farm loans, are directly related to, or are a logical outgrowth of, the lending relationship.

The involvement of state banks in selling crop insurance to farm customers illustrates how these insurance activities are a logical outgrowth of the lending relationship and are part of the business of banking. According to the IBI, state banks in Iowa and in other agricultural states already sell crop insurance, as agent, through licensed agents that are employed by the banks. Iowa Code Ann. 524.710.1.b. (West 1997). The IBI represents that crop insurance programs have been successful because the insurance provides valuable risk management protections for farm borrowers when they assume debt obligations to produce crops, and because the insurance enhances a lender's future recovery on farm loans.

Crop insurance is similar to other previously approved credit-related insurance products that the OCC and the courts have determined to be directly related to, and logical outgrowths of, a bank's authority to make loans because they protect a bank's ability to recover payment on loans to borrowers. *See* OCC Interpretive Letter No. 283 (March 16, 1984) (credit life, disability, mortgage life, involuntary unemployment, and vendors single interest insurance); 12 CFR Part 2 (credit life insurance); *IBAA* v. *Heimann,* 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied,* 449 U.S. 823 (1980) (confirming the OCC's authority to adopt its credit life insurance regulation at 12 CFR Part 2); Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division, June 3, 1986 (unpublished) (force placed vendors dual interest insurance); Letter of William B. Glidden, Assistant Director, Bank Operations and Assets Division, June 17, 1993 (unpublished) (mechanical breakdown insurance). *See also* OCC Interpretive Letter No. 671 (July 10, 1995), and OCC Interpretive

Letter No. 724 (April 22, 1996) (vehicle service contracts); Ruling 7495 (1963), Interpretive Ruling 7.013 (1996) (debt cancellation contracts); *First National Bank of Eastern Arkansas* v. *Taylor,* 907 F.2d 775 (8th Cir. 1990), *cert. denied,* 111 S. Ct. 442 (1990) (confirming the ability of national banks to enter into debt cancellation contracts).[5]

2. Respond to Customer Needs or Otherwise Benefit the bank or its Customers

Crop insurance benefits a bank's farm customers because it protects those customers against financial losses resulting from crop failures or low yields, and therefore enables them to continue meeting their financial obligations. Farmers no longer may rely on the federal government for help in repaying a debt if their crops are destroyed in a natural disaster, due to the 1996 Farm Bill, which repeals federal farm price guarantees on several crops. As a result, crop producers will need to assess the level of risk management that is appropriate, and will have to look to private sector options, such as purchasing crop insurance, to provide the "safety net" once provided by federal government programs. Permitting national banks to sell crop insurance will increase the availability of this important risk protection mechanism for crop producers and agricultural lenders.

[5] Under 12 USC 92, national banks in places of 5,000 inhabitants or less are authorized to sell various forms of insurance as agents for insurance companies. In 1968, the Fifth Circuit Court of Appeals ruled in *Saxon* v. *Georgia Association of Independent Insurance Agents, Inc.,* 399 F. 2d 1010 (5th Cir. 1968) ("*Saxon*"), that a national bank located in a place of more than 5,000 inhabitants could not sell to borrowers "broad forms of automobile, home, casualty and liability insurance." In *American Land Title Ass'n* v. *Clarke,* 968 F.2d 150, 156 (2d Cir. 1992), *cert. denied,* 113 S. Ct. 2959 (1993), the Second Circuit, citing *Saxon* as support, concluded that "section 92 impliedly bars national banks in towns with more than 5,000 inhabitants from engaging in insurance agency activities in general." The IBI's proposal does not involve "broad forms" of insurance. It involves only one type of specialized, credit-related insurance that is clearly connected to a bank's lending activities by protecting bank loans and enhancing and facilitating the lending function.

We also note that other courts have recognized the limits of the reasoning of *Saxon* and have held that 12 USC 24(Seventh) does authorize insurance activities that are incidental to banking. The District of Columbia Circuit, while choosing to distinguish *Saxon,* expressly rejected the argument that 12 USC 92 is the sole source of authority for national banks to engage in insurance activities, and held instead that there is incidental power to do so under 12 USC 24(Seventh). *IBAA* v. *Heimann,* 613 F.2d 1164 (D.C. Cir. 1979), *cert. denied,* 449 U.S. 823 (1980). We also note that in the eighth circuit, where Iowa is located, the Court of Appeals has strongly suggested that the *Saxon* case was wrongly decided. *Independent Insurance Agents of America, Inc.* v. *Board of Governors of the Federal Reserve System,* 736 F.2d 468, 477 and n.6 (8th Cir. 1984) ("There is a strong argument that *Saxon* was wrongly decided. The legislative history [of 12 USC 92] indicates that Congress was concerned only with providing small-town banks with an additional profit source, not with prohibiting city banks from selling insurance.").

Banks presently help farmers manage price risk by providing lines of credit and loans for hedging; holding seminars to educate farmers about risk management; and making referrals to risk management consultants. *See* Joanna Sullivan, *Farmers, Losing U.S. Aid, Ask Banks' Help to Hedge,* American Banker, July 2, 1997, at 1. The IBI has represented that farmers frequently inquire whether national banks can provide crop insurance coverage. Permitting national banks to sell crop insurance will provide another way that banks may help farmers manage risks resulting from fluctuations in the market price of their crops, and enable farmers to manage their risks by purchasing insurance at the same time they assume debt obligations.

Crop insurance sold in connection with banks' loans benefits banks by enhancing the safety and soundness of bank lending to farmers and providing an additional source of credit-related income to the banks. The elimination of traditional price support and crop production deficiency programs has increased the degree of risk to banks from loans to crop producers. The need for actively managing revenue risk through insurance arrangements therefore has become more important for agricultural lenders. Additionally, crop insurance sold in connection with banks' loans serve to mitigate the impact of banks' concentrations in agricultural loans. Finally, the proposed insurance activities also benefit national banks by enhancing their ability to compete with other lenders that are authorized to sell crop insurance, as agent, to their borrowers.

3. Risks Similar in Nature to Those Already Assumed by National Banks

National banks are already authorized to sell crop insurance, as agent, under 12 USC 92. The risks associated with selling crop insurance, as agent, are therefore familiar to national banks. Also, national banks already have the authority to assume the risks arising from sales of credit-related insurance in general. The OCC has approved numerous other credit-related insurance activities that serve to protect bank loans. *See, e.g.*, OCC Interpretive Letter No. 283, *supra;* Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division, June 3, 1986, *supra;* Letter of William B. Glidden, Assistant Director, Bank Operations and Assets Division, June 17, 1993, *supra;* 12 CFR Part 2, *supra. See also* OCC Interpretive Letter No. 671, *supra;* OCC Interpretive Letter No. 724, *supra;* Ruling 7495 (1963), Interpretive Ruling 7.013 (1996), *supra.* The risk assumed by a bank when it engages in the proposed credit insurance activity is the same risk already assumed by national banks when they sell other credit-related insurance, as agent.

B. The "Incidental to Banking" Analysis

Even if the IBI's proposal were not viewed as part of the business of banking, the proposal is incidental to the business of banking. The IBI's proposal is incidental to a bank's authority to make loans, pursuant to 12 USC 24(Seventh), because selling crop insurance enhances a bank's ability to receive repayment for its loans; promotes a bank's lending business by making available a credit-related product sought by borrowers; and enables a bank to avoid economic waste in connection with its lending activities.

The OCC and the courts have long authorized national banks to engage in a host of credit-related insurance activities. The OCC's approvals and court holdings concluded that these activities are incidental to a bank's lending activities because they protect banks' interest in their loans by reducing the risk of loss if borrowers cannot make their loan repayments. *See* OCC Interpretive Letter No. 283, *supra;* 12 CFR Part 2, *supra; IBAA* v. *Heimann, supra;* Letter of William B. Glidden, Assistant Director, Legal Advisory Services Division, June 3, 1986, *supra;* Letter of William B. Glidden, Assistant Director, Bank Operations and Assets Division, June 17, 1993, *supra. See also* OCC Interpretive Letter No. 671, *supra;* OCC Interpretive Letter No. 724, *supra;* Ruling 7495 (1963), Interpretive Ruling 7.013 (1996), *supra; First National Bank of Eastern Arkansas* v. *Taylor*, *supra.* The rationale behind the above OCC precedents and court cases on credit-related insurance is applicable to the IBI's proposal. Specifically, crop insurance protects banks' interest in their loans by reducing the risk of loss if borrowers cannot make their loan repayments due to crop failure.

OCC precedent has also established that the provision of certain products and services is permissible as incidental to the business of banking when needed to successfully package or promote other banking services. *See* OCC Interpretive Letter No. 754 (November 6, 1996) (national bank operating subsidiary may sell general purpose computer hardware to other financial institutions as part of larger product or service when necessary, convenient, and useful to bank permissible activities); OCC Interpretive Letter No. 742 (August 19, 1996) (bank may provide full Internet access to customers and non-customers in order to create a package of related services needed to satisfy consumer demand and enable the bank to successfully market its home banking services); OCC Interpretive Letter No. 653 (December 22, 1994) (national banks may offer nonbanking products as part of larger product or service when necessary, convenient, and useful to bank permissible activities); OCC Interpretive Letter No. 611 (November 23, 1992) (bank selling home banking service may also provide customer access to nonbanking services "to increase the customer base and the usage of the program").

Case authority also holds that national banks have an incidental power to promote their banking services, including offering incidental services desired by customers. *See Franklin Nat'l Bank* v. *New York,* 347 U.S. 373 (1954) (advertising of savings accounts); *Clement National Bank* v. *Vermont,* 231 U.S. 120 (1913) (promoting the bank's deposit services by computing, reporting and paying the state tax levied upon the interest earned by bank customers on their deposits); *Corbett* v. *Devon Bank,* 299 N.E.2d 521, 12 Ill. App. 3d 559 (1973) (as a means of promoting its banking business, a national bank may sell state motor vehicle licenses).[6] Customer convenience is one of the most important elements involved in competition among financial institutions. *See Oklahoma* v. *Bank of Oklahoma,* 409 F.Supp. 71, 88. *Cf.* Order of the Federal Reserve Board Approving Notice by Mellon Bank Corporation to Acquire an Employee Benefits Consulting Company (June 16, 1997) (The Federal Reserve Board's (the "Board") Order approved Mellon Bank Corporation's application to acquire an employee benefits consulting company that also provided insurance-related services. The Board determined that the provision of insurance-related activities was necessary and "incidental" to banking activities, because the employee benefits consulting company would operate at a competitive disadvantage if it could not provide the insurance-related services.).

The sale of crop insurance to farm borrowers similarly is incidental to a bank's lending activities to the extent offering this insurance is necessary to successfully package[7] or promote the bank's lending activities.[8] The IBI has represented that agricultural borrowers seek to purchase crop insurance from their national bank lenders, and that the availability of crop insurance can influence a borrower's choice of lenders. In this environment, to effectively market farm loan products, banks need to be able to provide the credit risk management products borrowers desire to protect their expected sources of repayment. Thus, national banks must be able

---

[6] The concept of promotional incidental powers for bank holding companies was judicially approved in *National Courier Ass'n* v. *Board of Governors,* 516 F.2d 1229, 1240 (D.C. Cir. 1975) (analogizing to the powers of national banks under 12 USC 24(Seventh), the court agreed that "[i]n enumerating the activities that could be carried on, [Congress] certainly could not have meant to forbid engagement in other 'incidental' activities as were reasonably necessary to carrying out those that were enumerated").

[7] Any packaging or promotion of a bank's loans must be consistent with any applicable anti-tying provisions of 12 USC 1972.

[8] Notably, since the IBI's proposal is related to a specific bank product, *i.e.,* bank loans, the conclusion that the IBI's proposal is incidental to banking is particularly compelling. *Compare Corbett* v. *Devon Bank,* 299 N.E.2d 521, 12 Ill. App. 3d 559 (1973) (where the activity permitted by the court, *i.e.,* selling state motor vehicle licenses, was not related to a specific bank product).

to offer customers these credit risk management products to remain competitive.

Finally, in connection with reviewing the scope of national banks' incidental powers authority, the courts have also determined that, within reasonable limits, certain activities can be incidental to banking when those activities enable a bank to realize gain or avoid loss from activities that are part of or necessary to its banking business. *See generally, Morris* v. *Third Nat'l Bank,* 142 F. 25 (8th Cir. 1905), *cert. denied,* 201 U.S. 649 (1906); *Birdsell Mfg. Co.* v. *Anderson,* 104 F.2d 340 (6th Cir. 1939); *Bailey* v. *Babcock,* 241 F. 501 (W.D. Pa. 1915); *Cooper* v. *Hill,* 94 F. 582 (8th Cir. 1899); *Cockrill* v. *Abeles,* 86 F. 505 (8th Cir. 1898); *National Bank* v. *Case,* 99 U.S. 628 (1879); *First Nat'l Bank* v. *National Exchange Bank,* 92 U.S. 122 (1875). Thus, for example, national banks as an exercise of their incidental powers related to their lending powers have been permitted to acquire and hold otherwise impermissible property and engage in otherwise impermissible business activities. As one court observed: "A national bank may lawfully do many things in securing and collecting its loans, in the enforcement of its rights and the conservation of its property previously acquired, which it is not authorized to engage in as a primary business." *Morris* v. *Third Nat'l Bank, supra.*

The general conclusion reached by the courts, *i.e.,* that activities that enable a bank to realize gain or avoid loss from activities that are part of or necessary to its banking business are incidental activities to banking, is directly applicable to the IBI's proposal. The proposed activity is clearly related to a bank's express lending powers, and will enable a bank to avoid loss or economic waste in its banking franchise by both increasing the ability of bank customers to make timely repayments on their loans, and by enhancing the competitiveness of national banks to promote their lending business. Additionally, the proposed activity will serve to mitigate the impact of banks' concentrations in agricultural loans, and thereby enable banks to avoid loss.

III. Conclusion

Based on the foregoing facts and analysis, we conclude that selling crop insurance, as agent, in connection with the bank's loans, is permissible for national banks.

Julie L. Williams
Chief Counsel

813—October 14, 1997

12 USC 24(7) *[file 23C]*

Dear [ ]:

This is in response to your letter dated August 29, 1997, supplemented by letters dated September 22, 1997 and October 8, 1997, requesting confirmation that [ ], *[city, state]* (bank) may lawfully acquire and hold a noncontrolling minority interest in a limited liability company (LLC) which will engage in the business of merchant credit and debit card processing. For the reasons set forth below, it is our opinion that this transaction is legally permissible in the manner and as described herein.

I. Background

The bank proposes to hold a 49 percent noncontrolling interest in a newly formed LLC. [ ] *[Co.]* will acquire and hold the remaining 51 percent interest in the LLC. The LLC will be established under Wisconsin law pursuant to a written agreement between the bank, *[Co.],* and [ ], *[city, state] [affiliate],* an affiliate of the bank. Initially, the bank and *[affiliate]* will organize the LLC and each will contribute their merchant processing assets to the LLC in exchange for a 99 percent interest and a 1 percent interest, respectively, in the company. Immediately following the establishment of the LLC, *[Co.]* will purchase all of *[affiliate]'s* interest in the LLC, and enough of the bank's interest in the LLC so that *[Co.]* will hold a 51 percent in the LLC and the bank will own a 49 percent interest.

The LLC will be governed by an operating agreement between the bank and *[Co.].* Under the terms of the operating agreement, the LLC's manager is specifically prohibited from causing the company to engage in activities that would be impermissible for the bank or a subsidiary of the bank. Moreover, the bank will have the authority to veto decisions of the LLC manager that will result in the company engaging in activities that are inconsistent with activities that are part of, or incidental to, the business of banking. The bank is also authorized to terminate the operating agreement and dispose of its interest in the LLC in the event the company engages in activities in which the bank or a subsidiary of the bank may not engage.

The LLC will provide debit and credit card processing products and services to merchants, including commercial loan and deposit customers of the bank. Initially, the LLC will be staffed only by members of the management committee. All other operations of the LLC will be conducted by the bank, *[Co.],* or third-party vendors pursuant to contracts with the LLC. The bank and its affiliates will generate new agent bank contracts and merchant

processing arrangements for the benefit of the LLC. Furthermore, the bank will enter into an agreement with the LLC to provide banking and related services to the LLC, such as serving as the member bank for Visa, MasterCard, and other payment networks on behalf of the LLC. Pursuant to a long-term exclusive processing arrangement, *[Co.]* will provide back room processing services to the LLC.

II. Discussion

A. National Bank Express and Incidental Powers (12 USC 24(Seventh))

In a variety of circumstances the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a noncontrolling interest in an enterprise. The enterprise might be a limited partnership, a corporation, or a limited liability company.[1] In recent interpretive letters, the OCC concluded that national banks are legally permitted to make a noncontrolling investment in a limited liability company provided four criteria or standards are met. *See* OCC Interpretive Letter No. 692 (November 1, 1995), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007, and No. 694 (December 13, 1995), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009.[2] *See also* Letter of Steven J. Weiss, Deputy Comptroller, Bank Organization and Structure (December 27, 1995 unpublished) ("Weiss Letter"). These standards, which have been distilled from our previous decisions in the area of permissible noncontrolling investments for national banks and their subsidiaries, are: (1) The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking; (2) The bank must be able to prevent the enterprise or entity from engaging in activities that do not meet the foregoing standard or be able to withdraw its investment; (3) The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and (4) The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

[1] *See also* 12 CFR 5.36(b). National banks are permitted to make various types of equity investments pursuant to 12 USC 24(Seventh) and other statutes.

[2] In other recent letters, the OCC has permitted national banks to make a noncontrolling investment in an enterprise other than an LLC, provided the investment satisfies these four standards. *See e.g.,* OCC Interpretive Letter No. 697 (November 15, 1995), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,012; OCC Interpretive Letter No. 705 (October 25, 1995), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. ¶ 81,020.

Based upon the facts presented, the bank's proposal satisfies these four standards.

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking.

Our precedents on noncontrolling ownership have recognized that the enterprise in which the bank holds an interest must confine its activities to those that are part of, or incidental to, the conduct of the banking business. *See, e.g.,* OCC Interpretive Letter No. 380, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (December 29, 1986) (since a national bank can provide options clearing services to customers it can purchase stock in a corporation providing options clearing services); Letter from Robert B. Serino, Deputy Chief Counsel (November 9, 1992) (since the operation of an ATM network is "a fundamental part of the basic business of banking," an equity investment in a corporation operating such a network is permissible).

The LLC will provide merchant credit and debit card processing services. It is clear that merchant processing activities are permissible under 12 USC 24(Seventh).[3] *See, e.g.,* OCC Conditional Approval #248 (June 27, 1997); OCC Interpretive Letter No. 720 (January 26, 1996), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,035; OCC Interpretive Letter No. 689 (August 9, 1995), [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–004; Banking Bulletin 92–94, Merchant Processing (May 5, 1992). Therefore, this standard is satisfied.

2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

The activities of the enterprise in which a national bank may invest must be part of, or incidental to, the business of banking not only at the time the bank first acquires its ownership, but for as long as the bank has an ownership interest. This standard may be met if the bank is able to exercise a veto power over the activities of the enterprise, or is able to dispose of its interest. *See, e.g.,* OCC Interpretive Letter No. 711, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–026 (February 3, 1996); OCC Interpretive Letter No. 625, *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993). This ensures that the bank will not become involved in impermissible activities.

[3] Merchant processing generally involves verifying credit and debit card authorizations at the time of purchase, processing card transactions, settlement of card transactions, and depositing funds in merchants' accounts.

Pursuant to the proposed operating agreement, the LLC is prohibited from engaging in activities which would be impermissible for the bank or a subsidiary of the bank. Also, the bank will have the authority to veto activities or decisions by the LLC's manager that are inconsistent with activities that are part of, or incidental to, the business of banking, as determined by the OCC. This provision will enable the bank on an ongoing basis to prevent the LLC from engaging in new activities which may be impermissible. Furthermore, the operating agreement authorizes the bank to terminate the agreement and dispose of its interest in the LLC if the company engages in any activities that are not part of, or incidental to, the business of banking.

Therefore, the second standard is satisfied.

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

a. Loss exposure from a legal standpoint

A primary concern of the OCC is that national banks should not be subjected to undue risk. Where an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that the national bank's investment not expose it to unlimited liability. As a legal matter, investors in a Wisconsin limited liability company will not incur liability with respect to the liabilities or obligations of the limited liability company solely by reason of being a member or manager of the limited liability company. Wis. Stat. Ann. 183.0304 (West Supp. 1996). Thus, the bank's loss exposure for the liabilities of the LLC will be limited by statute.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's 20–50 percent ownership share of investment in a limited liability company is to report it as an unconsolidated entity under the equity method of accounting. Under this method, unless the bank has guaranteed any of the liabilities of the entity or has other financial obligations to the entity, losses are generally limited to the amount of the investment, including loans and other advances shown on the investor's books. *See generally,* Accounting Principles Board, Op. 18 section 19 (1971) (equity method of accounting for investments in common stock). OCC Interpretive Letter No. 692, *supra.* Similarly, under the cost method of accounting, the investor records an investment at cost, dividends or distributions from the entity are the basis for recognition of earnings, and losses recognized by the investor are limited to the extent of the investment. In sum, regardless of which accounting method is used, the investing bank's potential loss is limited to the amount of the investment.

As proposed, the bank will have a 49 percent ownership interest in the LLC. The bank will account for its investment in the LLC under the equity method. Thus the bank's loss from an accounting perspective would be limited to the amount invested in the LLC and the bank will not have any open-ended liability for the obligations of the LLC.

Therefore, for both legal and accounting purposes, the bank's potential loss exposure relative to the LLC should be limited to the amount of its investment in those entities. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

4. The investment must be convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

12 USC 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking. "Necessary" has been judicially construed to mean "convenient or useful". *See Arnold Tours, Inc.* v. *Camp,* 472 F.2d 427, 432 (1st Cir. 1972). Our precedents on bank noncontrolling investments have indicated that the investment must be convenient or useful to the bank in conducting *that bank's* business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment. *See, e.g.,* OCC Interpretive Letter No. 697, *supra;* OCC Interpretive Letter No. 543, *reprinted in* [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991); OCC Interpretive Letter No. 427, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); OCC Interpretive Letter No. 421, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988); OCC Interpretive Letter No. 380, *supra.*

The bank is currently actively involved in providing merchant processing services of the same or similar type as the LLC will provide. The bank believes the best way for it to continue to provide merchant processing services is to enter into an alliance with another merchant processing provider, thereby achieving economies of scale necessary to lower per-transaction costs and other competitive advantages. *[Co.]* is a leading provider of merchant processing services, and the bank believes its participation in this joint venture will help ensure the investment in technology needed to achieve economies of scale that the bank could not achieve on its own. Thus the investment is "necessary" to the bank's ability to efficiently and capably carry out its banking business and to compete more effectively in the merchant processing services market.

For these reasons, the bank's investment in the LLC is convenient and useful to the bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, it is our opinion that the bank is legally permitted to acquire and hold a noncontrolling minority interest in the LLC in the manner and as described herein, subject to the following conditions:

1. the LLC will engage only in activities that are part of, or incidental to, the business of banking;
2. the bank will have veto power over any activities and major decisions of the LLC that are inconsistent with condition number one, or will withdraw from the LLC in the event they engage in an activity that is inconsistent with condition number one;
3. the bank will account for its investment in the LLC under the equity method of accounting; and
4. the LLC will be subject to OCC supervision, regulation, and examination.

Please be advised that the conditions of this approval are deemed to be "conditions imposed in writing by the agency in connection with the granting of any application or other request" within the meaning of 12 USC 1818.

If you have any questions, please contact me or Christopher Sablich, Senior Attorney, at 312–360–8805.

Coreen S. Arnold
District Counsel
Central District Office
One Financial Place, Suite 2700
440 South LaSalle Street
Chicago, Illinois 60605

814—November 3, 1997

12 USC 36 *[file J3]*

Joseph T. Green
General Counsel
TCF National Bank Minnesota
801 Marquette Avenue
Minneapolis, MN 55402

Dear Mr. Green:

This is in response to your letter of October 1, 1997, as supplemented by your letter of October 29, 1997, seeking our concurrence that offices of [ ] (the subsidiary), a wholly owned subsidiary of TCF National Bank Minnesota (the bank), are not branches of the bank.

The bank became a national bank on April 7, 1997, following its conversion from a federal savings bank charter. This conversion was approved by the OCC on February 24, 1997. At the time of the conversion, the OCC permitted the bank to continue to own the subsidiary, which engages in the sale of title insurance policies as agent for third-party title insurance companies as permitted under 12 USC 92. *See* Decision of the Comptroller of the Currency to Approve Applications by TCF Financial Corp., Minneapolis, Minnesota, to Convert Federal Savings Bank Located in Minnesota, Michigan, Illinois, and Wisconsin and to Establish *de novo* Banks in Ohio and Colorado and to Engage in Certain Related Transaction, p. 35 (OCC Corporate Decision 97–13) (February 24, 1997) (the Conversion Decision). In addition, this subsidiary performs abstracting, escrow, and closing services for first mortgage residential loans originated by the bank, other affiliates, and third parties and issues title reports for second mortgage loans originated by the bank, other affiliates, and third parties. *Id.*[1]

Offices of a subsidiary of a national bank may be considered branches of the national bank if they engage in branching functions. *See* 12 CFR 5.34(d)(3), 7.1003(a)(1). Because you have represented that the Minnesota offices of the subsidiary close loans made by the bank, and borrowers receive, in-person, the loan proceeds from the lender, branching issues are raised. *See* 12 CFR 7.1003(a). It was originally envisioned that the offices of the subsidiary would not constitute branches of the bank because funds disbursed to borrowers at the

[1] As described in the Conversion Decision, the OCC has permitted national banks to perform surveys and title searches and to arrive at legal opinions in connection with their real estate mortgage business. *Id.* The OCC also has permitted national banks to prepare and sell abstracts of title, the handling of escrow accounts, and the closing of real estate transactions at least in connection with its own real estate loans. *Id.* The Conversion Decision permitted the subsidiary to engage in these activities indefinitely. However, to the extent that the subsidiary provides services beyond those which were permitted at the time for national bank operating subsidiaries, the Conversion Decision required that those services must be terminated within two years of consummation of the conversion unless, within that time period, the OCC determines that the services are permissible. In this regard, the bank has requested a determination on the permissibility of a national bank operating subsidiary providing abstracting, closing, and escrow services to affiliates and to third parties. *Id.* at pp. 35–36. The OCC is reviewing this request. Consequently, at least until April 7, 1999, the subsidiary may conduct its business as it did prior to the conversion.

As stated in the Conversion Decision, the subsidiary operates offices for the conduct of this business in Minnesota, Michigan, Wisconsin, Illinois, and Indiana. You have clarified that the subsidiary does not operate offices in Missouri.

offices of the subsidiary would be those of an unaffiliated third party drawn on an account of that party at an unaffiliated bank, rather than funds of the bank or the subsidiary. *See* the Conversion Decision at p. 35, n. 57 and p. 26, n. 41. *See also* OCC Interpretive Letter No. 721, March 6, 1996, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–036. This procedure would be in accordance with 12 CFR 7.1003 and the OCC would not consider these offices to be branches of the bank. *Id.*[2] This procedure has not been possible to implement at these offices for a variety of reasons, however, and you have sought our concurrence that these offices should not constitute branches because they provide similar services on substantially similar terms and conditions to customers of the bank and its subsidiaries as well as to customers of unaffiliated entities including unrelated banks, savings associations and savings banks, credit unions, finance companies, and mortgage brokers. Based on your representations, we agree with your conclusion that, for the following reasons, these offices do not constitute branches of the bank.

In finalizing revisions to its branching rules, codified at 12 CFR 5.30, the OCC stated:

> Proposed 5.30(d)(1)(ii)(B) clarified that the term "branch" does not include a facility that is "generally available to customers of other banks to receive substantially similar services pertaining to their accounts at other banks on the basis of substantially similar terms and conditions." As recognized by a number of commenters, the primary impact of this provision would have been to exclude from the definition of branch ATMs that are linked to networks and, thus, provide services to bank customers and noncustomers alike. However, as a result of recent statutory changes contained in Section 2205 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, Public Law 104–208, September 30, 1996 (110 Stat. 3009), ATMs and remote service units are no longer considered branches and, thus, are not subject to the limitations on national bank branching imposed by the McFadden Act and codified at 12 USC 36. Consequently, the OCC has deleted this provision from the final rule and has also revised the final rule to state specifically that ATMs and remote service units are not branches. *The OCC also recognizes, however, that other situations may still arise where a particular facility should not be considered to be a bank branch because it, in fact, provides services generally on a nondiscriminatory basis with respect to accounts that its customers hold as well as accounts held by noncustomers in other banks and depository institutions. The OCC believes these issues are best considered on a case-by-case basis based on the particular circumstances involved.*

See 61 Fed. Reg. 60,342, 60,347 (November 27, 1996) (emphasis added).

As the OCC has recognized, a facility where members of the public—customers and noncustomers alike—receive substantially similar services on substantially similar terms is not a facility created to attract *bank* customers. *See* 59 Fed. Reg. 61,034, 61,037 (November 29, 1994) (Part 5 notice of proposed rulemaking). The analysis is a variation on the long-held analysis by the OCC that bank facilities that are engaged only in back office functions are not branches because they do not attract bank customers. *Id. See also, e.g.,* OCC Interpretive Letter No. 635, July 23, 1993, *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,519 (July 23, 1993) (deposit taking through facility to which public has no in-person access is not a branch) (and interpretations cited therein). Moreover, the OCC has specifically opined in the context of a lending situation, even if it is assumed that a branching function is involved, if a bank facility provides the same services to borrowers from the bank as well as borrowers from other lenders, the facility would not be considered to be a branch. *See* OCC Interpretive Letter by Christopher C. Manthey, Senior Attorney, Bank Activities and Structure, to Michael E. Bleier, General Counsel, Mellon Bank, N.A. (December 22, 1994) (addressing drop boxes established by an operating subsidiary of a national bank) (unpublished). That letter, assuming only for purposes of argument that receipt of loan payments constituted a branching function, stated:

> [T]he loan servicing payments received at the two drop boxes related not only to loans that were

[2] It is for this reason that the subsidiary's offices in Wisconsin and Illinois do not constitute branches of the bank or any other affiliated bank. These offices do not close loans or disburse proceeds on behalf of the bank. While the subsidiary, through its offices in Wisconsin and Illinois, does close loans and disburse proceeds in connection with loans originated by other affiliated banks in those states, you have represented that the procedures followed comport with those set forth in OCC Interpretive Letter No. 721. As that letter states: "[B]ranching limitations would not be violated when the affiliated bank issues its own cashier's check drawn on an account held in its own name, for the benefit of borrowers, and delivers those checks to the borrowers as part of the closing transaction." *Id.* at p. 5. This conclusion has now been codified at 12 CFR 7.1003(a) and the procedure you have described that is followed by these offices in closing loans and disbursing funds is consistent with the procedures set forth in OCC Interpretive Letter No. 721. In addition, we note that you have represented that only about 2.5 percent of the closing transactions undertaken in the Illinois office are undertaken on behalf of an affiliate, TCF Bank Illinois; 0.5 percent of the closing transactions undertaken in Wisconsin office are undertaken on behalf of an affiliate, TCF Bank Wisconsin. We further note that none of the transactions closed at the Indiana office are undertaken on behalf of an affiliated entity and the Michigan office does not provide closing services.

> originated by the Mortgage Company, but also to loans that were originated by other lenders, from whom the Mortgage Company purchased the servicing rights. In fact, over three-fourths of the loans serviced at the two service centers were originated by other lenders. Thus, the use of these facilities is not limited to borrowers from the Mortgage Company. Anyone whose loan is serviced by the Mortgage Company may use these drop boxes, regardless of who the original lender was. Much like a nonbranch, back office facility, these boxes do not provide a competitive advantage in gaining customers, but for the opposite reason. While a back office provides no competitive advantage because it serves no customers in person [citations omitted] the drop boxes provide no competitive advantage because they provide service to customers of competing lenders as well as the Mortgage Company's own customers. Indeed, in this case, the customers of other lenders appear to overwhelmingly predominate.

You have advised the OCC that the subsidiary is actively engaged in soliciting and providing its services to nonaffiliated lending entities and their customers and these services are offered to customers of nonaffiliated entities on substantially similar terms and conditions as are offered to customers of the bank. Moreover, you represent that less than 10 percent of the lending business conducted at the Minnesota offices arises from loans made by the bank and its subsidiaries while more than 90 percent arises from loans made by nonaffiliated entities.

Based on your representations and relevant precedent, as discussed above, we concur that the offices of the subsidiary do not constitute branches of the bank or any affiliated bank.

I hope that this has been responsive to your inquiry.

Eric Thompson
Director
Bank Activities and Structure

815—December 2, 1997

12 USC 24(7) *[files 68, 81]*

Dear [ ],

This responds to your letter of September 3, 1997, requesting confirmation that the *[bank], [city, state],* may lawfully retain its minority, noncontrolling interest in *[TC], [city, state],* a state-chartered trust company. Based on the information and representations provided and for the reasons set forth below, I agree with your conclusion that *[bank]* may retain its interest in *[TC].*

I. Background

[Bank], a nationally-chartered trust company and wholly-owned subsidiary of [ ] Corporation, a holding company, currently manages over $1.4 billion in assets in more than 1,500 accounts. On September 16, 1997, *[bank]* acquired a 15 percent interest in *[TC],* a trust company chartered under the laws of Indiana. *[TC]* was owned by three shareholders prior to *[bank]'s* purchase. Two of the shareholders, *[Mr. 1]* and *[Mr. 2],* are also in key management positions. The third shareholder is not active in the operation of *[TC]. [TC]* currently has approximately $250 million in assets under management in more that 600 accounts.

Pursuant to a stock acquisition agreement entered into between *[bank],* [ ] Corporation, *[TC],* and the *[TC]* shareholders, *[bank]* purchased newly issued common stock of *[TC]* equal to a 15 percent interest in *[TC].* As of the closing on the purchase of these shares, a Shareholders' Agreement was entered into governing the operation of *[TC],* establishing three positions on *[TC]'s* seven-person Board of Directors as *[bank]*-appointed directors and establishing voting provisions at the shareholder and director level which provide *[bank]* with veto power over major transaction or management decisions relating to *[TC].*

The acquisition agreement further states that *[bank]* will ultimately acquire the remainder of *[TC]* in a single transaction. Closing on the acquisition of *[TC]'s* remaining shares is anticipated to occur by June 30, 2002. Between June 30, 2000, and June 30, 2002, there will be a revenue valuation confirmation period during which the two organizations will work together for *[bank]'s* purchase of *[TC]'s* remaining shares. Prior to its closing on those remaining shares, *[bank]* will notify and seek approval of the Office of the Comptroller of the Currency for its acquisition of *[TC]* through a merger pursuant to 12 USC 215a.

The acquisition agreement also provides for various contingencies during the nearly five-year period from the initial purchase of the newly issued shares in September 1997 through the closing on the remaining shares in 2002. If any adverse change occurs with respect to *[TC], [bank]* would be relieved of any obligation to acquire the remaining shares and would be entitled to have the newly issued shares repurchased by the *[TC]* shareholders. Adverse changes include a material adverse change in the financial condition of *[TC];* a material adverse change in the customer base of *[TC];* the conviction of any shareholder of a felony; a revocation, withdrawal, suspension, or termination by banking regulators or other

governmental authorities of *[TC]'s* authority to conduct operations in the ordinary course of business; or the death and/or disability of *[TC]'s* two key officers prior to June 30, 2000, or within 12 months of each other.

II. Analysis

[Bank]'s purchase of a 15 percent interest in *[TC]* initially raises the issue of the authority of a nationally chartered trust company to hold a minority, noncontrolling interest in a corporation. In a variety of circumstances the OCC has permitted national banks to own, either directly, or indirectly through an operating subsidiary, a minority interest in an enterprise. In several recent interpretive letters, the OCC concluded that national banks are legally permitted to make a minority, noncontrolling investment in an entity provided that four standards are satisfied. *See* the following OCC Interpretive Letters: No. 737 (August 19, 1996), *reprinted in* [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,101; No. 732 (May 10, 1996), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,049; No. 694 (December 13, 1995), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,009; and No. 692 (November 1, 1995), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,007. These standards, which have been distilled from our previous decisions in the area of permissible minority, noncontrolling investments for national banks and their subsidiaries, are:

(1) the activities of the enterprise in which the bank invests must be limited to activities that are part of, or incidental to, the business of banking;

(2) the bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment;

(3) the bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and

(4) the investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

Each of these standards is discussed below and applied to *[bank]'s* investment.

1. The activities of the enterprise in which the bank invests must be limited to activities that are part of, or incidental to, the business of banking.

Our precedents on minority, noncontrolling stock ownership have recognized that the enterprise in which the bank takes an equity interest must confine its activities to those that are part of, or incidental to, the conduct of the banking business. *See, e.g.,* OCC Interpretive Letter No. 380 (December 29, 1986), *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (since a national bank can provide options clearing services to customers, it can purchase stock in a corporation providing options clearing services); Letter from Robert B. Serino, Deputy Chief Counsel (November 9, 1992) (since the operation of an ATM network is "a fundamental part of the basic business of banking," an equity investment in a corporation operating such a network is permissible).

You have represented that *[TC]* provides trust and fiduciary services, including the normal and customary services associated with administering trusts and estates, managing agency accounts, providing custodial and safekeeping services, serving in various fiduciary capacities, and providing pension and employee benefit services. It is well established that national banks may engage in trust activities. 12 USC 92a.

Thus, the activities performed by *[TC]* are activities that are part of, or incidental to, the business of banking, and the first standard is satisfied.

2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

The activities of the enterprise in which a national bank may invest must be part of, or incidental to, the business of banking not only at the time the bank first acquires its ownership, but for as long as the bank has an ownership interest. This standard may be met if the bank is able to exercise a veto power over the activities of the enterprise, or is able to dispose of its interest. *See, e.g.,* OCC Interpretive Letter No. 711 (February 3, 1996), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–026; and OCC Interpretive Letter No. 625 (July 1, 1993), *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507. This ensures that the bank will not become involved in activities which are not part of, or incidental to, the business of banking.

A number of provisions governing the relationship between *[bank]* and *[TC]* will cause *[TC]* to restrict its activities to those that are part of, or incidental to, the business of banking. First, *[TC]'s* articles of incorporation will be amended to limit its activities to those that are part of, or incidental to, the business of banking. Second, the acquisition agreement provides for *[bank]* to be relieved of any obligation to acquire the remaining shares and entitles it to have the newly issued shares repurchased by the *[TC]* shareholders in the event of an adverse or material change in *[TC]*. Third, the shareholders' agreement provides for the board of directors of *[TC]* to have

seven members, including the three *[TC]* shareholders, one individual chosen by those three shareholders, and three additional directors to be chosen by *[bank]*. The shareholders' agreement further provides that the affirmative vote of 80 percent of *[TC]'s* board of directors is required for major decisions and transactions, including adding a new line of business or making any changes in the scope or nature of the business of *[TC].*[1] Thus, *[bank]* has the veto power to prevent *[TC]* from engaging in any activities that are not part of, or incidental to, the business of banking.

Through the revised articles of incorporation, acquisition agreement, and the *[bank]*-designated positions on the *[TC]* board of directors, *[bank]* can assure that *[TC]* does not engage in activities that are not a part of, or incidental to, the business of banking. Therefore, the second standard is satisfied.

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

a. Loss exposure from a legal standpoint

A primary concern of the OCC is that national banks should not be subjected to undue risk. When an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that the national bank's investment not expose it to unlimited liability. In Indiana, trust companies are defined as "corporations,"[2] and, as a legal matter, "a shareholder of a corporation is not personally liable for the acts or debts of the corporation." Ind. Code Ch. 23–1–26–3(b) (1993). *See also Aronson* v. *Price,* 644 N.E.2d 864, 867 (Ind. 1994) ("corporate shareholders sustain liability for corporate acts only to the extent of their investment"). Thus, *[bank]'s* loss exposure for the liabilities of *[TC]* is limited by statute.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a minority investment is to report it as an unconsolidated entity under the equity method of accounting. Under this method, unless the bank has guaranteed any of the liabilities of the entity or has other financial obligations to the entity, losses are generally limited to the amount of the investment, including loans and other advances shown on the investor's books. *See generally,* Accounting Principles Board, Op. 18 section 19 (1971) (equity method of accounting for investments in common stock). OCC Interpretive Letter No. 692, *supra.*

[Bank] has a 15 percent ownership interest in *[TC],* and will account for its investment under the equity method. *[bank]'s* loss exposure is initially limited to the amount of its investment and is subject to certain rights to have its shares repurchased upon the occurrence of adverse changes in circumstances. Further, *[bank]'s* obligation to proceed with the purchase of the remaining shares is conditioned upon *[TC]'s* continued financial and operational performance.

Therefore, for both legal and accounting purposes, *[bank]'s* potential loss exposure relative to *[TC]* should be limited to the amount of its investment. Since that exposure is quantifiable and controllable, the third standard is satisfied.

4. The investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

12 USC 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking. "Necessary" has been judicially construed to mean "convenient or useful." *See Arnold Tours, Inc.* v. *Camp,* 472 F.2d 427, 432 (1st Cir. 1972). Our precedents on bank noncontrolling investments have indicated that the investment must be convenient or useful to the bank in conducting *that bank's* business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment. *See, e.g.* OCC Conditional Approval No. 186 (November 15, 1995) (National bank may indirectly own a 25 percent interest in a trust company.)

From your statements, it appears that *[bank]* has valid business reasons for its investment in *[TC].* You state that this investment allows *[bank]* to extend its trust business into a new market through *[TC],* an established trust provider. For this reason, *[bank]'s* investment benefits and furthers its banking business by enabling *[bank]* to gain new trust customers through *[TC].* In addition, *[bank]'s* investment is intended to provide a vehicle for the orderly acquisition of *[TC].* Thus, it is not merely a passive or speculative investment. Accordingly, the fourth standard is satisfied.

---

[1] Although the shareholders' agreement does not provide for *[bank]'s* withdrawal from its investment if *[TC]* engages in activities that are not part of, or incidental to, the business of banking, the agreement does require the unanimous vote of the shareholders to amend *[TC]'s* articles of incorporation. Since *[TC]'s* articles of incorporation will provide that it will not engage in activities that are not part of, or incidental to, the business of banking, *[bank]* will be able to enforce such provision.

[2] Ind. Code Ch. 28–1–5–1(a)(1993).

III. Conclusion

This opinion is based on a thorough review of all information available, including representations and commitments submitted by *[bank],* and by its representatives. Based on these representations and for the reasons outlined above, we conclude that the bank may legally retain its investment in *[TC],* subject to the following conditions:

1. *[TC]* will engage only in activities that are part of, or incidental to, the business of banking;
2. *[bank]* will have veto power over any activities and major decisions of *[TC]* that are inconsistent with condition number one, or will withdraw from *[TC]* in the event that it engages in an activity that is inconsistent with condition number one;
3. *[bank]* will account for its investment in *[TC]* under the equity method of accounting; and
4. *[TC]* will be subject to OCC supervision, regulation, and examination.

These conditions are conditions imposed in writing by the OCC in connection with its action on the request for a legal opinion confirming that *[bank]'s* investment is permissible under 12 USC 24(Seventh) and, as such, may be enforced in proceedings under applicable law.

If you have any questions, please contact me or Giovanna Cavallo, attorney, at 312–360–8805.

Coreen S. Arnold
District Counsel
Central District Office
One Financial Place, Suite 2700
440 South LaSalle Street
Chicago, Illinois 60605

816—December 22, 1997

12 USC 60

Dear [ ]:

This letter replies to your request earlier this year concerning how the OCC determines a bank's dividend paying capacity under 12 USC 60(b). Section 60(b) limits the amount of dividends a national bank may pay in any calendar year without obtaining OCC approval. You suggested that section 60(b) should be interpreted in a way that avoids the requirement that a national bank create an earnings deficit when a dividend is declared in excess of current net income. For the reasons explained in this letter, we conclude that neither section 60(b) nor the OCC's implementing regulations require a national bank to carry forward negative amounts that result from dividends in excess of a single year's earnings.[1] Instead, the bank may attribute such excess dividends to each of the prior two years, attributing the excess first to the earlier of the two years and then to the immediately preceding year.

Statutory Background

12 USC 60(b) provides:

> The approval of the Comptroller of the Currency shall be required if the total of all dividends declared by such association in any calendar year shall exceed the total of its net income of that year combined with its retained net income of the preceding two years, less any required transfers to surplus or a fund for the retirement of any preferred stock.

Thus, the total amount of dividends that a bank may declare in any one year is limited to the sum of the net income of the current year plus the retained net income of the prior two years.[2]

Discussion

In instances where a bank declares dividends in excess of its current year net income, the OCC's practice has been to require the bank to carry a negative amount in retained net income for determining future dividend paying capacity. You propose an alternate method to this calculation under which a bank would not carry forward a negative amount in retained net income; instead, the portion of the dividend in excess of the net income of the current year would be attributed to prior periods, as the statute contemplates.

---

[1] This opinion addresses only the treatment of earning deficits that result from dividends declared in excess of a single year's earnings and does not apply to other types of current earnings deficits.

[2] The dividend restrictions in section 60(b) have been implemented by regulations promulgated at 12 CFR Part 5, Subpart E. Section 5.64 contains a slightly more detailed version of the statutory earnings restriction and, in pertinent part, provides:

> (b) *Earnings limitation.* For purposes of 12 USC 60, a national bank may not declare a dividend if the total amount of all dividends (common and preferred), including the proposed dividend, declared by the national bank in any calendar year exceeds the total of the national bank's retained net income of that year to date, combined with its retained net income of the preceding two years, unless the dividend is approved by the OCC.

12 CFR 5.64(b) (1997). Retained net income is defined at section 5.61(b) as "the net income of a specified period less the total amount of all dividends declared in that period." Additionally, section 5.62 provides that "[a] national bank shall use the date a dividend is declared for the purposes of determining compliance with this subpart."

Section 60(b) establishes a three-year window, or reference period, by which a national bank is to gauge the permissibility of a dividend payment without prior OCC approval. Neither the plain language of section 60(b) nor the OCC's implementing regulations requires the carry-forward of *negative* retained net income, a concept that is, as your letter points out, at odds with both general corporate law and generally accepted accounting principles (GAAP). Accordingly, pursuant to section 60(b) and 12 CFR 5.64, we conclude that national banks may attribute dividends in excess of the current year's net income to each of the prior two years, *to the extent that there is sufficient net income in those years,* attributing the excess first to the earlier of the two years and then to the immediately preceding year.[3]

This interpretation is consistent with the purpose of the earning limitations in section 60(b). As explained in the legislative history:

> [Section 60(b)] is designed to restrict the payment of dividends by national banks where such payments would result in dissipating needed capital funds. This provision strengthens the regulatory authority of the Comptroller. Under it, he will be able to prevent the declaration of dividends which are not justified by *current and recent accumulated earnings,* and which would result in a weakened and under-capitalized bank and violate safe and sound banking practice. It is not anticipated, however, that this provision will interfere in any measure with the normal dividend policies of national banks.

S. Rep. No. 730, 86th Cong., 1st Sess.—(1959), *reprinted in* 1957 USCC.A.N. 2232, 2238 (emphasis added). This interpretation is consistent with the dividend limitation under section 60(b) because the total amount of dividends that a bank may declare remains limited to "current and recent accumulated earnings" based on the current and the prior two years. Any bank dividend in excess of section 60(b) is still subject to OCC approval. As a result, this change in the dividend calculation is consistent with the purpose of section 60(b) to prevent the dissipation of capital through excessive dividends.

This result also is consistent with the Federal Financial Institutions Examination Council's (FFIEC) policy of moving toward GAAP for regulatory reporting purposes. *See* FFIEC Press Release, dated November 3, 1995. Under GAAP, dividends are treated as distributions from surplus and not as specific reductions from earnings for the period in which the dividend is declared. Absent specific statutory restrictions, the total amount of undivided profits would be available for the payment of dividends; GAAP does not segregate undivided profits by source or income period.

Finally, it is important to note that, notwithstanding the permissibility of a particular dividend payment under section 60(b), national banks (and other types of insured depository institutions) may not pay dividends, if, after payment of the dividend, the bank would be undercapitalized. 12 USC 1831o(d)(1)(A). Thus, the flexibility for dividend payments allowed under section 60(b) is at all times subject to the safety and soundness protections provided by section 1831o(d)(1)(A).

Should you have further questions, please feel free to contact Ron Shimabukuro, Senior Attorney, Legislative and Regulatory Activities Division, at 202–874–5090.

Julie L. Williams
Chief Counsel

[3] If the dividend in any year exceeds the bank's net income for that year plus previously undistributed net income of the preceding two years, a negative amount would be carried forward in the future year dividend calculations. This situation, however, would only arise if the amount of the dividend exceeds the limitation in section 60(b), and therefore would require prior OCC approval. In determining any such request for approval, the OCC could consider any request for different treatment of the excess dividend amount, including advance waivers for future period. *See* OCC Bulletin 94–41 (June 24, 1994).

817—January 7, 1998

12 USC 85

Dear [ ]:

This is in response to your letter of December 10, 1997, seeking clarification as to whether certain fees levied by the bank in connection with its credit card accounts constitute "interest" for purposes of 12 USC 85 (section 85) as that term is defined in 12 CFR 7.4001(a) (section 7.4001(a)). If the fees constitute "interest" and if they are permitted by the state where the national bank is located, then section 85 provides authority to the national bank to charge those fees to borrowers who reside in another state even if that other state prohibits the imposition of a particular fee in connection with credit card loans.[1]

The fees about which you inquire are late fees and non-sufficient funds (NSF) fees imposed by the bank after either the bank or the customer notifies the other that

[1] *Marquette National Bank of Minneapolis* v. *First of Omaha Service Corp,* 439 U.S. 299 (1978). The bank about which you inquire is an intrastate bank—that is, its main office and any branch offices are located only in one state. Consequently, no issue arises about which state's interest rate law applies to loans made by an interstate national bank.

they are terminating credit privileges but before the outstanding credit balance is paid off. As you describe the facts, late fees are charged whenever a customer makes the minimum monthly payment after the date on which it is due and NSF fees are imposed whenever a borrower's check is presented in payment of an amount owed by the borrower to the bank and the check is returned by his or her bank.

Section 7.4001(a) specifically provides that late fees and NSF fees are considered interest for purposes of section 85 and, if permissible under the law of the state where the bank is located, may be charged without regard to the state of the residence of the borrower.[2] You are concerned, however, about the possible impact of a recent OCC letter addressing fees charged by a bank when it rejects items presented by a customer to draw against a home equity account following the termination of the account. The letter held that these fees were not "interest" for purposes of section 85 because "no debtor/creditor relationship exists at that point. . . ."[3] As that letter noted, under Regulation Z, banks may, under certain circumstances, terminate home equity lines of credit and demand repayment.[4]

However, the circumstances you describe differ in two respects. First, even after termination, the account retains an outstanding loan balance, incurred prior to termination, which the customer must repay. Second, you are not asking about fees charged in connection with impermissible new draws against the terminated account as described in OCC Interpretive Letter No. 803, but about late fees and NSF fees charged in connection with repaying the outstanding balance that existed before termination of the account. Under these circumstances, the debtor/creditor relationship between the bank and customer remains; consequently late fees and NSF fees charged in connection with the repayment of the existing balance continue to be considered interest under sections 85 and 7.4001(a). Nothing in OCC Interpretive Letter No. 803 compels a different conclusion.

I hope that this has been responsive to your inquiry.

Julie L. Williams
Chief Counsel

[2] 12 CFR 7.4001(a). This regulation has been upheld by the Supreme Court in *Smiley* v. *Citibank (South Dakota) N.A.,* 135 L.Ed.2d 25 (1996).

[3] OCC Interpretive Letter No. 803, October 7, 1997, *reprinted in* [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,250.

[4] *Id.* at fn. 4.

818—January 12, 1998

12 USC 36(j) *[file 4]*

Dear [ ]:

This is in response to your letter to the OCC's Midwestern District Office in Kansas City, requesting confirmation that two methods outlined in your letter for disbursing loan proceeds at a national bank's loan production office (LPO) would be legally permissible and would not cause the LPO to be a branch of the owning bank. Your letter has been forwarded here, and I apologize for the delay in responding. As explained below, I agree with your conclusion.

Facts

According to your letter, the [ ] (the bank) plans to open an LPO in *[city, state],* that primarily will originate mortgage loans. The long-established practice of mortgage companies and other banks that will be the bank's competitors in that area is to deliver checks representing loan proceeds to the real estate agents, seller, and sometimes a balance to the mortgagor, at the time and location of the closing. Since the LPO will have a limited staff, it will not be possible for employees to travel to other locations, such as the offices of escrow agents, for closings and loan disbursal. Therefore, for competitive reasons, the bank desires to have loan closings, including disbursal of loan proceeds, take place at the LPO.

You have suggested two possible ways to structure the LPO's operations that you believe would accommodate the bank's needs, while at the same time avoiding impermissible branching activities:

1. The bank would establish a correspondent account at an unaffiliated bank. Prior to the time of the closing, the correspondent bank would prepare cashier's checks drawn on itself and representing correspondent bank funds in amounts requested by the bank. The correspondent bank would deliver these checks to the LPO, where they would then be delivered by the bank LPO employee to the borrower and other parties entitled to payment from loan proceeds, *e.g.,* realtors. Afterwards, the correspondent bank would debit the bank's correspondent account for the amount of the checks and would be compensated for issuing the checks.

2. An unaffiliated correspondent bank would establish on its books a regular checking account in the correspondent bank's name. Prior to the time of the closing, the correspondent bank would place a sufficient amount of its own funds into this account to cover a planned loan disbursement by the bank. By agreement between the bank and the corre-

> spondent bank, the bank LPO employee preparing the documents and materials for the closing would also prepare and execute checks drawn on this account and representing the loan proceeds. In essence, the LPO employee would be preparing cashier's checks drawn on the correspondent bank. At the closing, the LPO employee would deliver these checks to the borrower and other appropriate parties. Thereafter, the correspondent bank would settle the account by charging the bank's correspondent account, receiving a fee for its services.

You believe that under either scenario, there would not be any disbursement directly from the bank's funds at the closing, and therefore the LPO should not be considered a branch for purposes of the McFadden Act, 12 USC 36. You have requested confirmation that we agree with that conclusion.

Legal Analysis

As you are aware, the courts have identified three requirements for a bank facility to be a branch under the McFadden Act. It must offer at least one of the "core" banking activities listed in 12 USC 36(j), namely, receiving deposits, paying checks, or lending money. *Clarke* v. *Securities Industry Association,* 479 U.S. 388 (1987). In addition, a facility must be "established," *i.e.,* owned or rented, by the bank. *Independent Bankers Association of America* v. *Smith,* 534 F.2d 921 (D.C. Cir.), *cert. denied,* 429 U.S. 862 (1976) *(Smith); Independent Bankers Association of New York* v. *Marine Midland Bank,* 757 F.2d 453 (2d Cir. 1985), *cert. denied,* 476 U.S. 1186 (1986). And, the convenience to the public of the facility's location must give the bank a competitive advantage in obtaining customers. *First National Bank in Plant City* v. *Dickinson,* 396 U.S. 122 (1969). For a more detailed discussion of these principles, *see generally* OCC Interpretive Letter No. 634, [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,520 (July 23, 1993).

The only issue raised by your letter is whether core banking activities would be performed, that is, whether loans would be "made" at the LPO if either of the plans you outline are implemented. The leading cases construing the core McFadden activities specifically conclude that a loan is "made" for purposes of the McFadden Act at the time and place a borrower receives lending bank funds. *Smith,* 534 F.2d at 948, 946 n.95; *Illinois ex rel. Lignoul* v. *Continental Illinois National Bank,* 409 F. Supp. 1167, 1178 (N.D. Ill. 1975), *aff'd,* 536 F.2d 176 (7th Cir.), *cert. denied,* 429 U.S. 871 (1976).

Accordingly, the OCC has concluded that if LPO operations are structured in such a way that a borrower does not receive bank funds, then funds representing loan proceeds may be disbursed at an LPO without violating branching restrictions. This conclusion has been embodied in an OCC interpretive ruling:

> (a) *General.* For purposes of what constitutes a branch within the meaning of 12 USC 36(j) and 12 CFR 5.30 [the OCC's rule on branch licensing], "money" is deemed to be "lent" only at the place, if any, where the borrower, in-person, receives loan proceeds directly from bank funds:
>
> (1) From the lending bank or its operating subsidiary; or
>
> (2) At a facility that is established by the lending bank or its operating subsidiary.[1]

Interpretive Ruling 7.1003, 12 CFR 7.1003. A loan disbursement that fits these criteria will constitute a branching activity; that is, the location will be deemed to be a place where money is "lent" for purposes of 12 USC 36, and will require licensing as a branch. On the other hand, if the criteria are not satisfied, the location will not be a branch.

Neither of the scenarios proposed in your letter would satisfy these requirements. Although disbursal would be performed by bank personnel at a bank-established facility, borrowers would not receive loan proceeds directly from bank funds, as required by the Interpretive Ruling and case law. Therefore, I agree with your conclusion that, under either alternative, the LPO would not be a branch of the bank under 12 USC 36.

The OCC has previously addressed a fact situation that was similar to your first alternative in its use of cashier's checks issued by a bank other than the lending bank. In that case, an affiliate of the lending bank originated loans on behalf of the lending bank, issued cashier's checks drawn on its own funds to represent loan proceeds, and delivered these checks to borrowers on its own premises. It was then reimbursed by the lending bank. OCC Interpretive Letter No. 721, [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–036 (March 6, 1996).

Although I am not aware of any OCC precedents addressing your second alternative, I find it to be legally permissible. The analysis is the same whether the borrower receives a correspondent bank cashier's check, or a check drawn on the correspondent bank by an LPO employee. The crucial factor in either case is that the borrower would not receive bank funds.

An additional option for the disbursal of funds at the LPO that you may wish to consider is the use of independent

---

[1] Paragraph (b) of the ruling deals with the permissible, off-premises disbursal of bank funds by independent third parties such as escrow agents. Your letter does not involve that situation.

third parties, such as escrow agents. The OCC has taken the position that disbursal may be performed at an LPO where the lending bank disburses loan funds to a closing or escrow agent several days prior to a loan closing, and at the closing the escrow agent delivers to the borrower a check drawn on the escrow agent's own account. Letter of Christopher C. Manthey, Senior Attorney, Bank Activities and Structure Division (December 22, 1994, unpublished). A copy of that letter is attached for your information.

I hope that this has been responsive to your inquiry. If you have further questions, please feel free to contact Senior Attorney Christopher C. Manthey of my staff at 202–874–5300.

Eric Thompson
Director
Bank Activities and Structure Division

Enclosure

December 22, 1994

Dear [ ]:

I am writing in response to your letter to June 1, 1994, in which you described the real estate lending activities of certain operating subsidiaries of [ ] N.A. (the bank). You wished to know whether the OCC would consider the loan origination offices of these operating subsidiaries to be branches of the bank for purposes of the McFadden Act, 12 USC 36. Based on the facts as you have described them, it is my opinion that they would not be branches.

Facts

The bank has a wholly owned operating subsidiary known as [ ] (CMMHI), a holding company that owns [ ] (CUSCS). CUSCS is also a non-operating holding company that, in turn, owns three finance companies: [ ] Inc. (CMPFS), a Delaware corporation; [ ] (CMFC), a Minnesota industrial loan company; and [ ] (CMU), a Utah corporation. CMFC and CMU are separately incorporated due to state requirements and are merely instrumentalities through which CMPFS does business in those states. These three companies will be referred to collectively hereafter as "PFS" unless it is necessary to specify a particular company. The end result is that CMMHI is a first-tier operating subsidiary of the bank; CUSCS is a second-tier operating subsidiary; and the members of the PFS group are third-tier operating subsidiaries.[1]

PFS specializes in providing direct retail origination of jumbo residential real estate mortgages, and refinancing. It offers a wide range of products, including fixed and adjustable-rate jumbo mortgages, home equity loans and lines of credit, and, in a few states, construction financing. It has a network of 55 district offices, *i.e.,* loan origination offices, in 20 states plus the District of Columbia. This includes one CMU district office in Utah, and one CMFC district office in Minnesota.[2] Approximately 80 percent of the district offices are in corporate office parks or otherwise not on ground level in traditional shopping or retail areas, and are therefore not designed to attract walk-in traffic. PFS does not have any district offices in the state of New York; therefore none of these offices is located at a bank branch. There are also five operations hubs, none of which is located in a district office. These operations hubs perform data processing and other back office functions, and are not accessible to the public.

Loans are generally closed at the time and place of the borrower's choosing. Most mortgage loans are consummated and loan proceeds delivered at closings held in the offices of title companies, escrow companies, attorneys, or other third parties, or at borrowers' offices or homes. However, some loan closings take place at the local district offices, if that location is requested by the borrower.

PFS does not disburse funds by check at mortgage loan closings. All loan proceeds for mortgage loan transactions (both purchases and refinancings) are disbursed by PFS by wire transfer to the escrow holder for each particular loan transaction. The wire transfer occurs several days in advance of the actual loan closing to satisfy state "wet settlement" statutes, which generally require delivery of good (or "wet") loan funds at or before the loan closing. Closing officers are generally responsible for verifying that funds are good, and disbursal of the funds to them in advance facilitates this. The dollar amount of the wire transfer is based on the amount of good funds necessary for the individual closing. Funds are electronically transferred from a loan disbursement account at the bank in New York directly into title

[1] CUSCS and its subsidiaries were formerly owned directly by [ ] Corporation, the parent holding company of the bank. One reason for transferring ownership to the bank was that, when PFS was an affiliate of the bank for purposes of section 23A of the Federal Reserve Act, 12 USC 371c, Federal Reserve Board regulations restricted the amount of good quality assets that the bank could purchase from PFS. *See* 12 CFR 250.250. This restriction does not apply to operating subsidiaries of the bank. *See* 12 USC 371c(b)(2)(A).

[2] As an industrial loan company, CMFC would be permitted under Minnesota law to obtain a certificate from the Minnesota Department of Commerce authorizing it to accept deposits. CMFC does not presently hold such a certificate, and you have acknowledged that prior approval from the OCC would be required before obtaining such a certificate.

company or attorney escrow accounts. The escrow holders then disburse the funds at the closings using checks drawn on their own escrow accounts at banks of their choosing. This is normally not an account at the bank, since PFS does not do business in New York.

A check is used at a closing only in the rare event that a wire transfer does not reach its destination. This can happen if account numbers or other digits are transposed, or wire instructions are input erroneously and there is not enough time to resend a corrected wire prior to the closing. According to your information, a wire transfer has failed to reach its intended destination approximately four times in the past two years; therefore, this would clearly be an exceptional circumstance if it occurred. If a wire transfer does not reach its destination, the local district office must request a check to be mailed from an operations hub, since check supplies are no longer maintained at the district offices. In that case, a check payable to the closing officer is sent by overnight mail.

While the initial draws under home equity lines of credit are typically made by wire transfer, they sometimes are funded by PFS checks drawn on a PFS account at the bank. For example, if a condition of the loan is debt payoff, PFS will prepare its checks payable to other creditors of the borrower. Such checks are generally prepared and sent out by the operations hubs, not the local district offices. Moreover, for home equity loans funds are not disbursed for at least three business days after the closing due to the right of rescission granted under the federal Truth-in-Lending Act and Regulation Z of the Board of Governors of the Federal Reserve System. Interest is not charged during this period.

Discussion

As an operating subsidiary of the bank, all banking laws and regulations applicable to the bank also apply to PFS. 12 CFR 5.34(d). This includes the branching restrictions contained in the McFadden Act, 12 USC 36. Therefore, we must determine whether PFS offices are branches of the bank for McFadden purposes.[3]

To be a branch, a facility must satisfy a number of requirements. It must offer at least one of the "core" activities listed in 12 USC 36(f), namely receiving deposits, paying checks, or lending money. *Clarke* v. *Securities Industry Ass'n.*, 479 U.S. 388 (1987). In addition, a facility must be "established," *i.e.,* owned or rented, by the bank. *Independent Bankers Ass'n. of America* v. *Smith,* 534 F.2d 921 (D.C. Cir.), *cert. denied,* 429 U.S. 862 (1976) *(Smith); Independent Bankers Ass'n. of New York* v. *Marine Midland Bank,* 757 F.2d 453 (2d Cir. 1985), *cert. denied,* 476 U.S. 1186 (1986) *(Marine Midland).* Finally, the convenience to the public of the facility's location must give the bank a competitive advantage in obtaining customers. *First Nat'l. Bank in Plant City* v. *Dickinson,* 396 U.S. 122 (1969) *(Plant City)*. Since a facility's location provides no convenience to the public if it does not serve customers in person, it follows that an office must be accessible to the public in order to be a branch. The OCC has referred to this as the "Public Access Test." Thus, a nonpublic back office cannot be a branch. For a more detailed discussion of these requirements, *see generally* OCC Interpretive Letter No. 634, [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,520 (July 23, 1993).

The PFS local district offices where loans are originated appear to satisfy at least some of the criteria above. All PFS premises are rented and are therefore "established;" and they will serve the public, since potential borrowers go there to obtain information and fill out paperwork. Therefore, the remaining question is whether the core activity of lending money is performed at the district offices, for purposes of 12 USC 36.

The loan origination process includes such things as providing potential borrowers with information on loan products, providing application forms, and accepting completed application forms. Loan origination is not "lending money" for purposes of the McFadden Act, but is merely preliminary to the making of a loan; therefore loan production offices are not subject to McFadden branching restrictions. Interpretive Ruling 7.7380, 12 CFR 7.7380. Thus, to the extent that the district offices merely originate loans, such offices are not branches within the meaning of 12 USC 36.

No credit underwriting is performed at PFS district offices. Credit approval for PFS loans is performed either at a bank branch or at a separate PFS back office that does not originate loans. The OCC has long maintained that approval of loans at a nonpublic back office does not constitute lending money and raises no branching concerns. OCC Interpretive Letter No. 634, *supra*; OCC Interpretive Letter No. 343, [1985–1987 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,513 (May 24, 1985).

Most courts that have examined the issue have concluded that a loan is "made" for purposes of the McFadden Act at the time and place that a borrower receives bank funds. *Smith,* 534 F.2d at 946 n. 95; *Illinois* v. *Continental Illinois Nat'l. Bank,* 409 F. Supp. 1167 (N.D. Ill. 1975). Thus, in the context of lending, a bank-established facility where funds

[3] There is no doubt that the activities of PFS are permissible for the bank. Real estate lending by national banks is authorized by 12 USC 371.

are received by a borrower is a branch.[4] As discussed above, loan closings are occasionally held at PFS district offices, and such closings include the delivery of a check to the borrower. Therefore, the question is whether the bank is making a loan for McFadden purposes when a loan closing takes place at a PFS district office. I believe that the answer to this question is "no."

Since the McFadden Act applies to national banks, it seems obvious that a core activity must be performed *by a bank* in order for McFadden to apply. *See* 12 CFR 7.7490(a) (branching relates to transactions between a bank and its customers). In the context of lending, this would appear to require that *bank* funds must be disbursed to a borrower in order for a loan to be "made" for McFadden purposes.

In my opinion, under the procedures used by PFS, the loan is "made" when bank funds are transmitted to the escrow holder several days prior to the closing. An escrow holder is generally considered to be the agent of both the buyer (*i.e.,* the borrower) and the seller with respect to things to which the respective parties are entitled. Normal agency concepts apply, and possession by the escrow holder is considered to be possession by the principal. 30A C.J.S. *Escrows* 10a (1992). Therefore, disbursal of loan proceeds to the escrow holder is equivalent to disbursal to the borrower. However, since this occurs off premises electronically or, infrequently, by the mailing of a check, the branching rules are not implicated. *See* note 4, *supra.*

Once that occurs, the bank no longer has title to those funds. Thus, the funds disbursed at PFS closings are not those of the bank, but those of the escrow holder, a third party not connected with the bank. The funds are drawn on that person's own account at an institution other than the bank. It is true that the escrow holder has a legal duty to apply the funds according to his or her instructions and is not free to convert the funds to personal use, but that is a separate matter. It does not change the fact that it is not bank funds that are delivered to the borrower at the closing. In short, for purposes of branching law, the transaction that takes place at a PFS district office is not between the bank and the borrower.[5]

[4] On the other hand, if funds are disbursed by the bank using an independent third party, such as a messenger service as described in Interpretive Ruling 7.7490, 12 CFR 7.7490, to a borrower at his or her home, office, or other nonbank facility, no branch certification would be required. In addition, proceeds could be disbursed through an electronic transfer to an account of the borrower without implicating the branching rules.

[5] This is not the same as a bank handing a cashier's check to a third party, who in turn hands it to a borrower while on bank premises. In that case, bank funds would be delivered to the borrower at a bank-established location, and branching requirements would apply to such a transaction. *Cf.* note 4, *supra.*

For the reasons outlined above, it is my conclusion that the occasional use of PFS offices for loan closings, under the circumstances described, does not make these locations branches within the meaning of the McFadden Act, 12 USC 36. I trust that this has been responsive to your inquiry. Please do not hesitate to contact me at 202-874-5300 if further questions arise.

Christopher C. Manthey
Senior Attorney
Bank Activities and Structure Division

819—January 20, 1998

12 USC 24(7)

Dear [ ]:

This is in response to your letter dated December 3, 1997, requesting confirmation that [ ] (bank) may lawfully acquire and hold a 50 percent noncontrolling interest in [ ], a general insurance agency which will be a Tennessee limited liability company (LLC). The principal office of the LLC will be located in the branch office of the bank in *[city 1],* Tennessee. For the reasons set forth below, it is our opinion that this transaction is legally permissible in the manner and as described herein.

I. Background

The bank proposes to hold a 50 percent noncontrolling interest in a newly formed LLC. *[Co.]* will acquire and hold the remaining 50 percent interest in the LLC. The LLC will be established under Tennessee law pursuant to a written agreement between the bank and *[Co.].* Initially, *[Co.]* will form a wholly owned subsidiary corporation *[Co.Sub]* and will contribute approximately one-half of its insurance divisions in *[city 2],* Tennessee, to *[Co.Sub]. [BHC],* the bank's holding company, will also form a wholly owned subsidiary ("InterimSub"). *[Co.]* will then merge *[Co.Sub]* into InterimSub, resulting in the business of *[Co.Sub]* being owned entirely by InterimSub. The consideration for the merger will be the issuance to *[Co.]* of 16,431 shares of common stock of *[BHC],* 2.15 percent of the 764,245 shares outstanding after the issuance thereof.[1]

Immediately after the merger of *[Co.Sub]* into InterimSub, *[BHC],* will contribute all of its ownership of InterimSub to

[1] The actual number will be finally determined based upon appraisals currently being conducted of the value of the LLC and the shares. The current estimate is based upon the total estimated value of the *[city 2]* insurance business (exclusive of furniture, fixtures, and equipment) being $2,464,719 and the *[BHC]* shares being $75.00 per share. You have represented that this contribution should be deemed tax free under IRC Section 368(a)(2)(D).

the bank.[2] The bank will then form the LLC and InterimSub will contribute its insurance division assets and business, along with approximately $216,000 in cash from the bank to the LLC in exchange for 50 percent ownership of the LLC. *[Co.]* will contribute its remaining *[city 2]* insurance business assets and business along with approximately $216,000 worth of furniture, fixtures, and equipment to the LLC in exchange for the remaining 50 percent ownership in the LLC. You have represented that these contributions should be deemed tax free under IRC Section 721. Finally, InterimSub will dissolve.

The LLC will be governed by a letter agreement, a management agreement, and a buy/sell agreement between the bank and *[Co.]*. Each shareholder will elect an equal number of members to the board of directors. Under the terms of the letter agreement, the LLC is specifically prohibited from engaging in activities that would be impermissible for the bank or a subsidiary of the bank. Moreover, the bank will have the authority to veto decisions of the LLC that will result in the company engaging in activities that are inconsistent with activities that are part of, or incidental to, the business of banking. Under the terms of the buy/sell agreement, the bank is also authorized to sell its interest in the LLC in the event the company engages in activities in which the bank or a subsidiary of the bank may not engage.

The LLC will provide general insurance agency activity with its main office in *[city 1]*, Tennessee, a place of less than 5,000, as shown by the 1990 census. *[Co.]* will provide direct management, support functions, computer operations and clerical functions for the LLC. Agents will be managed through the *[city 1]* office. The LLC will be responsible for collecting commissions from the insurance carriers and paying commissions and all other expenses relating to the operations of the agency. The LLC will be generally responsible for processing insurance applications, delivery of insurance policies, and collection of premiums, where consistent with procedures of the relevant insurance carriers. Management fees to be derived from the LLC shall consist of an equal 50/50 division of net profits in payment of services provided by *[Co.]* and the bank.

II. Discussion

A. National Bank Express and Incidental Powers (12 USC 24(Seventh))

The bank's plan to purchase and hold a 50 percent interest in the LLC raises the issue of the authority of a national bank to make a noncontrolling investment in a limited liability company.[3] A number of recent OCC Interpretive Letters have analyzed the authority of national banks, either directly or through their subsidiaries, to own a noncontrolling interest in an enterprise. *See, e.g.,* OCC Interpretive Letter No. 697, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–013 (November 15, 1995); OCC Interpretive Letter No. 732, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–049 (May 10, 1996). These letters each concluded that the ownership of such an interest is permissible provided four standards, drawn from OCC precedents, are satisfied.[4] They are:

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking;
2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment;
3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise; and
4. The investment must be convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to *that bank's* banking business.

Based upon the facts presented, the bank's proposal satisfies these four standards.

1. The activities of the entity or enterprise in which the investment is made must be limited to activities that are part of, or incidental to, the business of banking.

Our precedents on noncontrolling ownership have recognized that the enterprise in which the bank holds an interest must confine its activities to those that are part of, or incidental to, the conduct of the banking business.

[2] You have represented that the Federal Reserve Bank of St. Louis has opined that *[BHC]* is not required to provide an application or notice to the Federal Reserve Bank since InterimSub will not generate any earnings as a subsidiary of the holding company.

[3] The OCC recently amended its operating subsidiary rule, 12 CFR 5.34, as part of a general revision of Part 5 under the OCC's Regulation Review Program. Operating subsidiaries in which a national bank may invest include corporations, limited liability companies, or similar entities if the parent owns (1) more than 50 percent of the voting (or similar type of controlling) interest, or (2) less than 50 percent so long as the bank "controls" the subsidiary and no other party controls more than 50 percent. 12 CFR 5.34(d)(2). Here, the LLC will not be considered an operating subsidiary since the bank will not "control" the LLC.

[4] *See also* 12 CFR 5.36(b). National banks are permitted to make various types of equity investments pursuant to 12 USC 24(Seventh) and other statutes.

See, e.g., OCC Interpretive Letter No. 380, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,604 n.8 (December 29, 1986) (since a national bank can provide options clearing services to customers it can purchase stock in a corporation providing options clearing services); Letter from Robert B. Serino, Deputy Chief Counsel (November 9, 1992) (since the operation of an ATM network is "a fundamental part of the basic business of banking," an equity investment in a corporation operating such a network is permissible).

The LLC will act as a general insurance agency. It is clear that the bank may establish an LLC to engage in general insurance agency activities as permitted under 12 USC 92. *See, e.g.,* OCC Corporate Decision 97–24 (April 15, 1997) (approving operating subsidiary to engage in general insurance agency activities pursuant to 12 USC 92). Section 92 specifically authorizes a national bank located and doing business in a place having a population of less than 5,000 to act as the agent for fire, life, or any other insurance company. In its letter, the bank has represented that the LLC's activities will be limited to those permissible for national banks under 12 USC 92 and that the LLC's activities will be conducted in accordance with the principles set forth in OCC Interpretive Letter No. 753, *reprinted in* [1996–97 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–107 (November 4, 1996) and Advisory Letter 96–8 (Guidance to National Banks on Insurance and Annuity Sales Activities, dated October 8, 1996).[5] Thus, we conclude that the activities to be conducted by the LLC are activities that are part of, or incidental to, the business of banking.

2. The bank must be able to prevent the enterprise from engaging in activities that do not meet the foregoing standard, or be able to withdraw its investment.

The activities of the enterprise in which a national bank may invest must be part of, or incidental to, the business of banking not only at the time the bank first acquires its ownership, but for as long as the bank has an ownership interest. This standard may be met if the bank is able to exercise a veto power over the activities of the enterprise, or is able to dispose of its interest. *See, e.g.,* OCC Interpretive Letter No. 711, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–026 (February 3, 1996); OCC Interpretive Letter No. 625, *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,507 (July 1, 1993). This ensures that the bank will not become involved in impermissible activities.

[5] The bank has also represented that it will follow, to the extent appropriate, the Interagency Statement on Retail Sales of Nondeposit Investment Products, dated February 15, 1994, which provides guidance to banks on the sale of retail nondeposit investment products.

Pursuant to the proposed letter agreement, the LLC is prohibited from engaging in activities which would be impermissible for the bank or a subsidiary of the bank. Also, the bank will have the authority to veto activities or decisions by the LLC that are inconsistent with activities that are part of, or incidental to, the business of banking, as determined by the OCC. The activities of the LLC are limited to those powers in its charter (or articles of organization) and the bank's vote, as a 50 percent owner, will always be required to amend the charter (or articles). This provision will enable the bank on an ongoing basis to prevent the LLC from engaging in new activities which may be impermissible. Furthermore, the letter agreement and the buy/sell agreement authorizes the bank to dispose of its interest in the LLC if the company engages in any activities that are not part of, or incidental to, the business of banking.

Therefore, the second standard is satisfied.

3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the enterprise.

a. Loss exposure from a legal standpoint

A primary concern of the OCC is that national banks should not be subjected to undue risk. When an investing bank will not control the operations of the entity in which the bank holds an interest, it is important that the national bank's investment not expose it to unlimited liability. As a legal matter, investors in a Tennessee limited liability company will not incur liability with respect to the liabilities or obligations of the limited liability company solely by reason of being a member or manager of the limited liability company. Tenn. Code. Ann. 48–16–203(b) and 48–217–101(a) (West Supp. 1996). Thus, the bank's loss exposure for the liabilities of the LLC will be limited by statute.

b. Loss exposure from an accounting standpoint

In assessing a bank's loss exposure as an accounting matter, the OCC has previously noted that the appropriate accounting treatment for a bank's 20–50 percent ownership share of investment in a limited liability company is to report it as an unconsolidated entity under the equity method of accounting. Under this method, unless the bank has guaranteed any of the liabilities of the entity or has other financial obligations to the entity, losses are generally limited to the amount of the investment, including loans and other advances shown on the investor's books. *See generally,* Accounting Principles Board, Op. 18 section 19 (1971) (equity method of accounting for investments in common stock). OCC Interpretive Letter No. 692, *supra.*

As proposed, the bank will have a 50 percent ownership interest in the LLC. The bank will account for its investment in the LLC under the equity method of accounting. Thus, the bank's loss from an accounting perspective would be limited to the amount invested in the LLC and the bank will not have any open-ended liability for the obligations of the LLC.

Therefore, for both legal and accounting purposes, the bank's potential loss exposure relative to the LLC should be limited to the amount of its investment in those entities. Since that exposure will be quantifiable and controllable, the third standard is satisfied.

4. The investment must be convenient and useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

12 USC 24(Seventh) gives national banks incidental powers that are "necessary" to carry on the business of banking. "Necessary" has been judicially construed to mean "convenient or useful". *See Arnold Tours, Inc.* v. *Camp,* 472 F.2d 427, 432 (1st Cir. 1972). Our precedents on bank noncontrolling investments have indicated that the investment must be convenient or useful to the bank in conducting *that bank's* business. The investment must benefit or facilitate that business and cannot be a mere passive or speculative investment. *See, e.g.,* OCC Interpretive Letter No. 697, *supra;* OCC Interpretive Letter No. 543, *reprinted in* [1990–1991 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,255 (February 13, 1991); OCC Interpretive Letter No. 427, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,651 (May 9, 1988); OCC Interpretive Letter No. 421, *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,645 (March 14, 1988); OCC Interpretive Letter No. 380, *supra.*

By entering the general insurance business, the bank will be able to provide expanded services to its customers. Through its investment in the LLC, the bank expects to quickly and efficiently enter the general insurance business. Moreover, the bank believes it will gain experience and expertise through its joint venture partner, and leverage that experience and expertise for its own benefit and that of its customers. Furthermore, this arrangement also provides for access to a greater number of underwriters and limits the bank's risk in entering this business.

For these reasons, the bank's investment in the LLC is convenient and useful to the bank in carrying out its business and is not a mere passive investment. Thus, the fourth standard is satisfied.

III. Conclusion

Based upon the information and representations you have provided, and for the reasons discussed above, it is our opinion that the bank is legally permitted to acquire and hold a noncontrolling interest in the LLC in the manner and as described herein, subject to the following conditions:

1. the LLC will engage only in activities that are part of, or incidental to, the business of banking;
2. the bank will have veto power over any activities and major decisions of the LLC that are inconsistent with condition number one, or will withdraw from the LLC in the event they engage in an activity that is inconsistent with condition number one;
3. the bank will account for its investment in the LLC under the equity method of accounting; and
4. the LLC will be subject to OCC supervision, regulation, and examination.

These conditions are conditions imposed in writing by the OCC in connection with its action on the request for a legal opinion confirming that bank's investment is permissible under 12 USC 24(Seventh) and, as such, may be enforced in proceedings under applicable law.

If you have any questions, please contact me or Javier A. Maymir, senior attorney, at 404–588–4520.

H. Gary Pannell
District Counsel
Southeastern District Office
Marquis One Tower, Suite 600
245 Peachtree Center Ave., NE
Atlanta, Georgia 30303

820—January 27, 1998

[Note: This OCC Interpretive Letter was released jointly by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of Thrift Supervision.]

12 USC 2901

Dear [ ]:

This letter responds to your inquiry dated December 10, 1997, about the appropriate amounts to collect as the "gross annual" revenue or income of small business or

farm or consumer borrowers under the Community Reinvestment Act (CRA) regulations. As you know, the four federal bank and thrift regulatory agencies promulgated substantially similar CRA regulations on May 4, 1995.[1] Staff from all four agencies have considered your inquiry and concur in the opinions expressed in this letter.

Specifically, you asked whether the bank should collect and report, if appropriate, the gross annual revenue or income of the borrower or the *adjusted* gross annual revenue or income of the borrower, which the bank actually used in making its credit decision. As discussed below, the bank should collect and report, if required, the gross annual revenue or income of the borrower, not the adjusted gross annual revenue or income.[2]

Discussion

Small Business and Small Farm Loans

Institutions, except small institutions, must collect and maintain, in connection with small business and small farm loans, an "indicator whether the loan was to a business or farm with gross annual revenues of $1 million or less."[3] And, based on the small business and small farm loan information collected by the institution, the institution must report annually the aggregate number and amount of loans to "businesses and farms with gross annual revenues of $1 million or less (using the revenues that the bank considered in making its credit decision.)"[4]

The supplementary information published with the final CRA regulations discussed the purpose of the collection of small business and small farm revenue information. It stated:

> The information on the revenue size of business and farm borrowers is useful because, in combination with loan amount information, it will enable the agencies to make accurate judgments about the size of businesses and farms receiving reported loans. Some commenters questioned whether an institution should report the revenue of the entity to which the loan is actually extended or of its parent corporation if the entity is a subsidiary. An institution should report the revenues that the institution considered in making its credit decision.[5]

As the supplementary information indicates, the purpose of having financial institutions indicate whether a loan is made to a business or farm with revenues of $1 million or less is to enable examiners and the public to judge more reliably whether the institution is lending to small businesses and farms or whether it is only making small loans to larger businesses and farms.

In their "Interagency Questions and Answers Regarding Community Reinvestment,"[6] staff from the agencies clarified that, when indicating whether a small business borrower had gross annual revenues of $1 million or less, an institution generally should rely on the revenues of the companies that it considered in making its credit decision.

> For example, in the case of affiliated businesses, such as a parent corporation and its subsidiary, if the institution considered the revenues of the entity's parent or a subsidiary corporation of the parent as well, then the institution would aggregate the revenues of both corporations to determine whether the revenues are $1 million or less. Alternatively, if the institution considered the revenues of only the entity to which the loan is actually extended, the institution should rely solely upon whether gross annual revenues are above or below $1 million.[7]

This additional information about the "revenues that the institution considered in making the loan" is meant to provide guidance to institutions that lend to affiliated companies where repayment may come from either affiliate. In other words, if an institution makes a loan to a subsidiary because it is assured that the parent corporation will repay the loan in case of the subsidiary's default, the institution should report the aggregate gross annual revenues of both the subsidiary and the parent company.

The regulation provides that financial institutions indicate whether the gross annual revenues of the business or farm are $1 million or less. Therefore, to ensure consistency, financial institutions should collect gross annual revenues, not adjusted gross annual revenues. If an institution does not request or consider revenue information to make the credit decision regarding a small business or small farm loan, the institution need not collect gross annual revenue information in connection

---

[1] *See* 12 CFR pts. 25, 228, 345, and 563e.

[2] The agencies' staff recognize that this guidance regarding small business and consumer loans differs from that provided by the staff of the Federal Reserve Board in connection with home mortgage loans under the Home Mortgage Disclosure Act's (HMDA) disclosure requirements. When financial institutions provide income information pursuant to HMDA requirements, they are to provide the gross annual income upon which the institution relied in evaluating the creditworthiness of the applicant. *See* 12 CFR 203.4(a)(7) & Supp. 1, Comment 4(a)(7)–6.

[3] 12 CFR 25.42(a)(4), 228.42(a)(4), 345.42(a)(4), and 563e.42(a)(4).

[4] 12 CFR 25.42(b)(1)(iv), 228.42(b)(1)(iv), 345.42(b)(1)(iv), and 563e.42(b)(1)(iv).

[5] Community Reinvestment Act Regulations, 60 Fed. Reg. 22,156, 22,173 (May 4, 1995).

[6] 62 Fed. Reg. 52,105 (October 6, 1997).

[7] *Id.* at 52,126 (Question and Answer (Q & A) 1 addressing section _____.42(a)(4)).

with that loan.[8] Furthermore, the CRA regulations do not require an institution to verify revenue amounts; thus, the institution may rely on the gross annual revenue amount provided by the borrower in the ordinary course of business.

Consumer Loans

In connection with consumer loans, institutions may choose to collect and maintain data for one or more categories of consumer loans. The data collected includes the "gross annual income of the borrower that the bank considered in making its credit decision."[9] Financial institutions report no consumer loan data. The supplementary information published with the final CRA regulations provides insight on the consumer income data to be collected when an institution chooses to have its loans considered as part of its CRA evaluation:

> If the institution does not consider income in making an underwriting decision, it need not collect income information. Further, if the institution routinely collects, but does not verify, a borrower's income when making a credit decision, it need not verify the income for purposes of data maintenance.[10]

The purpose of data collection in connection with consumer loans is to enable examiners to determine the distribution, particularly in the institution's assessment area(s), of the institution's consumer loans, based on borrower characteristics, including the number and amount of consumer loans to low-, moderate-, middle-, and upper-income borrowers, as determined on the basis of gross annual income.[11] A financial institution that opts to have one or more categories of consumer loans considered in its CRA evaluation must collect borrower income information only if the institution considered the borrower's gross annual income when making the credit decision. If an institution *does* consider the borrower's income, it should collect and maintain gross annual income of consumer borrowers, not adjusted gross annual income, to provide consistency in income data. The CRA regulations do not require an institution to verify income amounts; thus, the institution may rely on the income amounts provided by the borrower on the loan application.

I trust this letter responds to your inquiry. If you have further questions, please contact me or Margaret Hesse, an attorney on my staff, at 202–874–5750.

Michael S. Bylsma
Director
Community and Consumer Law Division

[8] *Id.* (Q &A 2 addressing section _____.42(a)(4)). "In those instances, the institution should enter the code indicating 'revenues not known' on the individual loan portion of the data collection software or on an internally developed system. Loans for which the institution did not collect revenue information may not be included in the loans to businesses and farms with gross annual revenues of $1 million or less when reporting this data." *Id.*

[9] 12 CFR 25.42(c)(1)(iv), 228.42(c)(1)(iv), 345.42(c)(1)(iv), and 563e.42(c)(1)(iv).

[10] 60 Fed. Reg. at 22,172. This guidance has been adopted in the "Interagency Questions and Answers Regarding Community Development" as Q & A 1 addressing section _____.42(c)(1)(iv) (62 Fed. Reg. at 52,127).

[11] 12 CFR 25.23(b)(3)(iv), 228.23(b)(3)(iv), 345.23(b)(3)(iv), and 563e.23(b)(3)(iv).

821—February 17, 1998

12 USC 36(j) *[file 6]*

Hon. John P. Burke
Banking Commissioner
State of Connecticut
Department of Banking
260 Constitution Plaza
Hartford, Connecticut 06103

Re: Connecticut General Statutes 36a–158

Dear Mr. Burke:

It has come to our attention that your office recently wrote to Bank One, N.A., Columbus, Ohio (the bank) concerning a "satellite device"[1] that the bank[2] has installed in a retail store in the Brass Mill Center Mall in Waterbury, Connecticut. You cited Connecticut General Statutes 36a–158 (section 36a–158), which limits the ability of out-of-state banks to establish or use automated teller machines ("ATMs") in Connecticut, and requested the bank to advise you of its legal authority to establish satellite devices in Connecticut. According to your letter, if the bank is found to be in violation of state law, it could be subject to a cease and desist order, as well as civil penalties. This raises the issue of whether the provision of state law that you cited is applicable to the bank's operation of ATMs in Connecticut.

For the reasons discussed below, it is our opinion that the bank has not violated section 36a–158 because the bank's ATM falls within an exception provided in the

[1] Under Connecticut law, a "satellite device" is an off-premises automated teller machine. Conn. Gen. Stat. Ann. 36a–2(50) (West 1996).

[2] It is our understanding that this ATM is actually owned by Bank One Utah, N.A., an affiliate of the bank.

statute for out-of-state banks that are authorized by federal law to accept deposits in Connecticut. However, if Connecticut determines that the exception does not apply, we conclude that section 36a–158 is preempted by federal law and cannot be applied to the bank.[3]

Discussion

A. The Bank's ATM Does Not Violate State Law

The National Bank Act authorizes national banks to receive deposits, make loans, and engage in other activities that are incidental to the business of banking. 12 USC 24(Seventh). Since an ATM is an instrumentality for performing such functions, the establishment of ATMs by national banks is authorized by section 24(Seventh). The OCC has discussed this authority on a number of occasions.[4] Similarly, the OCC has consistently recognized the ability of national banks to perform authorized activities and functions via electronic means and facilities.[5]

Moreover, it is well-settled that national banks may conduct business without geographic restrictions unless Congress provides otherwise. *Clarke* v. *Securities Industry Ass'n.,* 479 U.S. 388 (1987); *NBD Bank, N.A.* v. *Bennett,* 67 F.3d 629 (7th Cir. 1995); *Independent Insurance Agents of America, Inc.* v. *Ludwig,* 997 F.2d 958 (D.C. Cir. 1993); *Shawmut Bank Connecticut* v. *Googins,* 965 F. Supp. 304 (D. Conn. 1997). As discussed below, Congress has not imposed any geographic restrictions on national bank ATMs. Similarly, there is no provision of federal law that gives states general authority to subject national bank activities to geographic or other restrictions. The establishment of branches is one of the few exceptions to this rule. But, while 12 USC 36 incorporates certain state geographic restrictions on the establishment of national bank branches, the definition of a national bank "branch" is governed by federal law. *First Nat'l. Bank in Plant City* v. *Dickinson,* 396 U.S. 122 (1969).

Automated teller machines established by national banks were, until recently, considered to be branches and were subject to locational restrictions. However, in 1996, Congress expressly excluded ATMs from the definition of a "branch" under 12 USC 36. Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), Pub. L. No. 104–208, 2205, 1996 U.S.C.C.A.N. (110 Stat.) 3009, 3009 [1188], *codified at* 12 USC 36(j). The legislative history of EGRPRA makes clear that Congress specifically foresaw and desired that this change would lead to the removal of geographic restrictions on ATMs. The Senate Report on the legislation could hardly be more clear in its explanation: "[A]n 'ATM' or 'remote service unit' is not considered a 'branch' for purposes of federal bank branching laws and is therefore not subject to prior approval requirements or *geographic restrictions.*" S. Rep. No. 185, 104th Cong., 2d Sess. 24 (1995) (emphasis added). Moreover, Congress rejected the House of Representatives' version of the legislation, which would have preserved existing geographic restrictions on ATMs and remote service units. *See* H. Rep. No. 193, 104th Cong., 2d Sess. 31 (1995).

As a result of EGRPRA, ATMs established by national banks, including those that accept deposits, are no longer branches under federal law and thus are not subject to state geographic restrictions on branches.[6] 12 USC 36(j); OCC Interpretive Letter No. 772, *supra* note 4; *see Independent Bankers Ass'n. of New York* v. *Marine Midland Bank,* 757 F.2d 453 (2d Cir. 1985), *cert. denied,* 476 U.S. 1186 (1986) (ATMs that are not "branches" under federal law are not subject to state geographic restrictions). This has brought national bank ATMs into harmony with ATMs (or "remote service units") of federal thrifts, which also are not branches and are not subject to geographic restrictions. 12 CFR 545.141.

This change has been beneficial to both the banking industry and consumers because it eliminates unnecessary regulatory burdens while enhancing customer access to banking facilities. As the court in *NBD Bank* noted, the ability to engage in transactions with customers on a widespread geographic basis "facilitate[s] commerce, increase[s] competition to the benefit of consumers, and help[s] banks diversify their portfolios (reducing the risk of failure)." 67 F.3d at 631.

The provision of Connecticut law under discussion provides as follows:

> (a) Except as provided in subsection (b) of this section, no out-of-state bank or out-of-state credit union may directly or indirectly establish or use an

---

[3] Our conclusion pertains solely to the application of section 36a–158 to ATMs operated by national banks.

[4] *See, e.g.,* OCC Interpretive Letter No. 789, [1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–216 (June 27, 1997); OCC Interpretive Letter No. 772, [1996–1997 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–136 (March 6, 1997); OCC Interpretive Letter No. 705, [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–020 (October 25, 1995); letter of Robert B. Serino, Deputy Chief Counsel, November 9, 1992 (unpublished).

[5] *See, e.g.,* OCC Interpretive Ruling 7.1019, 12 CFR 7.1019) ("A national bank may perform, provide, or deliver through electronic means and facilities any activity, function, product, or service that it is otherwise authorized to perform, provide, or deliver."). *See also* Letter of Frank Maguire, Acting Senior Deputy Comptroller for Corporate Policy and Economic Analysis, October 16, 1992 (unpublished) (electronic check cashing facility authorized under section 24(Seventh)).

[6] I note that Connecticut likewise does not consider satellite devices, *i.e.,* off-premises ATMs, to be branches. Conn. Gen. Stat. Ann. 36a–157 (West 1996).

> automated teller machine or point of sale terminal in this state. *This prohibition does not apply to an out-of-state bank* or out-of-state credit union *that is authorized under* the laws of this state or *federal law to accept deposits within this state.*

Conn. Gen. Stat. Ann. 36a–158 (West 1996) (emphasis added).[7] Subsection (b) permits out-of-state banks to use (but not own) ATMs subject to certain restrictions including, *inter alia,* that deposits cannot be accepted unless the out-of-state bank or an affiliate of the bank is authorized under state or federal law to accept deposits in Connecticut.

Your letter to the bank appears to suggest that section 36a–158 precludes the bank from establishing and operating ATMs in Connecticut. However, the bank's establishment of ATMs in Connecticut pursuant to federal law is not necessarily inconsistent with state law. Section 36a–158 permits out-of-state banks to establish ATMs if they are "authorized under . . . federal law to accept deposits within this state." Since ATMs are instrumentalities that may be used to accept deposits, and national banks are authorized by federal law to establish them without geographic restrictions, federal law *does* authorize the bank to accept deposits in Connecticut. Thus, it would appear that the statutory exception for federal law is applicable.

If this interpretation is not accepted, then the issue becomes whether there is a conflict between the Connecticut statute and the authority of national banks under federal law to establish ATMs, and whether section 36a–158 is preempted by federal law.

B. Federal Preemption

It is a fundamental principle of our constitutional system that when the federal government acts within the sphere of authority conferred upon it by the Constitution, federal law is paramount over, and may preempt, state law. U.S. Const. art. VI, cl. 2; *Cohen* v. *Virginia,* 19 U.S. (6 Wheat.) 264, 414 (1821) (Marshall, C.J.).

There are several ways in which federal preemption may arise. However, in the banking context, preemption usually involves a conflict between state and federal law. In a long line of cases, the Supreme Court has consistently held that state laws that conflict with federal law by preventing or impairing the ability of national banks to exercise powers granted to them under federal law are preempted. *See, e.g., Franklin Nat'l. Bank* v. *New York,* 347 U.S. 373, 378 (1954); *Davis* v. *Elmira Savings Bank,* 161 U.S. 275, 283 (1896); *Farmers & Mechanics' Nat'l. Bank* v. *Dearing,* 91 U.S. 29, 33–35 (1875); *Fidelity Federal Savings & Loan Ass'n.* v. *De la Cuesta,* 458 U.S. 141, 152–53 (1982) (same principle applied to federal savings and loan associations). The court has recently reiterated this message, noting that the history of the National Bank Act "is one of interpreting grants of both enumerated and incidental 'powers' to national banks as grants of authority not normally limited by, but rather ordinarily pre-empting, contrary state law." *Barnett Bank of Marion County* v. *Nelson,* 517 U.S., 134 L. Ed. 2d 237, 245 (1996) *(Barnett).*

As discussed earlier, national banks are authorized under federal law, specifically 12 USC 24(Seventh), to establish and operate ATMs. Since the passage of EGRPRA, this federal authority is no longer limited by state geographic restrictions formerly incorporated into 12 USC 36. Where Congress has not expressly conditioned a national bank power upon a grant of state permission, ordinarily, no such condition applies. *Barnett,* 517 U.S. at, 134 L. Ed. 2d at 246; *see Franklin Nat'l. Bank* v. *New York,* 347 U.S. 373, 378 (1954) (court found "no indication" that Congress intended to make national banks subject to local restrictions).

If the "authorized under federal law" exception is not applicable, then section 36a–158 purports to limit the federally authorized power to establish and operate ATMs to national banks that have a main office, or at least one branch, in Connecticut. Since the bank does not satisfy these requirements, the state law would completely prevent the bank's exercise of its power under 12 USC 24(Seventh) to establish and operate ATMs in Connecticut. Section 36a–158 therefore conflicts with federal law, and consequently, in our opinion, it is preempted with respect to national banks.[8]

---

[7] To properly understand the statute, a chain of definitions must be followed. Under Connecticut law, an "out-of-state bank" means any institution that engages in the business of banking, but does not include a "bank." A "bank" means a "Connecticut bank" or a "federal bank." A "Connecticut bank" means a "bank" or other enumerated types of financial institutions that are chartered and organized under the laws of Connecticut, while a "federal bank" means a national bank or federal thrift having its principal office in Connecticut. *See generally* Conn. Gen. Stat. Ann. 36a–2 (West 1996). Thus, for purposes of section 36a–158, the bank, which is a national bank with its principal office in Ohio, is an "out-of-state bank." As discussed earlier, *supra* note 1, under state law, ATMs include satellite devices.

[8] Since the Connecticut statute is plainly and exclusively directed against institutions from other states, it would appear that it also violates the Commerce Clause of the Constitution, which limits the power of states to erect barriers against interstate trade. U.S. Const. art. I, 8, cl. 3; *Lewis* v. *BT Investment Managers, Inc.,* 447 U.S. 27, 35 (1980). Since the statute is not authorized under any federal law that would shelter it from Commerce Clause scrutiny, such overtly discriminatory legislation is invalid under well-established Commerce Clause principles. *See generally* OCC Corp. December 95–05, Part III–B, [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 90,474 (March 8, 1995) (Bank Midwest Decision). By its action in EGRPRA of removing national bank ATMs from state geographic restrictions, Congress has made such restrictions subject to ordinary Commerce Clause analysis.

Conclusion

Section 36a–158 can be read in such a way that the bank's satellite device or ATM, referenced in your letter, is consistent with state law. That is, since the bank's ATM is authorized under federal law, the bank is an out-of-state bank that is authorized by federal law to accept deposits in Connecticut, thus qualifying for the exception provided in paragraph (a) for such institutions. Alternatively, section 36a–158 directly conflicts with the authority of national banks under 12 USC 24(Seventh) to establish ATMs without geographic restriction, and is therefore preempted by federal law with respect to national banks. Accordingly, the Connecticut statute may not be applied to prevent the bank's establishment and operation of ATMs in Connecticut.

Julie L. Williams
Chief Counsel

822—February 17, 1998

12 USC 85

Jeremy T. Rosenblum
Ballard Spahr Andrews & Ingersoll
1735 Market Street, 51st floor
Philadelphia, Pennsylvania 19103–7599

Dear Mr. Rosenblum:

I. Introduction

This is in response to your inquiry asking when an interstate national bank (a national bank with its main office in one state, the home state, and a branch in another state, the host state), may charge home state interest rates on its loans. You have represented that the bank desires to conduct interstate lending programs with uniform pricing policies based upon the interest allowed by its home state. You also have represented that if the bank determines to adopt such uniform pricing policies, it will include in its loan documents a choice-of-law clause disclosing to borrowers that loan charges will be governed by federal and home state law.[1]

[1] You also have represented that where bank loan officers provide substantial assistance to borrowers in taking loan applications in person or closing loans in person at host state branches, the bank will provide clear disclosure to this effect either orally or in writing before the borrower becomes obligated on the loan.

II. Discussion

A. Summary of issues

Under 12 USC 85, national banks may charge interest in accordance with the laws of the state in which they are "located." The question that you pose necessarily recognizes that an interstate national bank, as will be discussed, is considered to be "located," for purposes of applying section 85, in more than one state. Thus, the issue that arises is when the national bank should look to the laws of its home state and when it should look to the laws of a host state to determine the rates that it may permissibly charge with respect to its lending activities. This, of course, requires a review of relevant statutory provisions, case law and legislative history.

1. The statute: 12 USC 85 and judicial interpretations

Title 12 USC 85 (section 85) provides:

> Any [national] association may . . . charge on any . . . evidence of debt, interest at the rate allowed by the laws of the State . . . where the bank is located. . . . [2]

Consequently, the first issue that arises is where an interstate bank is "located." In interpreting section 85, the Supreme Court has specifically recognized that a national bank is "located" in the state of its main office.[3] Consequently, the court concluded that a national bank, under section 85, could charge the interest rates permitted by its home state no matter where the borrower resides and despite the contacts that occur in another state.[4] In addition, the Court of Appeals for the Fourth Circuit permitted a national bank to charge rates permitted by the home state even where face-to-face solicitation and signing of all loan documents by the borrower occurred in another state.[5] *Marquette, Cades* and *Wiseman* did not address the issue of the rates that may be charged by an *interstate* national bank.[6] Further, in

[2] Section 85 also provides several alternative rates that may be charged by the bank. Because you do not rely on any of these alternative bases for determining the applicable interest rate, this letter does not address interest that may be charged under these provisions.

[3] *Marquette National Bank* v. *First of Omaha Service Corp.,* 439 U.S. 299, 308–310 (1978) *(Marquette).*

[4] *Id.* at pp. 313–319. *Cf. Wiseman* v. *State Bank & Trust Co., N.A.,* 854 S.W.2d 725 (Ark. 1993) *(Wiseman)* (national bank located in one state may use that state's rates in making loans to a resident of a second state even though national bank's parent company is incorporated in that second state).

[5] *Cades* v. *H&R Block,* 43 F.3d 869 (4th Cir. 1994), *cert. denied,* 515 U.S. 1103 (1995) *(Cades).*

[6] *Marquette* at p. 309; *Cades* at p. 874; *Wiseman* at pp.727–728.

both the *Marquette* and *Cades* decisions, the courts specifically noted that the bank did not have a branch in the state in which the borrower resided.[7]

2. For purposes of section 85, a national bank may be located in both its home state and its host states

Since the adoption of the Riegle–Neal Interstate Banking and Branching Act of 1994,[8] (which for the first time paved the way for extensive interstate branching by national banks), the OCC has been called upon to determine whether an interstate national bank is also considered to be "located" in a host state as well as its home state for purposes of section 85.[9]

While the courts never have specifically addressed the issue of whether a national bank is considered, for purposes of section 85, to be located in a state or states in which it operates branches, based on precedents construing 12 USC 36 and 94 (respectively, section 36 and section 94), the OCC determined that, for purposes of section 85, a national bank is considered to be located in states in which it maintains branches.[10] Notably, the Court in *Marquette,* citing *Bank of California* and *Bougas,* recognized that a bank could be considered to be "located" in a state in which it has a branch.[11]

Consequently, an interstate national bank may be "located" for purposes of section 85 in both its home state and its host state or states. As a result, the issue that arises is when a national bank should apply the usury laws of its home state, and when it should apply the usury laws of a host state, to a loan. This analysis requires a consideration of relevant statutory provisions and legislative intent.

3. Where a national bank is located in more than one state, which state's usury laws govern interest that may be charged by the bank?

a. The Riegle–Neal Act

The Riegle–Neal Act for the first time established a comprehensive federal statutory scheme permitting general interstate branching by national banks and by state banks.[12] Thus, Congress permitted, for the first time, national banks and state banks, as a general matter, to have main offices in one state and branches in one or more other states. In doing so, Congress recognized that this new corporate structure would raise issues with respect to the applicability of usury laws to loans made

---

[7] The Supreme Court stated that the bank had no branches in the borrower's state. *Marquette* at p. 309 and fn. 20. The court in *Cades* took a similar approach determining first that a bank with its main office in Delaware did not have a branch in South Carolina before it determined that the Delaware interest rates applied. *See Cades* at p. 874. *See also Christiansen* v. *Beneficial National Bank,* 972 F. Supp. 681 (S.D. Ga. 1997).

[8] Pub. L. No. 103–328, 108 Stat. 2338 (1994) (the Riegle–Neal Act).

[9] *See* OCC Interpretive Letter No. 686, September 11, 1995, *reprinted in* [1995–96 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–001; OCC Interpretive Letter No. 707, January 31, 1996, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–022; OCC Interpretive Letter No. 782, May 21, 1997, *reprinted in* [Current Binder] Fed. Banking L. Rep. ¶ 81–209.

[10] *See* OCC Interpretive Letter No. 686 reaffirmed in OCC Interpretive Letters No. 707 and 782 (relying on *Seattle Trust & Savings Bank* v. *Bank of California, N.A.,* 492 F.2d 48, 51 (9th Cir.), *cert. denied,* 419 U.S. 844 (1974)) *(Bank of California)* (under 12 USC 36(c), an interstate national bank with grandfathered branches in a state other than its home state is "situated" in the state of the grandfathered branches for purposes of establishing additional branches in that state); *Citizens & Southern National Bank* v. *Bougas,* 434 U.S. 35, 43–45 (1977) *(Bougas)* (for purposes of section 94 as it then existed, for venue purposes a national bank was "located" in a city or county in which it had a main office or a branch office).

[11] *Marquette* at p. 309, fn. 21. *See also Ghiglieri* v. *Sun World National Association,* 117 F.3d 309, 316 (5th Cir. 1997). In addition, the relationship between section 94, addressing the "location" of national banks for venue purposes, as interpreted by the Supreme Court in *Bougas,* and section 85, addressing the "location" of national banks for usury purposes, is clear and direct. Section 94 was originally adopted as Section 57 of the Act of June 3, 1864, 13 Stat. 116–117, but was omitted in the Revised Statutes of 1873. *See Mercantile National Bank at Dallas* v. *Langdeau,* 371 U.S. 555, 561, 568 (1963). Congress reenacted it in 1875 as an amendment to section 5198 of the Revised Statutes, codified at 12 USC 86, which specifically provides the remedies for violations of section 85. *Id. See also* 18 Stat. 320; *Michigan National Bank* v. *Robertson,* 372 U.S. 591, 594 (1963) *(Michigan National).* As the Supreme Court recognized in *Michigan National,* "when [section 94] was reenacted [in 1875], it was appended to the provisions dealing with usury actions against national banks." Thus, the venue provisions, grounded on where a national bank was "located," provided a forum to apply the remedy specifically for violations of section 85 which, of course, also were grounded on where a national bank was "located." As noted, the Court in *Bougas* held that a national bank was "located" for purposes of section 94 wherever it had a main office or a branch and, even before *Bougas,* at least one Court of Appeals observed: "none of the cases [interpreting section 85 or 94] indicate that Congress gave one meaning to "locate" in section 94 and another meaning to the same word in section 85." *See Fisher* v. *First National Bank of Chicago,* 538 F.2d 1284, 1289 (7th Cir. 1976), *cert. denied,* 429 U.S. 1062 (1977) *(Fisher).*

[12] Prior to the adoption of the Riegle–Neal Act, branching by national banks and state banks that were members of the Federal Reserve System was constrained, with certain exceptions, by federal law to intrastate branching. 12 USC 36, 321. *But see* 12 USC 36(a) (permitting interstate grandfathered branches); *Sun World* at p. 315 (following relocation by a national bank of its main office from one state to another, permitting branch retention in the former main office state). In addition, while states could permit state banks that were not members of the Federal Reserve System to branch on an interstate basis, few did. Hearing before the Subcommittee on Financial Institutions Supervision, Regulation and Deposit Insurance of the Committee on Banking, Finance and Urban Affairs, House of Representatives, 103d Cong., 1st Sess., p. 53, 56 (October 26, 1993) (Written Statement of Comptroller of the Currency Eugene A. Ludwig).

by interstate national and state banks.[13] Two provisions of the Riegle–Neal Act address interest rates that may be charged by interstate national banks.

(1) The applicable law clause

Section 103(b)(1) (the applicable law clause) of the Riegle–Neal Act provides that:

> The laws of the host State regarding community reinvestment, *consumer protection,* fair lending, and establishment of intrastate branches shall apply to any branch in the host State of an out-of State national bank to the same extent as such State laws apply to a branch of a bank chartered by that State, except—
>
> (i) when Federal law preempts the application of such State laws to a national bank. . . .

See 12 USC 36(f)(1)(A) (emphasis added).[14]

The Riegle–Neal Act Conference Report notes that the reference to host state consumer protection laws includes “applicable usury ceilings.” *See, e.g.,* H.R. Rep. No. 651, 103d Cong., 2d Sess., 51 (1994) (the Riegle–Neal Act Conference Report or Conference Report). However, with respect to state usury ceilings, application of the preemption provision in clause (i) brings into play section 85 and the standards of section 85 then govern how state usury law is made applicable to a host state branch of a national bank. In other words, the state usury law of the host state of a national bank applies to particular loans made by the bank because section 85 sets forth the framework that determines the permissible rates of interest that national banks may charge and that framework makes the host state’s usury ceilings applicable (with limited exception[15]) to particular loans made by a national bank that is considered to be “located” in that state.

However, the framework of section 85 does not expressly address two crucial questions that arise when section 85 is applied to an interstate bank’s lending operation:

(1) May a national bank use the rates of one state in which it is “located” even when it is doing business with customers in a second state in which it is also “located”?

(2) When a national bank is “located” in more than one state for purposes of section 85, what usury ceiling does section 85 make applicable to the bank’s lending activities?

(2) The usury savings clause

Because of these uncertainties about how section 85 would apply to interstate banks, Senator Roth introduced a provision at section 111 of the Riegle–Neal Act (the usury savings clause) which provides:

> No provision of this title and no amendment made by this title to any other provision of law shall be construed as affecting in any way—
>
> * * * * *

(3) the applicability of [section 85]. . . . [16]

As Senator Roth stated in explaining the intent underlying this provision:

> In order to ensure that banks providing credit to out-of-State borrowers would be unaffected by structural changes brought about by interstate branching legislation, I offered the [usury] savings clause in committee, and it is now part of this conference report.
>
> The essential point of my amendment is that a branch of a bank that provides credit across State lines may impose its State law loan charges even though there is a branch of that same bank in the State of its customer.[17]

With respect to the usury savings clause, the Conference Report is explicit that the clause was intended to preserve existing authorities related to the interest charges that may be imposed by interstate national banks under section 85 notwithstanding the state of residence of the

[13] While the Riegle–Neal Act raised this issue with respect to both national and state banks, because only national banks are within the regulatory jurisdiction of the OCC, this response will address the impact of the Riegle–Neal Act only on interest rates that may be charged by national banks.

[14] An exception also was provided if the Comptroller determines that the state law discriminates between an interstate national bank branch and state bank branches. *Id.* at (f)(1)(A)(ii). A similar provision, absent the preemption and discrimination exceptions, was adopted with respect to state banks. *See* 12 USC 1828(j).

[15] As mentioned in fn. 2, *supra,* section 85 also provides for alternative rates. One such rate, that tied to the discount rate on commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the bank is located, is not tied to state law.

[16] 12 USC 1811 note.

[17] 140 Cong. Rec. S12789 (daily ed., September 13, 1994) (the Roth statement). As the courts have long recognized, the views of the sponsor of an amendment provide a “weighty gloss” as to the meaning of legislation.” *See, e.g., Galvin* v. *U.L. Press,* 347 U.S. 522, 527 (1954).

borrower. As the Conference Report states, the Riegle–Neal Act:

> [does] not affect existing authorities with respect to any charges under . . . [section 85] . . . imposed by national . . . banks for loans or other extensions of credit made to borrowers outside the state where the bank or branch making the loan or other extension of credit is located.[18]

Moreover, as Senator Roth noted, prior to the adoption of the usury savings clause, the Federal Deposit Insurance Corporation was "uncertain" whether interstate branching might prevent a bank from charging home state rates to customers in host states.[19] As a result of his concern with the FDIC's response, Senator Roth offered the usury savings clause during Senate Banking Committee consideration of the legislation. As he subsequently told the Congress:

> I immediately began to take steps to address this potential threat not only to Delaware's credit card industry but to all banks that extend credit to borrowers who reside outside the State where the bank, or under this legislation, the branch making the loan or other extension of credit is located.
>
> * * * * *
>
> The savings clause means that the establishment of a branch in the borrower's state does not defeat the powers that a Delaware bank enjoys today under [section 85]. . . .[20]

Thus, the usury savings clause answers the first question and assures that the *Marquette* doctrine, permitting a bank to utilize interest rates allowed by the law of the state where the bank is located regardless of the state of the residence of the borrower, is not defeated simply because a bank has a branch in the state where the borrower resides.[21] This, then leads directly to the second question which you pose: under what circumstances may the bank use and export the interest rates permitted by its home state, as well as the corresponding question, under what circumstances may the bank use and export the interest rates permitted by a host state.

(3) Applicability of home state rates and host state rates

In discussing the interplay of the applicable law clause, the usury savings clause and section 85 in the context of interstate branching, Senator Roth also addressed the issue of when a bank may look to home state and host state usury law in determining permissible interest rates that it may charge. He stated:

> The statement of managers expressly refers to the potential of a "branch making the loan or other extension of credit. . . ."[22] This language underscores the widespread congressional understanding that, in the context of nationwide interstate branching, *it is the office of the bank or branch making the loan that determines which State law applies.* The savings clause has been agreed to for the very purpose of addressing the FDIC's original concerns and making clear that after interstate branching, [section 85 is] applied on the basis of the *branch making the loan.*[23]

---

[18] Riegle–Neal Act Conference Report at p. 63. Courts have long recognized that "Committee Reports represent the most persuasive indicia of congressional intent" and "are powerful evidence of legislative purpose." 2A Sutherland Statutory Construction 48.06 (5th ed.1992 & Supp. 1996).

[19] *Id.* In response to a written question from Senator Roth concerning the ability of an interstate bank to use home state interest rates in making loans to residents of host states, Andrew Hove Jr., acting director, FDIC, explained that the effect of interstate banking in this respect was uncertain. *See Nationwide Banking and Branching and the Insurance Activities of National Banks: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs,* 103d Cong., 1st Sess. 272 (1993) (Response to Written Questions of Senator Roth from Andrew C. Hove Jr.). Governor John P. LaWare of the Federal Reserve Board also expressed similar uncertainty in response to Senator Roth's question. *Id.* at pp. 28–281.

[20] Roth statement at S12789.

[21] It is likewise clear that the interest charges that may be imposed under section 85, as preserved by the usury savings clause, include those permitted to any lender in the state as determined by the Supreme Court in enunciating the most favored lender doctrine. *Tiffany* v. *The National Bank of the State of Missouri,* 85 U.S. 409, 413 (1874).

[22] The Riegle–Neal Act Conference Report at p. 63 discussed loans made to borrowers outside the state where the "bank or branch making the loan is located."

[23] Roth statement at S12789. (Emphasis added.) In this regard, Senator Roth's comments were similar to those of Senator Riegle with respect to the impact of interstate branching on interest charges that could be imposed by national banks. As Senator Riegle had earlier stated:

> During discussions of the interstate banking bill, Senator Pryor raised concerns about the applicability of State usury laws to out-of-state branches. He wanted to ensure that branches of out-of-State banks coming into Arkansas were subject to that State's usury ceiling. My staff consulted with his staff and we addressed his concern in the committee report on S.1963 in which we made clear State usury laws would apply to interstate branches coming into the host state.

140 Cong. Rec. S4810 (April 26, 1994). S. 1963 had provided that:

> Any branch of a national bank that is established as a result of a combination [under this legislation] shall be subject to the laws of the host State, including those that govern intrastate branching, consumer protection, fair lending, and community reinvestment, *as if it were a branch of a national bank having its main office in that State.*

Thus, Congress had a clear recognition in the dawning age of comprehensive interstate branching, that host state rates could apply to loans made by an interstate bank. Senator Roth went on to identify circumstances under which host state rates would apply—that is, when a branch or branches in a host state would be considered to be making a loan. He stated:

> The conferees were very careful in drafting . . . agency authority, whereby one bank may use an affiliated bank in another State as its agent with respect to some, but not all, aspects of an interstate loan.[24] What the conferees intended was to allow the principal bank in State A to use an agent bank in State B to assist with deposits and loans in a way that the law of State A would be applicable even though the agent bank in State B helped in some respects. The statement of managers correctly characterizes these permissible functions of the agent as 'ministerial.' *Excluded from the ministerial category are the decision to extend credit, the extension of credit itself, and the disbursal of the proceeds of a loan. . . .*[25] (These are referred to as the "nonministerial functions.")

Senator Roth applied these same principles to interstate branches.[26] As he stated:

> [I]t is clear that the conferees intend that a bank in State A that approves a loan, extends the credit, and disburses the proceeds to a customer in State B may apply the law of State A even if the bank has a branch or agent in State B and even if that branch or agent performed some ministerial functions such as providing credit card or loan applications or receiving payments.
>
> * * * * *
>
> Thus, it is clear that a branch of a multistate bank located in State A that approves a loan application and extends credit to a customer in State B where the bank also has a branch may, under the savings clause, impose loan charges allowed by the law of State A and may, without affecting the applicability of State A's law to such charges, use its State B facility to perform some ministerial functions regarding such extension of credit.[27]

In light of the above legislative history, we conclude that the mere presence of a host state branch does not defeat the ability of a national bank to apply its *home* state's rates to loans made to borrowers who reside in that host state. However, as described by Senator Roth, if a branch or branches in a particular *host* state approves the loan, extends the credit, and disburses the proceeds to a customer, Congress contemplated application of the usury laws of that state regardless of the state of residence of the borrower.

4. Loans where the nonministerial functions occur in different states or in offices other than a bank's main office or branches

As discussed, Senator Roth clearly addressed loans by interstate banks that would be considered to be "made" in a host state because each of the three elements—the three nonministerial functions—occurs at a branch or branches in that host state.

Senator Roth's three element test of where a loan is made by an interstate bank, however, creates unaddressed categories of interstate loans: that is, (1) loans where the three nonministerial functions occur in the main office or branches in different states; or (2) loans where any of the three nonministerial functions occurs in an office not considered to be the main office or a branch of the bank.

In these circumstances, where the plain language and meaning of a statute, taking into consideration its legislative history, are silent as to a particular issue, the agency

---

S. Rep. No. 240, 103d Cong., 2d Sess., 30 (March 23, 1994) (emphasis added). The commentary, as did the commentary in the Riegle–Neal Act Conference Report, explicitly stated that consumer protection laws included "applicable usury ceilings." *Id.* at p. 17.

[24] Under this provision, affiliated banks could, at their offices, provide certain services (agency banking services) for customers of each other without being considered to be branches. 12 USC 1828(r). With regard to lending, the statute lists agency banking services as closing loans, servicing loans and receiving payments on loans. *Id.* The Riegle–Neal Act Conference Report and Senator Roth's remarks elaborate on the activities that fall within these functions: providing loan applications, assembling loan documents, providing a location for returning documents necessary for making a loan, providing loan account information and receiving loan payments. Riegle–Neal Act Conference Report at p. 49; Roth statement at S12789–12790.

[25] *Id.* at S12789. (Emphasis added).

[26] As Senator Roth explained:

> Were it any other way, that is, if the branch in State B could not perform at least the ministerial functions of an agent in State B without affecting the authority of the bank in State A to apply the law of State A to the extension of credit to a customer in State B, then Congress would have constructed a significant disincentive to nationwide branching in authorizing agency powers for bank holding companies. . . .

Roth statement at p. S12790.

[27] *Id.* We recognize that Senator Roth's formulation of where a loan is made for purposes of applying section 85 in the new world of comprehensive interstate branching, may not be relevant for other purposes, *e.g.,* 12 CFR 7.1003 (interpreting 12 USC 36(j)). Of course, depending on their underlying policies, analogous but unrelated statutes may be construed differently. *See, e.g.,* 2A and 2B Sutherland at 45.15, 51.1, and 53.05.

charged with interpreting the statute is required to render a reasonable interpretation.[28] We conclude that, for the following reasons, in circumstances, such as those listed above, where a loan cannot be said to be "made" in a host state under the approach laid out in the Riegle–Neal legislative history, the loan must be considered to be a bank loan and the home state's rates may always be applied.[29]

First, nothing in the *Marquette* decision, specifically preserved by the usury savings clause, requires that a bank must conduct certain lending activities in the home state to use the home state's rates notwithstanding the state of residence of the borrower.[30]

Second, a determination that the rates permitted by a national bank's home state may always be used, absent a statutory requirement that the laws of another state must apply, is fully consistent with the determination by the Supreme Court in *Marquette* that section 85 "not be interpreted so as to throw into confusion the complex system of modern interstate banking."[31] Were it any other way, in circumstances where a loan is not considered to be "made" in any particular host state taking into consideration the three elements set forth in the Riegle–Neal Act legislative history, the bank would have no state to look to for determining the applicable rate of interest. The "confusion" that the Supreme Court sought to avoid in *Marquette* would be unavoidable.[32]

Third, when a loan is made, the bank is always the lender regardless of where certain functions occur. As has been stated:

> A branch is not a separate corporation or legal entity but is an office or agency operated by the legal entity which operates the main bank. It has no separate board of directors or capital structure, its deposits are pooled with those of the main bank, and its loan limits are based on the main bank's capital structure.[33]

We note, however, that the situation arising where fewer than all three of the nonministerial functions occur in a particular host state's branch or branches raises additional considerations. One scenario in which this could happen is if a loan is approved at a home state back office, but the proceeds of the loan are disbursed to the borrower at a host state branch. The OCC letters previously discussed have addressed this type of situation.[34] In those situations, a loan would not be considered to be made in a host state based *solely* on the one or two nonministerial functions that occurred in that state; on the other hand, nonministerial functions beyond those ministerial functions contemplated by Senator Roth would, in fact, be performed in the host state.[35] Neither the statute nor the legislative history specifically address whether

---

[28] *Sun World* at p. 313–314.

[29] Of course, if the three nonministerial functions occur in the main office or in branches in the home state, under section 85, *Marquette,* and the Riegle–Neal Act legislative history, as discussed, the home state rates will apply.

[30] *Marquette* at pp. 309–313. *See also* OCC Interpretive Letter No. 721, March 6, 1996, *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–036.

[31] *Marquette* at p. 312.

[32] We note, too, that any interpretation leading to the conclusion that there was no state to which a national bank could look in determining permissible interest rates, would be the kind of result that the court in *Sun World,* in a different context, sought to avoid. *Sun World* at pp. 314–315, n. 5. In that case, plaintiff argued that following an interstate main office relocation, a national bank had to re-establish its branches in its former main office state. For a variety of reasons, the court in *Sun World* found the plaintiff's interpretation, that when a bank relocated its main office it had to re-establish its branches, "nonsensical" and in "sharp contrast" to the opposite result urged by the Comptroller. Similarly, a result leaving a national bank without a reference point for determining appropriate state interest rate law would be equally "nonsensical" and, for the reasons stated, we believe the appropriate state law, if a loan is not "made" in a host state in accordance with the three elements set forth in the Riegle–Neal Act legislative history, is the law of the home state.

We further note that our conclusion that, absent a federal statutory requirement otherwise, a national bank may charge interest as permitted by home state laws, is consistent with the recognition by courts of the need for a company with far-flung operations to adopt a uniform law to govern its transactions and of the appropriateness of permitting those companies to adopt the law of their headquarters state. *See, e.g., Kruzits* v. *Okuma Machine Tool, Inc.,* 40 F.3d 52, 56 (3d Cir. 1994); *Sarnoff* v. *American Home Products Corp.,* 798 F.2d 1075, 1082 (7th Cir. 1986). *See also Clarkson* v. *Finance Company of America at Baltimore,* 328 F.2d 404, 406–407 (4th Cir. 1964) *(Clarkson)* which reached the same conclusion in a usury case noting the "convenience, uniformity and simplicity achievable by having one law govern the activities of [the lender] through the several states of its operations." Notably, the rationale as set forth in these cases mirrors the concerns of Congress, as discussed, 130 years ago in enacting section 85 to apply to a national banking system operating in an interstate environment. *Marquette* at pp. 312, 314–318. *Cf. Gray* v. *American Express Co.,* 743 F.2d 10, 17 (D.C. Cir. 1984) (upholding choice of law, based on principal place of business of the lender, governing contractual terms applying to cancellation of a credit card).

[33] *See, e.g., Kenilworth State Bank* v. *Howell,* 230 A.2d 377, 380 (N.J. 1967). *See also Ramapo Bank* v. *Camp,* 425 F.2d 333, 341–342 (3d Cir.), *cert. denied,* 400 U.S. 828 (1970) (recognizing that a bank's main office represents the legal existence of the bank). We further note that all of a bank's loans are aggregated and reported on its call report, and profits and losses arising from loans are profits and losses of the bank, a bank's directors are ultimately responsible for a bank's loan policies and standards, and compliance with restrictions on lending limits and loans to insiders and affiliates are based on relationships that borrowers have with the bank.

[34] OCC Interpretive Letters No. 686 and 707 (proceeds disbursed at branch in host state); OCC Interpretive Letter No. 782 (approval in branch state).

[35] Roth statement as S12789–12790.

home state or host state rates apply in that situation. While, for the reasons discussed above, we conclude that home state rates may be used, the OCC, in the interpretive letters previously discussed, has reviewed the entire transaction to determine whether there was a clear nexus between the host state, the rates of which the bank sought to apply, and the loan to justify imposition of the *host* state's rates.[36] In each of the letters, the OCC concluded that it was permissible for the lending bank to charge the rates permitted by the host state even if the borrower resided in another state. In doing so, the OCC recognized the significance of an appropriate disclosure to the borrower that the interest charged is governed by applicable federal law and the law of the relevant state.[37]

5. The definition of nonministerial functions

You next ask what we consider to constitute the making of a loan as described by Senator Roth[38]—that is, what constitutes approval, disbursal and the extension of the credit—and where those actions occur.

a. Approval

You contend that a determination of where approval occurs may depend on whether a loan decision is made based on subjective underwriting criteria applied by bank personnel with the authority to exercise discretion or whether the decision is subjected to a credit-scoring model or other nondiscretionary underwriting standard. You note that approval in the former situation can involve a host of factors including the circumstances underlying any past credit problems of the applicant, special strengths of the applicant, recent changes in circumstances and the nature of the relationships between the bank and the applicant and related parties. Under these circumstances, we agree that the approval cannot be considered merely a ministerial act, as described by Senator Roth, and that the appropriate location of the approval is where the person is located who is charged with making the final judgment of approval or denial.

If, however, a loan is subject to nondiscretionary criteria that will be applied mechanically, we agree with your analysis that the loan is approved where the decision to apply those criteria to that loan is made. The decision to use the credit-scoring system or other nondiscretionary underwriting standard requires the exercise of skill and judgment and may have a significant effect on the credit quality of a loan portfolio. This action simply must be viewed as nonministerial. Once that decision is made, however, the other steps in the underwriting process—that is, the entry of the application data into a computerized or mechanistic underwriting formula—are, to use Senator Roth's term, ministerial, since the mere application of the particular facts to the predetermined and automatic criteria cannot alter the pre-ordained credit decision.

Of course, where a credit scoring system is utilized, but bank personnel have discretion to review and change an automatically rejected loan application, the situation becomes similar to the former situation where a loan, from the time of initiation, is to be reviewed according to underwriting criteria involving discretion. In these situations, where that discretion is actually utilized with respect to a particular loan, and where the loan previously rejected by the nondiscretionary underwriting criteria is then approved, we concur, for the reasons stated above, with your conclusion that the act of final approval is nonministerial and that the site of the final approval is the location in which it is granted.

b. Disbursal

With regard to disbursal, you contend that the relevant site is the site of "physical disbursal" of the funds or, if loan proceeds are deposited into an account of the borrower, the branch at which the account is booked. Senator Roth distinguished between "the actual disbur-

[36] *See, e.g.,* OCC Interpretive Letter No. 782.

[37] *Id.* This determination is consistent with common law principles regarding choice of law provisions in usury and non-usury contexts. Courts have long held, even at the time of the adoption of section 85, that parties, within parameters, may choose the state whose laws will govern their transaction. *See Miller* v. *Tiffany,* 68 U.S. 298, 310 (1864) (choice of usury law among that of several states left to how parties structured their transaction). *See also McAllister* v. *Smith,* 17 Ill. 328, 333–335 (1856). This ability of the parties to make a choice of applicable usury law among jurisdictions with a nexus to the loan contract, while articulated in different ways in different jurisdictions, has been repeated over the years in both usury and non-usury cases. *See, e.g., Seeman* v. *Philadelphia Warehouse Company,* 274 U.S. 403, 407–409 (1927); *Fahs* v. *Martin,* 224 F.2d 387, 397–398 (5th Cir. 1955); *Clarkson* at p. 406–407 (4th Cir. 1964); *Uniwest Mortgage Corp.* v. *Dadecor Condominiums, Inc.,* 877 F.2d 431, 435 (5th Cir. 1989).

Courts have recognized exceptions to this general rule if the contracts do not have sufficient links to the chosen forum) or if the law chosen violates the public policy of the forum state whose law also could be applied to the transaction. *See, e.g., Solman Distributors, Inc.* v. *Brown-Forman Corporation,* 888 F.2d 170 (1st Cir. 1989); *American Star Insurance Co.* v. *Girdley,* 12 F.3d 49 (5th Cir. 1994); *General Electric Co.* v. *Keyser,* 275 S.E.2d 289 (W. Va. 1989); *North American Bank, Ltd.* v. *Schulman,* 474 N.Y.S.2d 383 (N.Y. Co. Ct. 1984). These exceptions are inapplicable: as discussed, the OCC requires that the chosen forum have a clear nexus to the transaction and the Supreme Court has made it clear that "the interest rate that [a national bank] may charge . . . is . . . governed by federal law." *Marquette* at p. 308. Consequently, policies underlying federal law, not state law, are relevant and these policies are designed to promote flexibility and efficiency in lending by national banks. *See, e.g.,* section 85; *Marquette* at p. 312; *Tiffany* at p. 413; *Fisher* at p. 1291 (permitting use of most favored lender rate, use of higher of several alternative rates, and use of permissible rate irrespective of the state of residence of the borrower).

[38] Roth statement at S12789.

sal of proceeds" and "delivering previously disbursed funds to a customer." He characterized the former as nonministerial—"so closely tied to the extension of credit that it is a factor in determining, in an interstate context, what State's law applies."[39] While it is not possible at this time to ascertain and analyze all of the different ways in which funds can be disbursed at a branch, it is clear that where a bank gives the proceeds of a loan in person to a customer[40] or credits the borrower's account at a branch, the funds are being "actually" disbursed at a branch and would constitute "disbursal" as contemplated by Senator Roth. On the other hand, it appears equally clear, for instance, that if funds are disbursed by the bank to an escrow agent or title agent who, in turn, disburses them to the borrower, that would, to use Senator Roth's formulation, constitute "delivering previously disbursed funds to a customer" and the disbursal to the customer would be a ministerial event regardless of where it occurred.

c. Extension of credit

Finally, Senator Roth noted a third element in his formulation of the nonministerial functions that constitute the making of a loan—extension of credit. While it might be argued that the approval and disbursal constitute the extension of credit, you contend that Senator Roth clearly added a third prong by separately referencing the "extension of credit" and that, in adding this, Senator Roth was intending to incorporate the communication of the final approval by the bank to the borrower. You further contend that the relevant site is the site from which the first communication of final approval comes. We agree with your assessment. First, Senator Roth clearly spoke of a test with three distinct elements. Second, it stands to reason that an approval of a loan or line of credit and disbursal of the proceeds in some form or fashion is of no significance if the bank does not communicate to the borrower that the loan has been approved. Approval of a credit card is irrelevant, for instance, if the applicant is never informed and never receives the card. Thus, in our view, communication from the bank to the customer that the loan has been granted complements the approval of the loan and the disbursal of the proceeds.

We also note that, while it may be argued that the closing of a loan could constitute the "extension of credit," as described by Senator Roth, it is clear from his statement that his characterization of certain functions as either ministerial, not affecting what state's law applies, or nonministerial, affecting what state's law applies, is based on the line that Congress drew in permitting "agency banking" activities without implicating branching concerns.[41] In adopting "agency banking," Congress explicitly provided that the closing of loans, as long as that did not implicate approval or disbursal, was to be considered a ministerial function.[42] Consequently, Senator Roth could not have considered loan closings to be a nonministerial function.

For these reasons, we conclude that the first communication of final approval constitutes the final element of Senator Roth's three-part test and that the relevant site is the site from which that communication comes.

B. Conclusion

Consequently, for the reasons set forth above, we conclude that an interstate national bank may charge interest permitted by the laws of its home state unless the loan is made—that is, the loan is approved, credit is extended and funds are disbursed—in a branch or branches of the bank in a single host state. If one or two of those three functions occur in a host state, the bank may, alternatively, charge the interest permitted by that state if, based on an assessment of all of the facts and circumstances, the loan has a clear nexus[43] to that state.[44] Moreover, if a bank is permitted to charge the rates of a particular home or host state, it may under section 85, the usury savings clause, and the Supreme Court's decisions in *Marquette* and *Tiffany,* charge the most favored lender rates permitted by that state and may charge the permissible interest rates irrespective of the state of residence of the borrower.

I hope that this has been responsive to your inquiry.

Julie L. Williams
Chief Counsel

[39] Roth statement at S12789–12790.

[40] *See* 12 CFR 7.1003—7.1005 regarding the circumstances under which disbursal of loan proceeds by a bank requires branch authorization.

[41] Roth statement at S12789.

[42] 12 USC 1828(r)(1); Riegle–Neal Act Conference Report at p. 49.

[43] For examples of what the OCC has recognized as a clear nexus supporting use of host state rates, *see* OCC Interpretive Letters No. 686, 707, and 782.

[44] In any event, you have represented that the bank will include in its loan contracts choice-of-law provisions disclosing to borrowers that the interest rates are governed by federal law and the law of the relevant state.

823—February 27, 1998

12 USC 92

Mr. Donald A. Dowdell
Director
Division of Legal Services
Department of Insurance
The Capitol, LL-26
Tallahassee, Florida 32399–0307

Dear Mr. Dowdell:

This is in response to your letter to the Office of the Comptroller of the Currency (OCC) dated January 23, 1998, inquiring about the definition of the term "place" in 12 USC 92 ("section 92"). In particular, you asked if the OCC has concluded that a "census designated place" is a "place" for purposes of section 92. You also asked for information on "census designated places" in Florida.

For the reasons discussed below, we treat an area designated a "place" by the United States Bureau of the Census (Census Bureau) as a "place" under section 92. This has been our practice for the past several years.

Section 92

The OCC's interpretation of the word "place" is based upon the language used in section 92 that provides:

> . . . national banking associations. . . located and doing business in any *place* the population of which does not exceed five thousand inhabitants, *as shown by the last preceding decennial census,* may . . . act as the agent for any fire, life, or other insurance company. . . . (emphasis added)

Section 92 was introduced in the Senate in 1916 as an amendment to the Federal Reserve Act.[1] There are two well-accepted principles of statutory construction that aid us in interpreting the proper scope of the term "place" as used in section 92.

First, it is a well-established rule of statutory interpretation that "absent sufficient indication to the contrary . . . Congress intends the words in its enactments to carry 'their ordinary, contemporary, common meaning.'"[2] The Supreme Court has frequently relied on dictionaries for guidance for the common meaning, and thus proper interpretation of words and phrases used in statutes.[3]

The definition of "place" found in the *Webster's New International Dictionary* in use in 1916 provides that the term includes ". . . an area . . . an open space . . . a square, in a city or town . . . a village, town, or city . . . a spot set apart for a special purpose. . . ."[4] This dictionary lists synonyms for "place" to include: "locality, location, site, (and) spot."

Black's Law Dictionary in use in 1916 provides:[5]

> This word ["place"] is a very indefinite term. It is applied to any locality, limited by boundaries, however large or however small. It may be used to designate a country, state, county, town, or a very small portion of a town. The extent of the locality designated by it must generally be determined by the connection in which it is used.

Thus, relying on its common ordinary meaning, the word "place" indicates "an area," "a village, town or city," "a spot set apart for a special purpose," or more generally "any locality limited by boundaries" including "a state, country, town, or a very small portion of a town."

The second principle of statutory construction directs us to consider not only the plain meaning of the word "place," but the *context* in which it is used.[6] As the Supreme Court has often explained: "We consider not only the bare meaning of the word but also its placement and purpose in the statutory scheme. The meaning of statutory language, plain or not, depends on context."[7] Thus,

---

[1] The provision was offered by Senator Robert L. Owens, with reference to a letter received from the incumbent Comptroller of the Currency, John Skelton Williams. Comptroller Williams' letter notes that the authority of section 92 could be exercised from "small communities." *See* 53 Cong. Rec. 11001. We could find no other relevant legislative history.

[2] *Pioneer Investment Services Co.* v. *Brunswick Associates Ltd. Partnership,* 507 U.S. 380, 388 (1993); Sutherland Stat. Const. 46.01 (5th ed., 1992).

[3] For example, the Supreme Court has relied on the *Webster's New Collegiate Dictionary* for the definition of the word "neglect" as used in the Rules of the Bankruptcy Court *(Id.);* the *American Heritage Dictionary* for the definition of the word "has" as used in the Civil Rights Act of 1964 (*Walters* v. *Metropolitan Educational Enterprises, Inc.,* 519 U.S., 136 L. Ed. 2d 644, 652 (1997)); and both *Webster's New International Dictionary* and *Black's Law Dictionary* to define the word "use" found in a federal firearms statute (*Bailey* v. *U.S.*, 516 U.S. 137, 145 (1995)).

[4] *Webster's New International Dictionary* at 1646 (1913).

[5] *Black's Law Dictionary* at 901 (2d ed., 1910).

[6] Sutherland Stat. Const. 46.05 (5th ed., 1992). In this instance, not only do the rules of statutory construction direct us to consider context, but the *Black's Law Dictionary* definition of "place" also instructs the reader to determine the meaning of this word by reference to the "connection in which [the word 'place'] is used." *Black's Law Dictionary* at 901, discussed *supra.*

[7] *Bailey* v. *U.S.,* 516 U.S. 137, 145 (1995).

in interpreting the language of a statute, courts do not look at one provision in isolation, but rather look to the entire statutory scheme for clarification and contextual reference.[8]

In this case, the word "place" is immediately followed by the words "the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census. . . ." Thus, in context, the word "place" clearly contemplates a "place" that the Census Bureau has identified and for which a population total may be computed using census data. This would include "census designated places."

In summary, both the plain meaning of the word "place" and the context in which it is used in section 92 provide substantial guidance in defining what types of locations constitute a "place" for purposes of that section. As commonly understood, the term refers to a locality that can be geographically identified by some type of boundary. Based on the context in which the word is used, it should also be a "place" for which a population total is ascertainable using census information.

Accordingly, where the Census Bureau has designated certain "places" for purposes of measuring the population in that particular geography, we have concluded that those "places" should qualify as "places" for purposes of section 92. We have relied heavily on this type of census designation in concluding that particular locations qualify as section 92 "places."[9]

Census' Definition of "Place"

In the 1990 census, the Census Bureau defined "places" to include incorporated places and "census designated places" ("CDPs").[10] Incorporated places are cities, boroughs, towns, and villages legally in existence in their respective states and reported as such to the Census Bureau.[11]

CDPs are currently defined as densely settled concentrations of population that are identifiable by name, but are not legally incorporated places.[12] To qualify as a CDP for the 1990 census, an unincorporated community must generally[13] have met the following criteria: (i) 1,000 or more persons if outside the boundaries of an urbanized area;[14] or (ii) 2,500 or more persons if inside the boundaries of an urbanized area.[15] A list of CDPs in the state of Florida is attached for your convenience [enclosures omitted].

Conclusion

In sum, we treat an area designated as a "place" by the Census Bureau as a "place" for purposes of section 92. We have followed this approach for the last several years.

Julie L. Williams
Chief Counsel

Enclosure(s) [Enclosures omitted.]

824—February 27, 1998

12 USC 92
12 USC 24(7) *[file 21]*

Dear [ ]:

This is in response to your letter inquiring if national banks may participate in a proposed insurance program involving a corporation owned by independent insurance agencies. Based on the representations in your letter and for the reasons discussed below, we find that the proposed activities for national banks are permissible and

[8] *U.S.* v. *McLemore,* 28 F.3d 1160, 1162 (11th Cir. 1994).

[9] The OCC recognizes that there may be unusual circumstances where other localities also could qualify as a "place"—where the locality met the commonly understood definition of a place, and the population within the boundaries of that place was measurable according to census data. Each particular situation would require specific analysis.

[10] *See* "1990 Census of Population and Housing, Finders Guide to Census Tract Reports," p. A–9.

[11] There are some exceptions to this definition of "incorporated places." For more information, *see* Bureau of the *Census, Geographic Areas Reference Manual* (1994).

[12] *See* "1990 Census of Population and Housing, Finders Guide to Census Tract Reports," p. A–9.

[13] Alaska, Hawaii, American Indian Reservations, and Puerto Rico, for example, are subject to different standards. *See Id.* at pp. A–9 and A–10.

[14] An urbanized area is defined as comprising one or more places and the adjacent densely settled surrounding territory that together have a minimum of 50,000 persons. *See Id.* at p. A–12.

[15] *See Id.* at p. A–10.

are consistent with prior Office of the Comptroller of the Currency (OCC) opinions.[1]

I. Proposal

As described in your letter, you propose a program through which a group of independent insurance agencies would pool their resources to offer smaller national banks the opportunity to provide insurance products to their customers. The agencies would form and own a corporation that would solicit and sell insurance to customers of the participating national banks.[2] Employees of the banks participating in the program would refer customers to the corporation and would provide brochures, leaflets, and other literature informing customers of the availability of the insurance products and services from the corporation. Your program contemplates the following arrangements:[3]

(1) Each participant bank and a wholly owned operating subsidiary ("participating bank agency") would be located in a place with a population of fewer than 5,000 inhabitants according to the last census ("place of 5,000").[4]

(2) Licenses obtained by the participating bank agency or its state-licensed insurance agent, as appropriate, ("bank representative") would list the "place of 5,000" as the agency's business location and appropriate licensing documentation would be maintained at that location.

(3) The bank representative or the participating bank agency would receive a percentage of the premium, commission, or net income generated as a result of the bank's referrals based on the contract terms between the corporation and the respective national bank or its participating bank agency.

(4) Business records of the participating bank agency, including copies of customer applications and policy information, and licensing, customer complaint, and other compliance records would be available to the bank representative either directly or via electronic media, i.e., the bank representative would have electronic access to all scanned applications, correspondence, complaints, and other customer related documents from an off-site location.

II. Analysis

National banks are authorized to engage in insurance activities as "agent" pursuant to 12 USC 92. In addition, the OCC has long recognized that national banks may act as "finders" by providing referral or other services related to a wide variety of products, including insurance.[5] These finder activities are part of the business of banking pursuant to 12 USC 24(Seventh). *See* Conditional Approval No. 221 (December 4, 1996). As discussed below, based on the facts you represent, it appears that your proposed insurance program for national banks may be permissible under both 12 USC 92 and 12 USC 24(Seventh).

A. Authority of a National Bank to Act as an "Agent" under 12 USC 92

Section 92 provides:

> In addition to the powers now vested by law in national banking associations . . . any such association located and doing business in any place the population of which does not exceed five thousand

[1] This letter does not address and is not intended to express any opinion on the permissibility of the proposed program under state laws. We would expect any national bank considering your program to seek assurance itself concerning compliance with applicable state laws.

[2] You note that, in particular, smaller national banks may benefit by having greater access to insurance carrier markets because the individual premium developed from each bank's customers could be combined with that from other banks to satisfy insurance carrier premium volume requirements.

[3] Your proposed program is one example of an arrangement between national banks and third party vendors involving insurance-related services. Currently, national banks engage in various types of arrangements related to the solicitation and sale of insurance. This letter is intended only to address the specific program you proposed and may not necessarily effect national banks engaging in other types of arrangements.

[4] Consistent with 12 CFR 7.1001, the bank may have a "branch" rather than the bank's main office located in the "place of 5,000."

[5] *See, e.g.,* 12 CFR 7.1002 (formerly 12 CFR 7.7200); Corporate Decision 97–60 (July 1, 1997) (Internet-based referral services for used vehicles, including related insurance products); Conditional Approval No. 221 (December 4, 1996) (links to third-party vendors' Web sites); OCC Interpretive Letter No. 653 (December 22, 1994), *reprinted in* [1994–95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601 (insurance-related services for underwriters and insurance agencies); Letter from Lee Walzer, Attorney, Securities, Investments, and Fiduciary Practices Division (August 24, 1992) (trust referral activities); OCC Interpretive Letter No. 566 (December 2, 1991), *reprinted in* [1991–92 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,320 (insurance-related activities for insurer); OCC Interpretive Letter No. 472 (March 2, 1989), *reprinted in* [1989–90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,008 (services related to homeowners insurance); No-Objection Letter No. 89–02, *reprinted in* [1989–90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,014 (April 7, 1989) (automobile club membership services); OCC Interpretive Letter No. 437, *reprinted in* [1988–89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,661 (July 27, 1988) (tax auditing representation services); OCC Interpretive Letter No. 238, *reprinted in* [1983–84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,402 (February 9, 1982) (real estate-related services); Letter from John M. Miller, Acting Deputy Chief Counsel (July 26, 1977) (activities related to the purchase and sale of businesses).

> inhabitants . . . may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company; and may receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent. . . .

12 USC 92.

Section 92 authorizes a national bank that is located and doing business in a place with a population of less than 5,000 to solicit and sell insurance as agent for state-authorized insurance companies. Since 1963, the OCC has interpreted the reach of section 92 to permit a branch office of a bank to act as agent for insurance companies if the branch is located in a community with a population of less than 5,000, even if the main office of the bank is located elsewhere. 12 CFR 7.100l.[6]

The Supreme Court in *Barnett Bank of Marion County, N.A.* v. *Nelson,* 517 U.S. _____, 116 S.Ct. 1103 (1996) examined the language of section 92 and found that section 92 suggests "a broad, not limited permission" for national banks to act as the agent for insurance sales. The OCC and the courts have construed the language of section 92 to permit national banks to engage in a range of agency insurance activities from locations of less than 5,000 in population. In taking this view, the OCC has carefully considered the plain language of the statute, the legislative history, the contemporaneous practices of banks and insurance agents in 1916 when the law was enacted, the OCC's longstanding interpretive ruling under section 92 (12 CFR 7.1001), and recent judicial opinions construing the scope of section 92. *See* OCC Interpretive Letter No. 753 (November 4, 1996), *reprinted in* [1996–97] Fed. Banking L. Rep. (CCH) ¶ 81–107 (the "First Union letter") (copy attached for your reference). [Attachment omitted.]

The First Union letter provides an extensive legal interpretation on the scope of activities permissible under 12 USC 92.[7] In particular, the OCC stated that the "place of 5,000" must be the national bank insurance agency's business location for licensing purposes, and accordingly, that business records of the agency, including copies of customer application and policy information, and licensing, customer complaint, and other compliance records, must be available at the "place of 5,000."[8]

The OCC also concluded in the First Union letter that a bank insurance agency and its agents may seek the same market range and use the same marketing tools and facilities as generally available for a licensed insurance agency that is based in the "place of 5,000." This will generally permit the following:

- Meetings with customers and solicitations and sales of insurance by the bank's agents may generally take place at locations inside the "place of 5,000" as well as at locations outside that "place," provided the agents are managed and paid through the bank agency located in the "place of 5,000" and use that location as their place of business for licensing purposes.
- Mailings to advertise and sell insurance may originate from inside or outside of the "place of 5,000" and brochures, leaflets, and other literature alerting potential customers to the bank's insurance activities may be distributed from locations inside and outside of the "place of 5,000," including other branches of the same bank.
- Personnel at bank branches inside and outside of the "place of 5,000" may make referrals to the bank's insurance agency.
- Telephone and cybermarketing may be used and the calls and messages need not originate within the "place of 5,000."
- The bank may contract with third parties to assist the agency's sales activities, including advertising support, direct mail marketing services, telemarketing services, payments processing, and other types of "back office" support.

The proposed activities for national banks that you describe involve customer referrals and the distribution of informational materials on insurance. To the extent that the described activities constitute acting as an agent to sell insurance, they are within the scope of activities

---

[6] Interpretive ruling section 7.1001 provides:

> Pursuant to 12 USC 92, a national bank may act as an agent for any fire, life, or other insurance company in any place the population of which does not exceed 5,000 inhabitants. This provision is applicable to any office of a national bank when the office is located in a community having a population of less than 5,000, even though the principal office of such bank is located in a community whose population exceeds 5,000.

12 CFR 7.1001 (formerly 12 CFR 7.7100).

[7] The OCC noted in the First Union letter that this description was not intended to be exhaustive and that variations could be consistent with the general principles set forth in the letter.

[8] The letter indicated, however, that business records may be maintained and available at the agency in electronic form, with the original hardcopy kept in off-site storage.

permitted by 12 USC 92 and the OCC's First Union letter. The framework you propose for national banks conducting the activities appears consistent with the principles for applying section 92 set forth in the First Union letter. Section 92 also expressly permits national banks to receive fees or commissions for services rendered. 12 USC 92. Accordingly, we find the activities you propose permissible for national banks and their subsidiaries under 12 USC 92.

B. Authority of a National Bank to Act as a "Finder" under 12 USC 24(Seventh)

A long line of OCC precedents and an OCC interpretive ruling authorizing national banks under 12 USC 24(Seventh) to act as a "finder," including bringing together a potential purchaser of insurance and the seller of the insurance, also permit the proposed activities.[9] Interpretive Ruling 7.l002 provides:

(a) *General.* A national bank may act as a finder in bringing together a buyer and seller.

(b) *Qualification.* Acting as a finder includes, without limitation, identifying potential parties, making inquiries as to interest, introducing or arranging meetings of interested parties, and otherwise bringing parties together for a transaction that the parties themselves negotiate and consummate. Acting as a finder does not include activities that would characterize the bank as a broker under applicable Federal law.

(c) *Advertisement and fee.* Unless otherwise prohibited, a national bank may advertise the availability of, and accept a fee for, the services provided pursuant to this section.

12 CFR 7.1002. This finder function is an activity authorized for national banks under 12 USC 24(Seventh) as part of the business of banking. Hence, a national bank may engage in permissible insurance-related finder activities and receive a fee for these activities based on section 24(Seventh) rather than on 12 USC 92.[10] Some state laws may, however, treat these finder activities as activities that constitute acting as an insurance agent under state law. Such a state law characterization does not alter the characteristics of what are permissible finder activities under federal law. But, where a state law characterizes finder activities as activities of an insurance agent, national banks should comply with the applicable state insurance licensing and other requirements.

In analyzing a national bank's proposed arrangement involving insurance activities for purposes of section 24(Seventh), various considerations may lead to the conclusion that certain activities are those of a finder. For example, the scope of activities proposed by the bank is one factor.[11] Another factor is whether there is another party or entity involved in the arrangement that is acting as an insurance agent or broker and actually conducting the insurance sales transactions.[12] We also examine whether any contractual or express agency relationship exists between the bank and the insurance company whose products are being offered and sold to customers.[13] If so, we may inquire whether the relationship is typical of one in the insurance industry where an agent sells the policies of a particular company or companies. Further, the nature of the compensation received by the bank for its involvement in the activities may be a consideration, such as whether the compensation is based on the performance of a specific service (e.g., a flat fee), or otherwise differs from compensation typically paid to insurance agents.[14]

---

[9] *See e.g.,* 12 CFR 7.1002 (formerly 12 CFR 7.7200); OCC Interpretive Letter No. 653 (December 22, 1994), *reprinted in* [1994–95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601; OCC Interpretive Letter No. 566 (December 2, 1991), *reprinted in* [1991–92 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,320; OCC Interpretive Letter No. 472 (March 2, 1989), *reprinted in* [1989–90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,008.

[10] Notably, section 92 grants authorities to national banks "[i]n addition to the powers now vested by law in national banking associations."

[11] For example, among other activities, as a finder the bank may engage in customer referral activities, provide brochures or other insurance-related materials, forward completed materials to an insurance agency or an insurer, provide listing services, and perform billing services to assist in the collection of premiums. *See, e.g.,* OCC Interpretive Letter No. 653 (December 22, 1994), *reprinted in* [1994–95 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,601; OCC Interpretive Letter No. 566 (December 2, 1991), *reprinted in* [1991–92 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,320; Letter from Elizabeth H. Corey, Attorney, Southwest District (May 18, 1989).

[12] *See, e.g.,* Letter from Asa L. Chamberlayne, Senior Attorney, Securities and Corporate Practices Division (March 6, 1995) (bank refers customers to an independent insurance agency); OCC Interpretive Letter No. 472 (March 2, 1989), *reprinted in* [1989–90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,008 (insurer's licensed telemarketing employees contact customers); Letter from William B. Glidden, Assistant Director, Legal Advisory Services Division (May 8, 1986) (bank forwards completed insurance authorization forms to independent agency).

[13] *See, e.g.,* OCC Interpretive Letter No. 472 (March 2, 1989), *reprinted in* [1989–90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,008 (no agency agreement with insurer); Letter from Elizabeth H. Corey, Attorney, Southwest District (May 18, 1989) (same); Letter from James M. Kane, District Counsel, Central District (January 30, 1987) (same).

[14] *See, e.g.,* OCC Interpretive Letter No. 566 (December 2, 1991), *reprinted in* [1991–92 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,320 (fees based on a specific service); Letter from Elizabeth H. Corey, Attorney, Southwest District (May 18, 1989) (fee based on percentage of commissions); OCC Interpretive Letter No. 472

In summary, in determining that national bank finder arrangements are permissible in the insurance context, the OCC may examine:

(1) the scope of the proposed activities;

(2) the existence or absence of another insurance agent or broker in the arrangement;

(3) whether the bank has a contractual relationship with an insurance company for selling its products, and, if so, the nature of the relationship; and

(4) the bank's compensation arrangement for the proposed activities. This analysis reviews the extent of the bank's activities, including the precise nature of the bank's relationships with insurance companies and the payment the bank receives for its services. However, none of these factors alone are determinative of whether the bank's activities are those of a finder. Generally we would apply all of the factors to each set of facts and consider the entire situation.[15]

Specifically, in your situation, we note that the proposed activities for a national bank are limited to the referral of customers and the distribution of informational insurance materials. An independent corporation with its own insurance agents actually will solicit and sell the insurance policies, not the bank's employees. Further, as we understand it, there will be no relationship between the national bank and the insurance companies whose products are being sold to customers. The bank's compensation will be based on a percentage of the insurance premiums, commission, or net income generated as a result of the bank's referrals. Under the above analysis, we would conclude that the bank's proposed activities are permissible as those of a finder.[16]

C. Census Designated Places (CDPs)

You also asked for confirmation that in unincorporated areas the OCC is using census designated places (CDPs)[17] as the standard to determine if a branch qualifies as being located in a "place of 5,000" for purposes of 12 USC 92. Please be advised that it has been our practice to treat an area as a "place" for purposes of section 92, if the area is designated a "place" by the United States Bureau of the Census. Accordingly, an unincorporated area would qualify as a "place of 5,000" if it were designated as a CDP.

If you should have any questions, please feel free to contact me at 202–874–5200 or Suzette H. Greco, Senior Attorney, at 202–874–5210.

Julie L. Williams
Chief Counsel

[Attachment omitted. OCC Interpretive Letter No. 753 may be found in the *Quarterly Journal,* Vol. 16, No. 1 (p. 151) and on the World Wide Web at http://www.occ.treas.gov/interp/monthly.htm under November 1996.]

(March 2, 1989), *reprinted in* [1989–90 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,008 (payment unrelated to placement of insurance coverage); Letter from William B. Glidden, Assistant Director, Legal Advisory Services Division (May 8, 1986) (payment involves portion of commissions generated as a result of referrals).

[15] We also recognize that banks may engage in other types of arrangements that may preclude analysis under these factors. These arrangements also may be permissible. Nothing in this letter is intended to foreclose banks from proposing or engaging in other arrangements so long as they are in compliance with all applicable laws.

[16] As discussed previously in this letter, based on your representations, your particular arrangements and the framework you propose for conducting them also appear to satisfy the requirements necessary for a national bank to act as an "agent" for purposes of section 92.

[17] CDPs currently are defined as densely settled concentrations of population that are identifiable by name, but are not legally incorporated places. *See* 1990 Census of Population and Housing, Finders Guide to Census Tract Reports, p. A–9. The 1990 census is the most current decennial census.

Mergers—January 1 to March 31, 1998

Page

Nonaffiliated mergers (mergers consummated involving two or more nonaffiliated operating banks) 131

Affiliated mergers (mergers consummated involving affiliated operating banks) 133

Affiliated mergers—thrift (mergers consummated involving affiliated national banks and savings and loan associations) 139

Mergers—January 1 to March 31, 1998

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, 1998[1]

Title and location (charter number)	Total assets[2]
Louisiana	
Hibernia National Bank, New Orleans (013688)	$9,335,638,000
and ArgentBank, Thibodaux	759,610,000
merged on February 1, 1998 under the title of Hibernia National Bank, New Orleans (013688)	$10,095,248,000
Mississippi	
Trustmark National Bank, Jackson (010523)	52,989,000
and Smith County Bank, Taylorsville	96,889,000
merged on March 14, 1998 under the title of Trustmark National Bank, Jackson (010523)	67,461,000
Oklahoma	
The First National Bank and Trust Company of Miami, Miami (005252)	73,439,000
and Bank of Miami, Miami	19,698,000
merged on February 27, 1998 under the title of The First National Bank and Trust Company of Miami, Miami (005252)	93,966,000

Comptroller's Decision

Introduction

On December 15, 1997, application was made to the Comptroller of the Currency for prior authorization to merge Bank of Miami, Miami, Oklahoma (hereinafter "Bank of Miami") into The First National Bank and Trust Company of Miami, Miami, Oklahoma (hereinafter "First National") under the charter and the title of First National. This application was based on an agreement entered into between the proponents on December 8, 1997.

Participating Financial Institutions

As of September 30, 1997, Bank of Miami, a state member bank, had total deposits of $18.1 million and operated one office. On the same date, First National had total deposits of $65.9 million and operated two offices. First National is 97 percent owned and controlled by First Miami Bancshares, Inc., a one-bank holding company.

Competitive Analysis

The relevant geographic market for this proposal is the Federal Reserve market of Ottawa County, including the town of Welch, in Craig County. The relevant geographic market consists of the area surrounding the bank to be acquired. This is the area where the effect of this transaction on competition would be direct and immediate.

Within the relevant geographic market, eight banks and two thrift institutions compete for approximately $320 million in deposits. First National ranks second with approximately 22 percent of the market's total deposits. Bank of Miami ranks sixth with approximately 6 percent of the market's total deposits. Upon consummation of the proposed transaction, First National Bank would become the largest depository institution in the market with approximately 28 percent of the market's deposits. While the proposed transaction would eliminate some direct competition in the relevant geographic market, any adverse competitive effects would be mitigated by the

[1] Nonaffiliated mergers include mergers, consolidations, or purchase and assumptions of nonaffiliated operating banks or savings and loan associations, when the resulting bank is a national bank. Note that earlier mergers that were not previously published are also included in this issue.

[2] Asset figures for merging institutions are not necessarily as of the date of the merger and thus may not sum to the total assets given for the merged bank.

presence of a number of other banking alternatives, including a subsidiary of one of the largest banking companies in the country.

Accordingly, consummation of this transaction would not have a significantly adverse effect on competition in the relevant geographic market.

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 First National and Bank of Miami 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. No branches will be closed, and customers of Bank of Miami will be offered the expanded products of services of First National.

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: 97–MW–02–0087]

Nonaffiliated mergers (continued)

Title and location (charter number)	Total assets
Texas	
The Herring National Bank, Vernon (007010)	147,812,000
and BFNB Trust Company, National Association, Amarillo (023500)	200,000
merged on January 1, 1998 under the title of The Herring National Bank, Vernon (007010)	148,012,000
The American National Bank of Texas, Terrell (017043)	518,411,000
and The First National Bank of Wills Point, Wills Point (005018)	32,660,000
merged on January 1, 1998 under the title of The American National Bank of Texas, Terrell (017043)	548,216,000

Affiliated mergers (mergers consummated involving affiliated operating banks), from January 1 to March 31, 1998[1]

Title and location (charter number)	Total assets[2]
California	
City National Bank, Beverly Hills (014695)	4,651,527,000
and Harbor Bank, Long Beach	204,000,000
merged on January 9, 1998 under the title of **City National Bank, Beverly Hills** (014695)	5,100,000,000
Colorado	
The First National Bank in Alamosa, Alamosa (007904)	120,145,000
and Valley National Bank of Cortez, Cortez (016808)	92,262,000
merged on January 23, 1998 under the title of **Bank Colorado, National Association, Cortez** (007904)	212,407,000
Bank Colorado, National Association, Denver (007904)	92,262,000
and Tri-State Bank, Denver	122,905,000
merged on February 27, 1998 under the title of **Bank Colorado, National Association, Denver** (007904)	215,167,000
Delaware	
CoreStates Bank of Delaware National Association, Wilmington (018011)	2,086,348,000
and CoreStates Delaware, National Association, Wilmington (022872)	4,555,000
merged on January 1, 1998 under the title of **CoreStates Bank of Delaware National Association, Wilmington** (018011)	2,090,903,000
Georgia	
Pinnacle Bank, National Associaton, Elberton (014061)	140,448,000
and Pinnacle Bank, Royston	95,675,000
merged on January 1, 1998 under the title of **Pinnacle Bank, National Associaton, Elberton** (014061)	140,884,000
Illinois	
First Midwest Bank, National Association, McHenry (013660)	3,096,671,000
and McHenry State Bank, McHenry	438,084,000
merged on February 23, 1998 under the title of **First Midwest Bank, National Association, McHenry** (013660)	3,534,755,000
LaSalle National Bank, Chicago (014362)	15,383,920,000
and LaSalle Bank NI, Chicago	2,173,299,000
merged on February 2, 1998 under the title of **LaSalle National Bank, Chicago** (014362)	17,540,983,000
Indiana	
First National Bank, Kokomo (014519)	659,330,000
and First Bank and Trust, Sullivan	232,500,000
merged on March 16, 1998 under the title of **First National Bank & Trust, Kokomo** (014519)	891,830,000
Iowa	
Magna Bank, National Association, Waterloo (013702)	660,627,000
and Magna Interim—Cedar Rapids, National Association, Cedar Rapids (023423)	8,460,000
and Magna Interim Bank—Decorah, National Association, Decorah (023424)	25,939,000
and Magna Interim Bank—Iowa City, National Association, Iowa City (023425)	39,842,000
and Magna Interim Bank—Vinton, National Association, Vinton (023426)	26,606,000
and Magna Interim Bank—Waterloo, National Association, Waterloo (023427)	103,199,000
and Magna Interim Bank—Des Moines, National Association, Des Moines (023428)	220,518,000
and Magna Bank, Indianola	143,086,000
and Magna Bank, Monticello	149,205,000
and Magna Bank, Oelwein	99,677,000
merged on July 18, 1997 under the title of **Magna Bank, National Association, Waterloo** (013702)	1,318,795,000

[1] Affiliated mergers include mergers, consolidations, and purchase and assumptions of affiliated institutions, when the resulting bank is a national bank. Note that earlier mergers that were not previously published are also included in this issue.

[2] Asset figures for merging institutions are not necessarily as of the date of the merger and thus may not sum to the total assets given for the merged bank.

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Kentucky	
The Anderson National Bank of Lawrenceburg, Lexington (008604)	93,008,000
and Farmers Bank, Owingsville	39,106,000
merged on January 1, 1998 under the title of The Progressive Bank, National Association, Lexington (008604)	132,114,000
Louisiana	
Hibernia National Bank, New Orleans (013688)	9,335,638,000
and First National Bank in Mansfield, Mansfield (011669)	105,112,000
merged on January 1, 1998 under the title of Hibernia National Bank, New Orleans (013688)	9,440,769,000

Comptroller's Decision

Introduction

On October 20, 1997, application was made to the Office of the Comptroller of the Currency (OCC) for the merger of ArgentBank, Thibodaux, Louisiana with and into Hibernia National Bank (Hibernia), New Orleans, Louisiana under the charter and title of the latter. This application was based on an agreement entered into between the banks on June 15, 1997.

Participating Financial Institutions

As of June 30, 1997, ArgentBank had total deposits of $640 million. On the same date, Hibernia had total deposits of $7 billion. ArgentBank is an independent rural bank with no banking affiliates. Hibernia is owned by Hibernia Corporation which also owns Hibernia National Bank of Texas, Texarkana, Texas.

Competitive Analysis

There are four relevant geographic markets for this proposal: the Federal Reserve markets of Baton Rouge, Morgan City, New Orleans, and Houma-Thibodaux. Each relevant geographic market consists of an area surrounding one or more of the branches to be acquired. These are the areas where the effect of this transaction on competition would be direct and immediate.

The OCC reviewed the competitive effects of this proposal in the Baton Rouge, Morgan City, and New Orleans markets by using its standard procedures for determining whether a merger clearly has minimal or no adverse competitive effects. The OCC finds that the proposal satisfies its criteria for a merger that clearly has no or minimal adverse competitive effects.

Within the Houma-Thibodaux market, twelve banks and two thrift institutions compete for approximately $1.9 billion in deposits. ArgentBank ranks first with approximately 26 percent of the market's total deposits. Hibernia ranks sixth with approximately 8 percent of the market's total deposits. Upon consummation of the proposed transaction, Hibernia would replace ArgentBank as the largest depository institution in the market. While the proposed transaction would eliminate some direct competition in the relevant geographic market, any adverse competitive effects would be mitigated by the presence of a number of other banking alternatives, including subsidiaries of some of the largest banking companies in the country. Accordingly, consummation of this transaction would not have a significantly adverse effect on competition in any of the relevant geographic markets. In making this determination, the OCC carefully considered the report of the Department of Justice, which similarly found that the proposed transaction would not have a significant adverse effect on competition.[1]

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 Hibernia, before and after the merger, 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

---

[1] In reaching this conclusion, the Department of Justice relied on commitments made by Hibernia. Hibernia agrees, regarding their existing physical facilities in Terrebonne and Lafourche parishes and Hibernia's additional physical facilities acquired in said parishes as a result of this transaction, that Hibernia will not impose any conditions, other than those in current deeds or lease agreements, that would preclude the future use by another commercial banking institution of any of Hibernia's properties that Hibernia closes and thereafter leases or sells as a result of the subject transaction. This commitment will remain in effect for three years following the consummation of this transaction. Hibernia agrees to suspend the operation of any existing non-compete agreements and to not enter into any new non-compete agreements with any current Hibernia loan officer or branch manager associated with customer relationships associated with Hibernia commercial bank offices in Terrebonne and Lafourche parishes, Louisiana. These commitments will remain in effect for a period of 180 days following the date of the consummation of this transaction.

resulting bank is expected to meet the convenience and needs of the community to be served.

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 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: 97-SW-02-0085]

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Louisiana (continued)	
Whitney National Bank, New Orleans (014977)	3,993,172,000
and Whitney National Bank of Mississippi, Gulfport (023322)	208,655,000
and Whitney Bank of Alabama, Mobile	276,073,000
and Whitney National Bank of Florida, Pensacola (023161)	108,323,000
merged on January 1, 1998 under the title of Whitney National Bank, New Orleans (014977)	3,528,722,000
Montana	
Mountain West Bank, National Association, Helena (022141)	118,426,000
and Mountain West Bank of Great Falls, National Association, Great Falls (022815)	49,309,000
merged on January 1, 1998 under the title of Mountain West Bank, National Association, Helena (022141)	167,735,000
First National Bank of Montana, Inc., Libby (015150)	66,589,000
and First National Bank of Montana, Butte (022782)	23,757,000
merged on January 1, 1998 under the title of First National Bank of Montana, Inc., Libby (015150)	90,346,000
United Bank of Absarokee, National Association, Absarokee (015091)	22,192,000
and United Bank of Columbus, National Association, Columbus (022913)	6,805,000
merged on March 6, 1998 under the title of United Bank, National Association, Absarokee (015091)	28,997,000
Nebraska	
The Stockmens National Bank of Rushville, Rushville (009191)	84,435,000
and Stockmens Bank, National Association, Martin (023197)	22,655,000
merged on October 1, 1997 under the title of Stockmens National Bank, Rushville (009191)	106,000,000
Norwest Bank Nebraska, National Association, Omaha (002978)	2,130,999,000
and Packers Bank, Omaha	162,147,000
merged on March 21, 1998 under the title of Norwest Bank Nebraska, National Association, Omaha (002978)	2,289,768,000
New Hampshire	
First Deposit National Bank, Tilton (001333)	2,983,805,000
and Providian National Bank, Concord (022028)	670,118,000
merged on January 1, 1998 under the title of Providian National Bank, Tilton (001333)	4,846,763,000
North Carolina	
First Union National Bank, Charlotte (015650)	83,858,310,000
and Signet Trust Company, Richmond	1,000
merged on February 27, 1998 under the title of First Union National Bank, Charlotte (015650)	83,858,310,000
NationsBank, National Association, Charlotte (014448)	168,855,893,000
and Sun World, National Association, Santa Teresa (023012)	114,851,000
merged on January 15, 1998 under the title of NationsBank, National Association, Charlotte (014448)	168,646,671,000
NationsBank, National Association, Charlotte (014448)	198,829,921,000
and Boatmen's Trust Company, St. Louis	497,060,000
merged on March 13, 1998 under the title of NationsBank, National Association, Charlotte (014448)	199,326,981,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
NationsBank, National Association, Charlotte (014448)	199,326,981,000
and Boatmen's Trust Company of Illinois, Belleville	5,704,000
merged on January 23, 1998 under the title of NationsBank, National Association, Charlotte (014448)	199,332,685,000
NationsBank, National Association, Charlotte (014448)	199,115,000,000
and Boatmen's Trust Company of Oklahoma, Oklahoma City	9,192,000
merged on March 13, 1998 under the title of NationsBank, National Association, Charlotte (014448)	199,115,122,000
First Union National Bank, Charlotte (022693)	27,687,437,000
and First Union National Bank, Charlotte (015650)	120,446,313,000
merged on February 26, 1998 under the title of First Union National Bank, Charlotte (022693)	146,796,287,000
NationsBank, National Association, Charlotte (014448)	205,421,203,000
and Boatmen's Trust Company of Arkansas, Little Rock	9,641,000
merged on March 28, 1998 under the title of NationsBank, National Association, Charlotte (014448)	205,430,844,000
Wachovia Bank, National Association, Winston-Salem (001559)	18,918,575,000
and Central Fidelity National Bank, Richmond (022667)	10,540,360,000
and Jefferson National Bank, Charlottesville (006031)	2,150,139,000
merged on March 20, 1998 under the title of Wachovia Bank, National Association, Winston-Salem (001559)	31,609,074,000
North Dakota	
U.S. Bank National Association ND, Fargo (023446)	38,493,000
and First Bank of South Dakota (National Association), Sioux Falls (023395)	1,600,154,000
merged on March 23, 1998 under the title of U.S. Bank National Association ND, Fargo (023446)	1,632,747,000
Ohio	
FirstMerit Bank, National Association, Akron (014579)	2,925,710,000
and Citizens National Bank, Canton (013687)	971,379,000
and Peoples National Bank, Wooster (022722)	152,594,000
and Peoples Bank, National Association, Ashtabula (018821)	344,515,000
merged on March 23, 1998 under the title of FirstMerit Bank, National Association, Akron (014579)	5,282,206,000
The Fifth Third Bank of Northwestern Ohio, National Association, Toledo (014586)	2,600,409,000
and Fifth Third Bank of Northeastern Ohio, Cleveland	2,463,035,000
merged on January 2, 1998 under the title of The Fifth Third Bank of Northwestern Ohio, National Association, Toledo (014586)	4,886,194,000
First-Knox National Bank, Mount Vernon (007638)	526,905,000
and The Farmers and Savings Bank, Loudonville, Ohio, Loudonville	60,165,000
merged on December 30, 1998 under the title of First-Knox National Bank, Mount Vernon (007638)	586,470,000
Bank One Trust Company, National Association, Columbus (016235)	1,154,651,000
and Bank One, Quad Cities, National Association, Moline (014561)	164,417,000
merged on March 20, 1998 under the title of Bank One Trust Company, National Association, Columbus (016235)	1,319,068,000
Oklahoma	
Tri Star National Bank, Blanchard (023336)	60,000
and Tri Star National Bank, Tuttle (018545)	31,124,000
merged on February 2, 1998 under the title of Tri Star National Bank, Blanchard (018545)	31,124,000
Pennsylvania	
PNC Bank, National Association, Pittsburgh (001316)	56,291,024,000
and PNC Bank, Ohio, National Association, Cincinnati (016416)	3,989,854,000
and PNC Bank, Kentucky, Inc., Louisville	4,650,451,000
and P N C Bank, Indiana, Inc., New Albany	561,915,000
merged on December 31, 1997 under the title of PNC Bank, National Association, Pittsburgh (001316)	65,492,224,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
South Carolina	
Anderson National Bank, Anderson (018282)	117,937,000
and The Community Bank of Greenville, National Association, Greenville (022935)	48,249,000
merged on March 13, 1998 under the title of Anderson National Bank, Anderson (018282)	166,091,000
Tennessee	
Union Planters Bank, National Association, Memphis (013349)	5,494,664,000
and Union Planters Bank of Mississippi, Grenada	518,808,000
and Union Planters Bank of South Central Tennessee, Hohenwald	59,112,000
and Union Planters Bank of Southeast Missouri, Cape Girardeau	358,673,000
and Union Planters Bank of Missouri, St. Louis	189,373,000
and Union Planters Bank of Lexington, Lexington	141,491,000
and Union Planters Bank of Chattanooga, National Association, Chattanooga (022758)	133,334,000
and Union Planters Bank of Central Mississippi, Jackson	594,940,000
and Union Planters Bank of North Central Tennessee, Erin	52,594,000
and Union Planters Bank of Southern Mississippi, Hattiesburg	358,673,000
and Bank of Commerce, Woodbury	79,404,000
and Union Planters Bank of Alabama, Decatur	439,584,000
and Union Planters Bank of Central Arkansas, National Association, Clinton (018604)	92,588,000
and Union Planters Bank of Northeast Mississippi, National Association, New Albany (015519)	270,975,000
and Union Planters Bank of Jackson, National Association, Jackson (022759)	328,127,000
and Union Planters Bank of the Tennessee Valley, Harriman	192,195,000
and Union Planters Bank of Southwest Missouri, Springfield	678,303,000
and Union Planters Bank of Middle Tennessee, National Association, Nashville (022761)	1,045,447,000
and Union Planters Bank of Louisiana, Baton Rouge	609,362,000
and The First National Bank of Crossville, Crossville (009809)	182,706,000
and First National Bank of Shelbyville, Shelbyville (010785)	198,388,000
and Union Planters Bank of West Tennessee, Humboldt	441,941,000
and The Bank of Goodlettsville, Goodlettsville	171,192,000
and Union Planters Bank of Mid-Missouri, Columbia	99,640,000
and Union Planters Bank of East Tennessee, National Association, Knoxville (022760)	436,775,000
and Union Planters Bank of the Tennessee Delta, Brownsville	84,179,000
and Simpson County Bank, Franklin	112,974,000
and First Financial Bank of Mississippi County, East Prairie	30,030,000
and Union Planters Bank of Northwest Mississippi, Clarksdale	548,881,000
and Union Planters Bank of the Cumberlands, Cookeville	244,974,000
and Union Planters Bank of Southwest Tennessee, Somerville	184,456,000
and Union Planters Bank of Northeast Arkansas, Jonesboro	707,222,000
merged on January 1, 1998 under the title of Union Planters Bank, National Association, Memphis (013349)	16,659,583,000
Texas	
NationsBank of Texas, National Association, Dallas (021834)	54,012,136,000
and Boatmen's First National Bank of Amarillo, Amarillo (004214)	1,495,046,000
merged on February 19, 1998 under the title of NationsBank of Texas, National Association, Dallas (021834)	55,429,512,000
First National Bank of Park Cities, Dallas (018307)	301,767,000
and First Texas Bank, Dallas	169,207,000
merged on January 1, 1998 under the title of Bank of Texas, National Association, Dallas (018307)	470,974,000
Commercial Bank of Texas, National Association, Nacogdoches (014371)	138,213,000
and Boet Interim Bank, National Association, Nacogdoches (023584)	120,242,000
merged on January 30, 1998 under the title of Commercial Bank of Texas, National Association, Nacogdoches (014371)	250,342,000
The Frost National Bank, San Antonio (005179)	5,093,663,000
and Harrisburg Bank, Houston, Texas, Houston	226,423,000
merged on January 2, 1998 under the title of The Frost National Bank, San Antonio (005179)	5,353,799,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Hibernia National Bank of Texas, Texarkana (003785)	623,206,000
and First National Bank, Marshall (003113)	288,656,000
merged on March 15, 1998 under the title of **Hibernia National Bank of Texas, Texarkana** (003785)	911,862,000
MainBank, National Association, Dallas (020513)	52,808,000
and MainBank, Dallas	122,416,000
merged on March 10, 1998 under the title of **MainBank, National Association, Dallas** (020513)	175,224,000
Wisconsin	
Hiawatha National Bank, Hager City (015698)	24,068,000
and First National Bank of Glenwood, Glenwood City (015696)	22,059,000
merged on February 28, 1998 under the title of **Hiawatha National Bank, Hager City** (015698)	46,127,000

Affiliated mergers—thrift (mergers consummated involving affiliated national banks and savings and loan associations), from January 1 to March 31, 1998[1]

Title and location (charter number)	Total assets
Alabama	
SouthTrust Bank, National Association, Birmingham (014569)	20,977,929,000
and First of America Bank-Florida, F.S.B., Tampa	1,160,195,000
merged on January 30, 1998 under the title of SouthTrust Bank, National Association, Birmingham (014569)	30,264,408,000
Kentucky	
Peoples First National Bank and Trust Company, Paducah (012961)	1,290,705,000
and Peoples First, F.S.B., Central City	177,732,000
merged on February 12, 1998 under the title of Peoples First National Bank and Trust Company, Paducah (012961)	1,468,278,000
Massachusetts	
The Foxboro National Bank of Foxborough, Foxboro (009426)	73,380,000
and Benjamin Franklin Savings Bank, Franklin	100,000
merged on March 20, 1998 under the title of The Foxboro National Bank of Foxborough, Foxboro (009426)	73,380,000

[1] Asset figures for merging institutions are not necessarily as of the date of the merger and thus may not sum to the total assets given for the merged bank.

Tables on the Financial Performance of National Banks

	Page
Assets, liabilities, and capital accounts of national banks, March 31, 1997 and March 31, 1998	143
Quarterly income and expenses of national banks, first quarter 1997 and first quarter 1998	144
Year-to-date income and expenses of national banks, through March 31, 1997 and through March 31, 1998	145
Assets of national banks by asset size, March 31, 1998	146
Past-due and nonaccrual loans and leases of national banks by asset size, March 31, 1998	147
Liabilities of national banks by asset size, March 31, 1998	148
Off-balance-sheet items of national banks by asset size, March 31, 1998	149
Quarterly income and expenses of national banks by asset size, first quarter 1998	150
Year-to-date income and expenses of national banks by asset size, through March 31, 1998	151
Quarterly net loan and lease losses of national banks by asset size, first quarter 1998	152
Year-to-date net loan and lease losses of national banks by asset size, through March 31, 1998	153
Number of national banks by state and asset size, March 31, 1998	154
Total assets of national banks by state and asset size, March 31, 1998	155

Tables are provided by the Financial and Statistical Analysis Division and include data for nationally chartered, FDIC-insured commercial banks that file a quarter-end call report. Data for the current period are preliminary and subject to revision. Figures in the tables may not sum to totals because of rounding.

Assets, liabilities, and capital accounts of national banks
March 31, 1997 and March 31, 1998
(Dollar figures in millions)

	March 31, 1997	March 31, 1998	Change March 31, 1997–March 31, 1998 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	2,722	2,549	(173)	(6.36)
Total assets	$2,611,566	$2,971,961	$360,395	13.80
Cash and balances due from depositories	188,521	215,266	26,745	14.19
Noninterest-bearing balances, currency and coin	133,876	145,890	12,014	8.97
Interest bearing balances	54,644	69,376	14,731	26.96
Securities	396,771	479,693	82,922	20.90
Held-to-maturity securities, amortized cost	71,405	66,225	(5,181)	(7.26)
Available-for-sale securities, fair value	325,365	413,468	88,103	27.08
Federal funds sold and securities purchased	115,473	122,007	6,534	5.66
Net loans and leases	1,640,778	1,845,202	204,423	12.46
Total loans and leases	1,673,755	1,880,502	206,747	12.35
Loans and leases, gross	1,676,289	1,882,637	206,348	12.31
Less: Unearned income	2,534	2,135	(398)	(15.72)
Less: Reserve for losses	32,977	35,300	2,323	7.05
Assets held in trading account	84,637	97,306	12,669	14.97
Other real estate owned	2,669	2,059	(610)	(22.85)
Intangible assets	43,738	53,235	9,497	21.71
All other assets	138,979	157,193	18,215	13.11
Total liabilities and equity capital	2,611,566	2,971,961	360,395	13.80
Deposits in domestic offices	1,543,314	1,715,983	172,669	11.19
Deposits in foreign offices	276,561	316,109	39,547	14.30
Total deposits	1,819,875	2,032,092	212,217	11.66
Noninterest-bearing deposits	386,432	415,013	28,581	7.40
Interest-bearing deposits	1,433,444	1,617,079	183,635	12.81
Federal funds purchased and securities sold	218,351	251,125	32,774	15.01
Demand notes issued to U.S. Treasury	10,545	12,852	2,307	21.88
Other borrowed money	172,228	219,025	46,796	27.17
With remaining maturity of one year or less	117,340	143,774	26,433	22.53
With remaining maturity of more than one year	54,888	75,251	20,363	37.10
Trading liabilities less revaluation losses	12,388	19,239	6,851	55.31
Subordinated notes and debentures	33,116	46,752	13,635	41.17
All other liabilities	121,523	137,181	15,659	12.89
Trading liabilities revaluation losses	41,891	49,268	7,377	17.61
Other	79,631	87,913	8,281	10.40
Total equity capital	223,540	253,695	30,156	13.49
Perpetual preferred stock	514	501	(13)	(2.49)
Common stock	17,897	17,660	(237)	(1.32)
Surplus	107,575	128,347	20,772	19.31
Net undivided profits and capital reserves	98,247	108,114	9,867	10.04
Cumulative foreign currency translation adjustment	(693)	(926)	(233)	NM

NM indicates calculated percent change is not meaningful.

Quarterly income and expenses of national banks
First quarter 1997 and first quarter 1998
(Dollar figures in millions)

	First quarter 1997	First quarter 1998	Change First quarter 1997–First quarter 1998 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	2,722	2,549	(173)	(6.36)
Net income	**$8,512**	**$9,983**	**$1,471**	**17.28**
Net interest income	**25,083**	**26,896**	**1,812**	**7.23**
Total interest income	46,544	52,199	5,655	12.15
On loans	36,128	39,651	3,523	9.75
From lease financing receivables	1,043	1,454	411	39.40
On balances due from depositories	801	1,158	357	44.57
On securities	6,351	7,483	1,131	17.81
From assets held in trading account	670	831	161	24.04
On federal funds sold and securities repurchased	1,551	1,623	72	4.67
Less: Interest expense	21,461	25,304	3,843	17.91
On deposits	15,318	17,660	2,342	15.29
Of federal funds purchased and securities sold	2,730	3,208	477	17.48
On demand notes and other borrowed money*	2,857	3,664	807	28.23
On subordinated notes and debentures	555	772	217	39.01
Less: Provision for losses	**2,710**	**3,311**	**601**	**22.19**
Noninterest income	**15,000**	**18,470**	**3,470**	**23.13**
From fiduciary activities	1,804	2,177	373	20.65
Service charges on deposits	2,934	3,262	328	11.19
Trading revenue	1,021	1,150	129	12.65
From interest rate exposures	449	305	(144)	(32.08)
From foreign exchange exposures	414	735	321	77.60
From equity security and index exposures	131	92	(40)	NM
From commodity and other exposures	27	19	(8)	NM
Total other noninterest income	9,241	11,881	2,640	28.57
Gains/losses on securities	**195**	**618**	**423**	**NM**
Less: Noninterest expense	**24,259**	**27,983**	**3,724**	**15.35**
Salaries and employee benefits	9,917	10,956	1,039	10.48
Of premises and fixed assets	3,155	3,420	265	8.40
Other noninterest expense	11,187	13,607	2,420	21.64
Less: Taxes on income before extraordinary items	**4,822**	**5,243**	**421**	**8.74**
Income/loss from extraordinary items, net of income taxes	**24**	**537**	**513**	**2,144.30**
Memoranda:				
Net operating income	8,361	9,047	685	8.20
Income before taxes and extraordinary items	13,310	14,689	1,379	10.36
Income net of taxes before extraordinary items	8,488	9,446	958	11.29
Cash dividends declared	5,423	7,671	2,248	41.45
Net charge-offs to loan and lease reserve	2,726	3,325	598	21.95
Charge-offs to loan and lease reserve	3,746	4,312	566	15.10
Less: Recoveries credited to loan and lease reserve	1,020	987	(32)	(3.19)

* Includes mortgage indebtedness

NM indicates calculated percent change is not meaningful.

Year-to-date income and expenses of national banks
Through March 31, 1997 and through March 31, 1998
(Dollar figures in millions)

	March 31, 1997	March 31, 1998	Change March 31, 1997–March 31, 1998 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	2,722	2,549	(173)	(6.36)
Net income	**$8,512**	**$9,983**	**$1,471**	**17.28**
Net interest income	**25,083**	**26,896**	**1,812**	**7.23**
Total interest income	46,544	52,199	5,655	12.15
On loans	36,128	39,651	3,523	9.75
From lease financing receivables	1,043	1,454	411	39.40
On balances due from depositories	801	1,158	357	44.57
On securities	6,351	7,483	1,131	17.81
From assets held in trading account	670	831	161	24.04
On federal funds sold and securities repurchased	1,551	1,623	72	4.67
Less: Interest expense	21,461	25,304	3,843	17.91
On deposits	15,318	17,660	2,342	15.29
Of federal funds purchased and securities	2,730	3,208	477	17.48
On demand notes and other borrowed money*	2,857	3,664	807	28.23
On subordinated notes and debentures	555	772	217	39.01
Less: Provision for losses	**2,710**	**3,311**	**601**	**22.19**
Noninterest income	**15,000**	**18,470**	**3,470**	**23.13**
From fiduciary activities	1,804	2,177	373	20.65
Service charges on deposits	2,934	3,262	328	11.19
Trading revenue	1,021	1,150	129	12.65
From interest rate exposures	449	305	(144)	(32.08)
From foreign exchange exposures	414	735	321	77.60
From equity security and index exposures	131	92	(40)	(30.16)
From commodity and other exposures	27	19	(8)	(30.91)
Total other noninterest income	9,241	11,881	2,640	28.57
Gains/losses on securities	**195**	**618**	**423**	**216.66**
Less: Noninterest expense	**24,259**	**27,983**	**3,724**	**15.35**
Salaries and employee benefits	9,917	10,956	1,039	10.48
Of premises and fixed assets	3,155	3,420	265	8.40
Other noninterest expense	11,187	13,607	2,420	21.64
Less: Taxes on income before extraordinary items	**4,822**	**5,243**	**421**	**8.74**
Income/loss from extraordinary items, net of income taxes	**24**	**537**	**513**	**NM**
Memoranda:				
Net operating income	8,361	9,047	685	8.20
Income before taxes and extraordinary items	13,310	14,689	1,379	10.36
Income net of taxes before extraordinary items	8,488	9,446	958	11.29
Cash dividends declared	5,423	7,671	2,248	41.45
Net charge-offs to loan and lease reserve	2,726	3,325	598	21.95
Charge-offs to loan and lease reserve	3,746	4,312	566	15.10
Less: Recoveries credited to loan and lease reserve	1,020	987	(32)	(3.19)

* Includes mortgage indebtedness

NM indicates calculated percent change is not meaningful.

Assets of national banks by asset size
March 31, 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Total assets	$2,971,961	$67,561	$268,590	$475,563	$2,160,247	$5,111,230
Cash and balances due from	215,266	3,645	13,087	29,153	169,381	330,571
Securities	479,693	18,389	71,459	93,063	296,782	905,415
Federal funds sold and securities purchased	122,007	4,534	12,436	18,021	87,017	276,157
Net loans and leases	1,845,202	38,094	159,474	304,459	1,343,174	2,967,939
Total loans and leases	1,880,502	38,628	161,834	312,347	1,367,693	3,023,214
Loans and leases, gross	1,882,637	38,786	162,216	312,525	1,369,109	3,027,593
Less: Unearned income	2,135	159	382	178	1,416	4,379
Less: Reserve for losses	35,300	534	2,360	7,888	24,519	55,275
Assets held in trading account	97,306	5	91	949	96,260	305,131
Other real estate owned	2,059	92	257	214	1,496	3,733
Intangible assets	53,235	213	1,562	8,910	42,551	66,205
All other assets	252,475	4,567	9,648	18,969	219,291	392,469
Gross loans and leases by type:						
Loans secured by real estate	743,435	21,658	97,338	124,425	500,014	1,272,719
1–4 family residential mortgages	374,457	10,830	46,878	60,704	256,045	640,107
Home equity loans	67,033	505	4,552	10,712	51,262	96,804
Multifamily residential mortgages	23,979	493	3,362	4,528	15,596	42,207
Commercial RE loans	193,792	6,015	31,794	36,853	119,129	346,376
Construction RE loans	49,424	1,479	7,132	9,788	31,025	90,772
Farmland loans	10,366	2,336	3,603	1,701	2,726	27,550
RE loans from foreign offices	24,384	0	16	139	24,230	28,904
Commercial and industrial loans	528,080	6,637	28,961	62,859	429,623	820,129
Loans to individuals	358,647	5,925	26,269	106,272	220,182	542,277
Credit cards	154,267	443	4,727	65,823	83,274	211,819
Installment loans	204,380	5,482	21,542	40,449	136,908	330,458
All other loans and leases	252,475	4,567	9,648	18,969	219,291	392,469
Securities by type:						
U.S Treasury securities	78,453	4,128	13,249	19,424	41,651	162,297
Mortgage-backed securities	232,649	4,088	22,921	47,169	158,471	402,427
Pass-through securities	157,070	2,653	15,291	31,258	107,868	268,282
Collateralized mortgage obligation	75,579	1,435	7,630	15,912	50,602	134,146
Other securities	168,591	10,172	35,290	26,470	96,660	340,691
Other U.S. government securities	60,412	6,578	20,689	14,374	18,770	151,416
State and local government securities	36,317	2,923	11,025	7,271	15,098	78,080
Other debt securities	56,302	278	1,782	2,017	52,224	84,123
Equity securities	15,560	393	1,793	2,807	10,567	27,071
Memoranda:						
Agricultural production loans	19,231	4,032	4,887	2,908	7,404	43,065
Pledged securities	212,722	6,366	31,211	43,120	132,025	401,548
Book value of securities	475,800	18,302	71,016	92,339	294,143	897,612
Available-for-sale securities	409,575	13,482	53,172	75,282	267,639	740,096
Held-to-maturity securities	66,225	4,819	17,844	17,057	26,504	157,515
Market value of securities	480,581	18,432	71,645	93,241	297,263	907,161
Available-for-sale securities	413,468	13,569	53,615	76,006	270,277	747,900
Held-to-maturity securities	67,113	4,862	18,030	17,234	26,986	159,262

Past-due and nonaccrual loans and leases of national banks by asset size
March 31, 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Loans and leases past due 39 days	$23,713	$672	$2,188	$5,195	$15,658	$38,884
Loans secured by real estate	9,684	321	1,108	1,539	6,715	16,366
1–4 family residential mortgages	5,431	194	609	737	3,890	9,029
Home equity loans	558	4	40	104	410	851
Multifamily residential mortgages	234	3	29	50	151	383
Commercial RE loans	2,090	70	290	423	1,307	3,813
Construction RE loans	774	17	91	189	477	1,393
Farmland loans	155	32	49	34	40	439
RE loans from foreign offices	441	0	0	2	440	457
Commercial and industrial loans	4,307	219	530	843	2,714	7,607
Loans to individuals	8,167	129	493	2,553	4,992	12,331
Credit cards	3,969	12	121	1,670	2,165	5,471
Installment loans	4,198	117	371	883	2,827	6,859
All other loans and leases	1,556	3	58	259	1,237	2,580
Loans and leases past due 90+ days	6,115	140	427	1,876	3,673	9,485
Loans secured by real estate	1,617	64	194	274	1,085	2,780
1–4 family residential mortgages	1,016	33	102	146	735	1,647
Home equity loans	122	0	6	33	82	179
Multifamily residential mortgages	18	1	2	4	11	41
Commercial RE loans	315	15	53	60	186	577
Construction RE loans	99	4	19	26	50	188
Farmland loans	31	12	11	4	4	113
RE loans from foreign offices	16	0	0	0	16	36
Commercial and industrial loans	467	49	100	116	202	1,058
Loans to individuals	3,871	25	122	1,453	2,270	5,407
Credit cards	2,777	6	68	1,245	1,458	3,629
Installment loans	1,093	19	54	209	812	1,778
All other loans and leases	160	1	11	32	116	241
Nonaccrual loans and leases	12,154	283	928	1,409	9,534	20,007
Loans secured by real estate	6,145	135	499	769	4,742	9,942
1–4 family residential mortgages	2,643	51	201	296	2,096	4,141
Home equity loans	169	1	10	21	136	258
Multifamily residential mortgages	206	2	21	33	149	345
Commercial RE loans	2,005	45	195	332	1,433	3,503
Construction RE loans	423	11	41	64	306	780
Farmland loans	146	25	30	22	69	281
RE loans from foreign offices	554	0	0	1	553	635
Commercial and industrial loans	4,172	122	324	414	3,312	6,850
Loans to individuals	1,264	23	79	163	998	2,419
Credit cards	254	1	30	84	139	999
Installment loans	1,010	22	50	79	859	1,420
All other loans and leases	574	3	26	63	482	795

Liabilities of national banks by asset size
March 31, 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Total liabilities and equity capital	$2,971,961	$67,561	$268,590	$475,563	$2,160,247	$5,111,230
Deposits in domestic offices	$1,715,983	$58,037	$219,664	$311,151	$1,127,131	$2,939,270
Deposits in foreign offices	316,109	0	494	5,537	310,078	528,573
Total deposits	2,032,092	58,037	220,158	316,688	1,437,209	3,467,843
Noninterest to earnings	415,013	9,154	35,123	68,422	302,314	665,331
Interest bearing	1,617,079	48,883	185,035	248,266	1,134,895	2,802,512
Other borrowed funds	502,240	1,557	18,999	96,820	384,865	856,618
Subordinated notes and debentures	46,752	5	180	4,606	41,961	66,177
All other liabilities	137,181	747	3,568	10,399	122,468	290,646
Equity capital	253,695	7,216	25,685	47,051	173,744	429,947
Total deposits by depositor:						
Individuals and corporations	1,834,039	52,656	202,032	291,144	1,288,206	3,090,188
U.S., state and local governments	68,053	4,536	14,469	15,631	33,416	132,331
Depositories in the U.S.	47,791	420	2,059	6,789	38,522	73,941
Foreign banks and governments	69,636	2	200	1,252	68,182	145,255
Certified and official checks	9,239	422	1,398	1,854	5,565	17,007
All other foreign office deposits	3,335	0	0	17	3,317	9,120
Domestic deposits by depositor:						
Individuals and corporations	1,605,056	52,656	201,693	286,408	1,064,299	2,736,715
U.S., state and local governments	68,053	4,536	14,469	15,631	33,416	132,331
Depositories in the U.S.	29,991	420	2,019	6,554	20,998	44,292
Foreign banks and governments	4,302	2	85	704	3,511	9,661
Certified and official checks	8,581	422	1,398	1,854	4,906	16,270
Foreign deposits by depositor:						
Individuals and corporations	228,982	0	339	4,737	223,907	353,473
Depositories in the U.S.	17,799	0	40	236	17,524	29,649
Foreign banks and governments	65,334	0	115	547	64,672	135,593
Certified and official checks	659	0	0	0	658	737
All other deposits	3,335	0	0	17	3,317	9,120
Deposits in domestic offices by type:						
Transaction deposits	434,193	17,774	57,753	73,969	284,697	733,489
Demand deposits	354,905	9,151	34,161	61,647	249,946	567,535
NOW accounts	77,949	8,413	23,170	12,085	34,281	163,194
Savings deposits	665,713	11,822	59,721	120,643	473,526	1,052,203
Money market deposit accounts	453,339	5,939	34,643	71,134	341,623	684,991
Other savings deposits	212,374	5,883	25,078	49,509	131,904	367,212
Time deposits	616,077	28,441	102,190	116,539	368,908	1,153,578
Small time deposits	412,278	20,922	73,013	78,203	240,139	747,970
Large time deposits	203,799	7,519	29,176	38,336	128,768	405,608

Off-balance-sheet items of national banks by asset size
March 31, 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Unused commitments	$2,243,631	$187,293	$116,629	$488,581	$1,451,128	$3,271,101
Home equity lines	78,663	376	4,657	11,011	62,619	108,694
Credit card lines	1,272,842	182,495	87,057	400,735	602,555	1,767,169
Commercial RE, construction and land	71,065	975	5,812	10,542	53,735	114,560
All other unused commitments	821,062	3,447	19,103	66,293	732,219	1,280,678
Letters of credit:						
Standby letters of credit	126,818	170	1,657	10,153	114,838	207,945
Financial letters of credit	98,207	107	1,030	8,383	88,686	167,642
Performance letters of credit	28,611	63	626	1,770	26,152	40,303
Commercial letters of credit	18,837	43	616	944	17,235	29,364
Securities borrowed and lent:						
Securities borrowed	11,702	37	478	3,824	7,362	24,130
Securities lent	47,255	3	1,550	8,138	37,565	332,979
Financial assets transferred with recourse:						
Mortgages—outstanding principal balance	10,678	22	151	1,463	9,041	22,215
Mortgages—amount of recourse exposure	4,605	20	115	639	3,830	7,646
All other—outstanding principal balance	165,511	1	700	66,233	98,578	223,388
All other—amount of recourse exposure	10,387	0	54	3,166	7,167	12,689
Spot foreign exchange contracts	270,381	0	2	75	270,304	677,548
Credit derivatives (notional value)						
Reporting bank is the guarantor	8,050	0	20	0	8,030	46,429
Reporting bank is the beneficiary	10,875	0	0	0	10,875	44,990
Derivative contracts (notional value)	9,003,564	557	3,731	67,674	8,931,601	26,049,179
Futures and forward contracts	3,627,728	83	381	12,273	3,614,991	9,379,944
Interest rate contracts	1,431,630	83	356	10,917	1,420,274	4,398,561
Foreign exchange contracts	2,164,774	0	25	605	2,164,144	4,866,116
All other futures and forwards	31,325	0	0	751	30,574	115,266
Option contracts	2,712,670	474	1,043	16,263	2,694,890	6,517,649
Interest rate contracts	1,931,083	474	1,034	16,231	1,913,344	4,615,994
Foreign exchange contracts	665,489	0	0	1	665,487	1,575,991
All other options	116,099	0	9	31	116,059	325,664
Swaps	2,644,241	0	2,288	39,138	2,602,815	10,060,167
Interest rate contracts	2,505,177	0	2,288	38,444	2,464,445	9,346,347
Foreign exchange contracts	122,022	0	0	695	121,327	626,294
All other swaps	17,043	0	0	0	17,043	87,526
Memoranda: Derivatives by purpose						
Contracts held for trading	8,167,655	400	109	9,914	8,157,232	24,521,054
Contracts not held for trading	816,984	157	3,602	57,761	755,464	1,436,707
Memoranda: Derivatives by position						
Held for trading—positive fair value	106,893	0	0	40	106,853	365,556
Held for trading—negative fair value	106,243	0	0	63	106,180	363,974
Not for trading—positive fair value	6,157	0	7	472	5,679	9,960
Not for trading—negative fair value	3,507	0	30	224	3,253	8,591

Quarterly income and expenses of national banks by asset size
First quarter 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Net income	$9,983	$202	$923	$2,342	$6,517	$15,923
Net interest income	26,896	716	2,733	5,169	18,278	44,326
Total interest income	52,199	1,269	4,975	9,199	36,756	88,580
On loans	39,651	920	3,692	7,346	27,693	64,148
From lease financing receivables	1,454	4	24	101	1,325	2,054
On balances due from depositories	1,158	11	26	54	1,066	1,891
On securities	7,483	277	1,078	1,426	4,702	13,963
From assets held in trading account	831	0	1	13	817	2,650
On federal funds sold and securities repurchased	1,623	58	154	258	1,153	3,874
Less: Interest expense	25,304	553	2,242	4,030	18,478	44,254
On deposits	17,660	531	1,988	2,593	12,548	30,988
Of federal funds purchased and securities sold	3,208	8	121	535	2,544	5,747
On demand notes and other borrowed	3,664	15	130	830	2,689	6,321
On subordinated notes and debentures	772	0	3	73	696	1,198
Less: Provision for losses	3,311	36	185	1,128	1,962	4,961
Noninterest income	18,470	366	1,406	3,487	13,211	29,237
From fiduciary activities	2,177	3	210	298	1,666	4,407
Service charges on deposits	3,262	84	262	509	2,408	4,711
Trading revenue	1,150	0	9	29	1,112	2,652
From interest rate exposures	305	0	8	19	277	1,075
From foreign exchange exposures	735	0	0	3	732	1,364
From equity security and index exposures	92	0	0	4	87	148
From commodity and other exposure	19	0	0	2	16	125
Total other noninterest income	11,881	280	925	2,651	8,025	17,467
Gains/losses on securities	618	2	12	38	566	795
Less: Noninterest expense	27,983	768	2,592	4,732	19,891	45,771
Salaries and employee benefits	10,956	309	1,117	1,562	7,968	19,167
Of premises and fixed assets	3,420	82	314	474	2,549	5,704
Other noninterest expense	13,607	377	1,160	2,696	9,374	20,899
Less: Taxes on income before extraordinary items	5,243	79	452	1,028	3,684	8,241
Income/loss from extraordinary items, net of taxes	537	0	1	536	0	537
Memoranda:						
Net operating income	9,047	200	913	1,781	6,153	14,868
Income before taxes and extraordinary items	14,689	281	1,374	2,834	10,201	23,626
Income net of taxes before extraordinary items	9,446	202	922	1,806	6,517	15,385
Cash dividends declared	7,671	198	482	921	6,071	10,869
Net loan and lease losses	3,325	19	132	1,291	1,883	4,804
Charge-offs to loan and lease reserve	4,312	33	197	1,550	2,532	6,266
Less: Recoveries credited to loan and lease reserve	987	14	65	260	649	1,462

* Includes mortgage indebtedness

Year-to-date income and expenses of national banks by asset size
Through March 31, 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Net income	$9,983	$202	$923	$2,342	$6,517	$15,923
Net interest income	26,896	716	2,733	5,169	18,278	44,326
Total interest income	52,199	1,269	4,975	9,199	36,756	88,580
On loans	39,651	920	3,692	7,346	27,693	64,148
From lease financing receivables	1,454	4	24	101	1,325	2,054
On balances due from depositories	1,158	11	26	54	1,066	1,891
On securities	7,483	277	1,078	1,426	4,702	13,963
From assets held in trading account	831	0	1	13	817	2,650
On federal funds sold and securities repurchased	1,623	58	154	258	1,153	3,874
Less: Interest expense	25,304	553	2,242	4,030	18,478	44,254
On deposits	17,660	531	1,988	2,593	12,548	30,988
Of federal funds purchased and securities	3,208	8	121	535	2,544	5,747
On demand notes and other borrowed	3,664	15	130	830	2,689	6,321
On subordinated notes and debentures	772	0	3	73	696	1,198
Less: Provision for losses	3,311	36	185	1,128	1,962	4,961
Noninterest income	18,470	366	1,406	3,487	13,211	29,237
From fiduciary activities	2,177	3	210	298	1,666	4,407
Service charges on deposits	3,262	84	262	509	2,408	4,711
Trading revenue	1,150	0	9	29	1,112	2,652
From interest rate exposures	305	0	8	19	277	1,075
From foreign exchange exposures	735	0	0	3	732	1,364
From equity security and index exposure	92	0	0	4	87	148
From commodity and other exposure	19	0	0	2	16	125
Total other noninterest income	11,881	280	925	2,651	8,025	17,467
Gains/losses on securities	618	2	12	38	566	795
Less: Noninterest expense	27,983	768	2,592	4,732	19,891	45,771
Salaries and employee benefits	10,956	309	1,117	1,562	7,968	19,167
Of premises and fixed assets	3,420	82	314	474	2,549	5,704
Other noninterest expense	13,607	377	1,160	2,696	9,374	20,899
Less: Taxes on income before extraordinary items	5,243	79	452	1,028	3,684	8,241
Income/loss from extraordinary items, net of taxes	537	0	1	536	0	537
Memoranda:						
Net operating income	9,047	200	913	1,781	6,153	14,868
Income before taxes and extraordinary items	14,689	281	1,374	2,834	10,201	23,626
Income net of taxes before extraordinary items	9,446	202	922	1,806	6,517	15,385
Cash dividends declared	7,671	198	482	921	6,071	10,869
Net loan and lease losses	3,325	19	132	1,291	1,883	4,804
Charge-offs to loan and lease reserve	4,312	33	197	1,550	2,532	6,266
Less: Recoveries credited to loan and lease reserve	987	14	65	260	649	1,462

* Includes mortgage indebtedness

Quarterly net loan and lease losses of national banks by asset size
First quarter 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Net charge-offs to loan and lease reserve	$3,325	$19	$132	$1,291	$1,883	$4,804
Loans secured by real estate	94	0	7	11	75	141
1–4 family residential mortgages	60	1	3	8	49	91
Home equity loans	35	0	1	8	26	42
Multifamily residential mortgages	(1)	(0)	0	0	(2)	(2)
Commercial RE loans	(12)	0	2	(4)	(10)	(3)
Construction RE loans	1	0	1	(0)	(0)	2
Farmland loans	(0)	(0)	(0)	(1)	1	(1)
RE loans from foreign offices	11	0	0	0	11	11
Commercial and industrial loans	297	5	15	7	270	583
Loans to individuals	2,834	14	108	1,259	1,453	3,864
Credit cards	2,187	5	73	1,141	968	2,991
Installment loans	647	9	35	119	484	873
All other loans and leases	100	0	2	13	85	216
Charge-offs to loan and lease reserve	4,312	33	197	1,550	2,532	6,266
Loans secured by real estate	205	3	15	32	156	310
1–4 family residential mortgages	84	1	8	13	63	131
Home equity loans	45	0	1	10	34	54
Multifamily residential mortgages	50	0	1	4	7	
Commercial RE loans	49	1	4	8	37	83
Construction RE loans	7	0	1	1	5	17
Farmland loans	2	0	0	0	2	4
RE loans from foreign offices	13	0	0	(0)	13	14
Commercial and industrial loans	505	10	34	54	406	937
Loans to individuals	3,441	20	145	1,445	1,831	4,711
Credit cards	2,506	6	91	1,273	1,136	3,455
Installment loans	934	14	54	172	695	1,256
All other loans and leases	162	0	3	20	139	309
Recoveries credited to loan and lease reserve	987	14	65	260	649	1,462
Loans secured by real estate	111	2	8	21	81	169
1–4 family residential mortgages	24	1	5	5	14	40
Home equity loans	10	0	0	2	8	12
Multifamily residential mortgages	6	0	0	1	5	9
Commercial RE loans	61	1	2	11	47	85
Construction RE loans	7	0	0	1	5	15
Farmland loans	3	1	1	1	1	5
RE loans from foreign offices	1	0	0	(0)	1	2
Commercial and industrial loans	207	6	19	46	136	354
Loans to individuals	607	6	37	185	378	847
Credit cards	319	1	18	132	168	464
Installment loans	288	5	19	53	211	383
All other loans and leases	61	0	1	7	53	93

Year-to-date net loan and lease losses of national banks by asset size
Through March 31, 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	2,549	1,349	1,016	143	41	9,024
Net charge-offs to loan and lease reserve	3,325	19	132	1,291	1,883	4,804
Loans secured by real estate	94	0	7	11	75	141
1–4 family residential mortgages	60	1	3	8	49	91
Home equity loans	35	0	1	8	26	42
Multifamily residential mortgages	(1)	(0)	0	0	(2)	(2)
Commercial RE loans	(12)	0	2	(4)	(10)	(3)
Construction RE loans	1	0	1	(0)	(0)	2
Farmland loans	(0)	(0)	(0)	(1)	1	(1)
RE loans from foreign offices	11	0	0	0	11	11
Commercial and industrial loans	297	5	15	7	270	583
Loans to individuals	2,834	14	108	1,259	1,453	3,864
Credit cards	2,187	5	73	1,141	968	2,991
Installment loans	647	9	35	119	484	873
All other loans and leases	100	0	2	13	85	216
Charge-offs to loan and lease reserve	4,312	33	197	1,550	2,532	6,266
Loans secured by real estate	205	3	15	32	156	310
1–4 family residential mortgages	84	1	8	13	63	131
Home equity loans	45	0	1	10	34	54
Multifamily residential mortgages	5	0	0	1	4	7
Commercial RE loans	49	1	4	8	37	83
Construction RE loans	7	0	1	1	5	17
Farmland loans	2	0	0	0	2	4
RE loans from foreign offices	13	0	0	(0)	13	14
Commercial and industrial loans	505	10	34	54	406	937
Loans to individuals	3,441	20	145	1,445	1,831	4,711
Credit cards	2,506	6	91	1,273	1,136	3,455
Installment loans	934	14	54	172	695	1,256
All other loans and leases	162	0	3	20	139	309
Recoveries credited to loan and lease	987	14	65	260	649	1,462
Loans secured by real estate	111	2	8	21	81	169
1–4 family residential mortgages	24	1	5	5	14	40
Home equity loans	10	0	0	2	8	12
Multifamily residential mortgages	6	0	0	1	5	9
Commercial RE loans	61	1	2	11	47	85
Construction RE loans	7	0	0	1	5	15
Farmland loans	3	1	1	1	1	5
RE loans from foreign offices	1	0	0	(0)	1	2
Commercial and industrial loans	207	6	19	46	136	354
Loans to individuals	607	6	37	185	378	847
Credit cards	319	1	18	132	168	464
Installment loans	288	5	19	53	211	383
All other loans and leases	61	0	1	7	53	93

Number of national banks by state and asset size
March 31, 1998

	All national banks	National banks: Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	Memoranda: All commercial banks
All institutions	2,549	1,349	1,016	143	41	9,024
Alabama	34	19	14	0	1	172
Alaska	3	1	0	2	0	6
Arizona	14	4	4	5	1	40
Arkansas	61	24	35	2	0	223
California	98	42	52	1	3	338
Colorado	72	52	17	3	0	214
Connecticut	7	3	4	0	0	26
Delaware	17	2	7	6	2	34
District of Columbia	5	1	4	0	0	6
Florida	84	39	34	10	1	261
Georgia	63	30	32	1	0	345
Hawaii	1	0	1	0	0	14
Idaho	1	0	1	0	0	16
Illinois	228	115	98	12	3	773
Indiana	42	10	24	8	0	186
Iowa	51	31	18	2	0	445
Kansas	115	88	26	1	0	401
Kentucky	67	37	25	5	0	267
Louisiana	24	11	8	4	1	155
Maine	5	1	4	0	0	17
Maryland	21	4	15	1	1	82
Massachusetts	14	4	9	0	1	45
Michigan	39	16	20	2	1	163
Minnesota	142	87	49	4	2	519
Mississippi	22	10	10	2	0	100
Missouri	48	26	18	4	0	398
Montana	17	14	1	2	0	94
Nebraska	98	75	20	3	0	324
Nevada	7	3	0	4	0	26
New Hampshire	7	1	5	1	0	20
New Jersey	25	1	17	6	1	69
New Mexico	19	8	9	2	0	57
New York	64	24	33	5	2	154
North Carolina	10	2	5	0	3	60
North Dakota	19	9	8	2	0	117
Ohio	98	46	42	5	5	228
Oklahoma	118	81	35	2	0	318
Oregon	3	0	3	0	0	41
Pennsylvania	112	34	68	6	4	210
Rhode Island	3	0	0	2	1	9
South Carolina	22	8	13	1	0	78
South Dakota	22	13	7	1	1	105
Tennessee	36	10	18	5	3	214
Texas	413	276	126	8	3	827
Utah	8	3	2	2	1	50
Vermont	11	5	5	1	0	21
Virginia	27	6	20	1	0	149
Washington	18	14	4	0	0	81
West Virginia	33	15	14	4	0	100
Wisconsin	59	29	27	3	0	354
Wyoming	22	15	5	2	0	53
U.S. territories	0	0	0	0	0	19

Total assets of national banks by state and asset size
March 31, 1998
(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
All institutions	$2,971,961	$67,561	$268,590	$475,563	$2,160,247	$5,111,230
Alabama	37,127	1,236	3,240	0	32,650	109,940
Alaska	4,146	52	0	4,094	0	4,785
Arizona	35,014	49	1,936	18,351	14,678	38,735
Arkansas	13,193	1,457	8,449	3,288	0	28,711
California	379,728	1,973	13,856	5,645	358,253	480,654
Colorado	18,788	2,449	3,459	12,880	0	34,681
Connecticut	873	219	655	0	0	4,885
Delaware	78,438	119	1,822	25,086	51,411	121,167
District of Columbia	1,087	28	1,059	0	0	1,169
Florida	85,659	2,432	10,677	26,209	46,341	122,065
Georgia	14,774	1,648	9,099	4,027	0	63,716
Hawaii	298	0	298	0	0	22,728
Idaho	175	0	175	0	0	1,436
Illinois	166,445	5,812	25,605	40,997	94,031	265,899
Indiana	43,589	440	7,931	35,218	0	68,454
Iowa	14,815	1,557	4,544	8,714	0	43,646
Kansas	12,805	3,857	7,067	1,882	0	31,528
Kentucky	25,977	2,201	4,228	19,548	0	51,052
Louisiana	32,121	593	2,504	17,531	11,493	47,129
Maine	1,079	31	1,048	0	0	4,717
Maryland	16,984	254	5,262	1,134	10,335	36,279
Massachusetts	69,455	198	2,338	0	66,919	127,067
Michigan	31,976	842	3,890	12,201	15,043	121,064
Minnesota	114,308	3,837	11,255	9,461	89,756	133,359
Mississippi	15,547	614	2,162	12,771	0	31,782
Missouri	27,374	1,226	5,346	20,803	0	63,269
Montana	3,521	518	172	2,831	0	9,437
Nebraska	15,392	3,280	4,173	7,939	0	26,321
Nevada	16,298	145	0	16,153	0	24,062
New Hampshire	5,848	40	1,177	4,631	0	11,976
New Jersey	44,541	88	5,217	13,295	25,942	85,295
New Mexico	7,389	389	2,602	4,398	0	11,501
New York	351,633	1,641	11,246	8,897	329,849	1,137,594
North Carolina	442,269	143	2,608	0	439,519	497,724
North Dakota	5,636	341	2,417	2,878	0	10,402
Ohio	192,941	2,313	15,257	16,546	158,825	233,987
Oklahoma	20,767	4,059	7,736	8,972	0	35,013
Oregon	386	0	386	0	0	5,990
Pennsylvania	194,056	1,893	20,012	7,932	164,218	237,864
Rhode Island	78,315	0	0	9,490	68,825	85,554
South Carolina	4,176	390	2,409	1,377	0	17,922
South Dakota	21,082	459	2,222	4,108	14,293	28,211
Tennessee	64,383	735	5,143	17,082	41,423	84,253
Texas	184,802	13,313	28,628	31,400	111,461	240,979
Utah	22,396	183	317	6,913	14,983	39,645
Vermont	3,477	339	1,350	1,788	0	7,160
Virginia	10,203	323	4,835	5,045	0	67,350
Washington	1,699	592	1,107	0	0	12,010
West Virginia	13,207	863	4,140	8,203	0	22,243
Wisconsin	19,238	1,638	6,694	10,906	0	73,748
Wyoming	6,531	755	837	4,939	0	9,084
U.S. territories	0	0	0	0	0	35,984

1997 Chief Financial Officer's Annual Report

Comptroller's Message

It is often said that the OCC's mission, as the administrator of the national banking system, is to lean against the wind. That was never more true than in 1997. At a time in which banks were earning record profits and maintaining some of the highest capital levels in the history of the industry, we continued to speak out about the slippage in underwriting standards—a trend that could lead to loan losses and bank failures if not checked now. We also used this time of extraordinary industry health to continue developing our system of supervision by risk, which directs examiner resources to those areas that pose the greatest threat to safety and soundness. Supervision by risk reverses the long-standing practice of analyzing lagging indicators and focuses our attention on data that helps us anticipate future developments.

The ability to peer into the future has never been more important. The Asian banking crisis reminded us just how quickly events can affect the system. Long before the crisis broke in the news, we had staff in Asia evaluating the system's potential weaknesses and the likely effect upon U.S. banks. The year-2000 computer bug is another example of a major issue that crept into the public consciousness only recently. The OCC began work on this problem long before year-2000 became a buzzword. We will have finished the first round of on-site examinations for year-2000 compliance by June 1998 and will be actively monitoring the progress of national bank remediation efforts each quarter until year 2000.

Through all of the change, our strategic goals—the "four pillars," as we call them—held up as well in 1997 as they did in 1993, when they were first established. The four pillars are listed below and are described more fully on page 3.

- Ensuring bank safety and soundness to advance a strong national economy.
- Assuring fair access to financial services for all Americans by enforcing the Community Reinvestment Act and fair lending laws and encouraging national bank involvement in community development activities.
- Fostering competition by allowing banks to offer new products and services to their customers as long as banks have the expertise to manage their risks effectively and provide the necessary consumer protections.
- Improving the efficiency of bank supervision and reducing burden by streamlining supervisory procedures and regulations.

To help meet these goals, the OCC identified seven priority objectives in 1997:

(1) Implement supervision by risk

This program, which was initiated in 1996, was further refined last year with the development of supervisory strategies to help us meet the next economic downturn, including the creation of a special training program for dealing with problem banks. The OCC also issued an advisory to all national banks providing guidance on making adequate provisions to a bank's allowance for loan and lease losses. Based upon the results of our survey of underwriting policies, the OCC warned the industry against further weakening in credit standards. The OCC revised the supervisory policies and procedures governing federal branches and agencies of foreign banks to collect more information about the entity as a whole.

The OCC also redesigned its examination structure and standards to consistently integrate risk-based supervision into all aspects of the supervisory process. As part of this process, the OCC is changing the focus of its fiduciary supervision to reflect a more risk-oriented assessment of assets under management. In addition, the OCC's National Risk Committee continues to monitor and advise OCC's Executive Committee on emerging risks.

Another critical concern of the OCC is the prevention of money laundering activities conducted within the national banking system. To coordinate these efforts, the OCC established a new employee task force, the National Anti-Money-Laundering Group, to be the OCC's focal point for Bank Secrecy Act and anti-money-laundering supervisory activities.

(2) Develop technology to support the workforce

The OCC is using and investing in technology, wherever practical, to improve the quality, effectiveness, and efficiency of bank supervision and to

support other OCC activities. In 1997, we continued development of two automated examination support systems—the Integrated Bank Information System (IBIS), which gives examiners and analysts access to data on banks, bank customers, and the competitive and economic environment in which banks operate; and the Industry Sector Information Service (ISIS), which provides data on different categories of bank customers to help examiners and analysts in credit risk evaluation and research. These systems, which should be fully on-line in 1998, will make it easier for examiners to identify potentially high-risk areas of bank operations—both for individual banks and the system as a whole—so that examiners can focus on the areas of greatest risk as soon as they enter the banks. Full implementation of these new systems will help make the examination process more efficient and more effective. Access to these systems was ensured through completing wide area network/local area network installations and providing training in 85 field offices and multinational banks. Dial-in modem capacity support was also increased by more than 400 percent to ensure access when employees are not working in OCC offices.

(3) Enhance workforce skills, abilities, and resources

While the number of national banks has steadily decreased in recent years, the complexity of bank activities has increased. To meet the new supervisory challenges of this changing industry, the OCC staff is becoming a more highly skilled workforce. As part of this process, the OCC is aligning employee skills and expertise more closely with changes in bank activities and products. To that end, the OCC is setting up programs to improve employee expertise in specific areas and recruiting people needed for additional expertise, such as in bank technology systems. In addition, the OCC is modifying the examiner training curriculum to ensure that examiners have the tools they need to examine banks effectively. To increase the cost-efficiency of OCC operations, the OCC evaluated its existing office space nationwide to identify lower-cost alternatives.

(4) Implement effectiveness measures for OCC programs, processes, and projects

This objective enables the OCC to measure its performance in carrying out its mission, one of the fundamental objectives of the Government Performance and Results Act (GPRA). The Chief Financial Officers (CFO) Act of 1990 required the OCC to institute a performance measurement and reporting system to evaluate how well the agency is meeting its goals and objectives, and OCC has included performance measures in the CFO Annual Report since 1991. Three years ago, we enhanced our efforts by measuring performance relative to our overall mission.

In 1997, to measure the effectiveness of our Regulatory Review Program, the OCC conducted focus group sessions with banks, community organizations, and members of the general public; distributed informal voluntary surveys; and added a feedback form to the OCC's Internet site to solicit input from our customers. We also developed draft measures for the 1997 objectives. In 1998, pilot projects will be conducted to determine how well these draft measures actually assess progress in achieving these objectives.

(5) Improve internal communications

Good internal communication is a critical element in promoting employee understanding of and commitment to carrying out the OCC's mission and objectives. Employees need a broad variety of information to do their jobs, and management needs regular input from staff. Risk-based supervision, in particular, relies on information from examiners as well as other sources to identify potential high-risk areas in banks and the industry as a whole.

Focus group meetings were held throughout the OCC in 1997 to discuss the strategic goals and begin developing objectives for 1998. Feedback from these meetings showed a significant increase in employees' knowledge and understanding of OCC's goals and objectives, and helped identify areas where employees wanted additional information.

To improve employee access to broader information and to speed the dissemination of up-to-date information, we developed an intranet system—the OCCnet—that was piloted in 1997 and became fully functional in January 1998. Information available on OCCnet includes new policies and procedures, databases of economic and banking information, information released publicly, announcements of upcoming events about which employees may be asked by bankers, and information about changes in compensation and benefits. The OCCnet also includes sites where employees can ask questions about particular subjects or OCC projects or submit comments on initiatives currently under consideration. Because this information is in electronic format, it can be readily updated or modified so that employees always have access to the most current information.

(6) Monitor and analyze electronic money and banking issues

In 1996, Secretary Rubin designated the OCC as the coordinator for the Treasury Department on electronic money activities. In support of this role and recognizing that electronic money and banking would have a significant impact on banking in the future, we established a 1997 objective to develop a timely and appropriate supervisory response to the introduction of electronic money and banking products and technologies.

The OCC has provided policy and technical support to the Treasury Department in its efforts to address the issues raised by emerging technology. In particular, the OCC chairs Treasury's Consumer Electronic Payments Task Force, an interagency effort, to examine consumer issues raised by electronic money and banking technologies. The OCC serves as the Department of the Treasury's delegate to the G-10 Working Party on electronic money, and made major contributions to its report on consumer, law enforcement, and supervisory issues related to electronic money. The Comptroller also chairs the Basle Committee's Small Group, a forum to facilitate sharing of information on supervisory issues raised by electronic money and banking. The Basle Small Group was formed to strengthen international cooperative efforts to address the cross-border issues posed by electronic money and banking systems.

In 1997, the OCC worked on developing guidance for examiners and bankers to manage the most significant risks posed by new technology-based products and services. Efforts are under way at the OCC to focus our bank information systems examinations more precisely on the most significant risks facing banks. The staff also continued educational activities to make sure the agency is knowledgeable about current developments in electronic money and banking, both domestically and internationally.

Also, the OCC worked to provide timely and appropriate responses to national banks filing applications or seeking legal opinions in connection with electronic money and banking products. During the year, the OCC granted preliminary conditional approval for the first electronic national bank, CompuBank, National Association, which will be headquartered in Houston, Texas. CompuBank will deliver products and services to customers primarily through electronic means—by telephone and personal computer. The bank will focus exclusively on offering checking and savings accounts and electronic bill payment services.

(7) Improve access to financial services

This multi-year objective is being accomplished through the enforcement of the Community Reinvestment Act and fair lending laws. In addition, pursuant to this objective, we encourage national bank involvement in community development activities and in providing financial services profitably to those currently outside the banking system.

The Native American Working Group, formed by the OCC in 1994, produced an information guide earlier this year, "A Guide to Mortgage Lending in Indian Country," that helps banks understand and address legal and operational challenges confronted when making home loans in Indian country.

The OCC encourages expansion of banking services in low-to-moderate income areas through its licensing activities. No corporate filing fee is charged for applications for new national bank charters and branches to be located in nonbanked low-to-moderate income areas. The OCC also continues to work to facilitate chartering national community development banks. The first such bank opened for business in September, located in a low-to-moderate income neighborhood. It was capitalized through a combination of direct equity investments from other national banks and a Community Development Financial Institution Program award.

The OCC is also working to develop an understanding of the impediments that limit access to banking services for other pockets of the economy, especially small businesses, low-income individuals, victims of illegal discrimination, and nonbanked individuals. The OCC initiated a project during 1997 called Expanding the Financial Frontier to collect and present information on the nonbanked population; barriers that prevent banks from reaching them; and innovative bank practices for servicing the nonbanked population.

In 1998, the OCC will undertake an initiative to identify and address the reasons many low-income individuals and households do not have banking relationships and will collect and disseminate information on innovative and profitable efforts by banks to reach this sector of the population.

In addition to OCC's emphasis on both supervising the national banking system and addressing the 1997 objectives, the OCC also restructured its operations; lowered

assessments and reduced fees; and issued revised rules, policies, and procedures for corporate activities.

Restructuring

The OCC requires a flexible structure that allows it to keep pace with the changes that have occurred within the banking industry. The OCC responded to changes in the industry by announcing a new organizational structure in March 1997. The agency's new structure has realigned the supervisory function into two lines of business—large banks and mid-size/community banks. The agency also realigned its supervisory policy department into two central processes—core policy and risk specialties.

Reduced fees and a new approach to assessments

The OCC relies almost exclusively on assessments to fund its operations, unlike the state regulatory agencies that share their bank supervisory responsibilities and costs with the Federal Deposit Insurance Corporation or the Federal Reserve. Recognizing this, the OCC studied alternative ways to structure its assessments and to assure adequate revenue flows while minimizing financial burdens on the banks it regulates. In 1997, OCC updated 12 CFR 8 to reallocate assessments to problem banks through a 25 percent surcharge and finalized its rules for a 12 percent assessment discount for non-lead national banks. The OCC also eliminated separate trust examination fees and securities dealers' fees on national banks. These actions have reduced charges on national banks. We also waived the inflationary adjustment for 1998 for the fourth consecutive year.

Revised rules, policies, and procedures for corporate activities

The OCC has a responsibility to foster competition in the industry through licensing appropriate activities that expand banking services, while ensuring the safety and soundness of the banking system. To maintain this balance and to streamline the corporate application process for the industry, the OCC revised and reorganized its policies and procedures for national bank corporate transactions and activities. The changes streamline requirements and time frames for the industry and enable the OCC to focus its resources on applications that present greater risk to bank safety and soundness or raise significant legal, policy, or compliance concerns. The revised regulation also expands public involvement in the corporate process, by providing opportunities for public and private meetings where interested parties may surface issues regarding the proposed activity.

Finally, it would be impossible to conclude without taking note of the fine men and women who are responsible for the good work of the OCC. We have accomplished much in the past five years, but none of it would have been possible without their hard work and keen professionalism. Americans can sleep easier knowing that our national bank system is in such capable and dedicated hands. It has been my great privilege to work with them.

Eugene A. Ludwig
Comptroller of the Currency
April 3, 1998

Overview

Bureau Profile

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 for a five-year term by the President, with the advice and consent of the Senate. The OCC is headquartered in Washington, D.C. At the end of 1997, the OCC had 2,766 employees nationwide.

The OCC is responsible for chartering, regulating, and supervising the national banking system. The OCC also supervises the federally licensed branches and agencies of foreign banks. In addition to supervising national banks, the OCC has continued its efforts to strengthen the banking industry, by encouraging national banks to improve the quality of their loan portfolios, increase capital, diversify their sources of income, ensure year-2000 compliance, and generally strengthen the banks' operations.

At year-end 1997, there were 2,597 federally chartered national banks representing about 28 percent of the 9,143 commercial banks in the United States. The national banking system had approximately $2.9 trillion in assets, accounting for about 58 percent of the commercial banking system assets. During the past several years, national bank assets have increased significantly. Between 1993 and 1997, national bank asset growth averaged 8.4 percent on an annual basis.

The decline in the number of national banks primarily results from the effect of the Riegle–Neal Interstate Banking and Branching Efficiency Act of 1994, which allowed banks to consolidate entities across state lines, and the intrastate consolidation of bank charters. This decrease has been slightly offset by an increase in the number of banks converting into the national banking system.

Organizational Structure

During 1997, the Comptroller received advice on policy and operational issues from an executive committee that consisted of the chief counsel, the ombudsman, and six senior deputy comptrollers (SDC), representing Economic and Policy Analysis, Public Affairs, Bank Supervision Policy, International Affairs, Bank Supervision Operations, and Administration.

In addition, the Comptroller's office, through the direction of the senior advisor, also oversees the management of OCC's Information Technology Services. Figure 1 displays the first level of organizational structure in the OCC at the end of 1997.

The SDC for Economic and Policy Analysis oversees the OCC's economic research, risk analysis, data analysis, and evaluation programs. The economists also provide technical support to national bank examinations. The SDC for Economic and Policy Analysis is also responsible for the preparation of congressional testimony.

The SDC for Public Affairs advises the Comptroller on external relations with the media, the banking industry, Congress, consumer and community organizations, other government agencies, and the public. The SDC for Public Affairs is also responsible for the OCC's Minority and Urban Affairs program.

The SDC for Bank Supervision Policy formulates, implements, and monitors examination policies and procedures. This area is also responsible for the development, maintenance, and dissemination of information and specialized expertise required to evaluate and supervise the risks of particular activities and procedures associated with banking.

The SDC for International Affairs oversees OCC's supervision of the federal branches and agencies of foreign banks in the United States, maintains OCC's relationships with the international financial community and foreign supervisory organizations, and conducts analyses of international banking issues.

The SDC for Bank Supervision Operations administers the OCC's direct examination and supervision of all national banks and the training of examiners and staff. Supervision activities are conducted by six district offices (see figure 2 for geographic districts), large bank

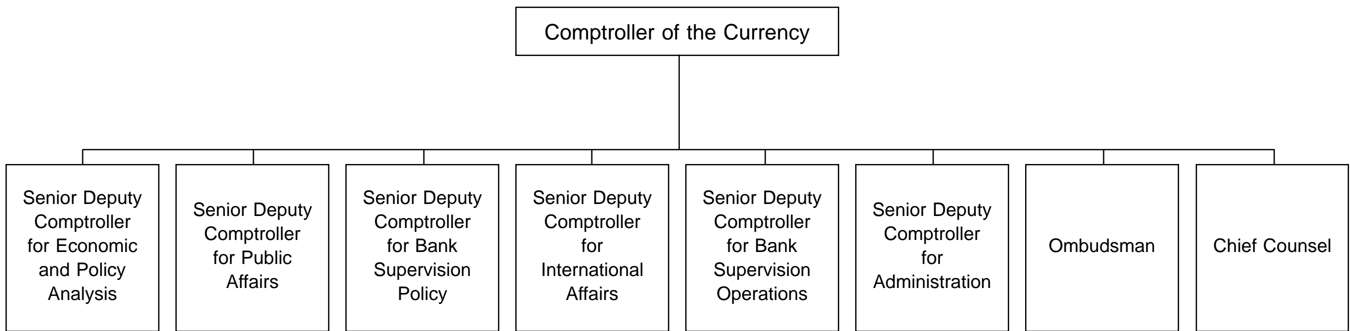
Table 1—Trends of national banks by number and assets, 1993–1997

($ in billions)

	1993	1994	1995	1996	1997*
Number of national banks	3,319	3,078	2,861	2,726	2,597
National bank assets	$2,102	$2,258	$2,403	$2,528	$2,894

* Based on preliminary call report data—subject to adjustments.

Figure 1—Organizational structure

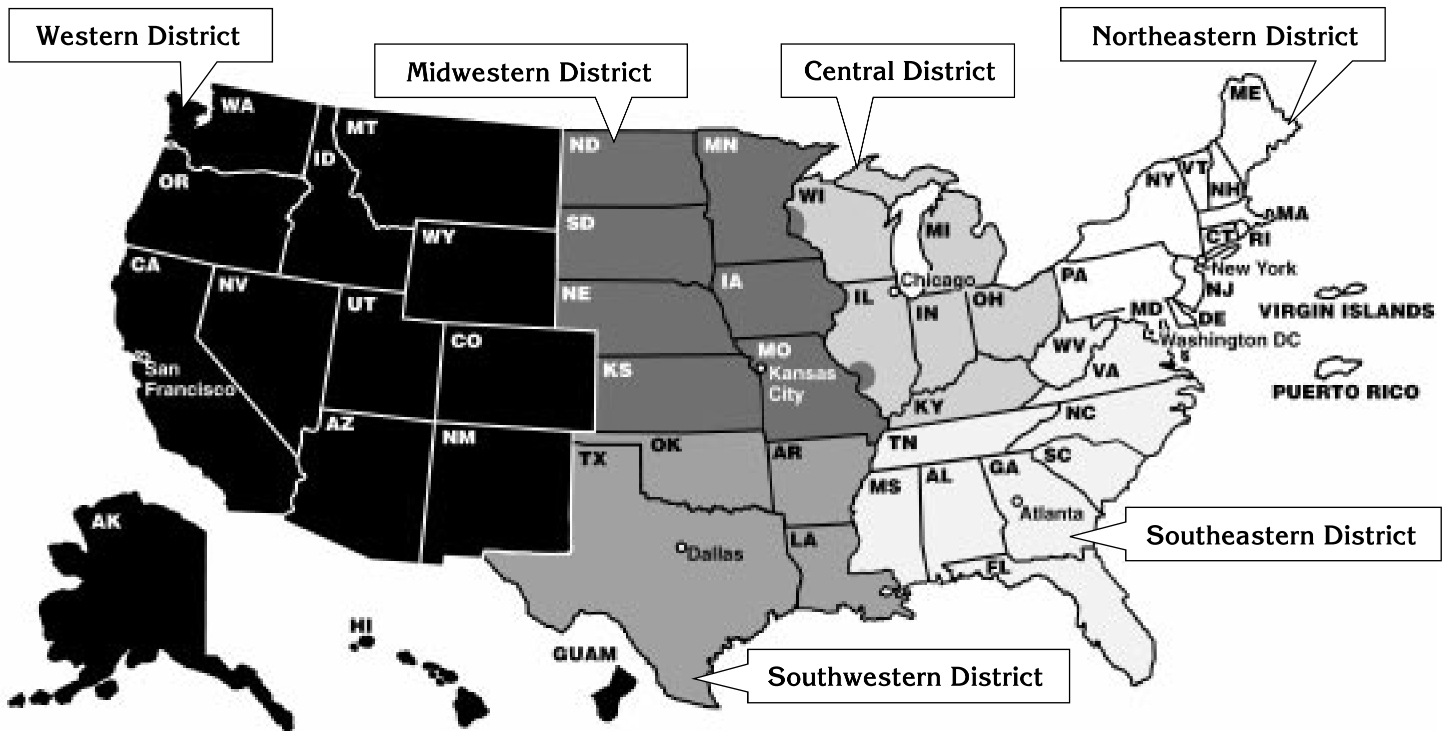


teams, and supervision support staff. The OCC Large Bank Supervision department directs the examination, supervision, and analysis of large national banks, including their international banking activities. The SDC for Bank Supervision Operations also formulates, implements, and monitors quality assurance and enforcement policies and procedures, supervises national banks with problem conditions, and coordinates bank closings.

The SDC for Administration manages the OCC's human resources department, administrative operations, financial functions, and provides guidance and assistance to the district administrative operations. In addition, the SDC for Administration has been designated by the Comptroller to administer the OCC's Equal Employment and Diversity programs.

The ombudsman oversees the national bank appeals process. With the consent of the Comptroller, the ombudsman has the discretion to supersede any agency decision or action during the resolution of an appealable matter. The ombudsman functions independently, outside of the bank supervision and examination area, and reports directly to the Comptroller. The ombudsman is also responsible for overseeing the Customer Assistance unit.

Figure 2—Geographic districts



The chief counsel advises the Comptroller on legal matters arising from the administration of laws, regulations, and rulings governing national banks. The chief counsel also oversees the OCC's Community Development division and the Bank Organization and Structure department, including corporate licensing functions at headquarters and in the six district offices.

The OCC's Mission

The OCC charters, regulates, and supervises national banks to ensure a safe, sound, and competitive national banking system that supports the citizens, communities, and economy of the United States.

The OCC's Four Pillars

- Ensure bank safety and soundness to advance a strong national economy. The OCC must maintain a proactive focus to identify potential problems in banking. The OCC must ensure its supervisory practices are both up-to-date and adaptable to the rapid evolution of highly complex new products and services being offered by the banking industry.
- Foster competition by allowing banks to offer new products and services to their customers as long as banks have the expertise to manage the risks effectively and to provide the necessary consumer protections. At the same time, the OCC must act responsibly to understand, to monitor, and where appropriate, to limit the risks of new banking activities.
- Improve the efficiency of bank supervision and reduce burden by streamlining supervisory procedures and regulations. The OCC must continue to introduce new examination procedures that reduce burden by focusing on banking activities that pose the highest risk. The OCC must ensure its regulations are clearly written to minimize regulatory burden and costs, and continuously eliminate regulations that are no longer necessary.
- Ensure fair access to financial services for all Americans by enforcing the Community Reinvestment Act (CRA) and fair lending laws and encouraging national banks' involvement in community development activities. The OCC must develop an understanding of and try to eliminate impediments that limit the access to banking services for certain segments of the population, especially small businesses, low-income individuals, rural individuals and businesses, and victims of illegal discrimination.

Priority Objectives

A formal plan for accomplishing the OCC's mission is set out in the OCC's Priority Objectives, which provide specific operating goals. The 1997 objectives include implementing supervision by risk; monitoring and analyzing electronic money and banking issues; improving internal communications; implementing effectiveness measures for OCC programs, processes and projects; enhancing workforce skills, abilities and resources; developing technology to support the workforce; and improving access to financial services, as discussed in more detail in the preceding Comptroller's Message.

Each of the 1997 priority objectives supports one or more of the four pillars. These objectives enhance the OCC's opportunity to make further progress in identifying and responding to systemic risks, and the need to address actual and potential risks related to the year-2000 effect on automated systems and the growth of banks' use of technology. Furthermore, the objectives are intended to reflect the recognition of working environment issues raised by employees, improve internal communications, and provide enhancements in automated systems and equipment for the OCC workforce. The objectives also continue OCC's commitment to promoting fair access to financial services for all Americans.

Overview of Funding Sources and Uses

The financial statements that follow summarize the OCC's December 31, 1997 financial position, including the costs of its operations and all significant sources and uses of resources during 1997 and 1996. The OCC's revenue was $390.0 million in 1997 and $373.7 million in 1996. Expenses totaled $350.3 million and $374.5 million respectively, resulting in a $39.7 million surplus in 1997 and a $0.7 million deficit in 1996. The 1997 surplus results from staffing under budget levels and increased revenue from asset-level changes in the national banking

Table 2—OCC total revenue and expense trends, 1995–1997
($ in millions)

	1995	1996	1997	$ Change 95 vs. 96	$ Change 96 vs. 97
Revenue	$372.9	$373.7	$390.0	$0.8	$16.3
Expenses	$372.3	$374.5	$350.3	$2.2	($24.2)
Surplus/(Deficit)	$0.6	($ 0.7)	$39.7	($1.3)	$40.4

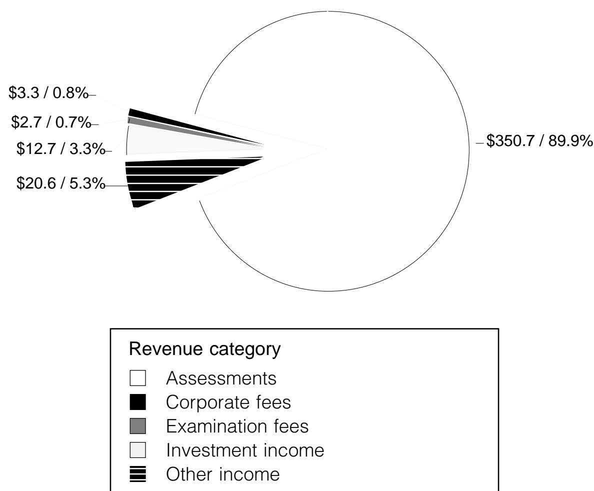
Note: Totals may not add because of rounding.

system. A secondary cause of the surplus is lower-than-planned spending on items other than salary.

Funding Sources

The OCC does not receive any appropriations from Congress. The OCC's operations are funded primarily by assessments on national banks for the supervision it provides. The OCC operates on a "trust fund" basis. In the financial statements, the OCC's revenues are categorized in accordance with federal accounting guidelines as "Revenues from goods sold/services provided to the public" and are generated from semiannual assessments on all federally chartered national banks (89.9 percent), fees for corporate applications (0.8 percent), and special examinations (0.7 percent). The OCC also receives other revenue (3.3 percent) categorized as "investment income," which is primarily generated from the interest earned from the investment of its operating funds in U.S. Treasury securities. In addition, revenue is collected from the sale of publications. In 1997, the OCC's total revenue was $390 million.

Figure 3—Components of OCC's 1997 revenues
($ in millions)

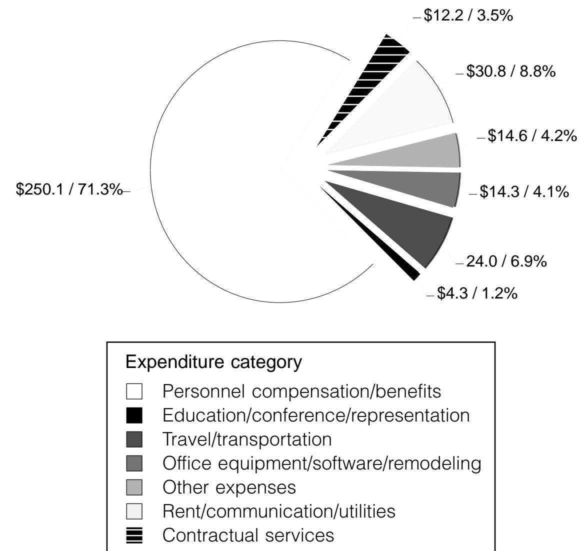


Funding Uses

The OCC is a personnel-intensive organization. In 1997, the OCC's expenses were $350.3 million, with $278.4 million or 79.5 percent of total expenditures incurred for "personnel compensation and benefits, travel, and education." These expenses primarily supported bank supervision and examination activities.

Of the OCC's remaining expenditures, 11.7 percent include costs for office equipment, software, contractual services, repairs and maintenance, supplies and materials, depreciation of assets, and printing and reproduction. "Rent, communications, and utilities" expenses required to

Figure 4—Components of OCC's 1997 expenditures
($ in millions)



support the nationwide system of examiner offices represents the 8.8 percent remainder of total expenditures.

Limitations of the Financial Statements

The OCC's financial statements have been prepared to report the financial position and results of its operations, pursuant to the requirements of the Chief Financial Officers Act of 1990. The statements have been prepared from the books and records of the OCC in accordance with the format prescribed by the Department of the Treasury, in conjunction with the Office of Management and Budget, generally accepted accounting principles, and the Federal Accounting Standards Advisory Board (FASAB). These statements differ in format from the internal financial reports used by the OCC to monitor and control its budgetary resources.

Management Discussion and Analysis—Program Highlights and Performance

Bank Supervision

Bank Supervision fundamentally entails promoting the safety and soundness of national banks, and ensuring their compliance with applicable laws and regulations. As OCC heads toward the millennium, this role has become an even greater challenge as banks continue to expand into nontraditional activities. Changes in the banking industry resulting from consolidation, new and rapidly developing technologies, increased competition, and the globalization of the economy have placed new demands on the OCC to adapt its operations and to develop specialized expertise in its workforce.

To assure Bank Supervision remains effective in this environment, a comprehensive reorganization was undertaken during 1997 to better position the OCC to address supervisory demands in the future. The reorganization also enhanced the effectiveness of the OCC's supervision by risk program.

In the operations area, the new organizational structure has fewer managerial layers and centralizes responsibility for training and administrative activities in the OCC's headquarters office in Washington. This allows more effective and consistent communications between field examiners and banks, and allows examiners to focus greater attention on direct supervision of the banks.

The reorganization consolidates oversight of large bank supervision in the OCC's Washington office and structures OCC's district operations to focus on the particular needs of community and mid-size national banks. The new organization assigns dedicated examiner staff to the 32 largest banks on a full-time basis. This program enhances the traditional annual or periodic examination, by allowing examiners to better understand a bank's operations and more quickly identify increases in risk or deterioration in risk management. This allows the OCC to act more quickly to ensure that weaknesses are corrected.

The restructuring also placed the supervision of all federal branches and agencies under the jurisdiction of the Northeastern district office where the majority of these institutions are located. As result, multiple federal branches under the same parent company in different geographic locations are now the responsibility of the same OCC manager.

The policy area was restructured to enhance its risk and product line focus. It was divided into two main functions that include: the development of core philosophies and policies used by the OCC to supervise banks; and the development, maintenance, and dissemination of policies and specialized expertise required to evaluate and supervise the risks of various banking activities and products.

Core Policy has the primary responsibility of developing and maintaining OCC's core policy platform for bank supervision; maintaining general examination programs; integrating policies into supervisory information systems; and developing policy to address emerging issues affecting the banks' capital, accounting, management, and operations.

The specialized risk units include Asset Management, Credit Risk, Community and Consumer Policy, Treasury and Market Risk, and Bank Technology. These units are primarily responsible for developing and maintaining the OCC's specialized expertise in their respective areas of risk and other banking products. The risk units create communication networks with field experts in order to better maintain and disseminate specialized knowledge, and improve the timeliness and quality of responses and analysis of risks associated with new areas of banking services and products. In early 1998, the Year 2000 Supervision Policy division was created to focus on this important risk and challenge to the banking industry.

The OCC is also continuing efforts to automate the examination process and to expand information resources. These efforts include connecting the field staff to the Internet and employing intranet-deliverable statistical and analytical resources and tools.

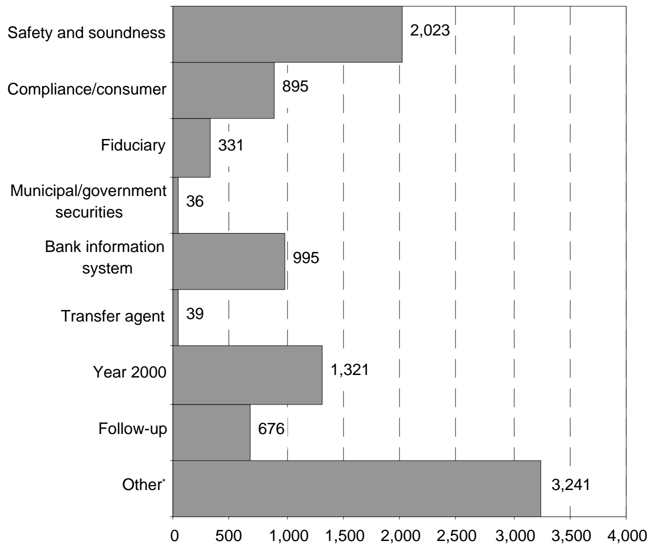
Examinations

To ensure the safety and soundness of banks and compliance with laws and regulations, the OCC conducts various on-site examinations and inspections in addition to its off-site monitoring efforts. Examinations, including speciality exams, are completed in accordance with Federal Deposit Insurance Corporation Improvement Act (FDICIA) and OCC requirements.

In 1997, 92 percent of safety and soundness examinations were started on schedule. This represents a 5 percent improvement over 1996. Without exception, high-risk banks are examined annually in compliance with FDICIA. With the reorganization of Bank Supervision Operations, resources are now more efficiently allocated geographically to meet this goal. Also, hiring efforts began during the last quarter of 1997 to acquire additional resources and specific expertise needed for the examination effort. Late exams are regularly tracked to ensure that they are scheduled for an examination as quickly as possible.

A total of 8,236 examinations (excluding year-2000 exams) were completed in 1997 compared to 9,330 in 1996. The number of examinations decreased not only as a result of consolidations and mergers within the national banking system, but also from a change in the examination cycle definition. At the beginning of 1997, the Economic Growth and Regulatory Paperwork Reduction Act extended the examination cycle from 12 months to 18 months for some 1- and 2-rated banks with up to $250 million in assets. For a bank to be eligible, they also must be well-capitalized, well-managed, not subject to an enforcement proceeding, and have not undergone a change in control in the previous 12 months. As a result, approximately 300 additional banks were changed from 12-month to 18-month examination cycles, increasing the total of national banks on a 18-month cycle to nearly 1,850. However, when a bank's examination cycle is extended from 12 months to 18 months, the OCC

Figure 5—Type and number of OCC examinations in 1997



* Other targeted exams, e.g., credit review, liquidity analysis, etc.

examiner-in-charge stays in regular communication with its management, and the OCC can accelerate an examination whenever the OCC believes it is necessary.

Year-2000 Examination Efforts

The OCC has an aggressive strategy to ensure that national banks are prepared to address the year-2000 problem. Bank readiness is especially important given that banks are at the center of our payments and credit system, and a program malfunction related to the century date could have a significant impact on the public and the financial marketplace.

The OCC's year-2000 supervisory strategy consists of an initial round of on-site examinations of all the banks it supervises by June 30, 1998; quarterly reviews in each institution to monitor their year-2000 efforts; and additional on-site examinations whenever necessary. All safety and soundness exams scheduled between now and the first quarter of 2000 will include year-2000 procedures.

As a part of OCC's supervisory oversight, examiners monitor the banking industry's actions to correct all year-2000 data exchange issues. Examiners consider the effect that external parties will have on banks' year-2000 efforts, including vendors, service providers, clearing houses, government entities, domestic and international customers, and other financial institutions. They also review the bank's efforts relating to environmental systems that use microchips such as security systems, elevators, and vaults. Additionally, a bank's lending practices are evaluated to ensure that they address the effect that year-2000 compliance may have on a customer's creditworthiness.

The OCC supervises about 2,800 national banks, federal branches and agencies, and uninsured trust companies. The Federal Financial Institutions Examination Council (FFIEC), (comprised of representatives of the five federal depository institutions regulators including the Federal Reserve Board, the Federal Deposit Insurance Corporation, the National Credit Union Association, and the Office of Thrift Supervision), oversees year-2000 policy development for member agencies. It also oversees the supervision of about 300 large and medium-sized data processing servicers. The FFIEC, through its member agencies, performs joint reviews in 16 large national data services and 12 large providers of bank application software. The OCC leads the examinations of 10 of these entities. The remaining data centers are small regional servicers that are divided among the FFIEC agencies. The OCC is the lead supervisor for 79 of these data centers. We also assist in the examinations of 44 of the data centers for which other regulatory agencies are the lead agency.

The OCC, along with the other FFIEC member agencies, meets quarterly with the major bank trade organizations to address year-2000 issues. The associations attending these meetings include the American Bankers Association (ABA), the Independent Bankers Association of America (IBAA), the Bankers Administration Institute (BAI), Bankers Roundtable, and Robert Morris Associates, among others. We also have participated in 25 year-2000 related conferences. And the OCC, through the Basle Committee on Banking Supervision, is working with foreign supervisors to ensure that foreign banks and their supervisors are fully aware of the issue, and we are encouraging foreign bank supervisors to take appropriate remedial action.

Problem National Banks

Under the Uniform Financial Institutions Rating System, banks are ranked on a scale of 1 through 5 CAMELS ratings in ascending order of supervisory concern. The CAMELS rating is based on capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. National banks rated either a 4 or 5 under the CAMELS rating system are considered to be "problem banks." Currently, there are 20 problem banks, representing less than 1 percent of the national bank population. The assets of these banks total less than $2 billion, representing only 0.06 percent of total national bank system assets. After reaching a high in the early 1990s, the number of problem banks has remained below 1 percent of all national banks since the beginning of 1996, reflecting favorable economic conditions and improvements in banks' risk management processes.

Only one problem bank has assets over $150 million. The others have assets under $125 million. Of these banks,

Figure 6—Number of problem national banks, by year, 1990–1997

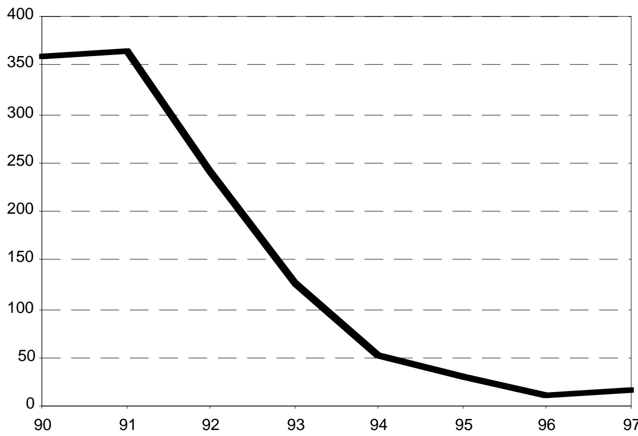
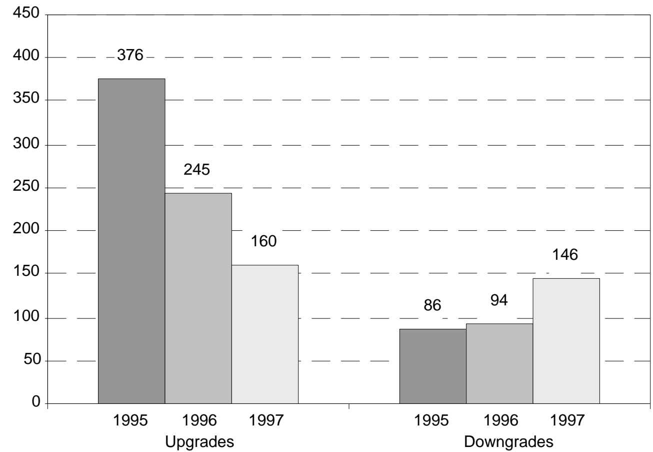


Figure 7—Levels of change in composite CAMELS ratings, 1995–1997



over half have assets under $50 million. Additionally, no national banks failed during 1997.

Change in Bank Ratings

In recent years, the improving condition of the national banking system was reflected in the overall positive trend in upgrades to banks' CAMELS ratings. Ratings are evaluated at least once during the supervisory cycle. For both 1995 and 1996, rating upgrades by far dominated downgrades. The condition of the national banking system has now stabilized as reflected in the balance between upgrades and downgrades. Banks with rating upgrades in calendar year 1997 totaled 160 versus 146 downgrades. This trend reflects that 93 percent of national banks are either 1- or 2-rated. Figure 7 provides a summary of the levels of change in composite CAMELS ratings.

Although the overall good health of the banking industry is good news, the OCC remains vigilant for any negative trend that may affect bank condition and result in an increase in the number of rating downgrades. During 1997, the Comptroller cautioned banks about the loosening of loan underwriting standards. In response to this slippage, the Comptroller took several steps to help ensure that banks identify and address weaknesses in their portfolios. Examiners have been instructed to review credit underwriting standards with the banks' Chief Executive Officer, discuss with them loans that demand their attention, and evaluate the banks' ability to deal with increases in problem loans.

In August, the OCC issued an advisory letter to banks reminding them of the need to perform quarterly reviews of their loan loss reserves because of a trend in weaker loan underwriting standards. In March 1998, the OCC issued definitive guidance on techniques for managing risk for loan portfolios as a whole. By taking such measures now, the OCC hopes to reduce the likelihood of more serious problems.

Enforcement

In addition to examinations, the OCC uses a number of other tools to carry out its supervisory responsibilities. These tools range from advice and moral suasion to specific types of enforcement actions. Enforcement actions are initiated to correct safety and soundness or compliance weaknesses and to memorialize, in writing, management and board commitments to enact specific measures addressing OCC concerns. Enforcement actions may be formal or informal and may be taken against banks or the individuals associated with the banks.

In 1997, the OCC completed 192 formal and informal enforcement actions against banks and individuals (this includes actions that were initiated in prior years). The OCC initiated slightly more enforcement actions in 1997 than in 1996 (193 in 1997, 170 in 1996, and 159 in 1995).[1] At year-end 1997, the OCC had either formal or informal enforcement actions outstanding against approximately 4.6 percent of the institutions it supervises (national banks and federal branches and agencies).

Informal enforcement actions against banks include commitment letters and memorandums of understanding. Generally, these actions are used to provide bank management with direction and guidance in addressing weaknesses in management or procedures before they result in more serious problems. Failure to correct practices identified through informal actions provide the OCC with evidence of the need to take formal action.

---

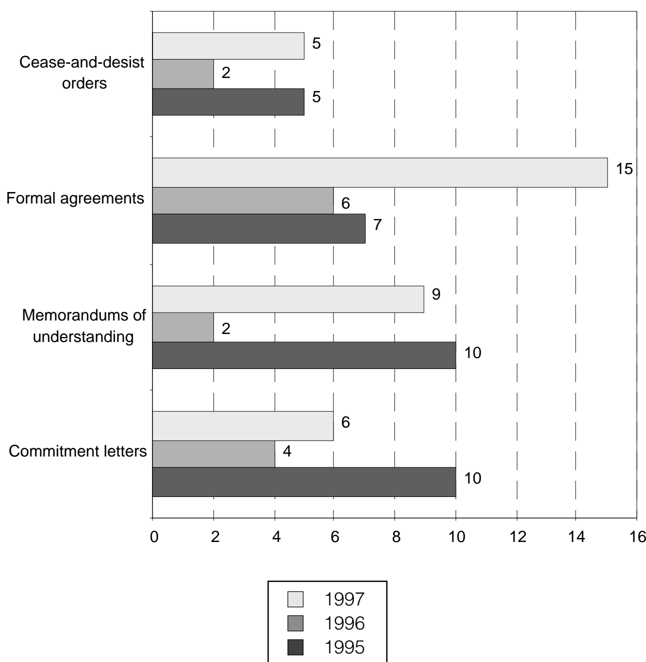
[1] Statistics for prior years may be adjusted to reflect revised aggregates.

The OCC uses formal enforcement actions against banks to secure commitments in a legally binding form when serious compliance or safety and soundness problems pose a threat to a bank's condition. Formal enforcement actions against banks include written formal agreements and cease-and-desist orders, which may be issued by consent or after litigation. Formal agreements are documents signed by a national bank's board of directors and the OCC that require specific corrective and remedial measures to return the bank to a safe and sound condition. Cease-and-desist orders are virtually identical in form and legal effect to formal agreements, but may be enforced in federal district court. The OCC may also impose civil money penalties (CMPs) upon banks for failing to comply with laws, regulations, formal agreements, cease-and-desist orders, or conditions imposed in writing in connection with an application or request, or for engaging in unsafe or unsound practices. The OCC issued two CMPs against banks in 1997, and one in 1996.

In most cases, however, the OCC imposes CMPs on the individuals responsible for the violation or unsafe or unsound practice rather than upon the institution. Figure 8 provides totals from 1995 through 1997 for some of the primary enforcement actions that the OCC completed against banks to help supervise troubled institutions.

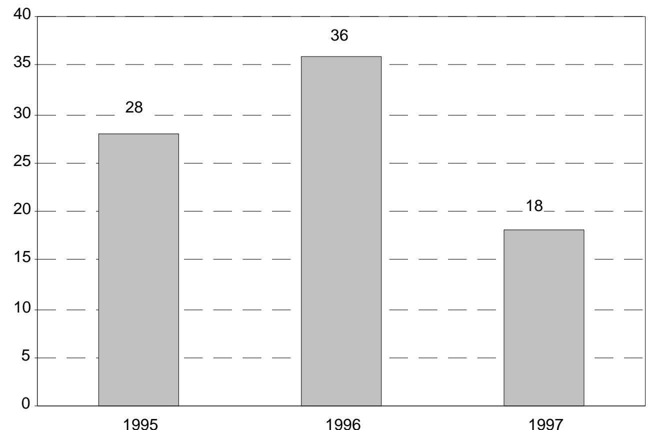
When appropriate, the OCC also takes formal and informal action against individuals at national banks—officers, directors, or other institution-affiliated parties. The primary informal enforcement tools used by the OCC for individuals are supervisory letters and letters of reprimand. Supervisory letters are used when a CMP is not warranted, but the OCC nonetheless wants to call attention to a supervisory problem. A letter of reprimand is a strongly worded document used in cases that may warrant a CMP, but when the assessment of a small CMP would consume excessive agency resources or when the individual has recognized the supervisory problem and taken steps to correct it. The OCC sent 41 supervisory letters and 12 letters of reprimand in 1997.

Figure 8—Type and number of traditional enforcement actions completed against banks, 1995–1997



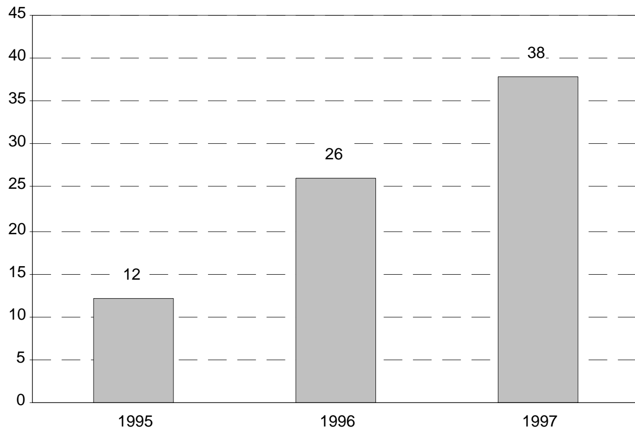
Formal actions against individuals include CMPs, removals, prohibitions, and personal cease-and-desist orders. Civil money penalties are imposed for violations of laws, regulations, rules, and noncompliance with formal written agreements, final orders, conditions imposed in writing, and, under certain circumstances, for unsafe or unsound banking practices or breaches of fiduciary duty. During 1997, the OCC imposed CMPs against individuals totaling $706,400. Figure 9 provides the number of CMPs levied during the past three years against individuals.

Figure 9—Number of civil money penalties, 1995–1997



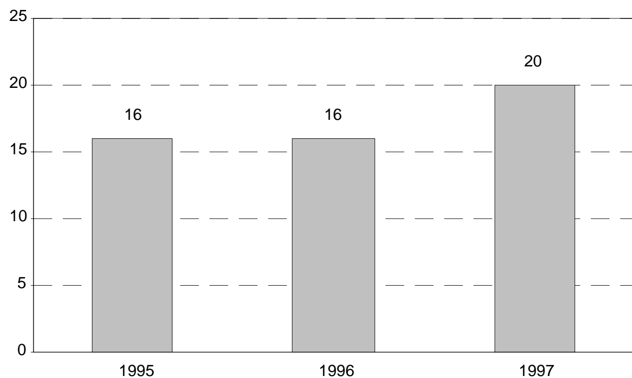
In addition, the OCC is sometimes compelled to take action to remove an individual from his or her current position and/or prohibit that person from further involvement in the banking industry. Figure 10 shows an increase in the number of removals processed since 1995. This increase can largely be attributed to the OCC's Fast Track Enforcement Program, which was implemented in 1996. The program follows up on Suspicious Activity Reports filed by banks in connection with suspected crimes committed by bank officials and employees. Under the Fast Track Program, the OCC initiates removal and prohibition orders against certain bank insiders and employees to ensure that they do not continue to be employed in the banking industry.

Figure 10—Number of removal and prohibition orders, 1995–1997



Finally, cease-and-desist orders against individuals address such issues as requiring restitution to the bank and/or prohibiting or restricting activities in the banking industry. During 1997, the OCC ordered restitution of $1.8 million. Figure 11 shows the number of personal cease-and-desist orders completed during the past three years.

Figure 11—Number of cease-and-desist orders against individual bankers, 1995–1997



Licensing

National banks must, by law and regulation, seek OCC approval for various types of corporate activities and changes. These changes include new bank charters, conversions to national banks, corporate reorganizations, mergers, branches, bank relocations, operating subsidiaries, capital and subordinated debt issues, and bank acquisitions. Most licensing requests are reviewed and decided in the licensing units located in the six district offices and in Washington, D.C. (Federal branches and agencies file with OCC's International Banking and Finance division.) Complex issues are forwarded to OCC's Bank Organization and Structure (BOS) in Washington for analysis and decision by senior management.

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

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

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

Processing Timeliness

One measure of OCC's effectiveness in processing corporate applications is the percentage of applications processed within target time frames. To ensure applications are processed in a timely manner, Bank Organization and Structure measures the processing time using benchmark time frames for routine applications and for more complex applications. Processing timeliness varies with the volume and complexity of applications. These, in turn, vary with economic conditions and changes in banking law. Table 4 shows the time-frame performance for the applications processed by the OCC in 1996 and 1997 (without including ATMs which did not require an application after September 30, 1996, and after-the-fact notices for subsidiaries in 1996 and 1997). The OCC generally meets target time frames for all application types. Deviations from these targets are primarily the

Table 3—Corporate licensing activity in 1997

	Applications received		District decisions 1997			Washington decisions 1997			Total
	1996	1997	Approved	Conditionally approved[4]	Denied	Approved	Conditionally approved[4]	Denied	1997 decisions
ATMs[1]	866	0	0	0	0	0	0	0	0
Branches	1,838	1,771	1,735	0	0	35	2	0	1,772
Capital	127	93	73	2	0	7	0	0	82
Change in control	17	23	21	0	0	3	0	0	24
Charters	81	80	56	5	0	4	12	2	79
Conversions[2]	75	58	69	6	0	16	1	0	92
Federal branches	0	1	0	0	0	0	0	0	0
Fiduciary powers	47	24	33	0	0	6	0	0	39
Mergers	111	128	126	1	0	13	0	0	140
Relocations	260	243	232	0	0	9	0	0	241
Reorganizations	238	309	209	0	0	97	1	0	307
Stock appraisals	3	5	0	0	0	3	0	0	3
Subsidiaries[3]	265	151	104	3	0	15	9	0	131
Total	3,928	2,886	2,658	17	0	208	25	2	2,910

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

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

[2] Conversions are conversions to national bank charters.

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

[4] Final approval subject to applicant fulfilling additional regulatory and/or operational requirements

Table 4—OCC licensing actions and timeliness, 1996–1997

		1996[1]			1997			Annual change		
Application type	Target time frame in days[2]	Number of decisions	Within target	Percent	Number of decisions	Within target	Percent	Number of decisions	Within target	Percent
Branches	45/60	1,848	1,773	95.9	1,772	1,762	99.4	–76	–11	3.5
Capital/sub debt	30/45	94	86	91.5	82	71	86.6	–12	–15	–4.9
Change in control	NA/60	13	13	100.0	24	21	87.5	11	8	–12.5
Charters[3]		69	41	59.4	79	63	79.7	10	22	20.3
Conversions	30/90	44	37	84.1	92	90	97.8	48	53	13.7
Federal branches & agencies	NA/120	0	0	0.0	0	0	0.0	0	0	0.0
Fiduciary powers	30/45	31	25	80.6	39	38	97.4	8	13	16.8
Mergers	45/60	100	95	95.0	127	110	86.6	27	15	–8.4
Relocations	45/60	262	235	89.7	241	236	97.9	–21	1	8.2
Reorganizations	45/60	223	173	77.6	320	292	91.3	97	119	13.7
Stock appraisals	NA/90	5	0	0.0	3	1	33.3	–2	1	33.3
Subsidiaries	30/60	222	147	66.2	131	112	85.5	–91	–35	19.3
Total	NA	2,911	2,625	90.2	2,910	2,796	96.1	–1	171	5.9

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

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

[2] 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.

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

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

result of application complexity, the need to acquire additional information, or peak workload demands.

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

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

Change in Bank Control Act

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

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

The CBCA gives the OCC the authority to disapprove changes in control of national banks. The OCC's objective in its administration of the CBCA is to enhance and maintain public confidence in the national banking system by preventing identifiable serious and adverse effects resulting from anti-competitive combinations or inadequate financial support and unsuitable management in national banks. The OCC reviews each notice to acquire controls of a national bank and disapproves transactions that could have serious harmful effects. If the notice is disapproved, the disapproval letter contains a statement of the basis for disapproval. The OCC's actions for 1997 are shown in Table 5. The OCC received 24 change in bank control notices in 1997, up from 17 in 1996. Two changes in bank control notices received in 1996 were acted on in 1997. Of the 24 notices received in 1997, 22 were acted upon, with no disapprovals.

Community Reinvestment Act

Under the Community Reinvestment Act (CRA), 12 USC 2901, et seq., the OCC must assess a national bank's record of helping to meet the credit needs of its entire community, including low- and moderate-income neighborhoods, consistent with safe and sound operation. The OCC also must consider the bank's record in its evaluation of an application for a deposit facility. A written performance evaluation describing the bank's activities, which includes the rating, is prepared at the end of each CRA examination and made available to the general public.

A bank's CRA performance may be rated "outstanding record of meeting community credit needs," "satisfactory record of meeting community credit needs," "needs to improve record of meeting community credit needs," or "substantial noncompliance in meeting community credit needs." In 1997, the OCC conducted examinations in

Table 5—Change in Bank Control Act notices processed at OCC districts and headquarters, 1988–1997

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

878 national banks. The OCC also considers CRA performance when it evaluates corporate applications. In 1997, the OCC conditionally approved two applications, based on CRA performance issues.

In 1997, the OCC, along with the other federal financial institution regulators, completed the implementation of the revised CRA regulation that focused on a bank's actual CRA performance. The OCC began examining large banks using the lending test, investment test, and service test. All CRA performance evaluations of large banks conducted after July 1, 1997, along with those for any large institution that chose to be examined under the lending, investment, and service tests prior to July 1, 1997, were reviewed by Community and Consumer Policy to ensure consistency among the OCC district offices. Also during 1997, all performance evaluations for banks designated limited purpose/wholesale were reviewed by OCC's Community and Consumer Policy.

In 1997, the OCC, together with other federal financial institution regulators, supplemented, and amended its "Interagency Questions and Answers Regarding Community Reinvestment" to provide further guidance and clarification on the CRA regulation to the banking industry and the public. During the year the OCC approved 18 requests from banks for limited purpose/wholesale designations and approved 5 strategic plan submissions.

Customer Complaints

The Federal Trade Commission Improvement Act of 1975 (15 USC 41, et seq.) requires the OCC to receive and take appropriate action on complaints directed against national banks and to report them annually to Congress.

During 1997, the OCC received 15,999 written customer complaints (compared to 13,695 in 1996) and 19,338 telephone inquiries (compared to 14,077 in 1996). Refer to table 6 for the major subjects of written complaints received during 1997.

As of January 27, 1998, the OCC had resolved 12,248 of the written complaints (77 percent) received during 1997, compared to 10,732 resolved (78 percent) in 1996. The remaining 1997 complaints were in process. Complaints involving loans accounted for 61 percent of the total complaints received by December 31, 1997. Credit cards were involved in 65 percent of those lending complaints. Complaints involving deposits were the next largest category, representing 27 percent of the total written complaints. No other category of complaints equaled or exceeded 5 percent of the total.

The OCC also received 43 complaints alleging violations of the Fair Housing Act. In accordance with the OCC's memorandum of understanding with the Department of Housing and Urban Development (HUD), those complaints were referred to HUD for administrative processing and, if appropriate, investigation.

Congressional Appearances

The OCC is often requested by Congress to submit written statements or appear before the various House and Senate committees and subcommittees to address

Table 6—1997 written complaints received, resolved, or pending

Finding	Deposits	Credit cards	Consumer installment loans	Home purchase loans	Other loans	All other	Total
Bank error	510	473	70	141	92	80	1,366
Bank legally correct	1,114	1,741	256	222	277	253	3,863
Communications problem	968	1,394	247	279	252	274	3,414
Conciliation agreement	2	15	2	3	2		24
Contractual dispute	138	181	41	65	59	73	557
Factual dispute	297	143	36	31	33	84	624
File transferred	37	61	13	21	26	183	341
Matter for litigation	185	49	15	21	32	52	354
Matter in litigation	35	23	7	26	28	25	144
Not a national bank	60	274	58	65	89	607	1,153
Violation of Reg B		10	3		1		14
Violation of Reg CC	6						6
Violation of Reg DD	1						1
Violation of Reg E	8					1	8
Violation of Reg Z		37	1		2		40
Violation of other law or reg	1	17		2			20
Withdrawn by customer	82	107	18	31	33	48	319
Pending	944	1,771	271	225	301	239	3,751
Total	4,388	6,296	1,038	1,132	1,227	1,918	15,999

significant public policy issues and questions affecting the national banking industry. In 1997, the Comptroller participated in nine hearings. Four of the hearings focused on financial modernization issues, two addressed the OCC's efforts to ensure that national banks are year-2000 compliant, one discussed the OCC's supervisory philosophy and practices, one focused on oversight of the OCC's overall operations, and the final hearing addressed the OCC's strategic planning process in response to the Government Performance and Results Act.

Examination Support Activities

The Economics Department provided significant statistical and modeling support to fair lending and safety and soundness examinations. Specifically, economists provided direct support to 14 fair lending examinations, through data collection and analysis and application of statistical sampling and modeling techniques that helped the OCC assess fair lending performance. Economists also supported 45 on-site, safety and soundness examinations through the application of quantitative methods and analysis of risks in bank portfolios and supervisory policies addressing those risks. In addition, the Economics Department provided safety and soundness examination support in seven different subject areas during 1997: interest rate risk; credit scoring; derivatives trading and pricing; mortgage banking; credit portfolio management; asset management; and internal models to comply with the new market risk regulation (currently being applied to seven internationally active banks).

Economics Research and Analysis

In 1997, the OCC completed four quarterly reports on the condition and performance of the banking industry. The OCC also undertook several long-term research projects in 1997. This research explored a variety of topics important to the mission of the OCC, including deposit insurance; derivatives market; interstate banking; bank risk-taking and returns; international bank regulations; newly chartered banks; bank organizational form; and CAMELS ratings. This work contributed to the completion of 13 Economics Working Papers, 14 papers for scholarly and trade journal publications, and 36 presentations of research to academic, government agency, and foreign audiences.

Electronic Money and Banking Issues

The OCC reorganized itself in 1997 to better address broad policy issues arising from emerging electronic money and banking technologies and to bring an increased focus on OCC's supervision of technology within the banking industry. The OCC worked aggressively to develop guidance and examination procedures for new technology-based products and services, making significant progress on the development of several key banking bulletins, including technology risk management, PC banking, and digital signatures, that will be issued in 1998.

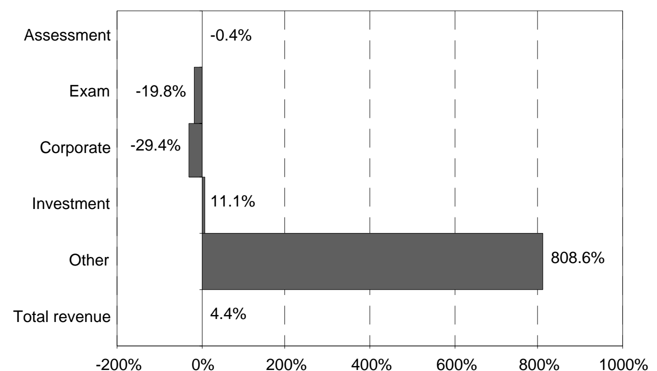
The OCC also played a Treasury-wide role as the coordinator for the Department of the Treasury on electronic money issues. In this role, the Comptroller chaired the Secretary's Consumer Electronic Payments Task Force. The Comptroller also chaired bi-monthly meetings with senior Treasury officials to focus on E-money developments, and advised the Secretary and Deputy Secretary on issues of significance to the Department. In addition, the OCC sponsored a series of briefings on emerging technology issues, and OCC management and staff made numerous speeches at industry meetings. Finally, the OCC made major contributions to the Report of the Working Party on E-Money that looked at consumer, law enforcement, supervisory, and cross-border issues. The report was presented by the G–10 Finance Ministers and Governors to the heads of state at the June 1997 Denver summit.

Financial Highlights and Performance

Revenue

Revenue—Prior Year Comparison: The OCC's 1997 revenue increased by $16.3 million and was approximately 4.4 percent more than 1996. This increase in revenue primarily resulted from additional income received for investments, publications, and other miscellaneous sources. Also note that an adjustment was required under the Statement of Federal Financial Accounting Standards (SFFAS) No. 5, "Accounting for Liabilities of the Federal Government." The adjustment was required to cover the costs associated with the Federal Employees Retirement System and the Civil Service Retirement System adjustments. The $15.9 million adjustment was subsequently offset by a similar adjustment posted to the OCC benefits expense account.

Figure 12—Percentage change in revenue, 1996–1997



Assessment revenue decreased by $1.3 million or 0.4 percent. This decrease resulted from the 12 percent reduction in assessments for the "non-lead" national banks and the continued effect of bank consolidation on OCC's regressive fee schedule. "Non-lead" banks are other than the largest national bank in assets in a bank holding company. The OCC also waived inflationary adjustments to its rates for 1997.

Examination fees are hourly charges for examinations that are not included in a bank's assessment and are primarily for fiduciary examinations. These fees decreased by $670,836 or 19.8 percent as a result of fewer billable hours. The OCC eliminated the fees charged for fiduciary examinations during the latter part of 1997.

Corporate fees decreased by $1.4 million or 29.4 percent during 1997. Contributing factors include an overall decline in the number of applications received in 1997 and the elimination of application fees for automated teller machines (ATMs) from OCC's fee schedule. During 1997, the OCC experienced a decrease in the number of branch, operating subsidiary, fiduciary powers, capital, and conversion filings. The decrease also resulted from the waiver of fees for charter and branch applications in low-income and moderate-income areas that have no depository institution offices.

Investment revenue increased by $1.3 million or 11.1 percent in 1997. This increase resulted from an increase in the amount of investable funds and higher interest rate yields earned on the OCC's portfolio of U.S. Treasury securities.

Other revenue showed an increase of $18.4 million. This primarily resulted from an adjustment required under SFFAS No. 5, "Accounting for Liabilities of the Federal Government." A $15.9 million adjustment was required and subsequently offset by a similar adjustment posted to the OCC benefits expense account.

Revenue—Budget Performance: Total revenue was over budget by $12.9 million or 3.4 percent in 1997. Table 7 provides a summary of the OCC's budget performance for revenue.

Expenses

Expenses—Prior Year Comparison: The OCC's 1997 total expenses decreased by $24.2 million or 6.5 percent over prior year expenses. The volume of staff vacancies and the organizational restructure are the primary factors contributing to the decrease.

Personnel compensation and benefits decreased by $28.3 million or 10.2 percent. The decrease stems from cost savings resulting from a decline in staffing levels. The number of OCC employees decreased by nearly 500 during 1997.

Rent, communications, and utilities increased by $2.0 million or 6.9 percent. The increase results from OCC's installation of the LAN/WAN and Windows 95 throughout the districts, field offices, and headquarters. Development and implementation of Human Resources pilot benefits program for the interactive voice response communications system was another factor contributing to the additional costs. Enhancements to the telephone services for the Customer Assistance Unit also contributed to the increased costs.

Travel and transportation increased by $0.4 million or 1.9 percent as a result of the costs incurred after the organizational restructure for relocating employees who were transferred to other locations. Additional costs were incurred for the district staff conferences and the cultural audit focus sessions held at various locations.

Supplies and materials increased by $0.6 million or 22.0 percent more than 1996 levels. This increase is primary due to the additional cost incurred to purchase

Table 7—1997 summary of budget performance for revenue
($ in millions)

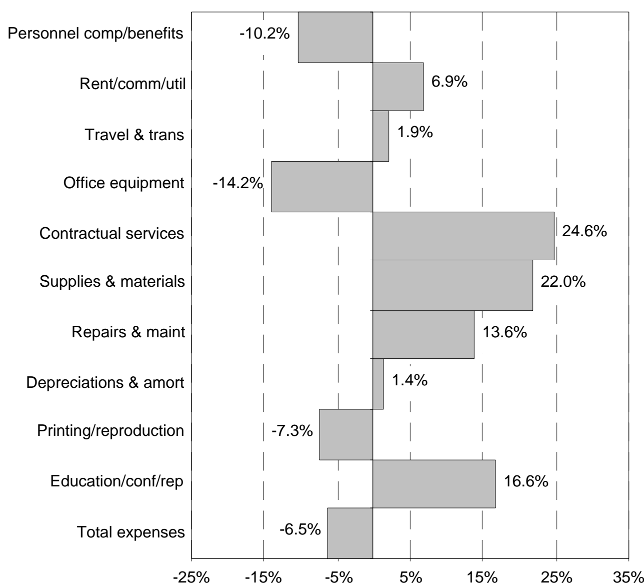
Revenue category	1997 actual	1997 budget	$ variance	Percent variance
Revenues from goods sold and services provided to the public				
Assessment revenue	$350.7	$343.5	$7.2	2.1%
Examination fees	2.7	1.5	1.2	80.0%
Corporate fees	3.3	3.5	–0.2	–5.7%
Investment revenue	12.7	10.6	2.1	19.8%
Other revenue*	20.6	18.0	2.6	14.4%
Total revenue	$390.0	$377.1	$12.9	3.4%

* Note: Refer to the discussion in text for SFFAS No. 5, under "Revenue—Prior Year Comparison" that substantiates the actual, dollar variance, and percentage change for "Other revenue" as cited above.

supplies and materials resulting from the organizational restructure.

Education, conference, and representation increased by $0.6 million or 16.6 percent. The increased costs resulted from new training schools established to enhance examiners' skills in retail credit, treasury and market risks, and the evaluation of bank management. The introduction of the Senior Examiner Training Pilot (SETP) program was another factor that contributed to the increased costs. The SETP program was developed to maintain a highly skilled examiner workforce in a rapidly changing environment, giving them the knowledge and skills necessary to perform their jobs better. This program encouraged the senior examiners to take external (vendor-provided) training that was generally more costly than the OCC's internal training programs. The costs incurred for several major fiduciary and community development conferences sponsored by the OCC also increased costs.

Figure 13—Percentage change in expenses, 1996–1997



Office equipment, software, and remodeling expenses decreased by $2.4 million or 14.2 percent. Extensive remodeling work and major computer purchases were made during 1996 and as a result fewer of these costs were incurred during 1997; therefore, expenses were lower.

Contractual services expenditures increased by $2.4 million or 24.6 percent. The increase is primarily due to the additional costs incurred during 1997 for investments made in contractual services that provided the technological knowledge and expertise required to perform tasks more proficiently using electronic and computer based programs.

Depreciation and amortization increased by $0.1 million or 1.4 percent.

Repairs and maintenance increased by $0.4 million or 13.6 percent as a result of inflationary factors and increased costs for equipment and microcomputer maintenance contracts.

Printing and reproduction decreased by $0.1 million or 7.3 percent. During 1996, the OCC produced and distributed the regulations that were revised as part of the Regulatory Review Program and also issued new guidelines to examiners and bankers for supervision by risk. There were fewer regulatory revisions published during 1997, which has resulted in lower printing and production costs.

Expenses—Budget Performance: Table 8 provides a summary of the OCC's budget performance for expenses. In 1997, the OCC's expenditures were $18.7 million under budget or 5.1 percent.

Payments

Prompt Payment: The Prompt Payment Act and OMB Circular A-125 require agencies to make payments on time, to pay interest penalties when payments are late, and to take discounts only when payments are made on

Table 8—1997 summary of expense budget performance
($ in millions)

Expense category	1997 actual	1997 budget	$ variance	Percent variance
Personnel compensation/benefits	$250.1	$265.4	$–15.3	–5.8%
Rent/communications/utilities	30.8	34.0	–3.2	–9.4%
Travel/transportation	24.0	25.1	–1.1	–4.4%
Education/conference/other	4.3	4.8	–0.5	–10.4%
Other expenses	41.1	39.7	1.4	3.5%
Total expenses	$350.3	$369.0	$–18.7	–5.1%

Note: Totals may not add because of rounding.

or before the discount date. The OCC's prompt payment of invoices has improved consistently over past years. The percentage of invoices paid on time continues to exceed the Treasury Department's standard.

Electronic Funds Transfer: Electronic funds transfer (EFT) of payments provides efficient and effective accounting services, greater control over the timing of payments, and lower payment cost compared with paper checks. The Debt Collection Improvement Act of 1996 requires government agencies to issue all payments electronically by January 1, 1999. The OCC has initiated a program, whereby some vendor, contractual, and employee payments will be issued by electronic funds transfer in 1997. It is anticipated that all of OCC's payments will be issued electronically by the act's deadline.

The percentage of the OCC's payroll payments made by electronic funds transfer has increased over the past three years. In 1997, the OCC met and surpassed OMB's prescribed goal for agencies to process 90 percent of their payroll payments through EFT.

Accounts Receivable: A comprehensive debt collection program was established in the OCC to assure collection of receivables and to allow management to evaluate debts owed to the agency. Table 11 identifies annual write-offs and delinquent accounts receivable. In accordance with the Debt Collection Improvement Act of 1996, the OCC continues to review delinquent accounts in order to determine if any are eligible for referral to the Treasury Department, Financial Management Services, for debt collection.

Financial Efficiency

The OCC's indirect rate measures the relationship between the OCC's direct and indirect costs. Direct costs are salary and travel costs incurred to examine banks and costs to review and decide upon corporate applications. Indirect costs are costs incurred within the OCC to perform other related activities including: other bank supervisory functions and analyses, the development of bank supervision policy, the review of bank supervision and examination products, legal analyses, outreach to bankers, support operations, and training. Indirect costs also include overhead, such as facilities, supplies, telephone service, and data processing.

In 1997, the indirect/direct cost-ratio moved downward because of the decrease in OCC's proportion of costs attributable to the indirect activities associated with examination and supervision of national banks. The decrease for indirect costs is primarily due to the cost

Table 9—Prompt payment comparisons, 1995–1997

Payments	1995	1996	1997
Invoices paid on time as a percentage of total invoices	97	97	97
Number of invoices paid late as a percentage of total invoices paid	2.9	1.9	2.6
Interest penalties paid as a percentage of total dollars paid	0.011	0.010	0.018

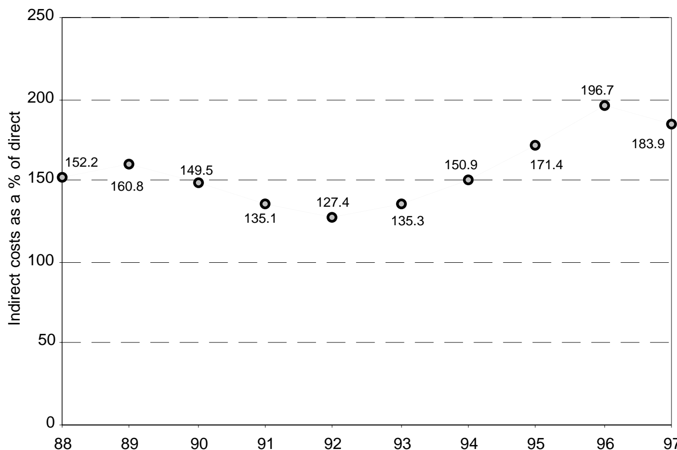
Table 10—Percentage of use for electronic funds transfer, 1995–1997

	1995	1996	1997
Percentage of payroll payments issued by EFT	93.8	95.2	96.1

Table 11—Percentage of annual write-offs and delinquent accounts receivable, 1995–1997

	1995	1996	1997
Accounts receivable write-offs as a percentage of dollar volume in accounts receivable	3.01	0.14	1.08
Percentage dollar volume of accounts receivable 30 days or more past due	4.90	6.90	9.71

Figure 14—Ratio of indirect costs to direct costs, 1988–1997



savings resulting from the organizational restructure that consolidated various functions, locations, and processes. The new structure has fewer managerial layers and centralizes greater responsibility for training and administrative activities within the OCC's headquarters office in Washington.

The reorganization also yielded savings in direct costs. The oversight for large bank supervision was consolidated in the OCC's Washington office. This enables the OCC's district operations to focus on the particular needs of community and mid-size national banks. The new organization assigns dedicated examiner staff to the 32 largest banks. Most of this staff is assigned on a full-time basis. As a result of this change, the examination process is improved, thereby allowing examiners to better understand a bank's operations and more quickly identify changes in risk.

Financial Management Systems Initiatives

The OCC is committed to continuing its progress in the following areas:

- Developing an integrated OCC financial management system that complies with applicable accounting principles and standards, provides timely information, responds to the OCC's management needs, conforms to governmentwide systems requirements, and provides timely monitoring of the budget through performance reports.
- Enhancing the OCC's systems ability to provide integrated reporting on the performance of programs, finances, and financial management.
- Streamlining processes to reduce data entry burdens through automatic uploads from other systems and more user-friendly screens.
- Eliminating antiquated system components, such as general financial system (GFS) accounts receivable, and replacing them with "off-the shelf" system components that provide more efficient operations and a better integrated system.

Current Status: The OCC's financial system is accrual-based and provides monthly budget reports and financial statements to management. The system operates on a calendar-year basis (January 1 through December 31). Financial personnel have on-line access to OCC's mainframe computer through remote terminals.

The primary financial information system is integrated with the following modules:

Accounts payable/cash disbursements
Accounts receivable/cash receipts
Budget/planning
Capital expenditures
Investments
Payroll

During 1997 OCC initiated plans to replace its antiquated financial and resource systems. A project team was formed to identify the financial and resource information needs of OCC management to assure that new systems addressed those needs. As part of that effort, interviews were conducted with private firms and other government agencies to determine the financial and resource information they use to manage.

Future Plans: As a result of the efforts begun in 1997, OCC will seek to acquire new financial, time reporting, and travel software during 1998, with a goal of 1999 implementation with enhanced delivery of financial and resource information that takes full advantage of modern technology. These efforts are synchronized with OCC's technical architecture and data architecture efforts.

Year-2000 Date Transition

The year-2000 problem represents one of the OCC's top priorities. An Oversight Committee, consisting of many of the OCC's most senior managers, was established to coordinate OCC's year-2000 strategy, and to provide guidance. The OCC has focused on internal year-2000 issues by redirecting resources, allocating funds to identify and renovate systems, and hiring consultants and contractors to assist in year-2000 activities. The

OCC's attention has been devoted to identifying mission critical systems, establishing priorities, reviewing system interfaces and interdependencies, and implementing strategies.

The OCC designated 13 systems as mission critical to the agency's mission. As of April 1998, one system has been retired and six have been renovated, tested, and implemented as year-2000 compliant. Plans call for renovation, testing, and implementation of the remaining six mission critical systems by July 1998. All other noncritical systems are expected to be tested and certified as compliant by September 1998.

The OCC completed a draft Non-Information Technology (IT) Project Management plan with a final plan expected in April 1998. The plan details Non-IT objectives, an assessment of the current environment, the management team, site priorities, approach, and the scope of the Non-IT working group. The OCC currently has over 100 facilities with 9 deemed to be mission critical. An independent consultant was contracted to assist the OCC in implementing the Non-IT Management plan.

Compliance with Financial Management Laws—FMFIA/FFMIA Program Summary

The OCC has evaluated its systems of internal control for the fiscal year ending September 30, 1997, according to the procedures and standards prescribed by the Office of Management and Budget (OMB) and the General Accounting Office (GAO). In addition, pursuant to Section 4 of the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and Section 803(a) of the Federal Financial Management Improvement Act of 1996 (FFMIA), we have reviewed the Financial Management Information System—Administrative. The OCC's financial management/accounting system conforms to generally accepted accounting principles; the relevant principles, standards, and related requirements of the Comptroller General; and the relevant financial management system and information objectives of the OMB, including implementation of the standard general ledger.

The OCC's internal control systems provide reasonable assurance that:

- Expenditures and costs comply with applicable law.
- All assets are safeguarded against waste, loss, unauthorized use, and misappropriation.
- Revenues and expenditures applicable to agency operations are recorded and accounted for properly, i.e., accounts and reliable financial and statistical reports are prepared and accountability for assets is maintained.
- The financial management/informational accounting system conforms to generally accepted accounting principles; the relevant principles, standards, and related requirements of the Comptroller General; and the relevant financial management system and information objectives of the Office of Management and Budget, including implementation of the standard general ledger.

Various feedback mechanisms and formal reviews serve as bases for this assurance. Among them are employee feedback from the OCC's first cultural audit, feedback from focus groups discussions of the effectiveness of the regulatory burden reduction program, and bankers' feedback on the examination process. Formal reviews include the community bank quality assurance program, an Office of Inspector General audit of examiner conflict of interest, a GAO audit of money laundering through private banking, and a Department of the Treasury review of the OCC's security program. Weaknesses revealed by these processes were addressed promptly and none was considered to be material.

One issue, however, warrants mentioning under Section 2 of the Federal Managers' Financial Integrity Act of 1982 (FMFIA). During the year, the Congress expressed interest in the OCC's procurement practices as a result of preliminary information provided to them by the Office of Inspector General. Prior to those congressional inquiries, the OCC retained a professional services firm to conduct a review of one type of the OCC's contracts to determine the accuracy and reasonableness of costs, pricing, and payments. The results of that review indicated no problems related to the equipment acquired or money expended, although it found insufficient controls over the contract administration process. The OCC has already taken steps to improve controls over the contract administration process and its linkage to payments. Starting in 1998, an external professional services firm will conduct a review of the OCC's contracting and simplified acquisition processes. Also, in carrying forward the OCC's strategic objective of developing technology to support the workforce into 1998, the focus will shift to internal administrative systems. The OCC will continue the process of upgrading its procurement, financial, and administrative systems in such a way as to eliminate these control concerns from the procurement area and enhance the linkage between the systems.

In addition, the OCC provides reasonable assurance that its accounting and financial systems achieve the objectives of Section 4 of the FMFIA and Section 803(a) of the FFMIA. This year's assurance is based on assurances from senior officials. Those assurances are supported by an audit of OCC's financial statements, detailed review of subsystems for cash receipts and accounts receivable,

cash disbursements, and accounts payable. In addition, independent reviews were conducted throughout the year of financial operations in one district and financial activities in the agency (e.g., time and travel reporting, capital leases and related expenses, prompt pay, imprest and petty cash fund verification, and district quarterly reporting of financial activities).

No material weaknesses were reported in 1997 nor in the two previous years. None of our functions was or is a high risk area. OCC management is confident that the Office of the Comptroller of the Currency, as a whole, meets the requirements of 31 USC 3512 and the policies and standards of OMB and GAO.

1616 North Fort Myer Drive
Arlington, VA 22209-3100

Telephone 703 741 1000
Facsimile 703 741 1616

Price Waterhouse LLP

REPORT OF INDEPENDENT ACCOUNTANTS

To the Comptroller of the Currency

We have audited the accompanying statements of financial position of the Office of the Comptroller of the Currency (OCC) as of December 31, 1997 and 1996, and the related statements of operations and changes in net position, and cash flows for the years then ended. These financial statements are the responsibility of OCC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements*, as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements audited by us present fairly, in all material respects, the financial position of the Office of the Comptroller of the Currency at December 31, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 3, 1998 on our consideration of OCC's internal controls and a report dated April 3, 1998 on its compliance with laws and regulations.

Price Waterhouse LLP

April 3, 1998
Arlington, Virginia

1616 North Fort Myer Drive
Arlington, VA 22209-3100

Telephone 703 741 1000
Facsimile 703 741 1616

Price Waterhouse LLP

REPORT ON INTERNAL CONTROLS

To the Comptroller of the Currency

We have audited the financial statements of the Office of the Comptroller of the Currency (OCC) as of and for the year ended December 31, 1997, and have issued our report thereon dated April 3, 1998.

We conducted our audit in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements,* as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of OCC is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal controls are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of OCC for the year ended December 31, 1997, we obtained an understanding of the internal controls. With respect to the internal controls, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures and performed tests of the internal controls for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal controls. Accordingly, we do not express such an opinion.

Our consideration of the internal controls would not necessarily disclose all matters in the internal controls that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal controls and their operation that we considered to be material weaknesses as defined above.

We also noted other matters involving internal controls and their operation that we have reported to the management of OCC in a separate letter dated April 3, 1998. Matters related to information systems are discussed in a limited-distribution report, as open discussion of these items could compromise OCC's existing controls.

This report is intended for the information of the Executive Committee, and the management of the Comptroller's Office. However, this report is a matter of public record and its distribution is not limited.

Price Waterhouse LLP

April 3, 1998
Arlington, Virginia

1616 North Fort Myer Drive
Arlington, VA 22209-3195

Telephone 703 741 1000
Facsimile 703 741 1616

Price Waterhouse LLP

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

To the Comptroller of the Currency

We have audited the financial statements of the Office of the Comptroller of the Currency (OCC) as of and for the year ended December 31, 1997, and have issued our report thereon dated April 3, 1998.

We conducted our audit in accordance with generally accepted auditing standards, *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 93-06, *Audit Requirements for Federal Financial Statements,* as amended. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of OCC is responsible for complying with laws and regulations applicable to the agency. As part of obtaining reasonable assurance about whether the agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 93-06, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996.

An audit of the financial statements conducted in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States and OMB Bulletin No. 93-06, as amended, is not designed to detect whether OCC's systems are Year 2000 compliant. Further, we have no responsibility with regard to OCC's efforts to make its systems, or any other systems, such as those of OCC's vendors, service providers, or any other third parties, Year 2000 compliant or provide assurance on whether OCC has addressed or will be able to address all of the affected systems on a timely basis. These are responsibilities of OCC's management.

The results of our tests of compliance disclosed no instances of noncompliance with other laws and regulations discussed in the preceding paragraph.

Under FFMIA, we are required to report whether the agency's financial management systems substantially comply with the Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997.

The results of our tests disclosed no instances where the agency's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express an opinion. This report is intended for the information of the management of OCC. However, this report is a matter of public record, and its distribution is not limited.

Price Waterhouse LLP

April 3, 1998
Arlington, Virginia

Office of the Comptroller of the Currency
Statement of financial position

	As of December 31, 1997	1996
Assets		
Fund balance with Treasury and cash		
Fund balance with Treasury (Note 2)	$7,997,719	$15,080,525
Cash (Note 2)	74,442	4,109,947
Subtotal, fund balance with Treasury and cash	8,072,161	19,190,472
Receivables, non-federal		
Accounts receivable, net	1,995,341	2,285,895
Travel advances	12,836	40,725
Prepayments and other advances	1,492,277	1,582,403
Subtotal, receivables, non-federal	3,500,454	3,909,023
Receivables, federal		
Accounts receivable	435,177	1,621,638
Advances and prepayments	882,173	490,981
Subtotal, receivables, federal	1,317,350	2,112,619
Investments, federal (Note 3)	192,665,669	163,530,268
Property, plant, and equipment, net (Note 4)	93,651,649	98,667,684
Total assets	$299,207,283	$287,410,066
Liabilities and net position		
Funded liabilities		
Non-federal liabilities		
Accounts payable	$21,987,168	$24,253,563
Accrued payroll and benefits	13,462,592	37,841,791
Capital lease liabilities	101,298,238	102,741,313
Subtotal, non-federal liabilities	136,747,998	164,836,667
Federal liabilities		
Accounts payable	848,421	32,767
Subtotal, federal liabilities	848,421	32,767
Total funded liabilities	137,596,419	164,869,434
Unfunded liabilities		
Accrued annual leave	16,631,920	18,083,488
Post-retirement benefits	5,135,948	4,333,735
Total unfunded liabilities	21,767,868	22,417,223
Total liabilities	159,364,287	187,286,657
Net position	139,842,996	100,123,409
Total liabilities and net position	$299,207,283	$287,410,066

The accompanying notes are an integral part of these statements.

Office of the Comptroller of the Currency
Statement of operations and changes in net position

	Years ended December 31, 1997	1996
Revenue and financing sources		
Revenue from goods sold/services provided		
Semiannual assessments	$350,687,810	$351,977,507
Corporate fees	3,280,167	4,649,401
Investment income	12,711,392	11,436,400
Examination fees	2,720,886	3,391,722
Other	20,620,900	2,269,528
Total revenues and financing sources	390,021,155	373,724,558
Expenses		
Operating expenses		
Personnel compensation and benefits (Note 6)	250,099,609	278,363,855
Rent, communications, and utilities (Note 5)	30,768,583	28,772,138
Travel and transportation	24,010,466	23,564,737
Office equipment, software, and remodeling (Note 4)	14,276,028	16,643,716
Contractual services	12,247,572	9,827,841
Depreciation and amortization (Note 4)	6,288,708	6,203,046
Education, conference, and representation expense	4,306,187	3,693,270
Repairs and maintenance	3,588,441	3,158,908
Office supplies	3,312,350	2,714,998
Printing, reproduction, and other	1,403,624	1,514,612
Total expenses	350,301,568	374,457,121
Excess of revenue and financing Sources over funded expenses	39,719,587	(732,563)
Net position, beginning balance	100,123,409	100,855,972
Net position, ending balance	$139,842,996	$100,123,409

The accompanying notes are an integral part of these statements.

Office of the Comptroller of the Currency
Statement of cash flows

	Years ended December 31, 1997	1996
Cash flows from operating activities		
Excess of revenue and financing		
Sources over total expenses	$39,719,588	$(732,563)
Adjustments affecting cash flow		
Decrease in non-federal receivables	408,569	689,063
Decrease (increase) in federal receivables	795,269	(573,399)
(Decrease) Increase in non-federal liabilities	(26,645,594)	32,136,956
Increase (decrease) in federal liabilities	815,654	(594,305)
(Decrease) Increase in unfunded liabilities	(649,356)	2,211,691
Depreciation and amortization	6,288,708	6,203,046
Net Cash Provided by Operating Activities	20,732,838	39,340,489
Cash flow from investing activities		
Proceeds from sales of investment securities	563,054,749	496,972,296
Purchases of investment securities	(592,190,150)	(546,151,412)
Purchases of property, plant, and equipment	(1,272,673)	(12,382,869)
Net cash provided (used) by investing activities	(30,408,074)	(61,561,985)
Cash flows from financing activities		
Principal payments on capital lease obligations	(1,443,075)	(1,225,820)
Net cash used by financing activities	(1,443,075)	(1,225,820)
Net cash provided (used) by operating, investing, and financing activities	(11,118,311)	(23,447,316)
Fund balances with Treasury and cash, beginning	19,190,472	42,637,788
Fund balances with Treasury and cash, ending	$8,072,161	$19,190,472

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

Note 1—Organization

The Office of the Comptroller of the Currency (Comptroller's Office) was created by an Act of Congress for the purpose of establishing and regulating a national banking system. The National Currency Act of 1863, rewritten and reenacted as the National Bank Act of 1864, created the Comptroller's Office and provided for its supervisory functions and the chartering of banks.

No funds derived from taxes or federal appropriations are allocated to or used by the Comptroller's Office in any of its operations. The revenue of the Comptroller's Office is derived principally from assessments and fees paid by the national banks and income on investments in U.S. government obligations. The Comptroller's Office is exempt from federal and state income taxes.

The Comptroller's Office is a bureau within the Department of the Treasury. The Department of the Treasury provides certain administrative services to the Comptroller's Office, which pays the Department of the Treasury for services rendered pursuant to its interagency agreements. Periodically, payments are made in advance for anticipated services in accordance with instructions from the Department of the Treasury. Administrative services provided by the Department of the Treasury totaled $2,869,204 and $1,772,812 for the years ending December 31, 1997 and 1996, respectively.

Note 2—Significant Accounting Policies

Basis of Accounting

The accounting policies of the Comptroller's Office conform to generally accepted accounting principles, and as required by the Chief Financial Officers Act of 1990. Accordingly, the financial statements are presented on the accrual basis of accounting. Under the accrual method, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to cash receipt or payment.

Funds with the U.S. Treasury and Cash

Cash receipts and disbursements are processed by the U.S. Treasury. The funds with the U.S. Treasury are primarily trust funds that are available to pay current liabilities and finance authorized purchase commitments. The Comptroller's Office considers demand deposits and overnight certificate investments to be cash equivalents.

Accounts Receivable

No allowance for uncollectible accounts is applied to "accounts receivable—federal," as OCC expects to collect these amounts in full.

Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the Comptroller's Office as the result of a transaction or event that has already occurred. They are removed when liquidated (i.e., paid). Liabilities represent the amounts owing or accruing under contractual or other arrangements governing the transactions, including operating expenses incurred but not yet paid. Payments are made promptly to take discounts offered by vendors when the discount terms are cost effective. Payments are also made in accordance with OMB Circular A-125 "Prompt Payment Act."

Annual, Sick, and Other Leave

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. Sick leave and other types of manifested leave are expended as taken.

Note 3—Investments

Investment securities reflect maturities through May 15, 2006 and are U.S. Treasury obligations stated at amortized cost, which is an approximation of market value. The Comptroller's Office plans to hold these investments to maturity. Premiums and discounts on investment securities are amortized over the term of the investment. The fair value of investment securities is estimated based on quoted market prices for those or similar investments. The cost and estimated fair value of investment securities as of December 31, 1997 and 1996 is as follows:

	1997	1996
Investments, amortized cost	$192,665,669	$163,530,268
Gross unrealized holding gains	1,868,501	—
Gross unrealized holding (losses)	—	(3,049,962)
Market value	$194,534,170	$160,480,306
Investments mature as follows:		
During 1998	$167,262,649	
During 2006	27,271,521	
Total	$194,534,170	

Note 4—Property and Equipment

Property and equipment, including assets under capital leases, are stated at cost. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets. Leasehold improvements are

stated at cost, less accumulated amortization computed over the terms of the related leases (including renewal options) or their estimated useful lives, whichever is shorter. Expenditures for furniture and fixtures, machines and equipment, portable computers, and motor vehicles costing less than $25,000 and for computer software and leasehold improvements costing less than $50,000 and for all maintenance and repairs are expended as incurred.

The following table summarizes property and equipment balances as of December 31, 1997 and December 31, 1996:

Classes of fixed assets	Service life (years)	Acquisition value	Accumulated depreciation/ amortization	1997 net book value	1996 net book value
Leasehold improvements	5–20	$22,887,180	$13,281,505	$9,605,675	$9,520,160
ADP software	5–10	2,021,763	1,977,677	44,086	63,859
Equipment	3–10	7,023,924	5,030,021	1,993,903	2,549,642
Building under capital lease	25	107,558,539	26,208,283	81,350,256	85,767,463
Furniture and fixtures	5–10	1,464,213	806,484	657,729	766,560
Motor vehicles	5	16,330	16,330	—	—
Total		$140,971,949	$47,320,300	$93,651,649	$98,667,684

Note 5—Leases

Office Space Leases

The Comptroller's Office occupies office space in Washington, D.C. under a lease agreement with an initial lease period of 15 years. The lease provides for two consecutive, five-year renewal options that will provide for occupancy through the year 2016. The Comptroller's Office classified this lease as a capital lease.

The district and field offices lease space under agreements which expire at various dates through 2008. These leases are treated as operating leases.

Future lease payments under office space leases for the district and field offices, as well as the Washington, D.C. office, are shown in the following table:

Year	Washington, D.C. capital lease	District and field office operating leases
1998	$11,966,721	$10,385,406
1999	12,006,958	8,496,710
2000	12,049,208	7,521,796
2001	12,093,570	7,059,509
2002	12,140,150	5,372,039
2003 and after	168,630,267	6,819,355
Total minimum lease payments	$228,886,874	$45,654,815
Less: amount representing interest	127,588,636	
Present value of net minimum lease payments	$101,298,238	

Certain of these leases provide that annual rentals may be adjusted to provide for increases in taxes and other related expenses. Total rental expense under district and field office operating leases was $11,538,398 and $12,185,495 for the years ended December 31, 1997 and 1996, respectively.

Other Leases

The Statement of Operations and Changes in Net Position caption "Rent, communications, and utilities" includes interest expense related to capital leases, which equaled interest paid, as follows:

	1997	1996
Washington, D.C. office	$10,485,324	$10,258,624
Equipment	—	608
Total interest expense	$10,485,324	$10,259,232

Depreciation expense on all leased assets was $4,417,209 and $4,293,853 in 1997 and 1996, respectively.

Note 6—Retirement and Benefit Plans and Accrued Annual Leave

Retirement Plans

The Comptroller's Office contributes to the Civil Service Retirement System and the Federal Employees' Retirement System administered by the Office of Personnel Management (OPM) for the benefit of U.S. government employees. The Comptroller's Office contributions aggregated $16,505,465 and $17,889,234 in 1997 and 1996, respectively. The retirement plans are participatory. Under the Civil Service Retirement System the employer and employee each contribute 7 percent of salary to the plan. Under the Federal Employees' Retirement System, 13 percent of salary is contributed by the Comptroller's Office and 0.8 percent of salary is contributed by the employee.

Although the Comptroller's Office contributes a portion of pension benefits under the Civil Service and Federal

Employees' Retirement Systems for its employees and withholds the necessary payroll deductions from them, it has no liability for future payments to employees under these programs, and is not accountable for the assets of the Civil Service and Federal Employees' Retirement Systems nor does the Comptroller's Office record actuarial data concerning the accumulated plan benefits or the unfunded pension liability relating to its employees. These amounts are reported by OPM for the retirement systems and are not allocated to the individual employers.

Benefit Plans

The Comptroller's Office contributes up to 5 percent of base pay for participants in the Thrift Savings Plan under the Federal Employees' Retirement System. The Comptroller's Office contributions for the savings plan totaled $3,957,365 and $4,380,123 in 1997 and 1996, respectively. The Comptroller's Office also contributes for Social Security and Medicare benefits for all eligible employees.

Similar to federal retirement plans, OPM, rather than the Comptroller's Office, reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits (FEHB) plans and Federal Employees Group Life Insurance (FEGLI) plan. The Comptroller's Office contributions for active employees who participate in the FEHB plans were $7,233,138 and $8,322,402 for 1997 and 1996, respectively. The Comptroller's Office contributions for active employees who participate in the FEGLI plan were $137,608 and $151,521 for 1997 and 1996, respectively.

The Comptroller's Office sponsors a life insurance benefit plan for current and former employees who are not enrolled in FEGLI plans. This plan is a defined benefit plan, and the Comptroller's Office is fully responsible for the associated liability. Premium payments made during 1997 for current employees totaled $120,369, while payments made on behalf of retirees totaled $21,241.

The following table shows the unfunded accrued post-retirement benefit cost at December 31, 1997 and the post-retirement benefit expenses for 1997.

Accumulated post-retirement benefits obligation	
Retired participants	$(2,572,254)
Active eligible	(564,726)
Active ineligible	(3,642,333)
Total	(6,779,313)
Fair value of assets	—
Funded status	(6,779,313)
Unrecognized transition obligations	2,592,562
Unrecognized net (gain)/loss	(949,197)
Accrued post-retirement benefit cost	$(5,135,948)

Net periodic post-retirement benefit cost for 1997	
Service cost	$246,001
Interest cost	524,986
Amortization of transition obligation over 20 years	172,837
Net periodic post-retirement benefit cost	$943,824

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 7.5 percent. Gains or losses due to changes in actuarial assumptions are fully recognized in the year in which they occurred.

Note 7—Disclosure About Fair Value of Financial Instruments

The carrying amount approximates the fair value of OCC's financial instrument assets and liabilities, because the amounts stated on the statement of position for Fund Balances with Treasury, Accounts Receivable, Travel Advances, Prepayments and Other Advances, Investments, Accounts Payable, and Accrued Payroll and Benefits are the amounts expected to be realized or paid.

Index

Affiliated mergers:
- For quarter, 133

Affiliated mergers—thrift:
- For quarter, 139

Appeals process, 15
Assets, liabilities, and capital accounts of national banks (financial table), 143
Assets of national banks by asset size (financial table), 146
Assets, total, of national banks by state and asset size (financial table), 155

Chief Financial Officer's Annual Report, 1997, 157
Clarification of whether certain fees charged by banks in connection with credit cards constitute interest (Interpretive Letter No. 817), 101
Commercial banks:
- Condition and performance of, 1
- Number of commercial banks by state, 154
- Off-balance-sheet items, 149
- Past-due and nonaccrual loans and leases, 147
- Quarterly income and expenses, 150
- Quarterly net loan and lease losses, 152
- Total assets, 155
- Total assets by state, 155
- Total liabilities, 148
- Year-to-date income and expenses, 151
- Year-to-date net loan and lease losses, 153

Community Reinvestment Act (CRA):
- Applicability of Community Reinvestment Act regulations to financial institutions' investments in a middle-income housing down payment assistance program (Interpretive Letter No. 810), 83
- Community reinvestment and development activities of commercial banks in California (testimony), 25
- Data collection requirements and performance standards for small wholesale institutions under the Community Reinvestment Act regulations (Interpretive Letter No. 809), 81
- Implications of financial modernization for community development (speech), 75
- "Forum on Community Reinvestment and Access to Credit: California's Challenge," (Los Angeles), testimony given at, 25

Comptroller's decisions (mergers), 131, 134
Comptroller's message, in 1997 chief financial officer's annual report, 157
Condition and performance of commercial banks, 1
Confirmation that a bank may offer, as agent, crop insurance in connection with loans made to its farmer customers (Interpretive Letter No. 812), 88
Confirmation that a bank may acquire and hold a noncontrolling minority interest in a limited liability company (Interpretive Letter No. 813), 92
Confirmation that a bank may retain its minority noncontrolling interest in a state-chartered trust company (Interpretive Letter No. 815), 97
Confirmation that a bank may acquire and hold a 50 percent noncontrolling interest in a limited liability company, established as a general insurance company (Interpretive Letter No. 819), 106
Congressional testimony, speeches and, 23
Corporate decisions, recent, 13
Current issues in small business banking (speech), 45

Decisions, Comptroller's (mergers), 131, 134
Decisions, recent corporate, 13
Definition of the term "place" by the United States Bureau of the Census as used by OCC (Interpretive Letter No. 823), 122
Determination of a bank's dividend-paying capacity (Interpretive Letter No. 816), 100

Explanation of when an interstate national bank may charge home state interest rates (Interpretive Letter No. 822), 114

Financial performance of national banks, tables on the, 141
Financial statements, in 1997 chief financial officer's annual report, 185, 186, 187
Future of banking (speech), 54

Interpretations, 79
International banking (speech), 51
Interpretive letters, 81

Key indicators, FDIC-insured national banks (condition tables):
- Annual 1994–1997, year-to-date through quarter, 4
- By asset size, 6
- By region, 8

Liabilities of national banks by asset size (financial table), 148

Loan performance, FDIC-insured national banks (condition tables):
Annual 1994–1997, year-to-date through quarter, 5
By asset size, 7
By region, 9
Ludwig, Eugene A.:
Speeches and congressional testimony, 25, 45, 48, 51, 54, 59

Mergers:
Affiliated, (involving affiliated operating banks), for quarter, 133
Affiliated, —thrift (involving affiliated national banks and savings and loan associations), for quarter, 139
Nonaffiliated, (involving two or more nonaffiliated operating banks), for quarter, 131

Nonaffiliated mergers:
For quarter, 131
Number of national banks by state and asset size (financial table), 154

Off-balance-sheet items of national banks by asset size (financial table), 149
Office of the Comptroller of the Currency:
Decisions (mergers), 131, 134
Interpretations, 79
Speeches and congressional testimony, 23

Participation by national banks in an insurance program with a separate corporation owned by independent insurance agencies (Interpretive Letter No. 824), 123
Past-due and nonaccrual loans and leases of national banks by asset size (financial table), 147
Permissibility of a bank to purchase a printing company to sell printing services to other financial institutions (Interpretive Letter No. 811), 84

Quarterly income and expenses of national banks by asset size (financial table), 150
Quarterly income and expenses of national banks (financial table), 144
Quarterly net loan and lease losses of national banks by asset size (financial table), 152

Recent corporate decisions, 13
Regulatory burden reduction (testimony), 59

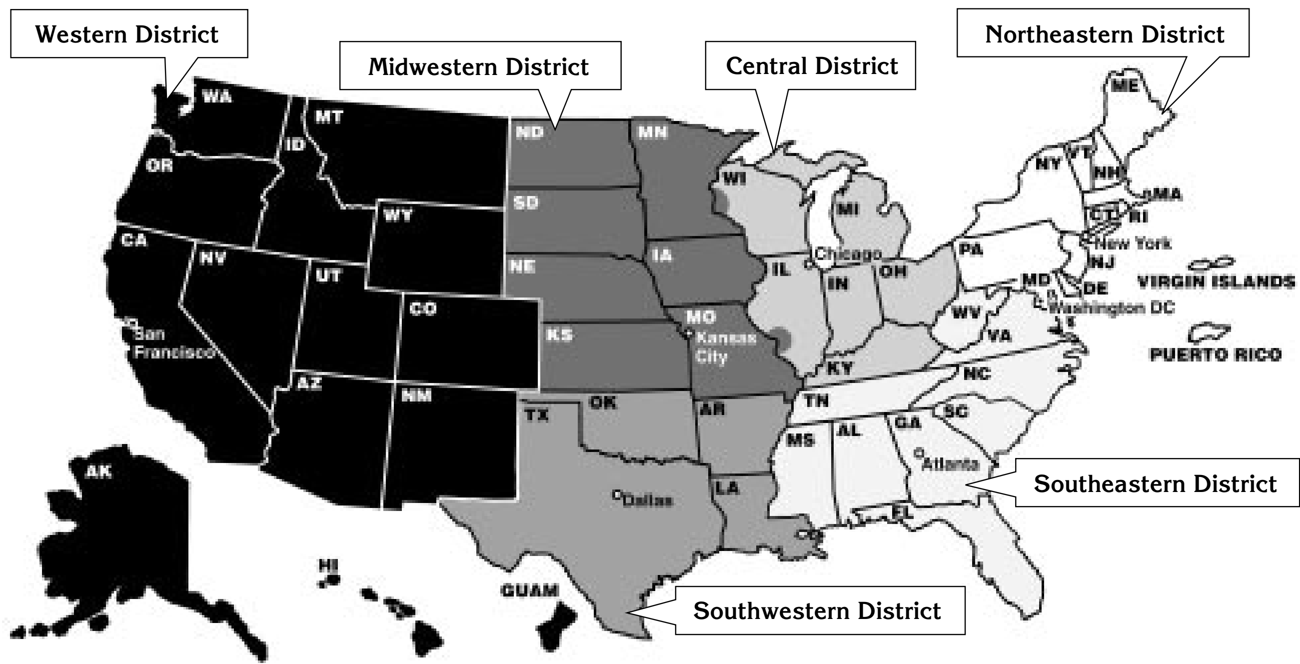
Significant OCC actions ensuring fair access to financial services, 1993–1997 (appendix 1 to testimony), 40
Speeches and congressional testimony, 23

Tables on the financial performance of national banks, 141
Tightening loan underwriting standards (speech), 48
Testimony, congressional, speeches and, 141
Total assets of national banks by state and asset size (financial table), 155
Types of permissible small business-related investments and activities by national banks (appendix 2 to testimony), 43

Whether Connecticut statute prohibits establishment and operation of out-of-state automated teller machines of a national bank (Interpretive Letter No. 821), 111
Whether disbursing loan proceeds at a bank's loan production office would cause that office to be considered a branch of the bank (Interpretive Letter No. 818), 102
Whether financial institutions should collect and report the gross adjusted gross annual revenue or income to use when making credit decisions under the Community Reinvestment Act (Interpretive Letter No. 820), 109
Whether offices of a wholly owned subsidiary of a national bank are branches of the bank (Interpretive Letter No. 814), 95
Williams, Julie L.:
Biography, inside front cover
Speech, 75

Year-to-date income and expenses of national banks by asset size (financial table), 151
Year-to-date income and expenses of national banks (financial table), 145
Year-to-date net loan and lease losses of national banks by asset size (financial table), 153

12 USC 24(7) (interpretive letters), 84, 88, 92, 97, 106, 123
12 USC 36 (interpretive letter), 95
12 USC 36(j) (interpretive letters), 102, 111
12 USC 60 (interpretive letter), 100
12 USC 85 (interpretive letters), 101, 114
12 USC 92 (interpretive letters), 122, 123
12 USC 2901 (interpretive letters), 81, 83, 109



Northeastern District

New York District Office
1114 Avenue of the Americas
Suite 3900
New York, NY 10036–7780

212–819–9860

Southwestern District

Dallas District Office
1600 Lincoln Plaza, Suite 1600
500 North Akard Street
Dallas, TX 75201–3394

214–720–0656

Central District

Chicago District Office
One Financial Place, Suite 2700
440 South LaSalle Street
Chicago, IL 60605–1073

312–360–8800

Midwestern District

Kansas City District Office
2345 Grand Boulevard
Suite 700
Kansas City, MO 64108–2683

816–556–1800

Southeastern District

Atlanta District Office
Marquis One Tower, Suite 600
245 Peachtree Center Ave., NE
Atlanta, GA 30303–1223

404–659–8855

Western District

San Francisco District Office
50 Fremont Street
Suite 3900
San Francisco, CA 94105–2292

415–545–5900

Headquarters

Washington Office
250 E Street, SW
Washington, DC 20219–0001

202–874–5000

For more information on the Office of the Comptroller of the Currency, contact:
OCC Public Information Room, Communications Division, Washington, DC 20219–0001
fax 202–874–4448****e-mail Kevin.Satterfield@occ.treas.gov****World Wide Web http://www.occ.treas.gov