

Department of the Treasury

Regulatory Bulletin

RB 32-7



Handbook: **Thrift Activities**
Subject: **Various Sections**

Thrift Activities Regulatory Handbook Update

Summary: This bulletin provides the first in a series of updates to the Thrift Activities Regulatory Handbook. Enclosed are eight sections: 010, Handbook Use; 011, Program Use; 020, Conduct of Agency Personnel; 070, Overall Conclusions; 280 (formerly 562), Margin Securities; 320, Meetings with the Board of Directors; 561, Reserve Requirements; and 563, Government Securities Act. Please replace the existing handbook sections with the enclosed revised sections. A summary of changes for each section is provided below.

For Further Information Contact: Your Office of Thrift Supervision (OTS) Regional Office or the Supervision Policy Division of the OTS, Washington, DC. If you wish to purchase a handbook and a subscription to the updates, please contact the OTS Order Department at (301) 645-6264.

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SUMMARY OF CHANGES

Changes to the enclosed Thrift Activities Handbook Sections are summarized below. Change bars in the margins of the handbook sections indicate revisions.

010 Handbook Use

Introduction: Adds a new paragraph regarding the Thrift Activities Handbook as not only providing guidance to regulatory staff but to the industry.

Chapters: Includes necessary revisions regarding the description of certain handbook chapters and the sections within pursuant to the revision of UFIRS.

Questionnaires: Streamlines the verbiage regarding the general questionnaires.

011 Program Use

Programs and Work Papers: Streamlines to improve readability and removes redundancies between Sections 011 and 060.

Work Paper Documentation: Omits redundancies.

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020 Conduct of Agency Personnel

Summary of Major Restrictions/Responsibilities of OTS Employees: Adds advice regarding the required filing of OTS Form 1569, Confidential Financial Disclosure.

References: Condenses the references, and adds a reference to the OTS Employee Ethics and Standards of Conduct Resource Guide.

070 Overall Conclusions

Revises applicable text throughout the section in accordance with TB 69, Revised Rating System; Disclosure of Component Ratings: changes references from CAMEL to CAMELS to incorporate the new Sensitivity to Market Risk component; and revises language to incorporate the disclosure of component ratings to institution management and the directors.

Reporting Results: Eliminates references to a transmittal letter.

Meetings with Institution Representatives: Incorporates two paragraphs from TB 69 regarding disclosure of component ratings and discussions with management.

References: Eliminates reference to RB 25; adds TB 69 and TB 69-1.

280 Margin Securities (Regulation G)

This section was previously included in the Liquidity -- Asset/Liability Management chapter of the Handbook as Section 562. Adds references to OMB control numbers for cited forms.

Introduction: Clarifies that the regulation applies only to thrifts that are required to register, rather than any thrift engaged in margin security lending.

Lending Restrictions: Clarifies definitions of "purpose loans" and "non-purpose loans;" adds definitions of "single credit rule" and "plan lender." Discusses withdrawal provisions.

Reporting and Regulatory Requirements: Discusses the collateral documentation requirements of Form FR G-3.

Deregistration: Eliminates discussion of telephone confirmation by FRB staff whether deregistration criteria are understood.

References: Adds a reference to Federal Reserve Board rulings and interpretations.

320 Meetings with the Board of Directors

Introduction: Minor edits to improve readability.

Regular Meetings: Incorporates New Direction Bulletin No. 96-03 regarding the OTS' policy requiring meetings with the boards of large and adversely rated institutions.

Documentation: Removes reference to the Continuing Examination File (CEF) because maintenance of a CEF is now optional. (See discussion in Section 060.)

561 Reserve Requirements (Regulation D)

Transaction Accounts: Adds a new section describing transaction accounts, savings deposits, nonpersonal time deposits and Eurocurrency liabilities.

Reserve Requirements: Revises section to provide additional explanation and the 1997 amount of reservable liabilities subject to the 3 percent and 10 percent reserve requirement tranches.

Frequency of Reporting: Revises and expands the section to describe which depository institutions are subject to weekly, quarterly and annual reporting of deposits to the Federal Reserve.

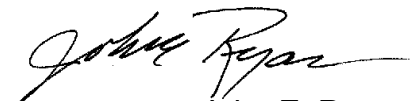
References: Adds FRB Amendments and Interpretations of Regulation D.

563 Government Securities Act

Hold-In-Custody Repurchase Agreements: Adds new language to include forward repurchase transactions and a definition of the term. Provides further explanation when confirmations and the contents of confirmations are to be sent.

References: Modifies and expands Department of Treasury Staff Interpretations of Regulations Implementing the Government Securities Act of 1986 - Reference made to April 19, 1996, letter from the Bureau of Public Debt regarding forward repurchase agreement transactions.

Enclosures



—John E. Ryan
Acting Executive Director
Supervision

Introduction

The Thrift Activities Regulatory Handbook is a "how to" manual to aid the Office of Thrift Supervision (OTS) regulatory staff and the savings and loan industry in the regulatory process. It is intended to address examination and supervisory issues.

This introductory section explains how to use the Regulatory Handbook in the examination process, describes the organization of the Handbook chapters and sections, and sets forth objectives and procedures common to all phases of the examination.

The Handbook is a guide for the examination of savings associations regulated by the OTS. It provides regulatory personnel with uniform standards for planning and conducting examinations and should be used as a reference tool, a training aid, and a guide to national policy and procedure.

The Handbook illustrates and describes, for the benefit of the OTS regulatory staff and the industry, certain standards of conduct and prudent operation that the OTS views as important to the safe and sound operation of savings associations, consistent with the respective fiduciary duties of those individuals who are associated with them.

Through the regulatory process, agency personnel assess an institution's degree of safety and soundness, objectively evaluate its condition, report their findings, inform boards of directors of institution strengths and weaknesses, and facilitate corrective action where needed. To be most effective, the regulatory process should not only identify existing regulatory violations, but also identify potential problems, prevent the development or continuation of unsafe operating practices, effect the timely resolution of problems, and identify strengths of the institution. Proactive regulatory supervision that evaluates future needs and potential risks helps to ensure the success of the thrift system in the long term. The Handbook provides a framework for the successful completion of this process.

The Handbook is designed to encourage independent reasoning, objectivity, efficiency, and professionalism in the examination process. To promote consistent application among the five OTS regional offices, the Handbook sets forth national minimum standards for examination objectives and procedures. While this promotes standardization of the examination process, regulators are encouraged to modify programs to fit specific institution needs.

The Handbook is designed for use by both new and experienced regulatory personnel. Background information, applicable references, and expanded procedures are included to serve as "memory joggers" and to facilitate the learning process.

The regulator should supplement use of the Thrift Activities Regulatory Handbook and associated programs with education, experience, and judgment. Supplemental pages, updates, and revisions to the Handbook will be published and distributed periodically. Separate manuals are also available concerning: Holding Companies, Trust Activities, Compliance Activities, Information Services (IS), and Application Processing.

References to specific sections of regulations within the text refer to all regulations promulgated by OTS unless otherwise designated. Those regulations authorized by other regulatory agencies will be identified by the following standard acronyms:

- OCC Office of Comptroller of the Currency
- FDIC Federal Deposit Insurance Corporation
- FRB Federal Reserve Board

Handbook Organization: Chapters

The Handbook contains a table of contents and 8 chapters; a chapter on the administration of the regulatory process; a chapter on each of the six areas of the examination, i.e., Capital Adequacy, Asset Quality, Management/Administration, Earnings, Liquidity, and Sensitivity to Market Risk (CAMELS); and a chapter that includes mortgage banking and other thrift activities. The Handbook also includes a Glossary.

Table of Contents

The table of contents lists each Handbook chapter, section number and title, and, if applicable, appendices and questionnaires.

000 Administration

This chapter gives a general overview of the administration and coordination of the regulatory process. The chapter includes instructions on determining the scope of an examination, discusses monitoring and the regulatory plan process, and provides guidance on assigning component and composite CAMELS ratings and examination strategy.

100 Capital Adequacy

This chapter provides useful information for assessing whether an institution's capital position is sufficient, given the institution's level of risk, to meet the institution's needs and to ensure its ongoing viability. The chapter, which includes topics such as minimum regulatory capital requirements, prompt corrective action (PCA) categories, and stock ownership and control, will assist examiners in determining the adequacy and composition of an institution's capital.

200 Asset Quality

This chapter addresses two issues: (1) the determination of risks related to the institution's assets and (2) the institution's management, administration, and evaluation of the quality of these assets. The chapter will assist regulators in assessing credit risk and reviewing asset portfolios (including loans, investments, and other assets). This chapter focuses on the quality of an institu-

tion's loan and investment underwriting and portfolio management, affirmation of the level of classified assets, and adequacy of valuation allowances. Sections discussing real estate appraisals, loan sampling, the Qualified Thrift Lender Test, and Margin Securities (Regulation G) are also included.

300 Management/Administration

This chapter provides guidance in evaluating the capability of executive management and the board of directors and includes a checklist of the board of directors major responsibilities. The chapter also covers objectives, procedures, and references for examining internal controls, internal and independent audits, fraud and insider abuse, and enforcement actions. A section on planning meetings with the board of directors is also included.

400 Earnings

This chapter provides direction for the analysis of an institution's financial condition. This chapter covers objectives, procedures, and references for examining the institution's financial recordkeeping and reporting methods and operations analysis. This chapter also discusses present value analysis.

500 Liquidity

This chapter provides assistance in assessing liquidity and the funding risk confronting an institution. The chapter includes material on funding and cash flow management, and investment activities. The Government Securities Act, Payments Systems Risk, and Regulation D are also discussed.

600 Sensitivity to Market Risk

This chapter provides assistance in assessing the market risk confronting an institution. The chapter includes guidance on interest rate risk management, hedging, and off-balance sheet derivative instruments.

700 Other Activities

This chapter provides guidance in the evaluation of risk that operating subsidiaries, service corporations, and lower-tier entities (such as joint ventures or limited partnerships) pose to the institution and thereby the insurance fund.

This chapter also addresses activities in which the thrift and subordinate organizations may be involved: mortgage banking, insurance, and non-deposit investment sales.

800 Glossary

The glossary contains an alphabetical list of terms and definitions specific to the examination process. Definitions of frequently used terms may also appear within individual handbook sections.

Chapter Organization: Sections

Within each chapter, examination materials are subdivided into sections by different areas of review. Each Handbook chapter contains several sections. For example, Chapter 300 contains a section for each area of review under Management.

To allow for easy identification and referencing of materials, each handbook section has a unique three-digit number. Within Management Chapter 300, the section on Oversight by the Board of Directors is number 310. Each handbook section, and any corresponding program, questionnaire, and work paper, is assigned the same number. Handbook pages are numbered in accordance with the section; hence, the introduction for Oversight by the Board of Directors, Section 310, is Handbook page number 310.1.

Each handbook section contains an introduction, examination objectives, procedures, regulatory references, related questionnaires, and appendices. These components are briefly discussed below. This discussion also includes a list of common objectives and procedures which, though perhaps not included in a particular handbook section or program, may be of value to the regulator in successfully conducting an examination.

Introduction

The introduction provides the reader with basic information such as OTS policy and pertinent accounting issues. Significant concerns are highlighted, including the nature and intent of enforcement actions that may be applicable to the area. Subheadings are used as appropriate.

Examination Objectives

This segment identifies the goals toward which the regulator is striving while conducting a review of the subject area. Objectives are presented in each handbook section and on the corresponding program, if applicable, for easy reference.

Certain objectives are germane to the overall examination process and to virtually every examination section. These common objectives, essential to the overall examination process, are presented below. Regulatory staff may wish to review this list during the course of an examination, as these objectives might not be specifically included in other handbook sections.

Common Objectives

- Document the effectiveness of an institution's operations.
- Determine compliance with laws and regulations.
- Determine the adequacy of and adherence to institution policies and procedures.
- Assess management's expertise and ability to manage the institution's affairs.
- Assess the board of directors' oversight and ensure that management and the board are receiving complete and accurate reports.
- Verify that an acceptable system of records and internal controls is in place.
- Assess the effect of anticipated internal and external changes on the institution.
- Assess the institution's ability to meet its future needs (e.g., fund growth, provide capital, absorb losses).

- Identify any actual or potential undue risk to the institution.
- Report examination findings:
 - Present analysis and conclusions regarding the institution's overall condition, trends, and prospects for future viability.
 - Report concerns of material risk and initiate corrective action when needed.

Examination Procedures

Procedures that the regulator should follow to achieve the objectives for each area of review are set forth in the handbook sections. Although circumstances may dictate some variation, the following steps will lead to an efficient conclusion for each area of review.

The procedures are divided into three groups: Levels I, II, and III. Level I procedures are basic to an analysis of a thrift's operations. Many of the general procedures enumerated in this section (010) are Level I procedures. There are also expanded procedures set forth in Levels II and III.

Level II procedures are usually used to test the conclusions drawn from the review of policies, procedures, skills, and organizational structures covered by Level I procedures. Although regulators often use Level II procedures, the extent of their use is left to the discretion of the regulator and regional office policy.

Level III procedures are even more discretionary. Regulators should follow these procedures only when they identify significant problems and it is necessary and expeditious to perform audit-like verification procedures. Level III procedures demonstrate the full spectrum of potential examination procedures.

Although examination subject areas differ greatly, certain procedures are applicable to any phase of an examination. A list of procedures that are common to the overall examination process and to virtually every examination section appears below. The regulator may wish to review this list when completing an area of review, as the proce-

dures might not be specifically incorporated in other handbook sections or programs.

General Procedures

Gather Data

- Review previous Report of Examination (ROE), PERK documents, exceptions, and work papers
- Review current year's scope, supervisory correspondence, and interagency data
- Consider regulatory policy associated with area of review
- Set forth special considerations pertinent to the areas of examination
- Obtain institution's management reports and written policies and procedures.

Set Scope (see also Handbook Section 060)

- Establish a clear understanding of examination objectives
- Perform analytical review procedures on financial data:
 - Identify new or unusual transactions requiring modified examination procedures
 - Indicate areas of greatest concern
- Tailor examination program to meet individual needs
- Consult with other regulators; take the nature of their initial findings into account in determining the procedures to perform
- Determine if expanded procedures are necessary
- Develop additional procedures not covered in the Handbook, if necessary
- Perform only those procedures necessary to achieve program objectives.

Perform Procedures

- Interview institution personnel

- Evaluate policies and procedures
- Spot check the reliability and accuracy of reports
- Test the institution's procedures
- Identify material changes in operation or policy since previous examination
- Evaluate trends
- Research significant variations from last year's examination to determine if there is cause for concern
- Obtain explanations for any matters of significance.

Assess Management

- Review adequacy of management reports to the board of directors
- Determine the extent to which the directors are involved in monitoring performance
- Review management's plan for future operations
- Interview management and staff to ascertain if personnel have adequate knowledge of policies and procedures
- Determine sufficiency of training and expertise to implement procedures
- Determine if policies and procedures are being communicated and regularly updated.

Formulate Conclusion

- Keep the examiner in charge (EIC) informed of progress
- Discuss concerns with other regulators
- Identify, and determine significance of, regulatory violations and deficiencies
- Discuss findings with management
- Determine adequacy of management's response to problem issues

- Consider possible strategies for corrective action and develop recommended course of action.

Conduct Postreview Activities

- Review work to ensure objectives have been satisfied
- Summarize results and conclusions
- Draft comments, including scope and recommendations
- Assign ratings if applicable
- Ensure that there are properly cross-referenced work papers to document and support substantive findings and conclusions
- Update the Continuing Examination File (CEF), if applicable (see Handbook Section 060)
- File exceptions in the General File (GF).

References

Pertinent legislative and regulatory citations appear in the reference section. References to other relevant OTS issuances are identified where appropriate, including: various bulletins, agency instruction and class manuals, industry sources, and accounting pronouncements.

The reference list is purposefully comprehensive, providing resources beyond those needed on a day-to-day basis. Therefore, a regulator should not be concerned if access to these references is not routinely available. If the institution under examination is state chartered, the regulator should also refer to state regulations in accordance with regional office policy. Regulatory references appear in the applicable handbook section and on the companion program.

Questionnaires

Questionnaires appear at the end of some handbook sections. The questionnaires are free-standing, so that they may be photocopied for use in an examination, if necessary.

General Questionnaires—General questionnaires reflect standards for safe and sound operating procedures and may be useful for evaluating an institution's operations. These questionnaires also include questions on internal controls that, for objectivity, regulatory staff must answer. They also assist in organization, act as memory joggers, and facilitate the review process.

It is not necessary to complete all questionnaires. The regulator should include only those questionnaires pertaining to the examination scope and objectives.

Procedural Questionnaire—This questionnaire is included in the Thrift Activities Regulatory Handbook Section 340, Internal Controls, as well as in the Preliminary Examination Response Kit (PERK). The Procedural Questionnaire contains questions about the institution's internal controls. The institution should complete this questionnaire prior to the examination and regulatory staff should verify the institution's answers onsite.

Appendices

The Appendices present additional sources of information, including available forms and guidelines.

Introduction

The examination program serves as a guide for the orderly completion of an examination. This Handbook Section offers information on program use, gives an overview of the program format, sets forth procedures for documenting work papers, and lists sources of information that may be useful during the examination process.

Programs supply the regulator with objectives for the review of a subject and a series of procedures for completing those objectives. Examination programs also help determine the examination scope and organization, serve as documentation, and help establish conclusions and recommendations. Once completed, the program becomes part of the foundation for an effective quality review process.

Each program corresponds to a handbook section for the examination process. Each handbook section contains a discussion of the subject area, examination objectives, examination procedures, questionnaires, and pertinent appendices, if any.

Program Organization

Examination programs mirror the format of a portion of their corresponding handbook section. Each program includes examination objectives and procedures, a summary section, and regulatory references. Space is provided for conclusions, recommendations for corrective action (if necessary), and other comments. An index block is also provided so that the regulator may index the program to the corresponding work papers. Each of the program segments is described briefly below.

Examination Objectives

Objectives listed on each program refer to specific areas of review. Handbook Section 010, Handbook Use, also presents and discusses some common objectives the regulator should be aware of throughout the examination process.

Examination Procedures

Examination procedures are organized in a top-down fashion and are divided into three groups, each representing a different level or depth of review: Levels I, II, and III. The top-down approach begins with a review of policies, procedures, and internal controls while focusing on the safety and soundness of the institution (Level I). With this approach, regulatory personnel can expeditiously assess the degree of risk in each area of a particular institution's operations early in the examination and determine the depth of review and the procedures (Levels II and III) needed.

The programs are intended to serve as guides and reminders for the regulator. Less experienced regulators will find the programs especially useful as guides for the effective completion of assigned phases of examinations. More experienced regulators will tend to use the programs as reminders of what is expected to be reviewed within each phase of an examination.

Handbook Section 010 contains a list of general procedures for all facets of the examination not necessarily included in individual programs, with which the regulator should be familiar.

Not all programs will be applicable to an institution. Further, of those programs that are used for a particular examination, not all procedures will be needed. The examination scope should help determine the level of review and procedures needed in each area. See Handbook Section 060, Examination Strategy, Management, and Scoping. When selecting programs and procedures for review, the regulator must ensure that procedures are sufficient to: (1) address the concerns in the scope and any other problems found during the review, (2) assess the safety and soundness of the institution, and (3) update and support the CAMELS composite and component ratings.

When using this risk-based examination approach, the regulator should use sound professional judgment to ensure that the depth of review is sufficient to accurately assess the institution's condition, but is not excessive. Following is a discussion of the three levels of procedures and the national policy guidelines for their use.

Level I

Level I procedures focus on the review of examination scoping materials and institution documents, such as policies and procedures. The Level I review is followed by interviews with personnel to determine if practices conform to written guidelines and to confirm any other preliminary findings.

If significant items of concern are uncovered during Level I analysis, or if significant problems were identified during the pre-examination monitoring and scoping, the regulator may need to use Level II procedures. In certain circumstances, the regulator may need to complete Level III procedures as well.

Level II

Level II procedures focus on the analysis of institution documents such as loan files, management reports, and supporting financial records. The regulator should select and complete Level II procedures when Level I procedures do not reveal adequate data on which to base a conclusion for an area of review. Regulators may develop an independent analysis of asset values at this level as well as independent verification of other items.

Level I and selected Level II procedures normally provide a comprehensive analysis from which conclusions can be drawn, but do not include any significant auditing procedures. If the regulator cannot rely on the data contained in institution records, Level III procedures may be necessary.

Level III

Level III procedures include steps that auditors usually perform. Although certain situations may require Level III procedures, it is not standard practice of Office of Thrift Supervision (OTS)

regulatory staff to duplicate the testing efforts of auditors.

Again, it may not be necessary to complete every program or every procedure within a program. The regulator must use discretion in determining which programs and procedures are necessary to address the scope and reach a sound conclusion. In some situations it may be appropriate to customize existing procedures or to perform procedures that are not listed within a program in order to achieve the most efficient and meaningful analysis. The regulator should document any decisions to deviate significantly from the initial scope instructions or to modify existing procedures on the relevant programs.

Programs and Work Papers

Properly prepared examination work papers are essential to the examination process. They are relied upon to support the conclusions and findings set forth in the report of examination (ROE). Conclusions regarding the effectiveness of the OTS examination process may be determined, in part, by the adequacy of work paper documentation. Proper documentation of procedures and subsequent conclusions leaves an effective audit trail for users of the completed programs. Moreover, examination work papers are often used by legal staff to support the OTS' position in litigation matters.

The programs allow space to the right of each procedure to record a work paper cross-reference that indicates where supporting documentation is found whether under the same topic or contained in another program. All substantive conclusions must be supported. Additional space between each procedure allows the regulator to include any pertinent information.

For those examination programs and procedures deemed unnecessary, you should include a notation, i.e., "N/A," "not required by scope," or other explanation, either on the index or on the program itself, as appropriate.

The following items are examples of information that should be included in work papers and programs, as appropriate:

- Statement of purpose, title, or heading
- Scope of review
- Procedures used
- Legend or explanatory footnotes, if necessary
- Results of testing
- All substantive conclusions
- Sources of information, including names or titles of institution contact personnel
- Identification of regulator performing the procedure
- Identification of person completing the review
- Institution name and location
- Institution docket number
- Examination date
- File index number
- Cross-references, where needed.

Regulator Summary, Recommendations, and Comments

The regulator should complete this portion of the program in narrative form, summarizing the following:

- Examination scope, including identification of any procedures used that are not already printed on the program.
- Salient findings as well as a conclusion regarding the strengths and weaknesses of the institution's operations in the particular area of review.
- Recommendations for corrective action, which may include a statement about the adequacy of management's response and commitments. (Note: The regulator should address any recommendation for revision of a formal supervisory action in a separate memorandum.)

The regulator may attach continuation pages for any additional comments. The regulator should

support in the work papers all substantive findings regarding the overall condition of the institution. It may be useful to attach copies of draft comments or schedules included in the ROE to this portion of the program.

Regulatory References

This segment contains a list of pertinent legislative and regulatory citations. References to relevant documents and industry sources are also identified where appropriate. If the institution under review is state chartered, the regulator should refer to appropriate state legislation.

The companion handbook section contains an identical list of references.

Index Block

The title of each program is centered in the top and bottom margins. The lower right-hand corner contains an index block for the following items: Examination Date, Prepared By, Reviewed By, and Docket Number. The regulator should fill in each of these items before completing the examination.

File work papers according to the OTS program number. To locate examination programs easily, the regulator may use the Handbook table of contents or the program index as a cover page for file folders. Information germane to the ROE or review process should be cross-referenced to supporting documentation.

Sources of Information

Following is a generic list of information sources that may be helpful in successfully completing the programs.

OTS documents:

- Laws and regulations
- Standard and supplemental accounting manuals
- Published memos
- OTS Training and Development materials

- Uniform Thrift Performance Report (UTPR)

Regional office examination materials:

- Previous ROEs, General File, and work papers
- Correspondence from the regional office
- Continuing Examination File (CEF), if applicable
- Thrift Financial Reports (TFRs)
- Regional office instructional manuals

Institution's documentation:

- Completed Preliminary Examination Response Kit (PERK) schedules
- Business plan
- Operating budget and forecasts
- General ledger trial balance
- Loan trial balance
- Investment trial balance

Reports and minutes:

- Independent audit report
- Internal audit report
- Internal management and board reports
- Securities and Exchange Commission (SEC) annual report, 10K, 10Q, and 8K (if stock institution)
- Board of directors' minutes

- Board committee minutes
- Operating committee minutes

New or revised policies, procedures, and corporate documents:

- Real estate lending policies
- Real estate appraisal policy
- Environmental risk policy
- Classification of assets policy
- Investment policies
- Interest rate risk policy
- Asset/liability management policy
- Interbank liabilities policy
- Futures and options policy
- Charter, bylaws
- Security policy
- Currency and Foreign Transactions Reporting Act (CFTRA) policy
- Community Reinvestment Act (CRA) statement
- Contracts (information systems, service bureau, employment, etc.)
- Contingency planning policy
- Leases (office building, etc.)
- Payments systems risk policy

Introduction

This Section summarizes the rules governing the conduct of OTS personnel, including OTS policies on professional conduct while performing on-site examinations.

All OTS employees are subject to the Standards of Ethical Conduct for Employees of the Executive Branch (Standards), the Supplemental Standards of Ethical Conduct for Employees of the Department of the Treasury (Supplemental Standards), and the Department of the Treasury Employee Rules of Conduct (Rules). "Covered employees" (all examiners, all employees grade 17 and above, and others as designated by the Director) are subject to additional financial restrictions and disclosures contained in the Supplemental Standards.

The areas covered by the Standards, Supplemental Standards, and Rules are outlined in the References portion of this Handbook Section. If you would like a copy of any of the referenced material, or have any questions about them, contact your regional ethics counselor.

Summary of Major Restrictions/ Responsibilities of OTS Employees

Listed below are some of the restrictions and responsibilities of OTS staff taken from the Standards, Supplemental Standards, and Rules. The following is not meant to be an exhaustive list. Each employee needs to be aware of his/her responsibilities, restrictions and disclosure requirements under these rules. If further information is needed or desired, contact your regional ethics counselor.

OTS employees:

- shall not have any financial interest or obligation that conflicts or appears to conflict with official responsibilities and duties;
- may not participate personally and substantially, by decision, approval, disapproval, recommendation, advice, examination, or other action, in any manner in which he/she or any household

member, partner, or organization with which there is a substantial personal involvement, has a known financial interest, unless otherwise approved by the Chief Counsel, Regional Director or designee;

- may not accept from a prohibited source (defined below) food, refreshments, or entertainment, unless of a nominal value on infrequent occasions in the ordinary course of an official conference or other function that the employee may properly attend;
- may accept unsolicited advertising or promotional material only if its retail value is \$20.00 or less. Other items of monetary value shall be returned to the sender or disposed of as directed by the Chief Counsel (or designee), or ethics counselor;
- must receive prior supervisory approval before speaking about OTS or publishing OTS-related material for a non-agency audience;
- may not engage in any activity incompatible with the full and proper discharge of his/her OTS duties and responsibilities, or any outside employment without prior written supervisory permission from the Executive Director, Regional Director, or Chief Counsel;
- may not make recommendations or suggestions, directly or indirectly concerning the acquisition or sale, or other divestiture of securities of any OTS-related savings association or savings association holding company; and
- may not purchase property owned by the government and under the control of the OTS, or sold under the direction or incident to the functions of the OTS, without an appropriate waiver.

OTS-covered employees:

- may not knowingly accept or become obligated on, directly or indirectly, any impermissible extension of credit from an OTS-regulated savings association or its subsidiaries (for limited exceptions, refer to Supplemental Standards 5 CFR § 3101.109(c));
- (or their spouse or minor child) may not purchase any asset of a savings association or its subsidiary, including an institution in receivership or conservatorship (for limited exceptions, refer to Supplemental Standards § 3101.109(f));
- may not purchase, own, or control, directly or indirectly, any security of an OTS-regulated savings association and most savings association holding companies (for limited exceptions refer to Supplemental Standards § 3101.109(b)); and
- must file required financial disclosures:
 - employees in Grades 17 through 20, and all examiners Grade 20 or below, must file an OTS Confidential Financial Disclosure Form (OTS 1569).
 - employees in Grades 21 through 23 must file an Executive Branch Personnel Confidential Disclosure Report (OGE 450) .
 - employees in Grades 24 and above must file an Executive Branch Personnel Public Financial Disclosure Report (SF 278).
- ¾ all covered employees in Grades 21 or higher must file a Confidential OTS Supplemental Financial Disclosure Form (OTS 1569A).

Prohibited Source

"Prohibited Source" means any person (or entity) who:

- 1) is seeking official action by OTS;
- 2) does business or seeks to do business with OTS;
- 3) conducts activities regulated by the OTS;

- 4) has interests that may be substantially affected by the performance or nonperformance of the employee's official duty; or
- 5) is an organization a majority of whose members are described in paragraphs (1) through (4) above.

Financial Disclosure

All OTS examiners and other OTS employees in Grades 17 through 23 must file by October 31st of each year annual financial disclosure forms, OGE 450 and/or an OTS supplement. Employees in Grade 24 or higher must file an SF 278 (instead of OGE 450) and an OTS Supplement in May of each year.

Except for the SF 278, which is public, financial disclosure is confidential and disclosure of reported information is governed by the Privacy Act (5 USC Section 552a). Authorized OTS, Treasury Department and certain other officials use the information to ensure ethical conduct, prevent conflicts of interest and monitor compliance with the Standards and the prohibitions on loans to and investments covered by employees in the Supplemental Standards. In addition, the disclosures also permit scheduling assignments so that no employee participates in any examination, supervision or decision involving any OTS-regulated savings association or savings association subsidiary that has extended credit to the employee,¹ employs a relative (especially in a policy-making position) or has opened employment contracts (see below for discussion on employment negotiations).

Negotiations for Employment

OTS staff should be aware that under 18 USC §208(a), it is a crime to negotiate or have any arrangement concerning employment with any person or organization while the employee simultaneously participates personally and sub-

¹ Covered employees are prohibited from obtaining new credit from savings associations or savings association subsidiaries. However, individuals with credit outstanding as of April 30, 1991, are grandfathered, provided the debt is repaid according to the original terms of the note or the loan agreement.

stantially as a representative of OTS in any particular matter affecting that person or organization.

If an employee does not unconditionally and immediately reject a job offer from a savings association or other prohibited source and it is likely that the employee is, or will be, assigned to examine, supervise, or make any regulatory decision affecting that prohibited source, the employee must immediately inform his/her supervisor of the offer of employment. The supervisor shall decide if an employment restriction (recusal) is needed to eliminate any potential conflict of interest. Recusal from any current assignment(s) should last until the employee resigns, or sends a written rejection of the offer. Outright and immediate rejection of unsolicited offers requires no recusal, but an employee memorandum to the file or his/her supervisor is advisable.

An employee rejected for a job by a prohibited source should refrain from participating in OTS matters relating to the potential employer for at least one year, unless written review of the matter by an OTS ethics official recommends earlier participation by the employee. As noted above, an unsolicited offer rejected immediately and unconditionally requires no recusal.

Professional Conduct in Institutions

The following policies governing professional conduct do not constitute an exhaustive or all-inclusive list; rather they are general guidelines addressing important issues that regulators face in their day-to-day work in an institution.

Duration of Onsite Examinations

Each examination should be conducted in the most efficient and least disruptive manner possible, so as to limit the time spent on site at each institution. To this end, the examination should be thoroughly scoped and planned, targeting problem and high-risk areas.

Pre-examination activities should include contacting the institution's management and obtaining lists of employees and documents necessary to perform the examination.

Working Hours

Agency personnel should manage time in a responsible, professional manner.

OTS examination staff work on an "Alternative Work Schedule" (AWS). This allows for eight 9-hour days, one 8-hour day, and one Friday off during each two-week pay period.

Regulators should obtain approval from the EIC for deviations from normal working hours during an examination and should provide an explanation to the EIC for all absences that were not preapproved. Also, the EIC should inform the institution's management of any unusual variances, especially absences, from the normal work schedule. Absences without notice give the impression of lack of responsibility and care.

Working Space

The institution should provide adequate working space for regulatory personnel. If space is inadequate, another space may be requested, as long as it does not unreasonably disrupt operations of the institution.

To help avoid all appearance of impropriety, agency personnel working in an institution should:

- Ensure that a representative of the institution is on the premises whenever they are working;
- Never accept keys to the institution's offices or assume responsibility for its property; and
- Avoid entering places where there is a possibility of access to cash or other negotiable instruments unless accompanied by a representative of the institution.

Access to Information

Agency personnel should carefully protect all information an institution entrusts to them and secure it from unauthorized access. Confidential documents should not be left unattended and should be locked up when not in use.

Agency personnel should never divulge confidential information in any form to unauthorized persons. On the other hand, if the institution refuses

to provide information needed to complete the examination, the EIC or other supervisors should be notified.

Computers should not be left unattended while logged onto the OTS systems, or in a status that would allow unauthorized access to the OTS systems, or to any confidential data stored on diskettes or disk drives.

Breaks

The EIC will determine the propriety, times, and lengths of breaks.

Lunches

Agency personnel may use an institution's dining facilities if they: (1) are invited to do so and (2) pay for their own meals. Examiners on assignments with large crews should stagger their lunch breaks so that the entire crew is not absent from the work place simultaneously.

Professional Decorum

The following guidelines are general prescriptions for interacting with other regulators and institution employees during an examination. Agency personnel should:

- Limit unnecessary conversations with other regulators and the institution's employees;
- Treat the institution's employees in a courteous, friendly, yet businesslike way; and
- Not discuss work with unauthorized employees. They should confer with the EIC before discussing anything other than routine matters with employees or management.

Smoking

If an institution has rules regarding smoking, they should be followed. Agency personnel who smoke should always be courteous and considerate of others.

Telephone Calls

Agency personnel should limit telephone usage, even for official matters. They should avoid personal telephone calls unless they are absolutely necessary.

Parking

Agency personnel may use an institution's private parking facilities if invited to do so by the institution. However, such use must be approved by the EIC and should not unduly inconvenience employees or customers.

If the institution uses an independent parking facility, agency personnel may not park there at the institution's expense.

Travel Expenses

All travel, lodging, and subsistence expenses incurred while on official duty shall be paid for or reimbursed only by the OTS. For further information regarding reimbursement for travel and lodging refer to the OTS National Travel Policy manual.

Business Attire

Agency personnel should wear appropriate business attire. Standards of appropriateness may vary depending on regional policy, the institution, and the customs of the community.

References

United States Code (18 USC)

Chapter 11 §§ 201-219	Bribery, Graft, and Conflicts of Interest
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Code of Federal Regulations (5 CFR)

Part 735 §§ 735.101-203	Employee Responsibilities and Conduct
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Part 2635 §§ 2635.101-902	Standards of Ethical Conduct for Employees of the Executive Branch
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Part 3101
§§ 3101.101-109(g) Supplemental Standards
of Ethical Conduct for
Employees of the De-
partment of the Treasury

Code of Federal Regulations (31 CFR)

Part O Department of the
Treasury

§§ 0.101- 0.217 Employees Rules of
Conduct

Code of Federal Regulations (12 CFR)

Part 505 Freedom of Information Act

Part 512 Rules for Investigative Pro-
ceedings and Formal Examina-
tion Proceedings

Part 513 Practice Before the Office

(For reference to the above United States Code and
Code of Federal Regulations, see OTS Employee
Ethics and Standards of Conduct Resource Guide,
July 1996.)

Introduction

This Section provides guidance on summarizing and effectively communicating conclusions developed as a result of analyzing an institution's overall condition and viability by means of the on-site examination as well as other on-site and off-site regulatory reviews.

Throughout this Section, which is written primarily from an examination perspective, references are made to the responsibilities of the examiner in charge (EIC), but traditional titles, roles, and responsibilities vary among the regional offices. Therefore, the regional office structure and policy should be reviewed to determine where responsibility rests. In some situations the responsibility may be shared by more than one individual from the regulatory staff.

In general, report comments should include a synopsis of the work that was performed (scope) and the examiner's findings based on that scope. Reporting conclusions in this manner will provide the reader with a clear understanding of the condition of the area reviewed. This is referred to as comprehensive reporting of findings and conclusions.

Examination reports should present a thorough and balanced portrayal of an institution's condition and future prospects. A comprehensive report is factual and is not predisposed to exclusive presentation of either negative or positive findings. It will inform its readers, be they regulators, managers, or directors, of an institution's present condition and recommend a course of action they should follow to either maintain or regain safe and sound operations. Comprehensive reporting does not equate to positive reporting. Regulatory personnel are not expected to report every positive aspect of an institution's condition and operations. However, identified strengths and weaknesses should be reported when necessary to provide a clear picture of the institution's prospects, or lack thereof, for future viability. Persons responsible for managing the regulatory process for a given institution will need to have a balanced picture of its significant strong and weak points.

There are three primary objectives of the discussion included in this Section:

- To provide guidance for developing conclusions, preparing comments, and assigning ratings to Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk (CAMELS).
- To provide guidance for formulating overall conclusions regarding the present condition and future prospects for the institution and for determining the institution's composite rating.
- To provide guidance for preparing well-developed and comprehensive report pages as well as orally presenting examination results.
- To provide guidance as to when a supervisory letter is necessary.

The performance of the EIC and other regulatory staff in this area is critical. The ability to formulate conclusions, prioritize findings, and communicate those findings to directors, management, and Office of Thrift Supervision (OTS) personnel will significantly affect the regulatory process. The findings will be used to help determine future regulatory strategies to be included in the Regulatory Plan for the institution and will guide the directors toward correcting identified weaknesses and capitalizing on indicated strengths.

A primary goal of the regulatory process is to ensure that savings associations are operated in a safe and sound manner. For examinations and supervisory analyses to be most effective, conclusions must be drawn from a comprehensive analysis of patterns and trends. Causes of significant negative trends or problems and their possible solutions should be identified. A comprehensive yet concise analysis and summary of the condition of the institution can provide for timely and appropriate actions by the institution's directors and the regulators.

Developing Conclusions and Comments

There are unique factors to consider when developing conclusions, comments, and ratings for each CAMELS component. As with the summary, each individual report comment should be comprehensive, discussing both major strengths and weaknesses of the component addressed.

This is done by identifying patterns and trends that are occurring, with appropriate summaries of supporting analysis. The deficient practices or problems underlying the patterns should be included, along with management's proposed corrective action.

The following checklist will assist in developing report comments.

- Present the scope of the review.
- Clearly identify patterns and trends, and their causes.
- Present comments in a comprehensive nature, discussing major strengths and weaknesses in a meaningful order, with proper emphasis and tone accorded to individual topics.
- Identify problems in relation to safety and soundness and substantive compliance issues.
- Include the deficient underlying practices where patterns of regulatory noncompliance are noted.
- Support conclusions with appropriate analysis and prepare an effective summary so that the reader does not get lost in detail.
- Assess the effect of examination findings on future operations.
- Include a discussion of corrective action where necessary.
- Support the comments with work papers and other retained documents.
- Disclose the component rating.

Formulating Overall Conclusions

The development of substantive overall conclusions involves:

- Reviewing major findings from the examination (including trends).
- Considering the institution's operating environment (both internal and external factors).
- Converting ultimate determinations into ratings.
- Communicating the results effectively.
- Facilitating the corrective action process.

There are both objective and subjective factors involved in a comprehensive analysis of the present condition and the expected future condition of the institution. The EIC must weigh the significance of criticisms, deficiencies, and exceptions in relation to offsetting strengths. This requires reviewing CAMELS comments and other findings for interrelationships. When determining if a practice or other factor materially affects safety and soundness, the regulator must look at both the present effect and the potential future effect.

Possible items to consider in evaluating the present condition of the institution include:

- Findings developed by the examiners, including all of the CAMELS comments and ratings, trends, patterns, exceptions, and other observations.
- Patterns of noncompliance with regulations, deficient procedures, and other factors that have caused the noncompliance.
- Interrelationships between the findings noted for each specific CAMELS component.
- Effectiveness of the corrective actions initiated to resolve earlier deficiencies.

Possible items to consider in evaluating the future condition of the institution include:

- Adequacy of the following: policies and procedures, personnel, information systems, books and records, accounting and other internal controls, audit function, and asset review function.
- Overall compliance with laws, regulations, and policies.

- Assessment of the board of directors' and management's ability to effect timely and appropriate corrective actions.
- Strategic planning and the written business plan, including changes expected in asset and liability composition, organizational structure, growth, etc.
- Management's ability to perform acceptably and in conformance with the business plan.
- Competitive, economic, and regulatory conditions, including: management's ability to assess market conditions, trends, composition, share, etc.; and expected changes in economic conditions, competitive factors, and the regulatory environment.

One of the goals of the regulatory process is to prevent problems from developing or escalating in the future; therefore, early identification of risk is necessary. When making projections of future events, however, the use of factual information, and explanation of assumptions made, will be necessary to support them.

When developing a conclusion about the institution's future prospects, give consideration to such items as: existing systems, policies, procedures, and practices; the business plan; the adequacy of intended corrective action necessary; projections for future operating performance; management ability; market factors; and economic factors.

Assigning CAMELS Composite and Component Ratings

The CAMELS rating system is a standardized system for rating savings associations supervised by the OTS in the individual components of Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk. Based on a quantitative and qualitative review of these components, an overall composite rating is also assigned, as is a rating for performance under the Community Reinvestment Act (CRA). (Refer to Compliance Activities Regulatory Handbook Section 500, Community Reinvestment Act.)

A systematic and logical approach to determining the ratings results in quantifiable conclusions that can be used by reviewers for a variety of purposes.

The regional office will disclose an institution's composite and component ratings to its directors. This will provide a yardstick for evaluating management and will also enable directors to recognize overall trends in the condition of the institution if they are not already apparent.

When the overall conclusions have been formulated, the composite rating is assigned. Since it is difficult to provide a specific formula for this process, experience and judgment is critical. It is not appropriate to simply average the individual CAMELS ratings or use any other standard formula in the process; however, there should be a high degree of correlation between the composite rating and the CAMELS component ratings. The ratings must be adequately supported with objective information in the Examination Conclusions and Comments page, the CAMELS comments, and the work papers. See Thrift Activities Regulatory Handbook Section 071, CAMELS Ratings, for a complete discussion of the component and composite rating criteria and disclosure of the ratings to the directors of the institution.

When composite ratings are changed based on an off-site analysis of an institution's condition, disclosure of the ratings should be communicated to the board of directors by supervisory letter. An on-site review may be appropriate when conditions warrant a downgrade in the rating. It is advisable to evaluate the need for changing all six CAMELS component ratings when the composite rating is changed.

OTS personnel use the ratings for a variety of purposes: to reflect trends for a particular institution, to make comparisons with peers, and to assess the condition of the industry. The CAMELS ratings are also considered when determining appropriate strategies including: frequency and scope of off-site and on-site analysis, enforcement actions, and meetings with institution representatives. The ratings, as an indication of the condition of the institution, are also considered in the analysis of applications for actions such as mergers and acquisitions and subordinated debt issuances.

Because ratings are used for a wide variety of critical decisions, a systematic and logical analysis is necessary. While most of the criteria for deter-

mining ratings are based on objective analysis and findings, subjective factors are also considered.

Reporting Results

There are three vehicles currently used by the regional offices for communicating findings to an institution's directors: the report, the supervisory letter, and meetings with institution representatives.

Report of Examination

All OTS type 10, 30, and 40 thrift safety and soundness examination reports are to be prepared according to the requirements and guidance in the Report of Examination (ROE) Instructions and the Thrift Activities Regulatory Handbook.

The Examination Conclusions and Comments page of the ROE should be the focal point for reporting overall conclusions resulting from an examination or other review, either onsite or offsite. To facilitate timely corrective action, the report comments should be directed to the institution's board of directors even though the document remains the property of OTS. The Examination Conclusions and Comments page should be completed according to the ROE instructions. Primary factors to consider when developing this page are:

- Items reported, other than regulatory compliance, should be material and should relate to safety and soundness.
- The information presented should provide the reader with a clear understanding of the overall condition, the causes of major problems and the action that is necessary to remedy concerns noted.
- For regulatory violations, only material patterns of noncompliance, along with the identified root(s) of the problem(s), should be included. A simple listing of violations is usually ineffective as a regulatory measure, particularly if violations are considered to be isolated incidents or errors. In certain situations isolated violations might appropriately be included in the report, but need not be brought forward to the Examination Conclusions and Comments page, unless they are of significant importance.

- State conclusions and comments briefly. Do not repeat analysis or support that is provided elsewhere in the report.
- The relative significance and interrelationship of the items discussed must be evident. A simple listing of items is not appropriate.
- All conclusions reported should be adequately documented in report comments, the work papers or other retained documents.

Conclusions should be presented in an order that first describes the matters requiring the most immediate follow-up supervisory action. The severity of any identified major problems will generally dictate their order of presentation. The effect of these most severe situations on other aspects of the institution's activities as well as any mitigating conditions should be concisely stated.

The following items should be addressed on the Examination Conclusions and Comments page:

- The type of examination and whether a holding company examination was conducted. If applicable, state that a separate holding company report has been prepared.
- The asset size of the institution, principal lines of business and the date of the financial statements used in the ROE.
- A statement of the scope of the examination or supervisory review.
- A concise statement of the examiner's conclusion about the overall condition of the institution.
- Disclosure of the component ratings and a brief discussion of the CAMELS components and other significant items reviewed, both the major positive and negative attributes. Focus should be placed on patterns, trends, causes of problems, and projections for future operations.
- Disclosure of the designation "troubled" institution.
- Disclosure of the composite CAMELS rating, reference to the definition of the assigned rating, and correlation of the institution's particular circumstances to the rating definition.

- A statement regarding the extent of compliance with outstanding enforcement actions and mandatory PCA restrictions, if any.
- A reference to corrective action(s) necessary, described on the Matters Requiring Board Attention page.

Supervisory Letter

The Examination Conclusions and Comments and Matters Requiring Board Attention pages should be used rather than a supervisory letter. If used in conjunction with an examination report, the supervisory letter should expand upon the examination findings rather than restate them. A transmittal letter that merely acts as a cover memo accompanying the ROE is discouraged; instead the standard ROE cover page letter should be customized.

When a composite rating is changed offsite, as a result of changes in the institution's condition or operating strategies that come to light through monitoring reviews or other means, the supervisory letter will be used to disclose the change in rating to the institution's board of directors. Ensure that the proper prohibition against outside disclosure of the rating is included in the letter, and that the letter discloses the reasons for the change.

Meetings with Institution Representatives

Meetings should be held with institution representatives on a regular basis during the course of the examination to:

- Introduce regulatory staff to institution staff who should be contacted for documents and additional information.
- Discuss the scope of the examination at the commencement of the examination.
- Discuss preliminary findings as they are developed and the need to extend the scope of the examination, if applicable.
- Discuss results of the institution's internal asset reviews, its asset classifications, and any differences between the asset classifications of the regulators and those of the institution.

At the conclusion of an on-site examination, a post-examination meeting should be held with the institution's senior management to discuss the regulators' overall conclusions and recommendations. This meeting is normally conducted after the preliminary draft examination report comments are prepared by the regulators. The EIC and CEO determine the appropriate date and time. The EIC is responsible for notifying other regulatory personnel who might also attend. An agenda of topics to be covered should generally be provided to the attendees in advance of the meeting. Any exhibits that will strengthen or clarify the presentation should also be prepared.

The purpose of the meeting is to discuss all of the examination findings that might be reported, to elicit management's corrective action responses, to ensure that conclusions are accurate, and to answer any questions posed by management. This meeting provides the examiner an opportunity to discuss the strengths as well as weaknesses noted and to discuss recommendations for corrective action if necessary and appropriate.

Regulators may also disclose preliminary component and composite CAMELS ratings per regional policy. Examiners should obtain sufficient concurrence with the ratings from regional management, so that the ratings disclosed are final, or subject to revisions only in rare instances. If the ratings are subject to further review, the examiner should disclose to thrift management that the ratings are not final.

During the discussion, examiners are expected to discuss the elements considered in assigning each component rating as well as the overall composite rating. Examiners should indicate that the composite rating is based on a careful evaluation of an institution's managerial, operational and financial performance as well as compliance with laws and regulations.

Depending on the examination findings and the seriousness of deficiencies noted, regulatory personnel may meet with the institution's board of directors to discuss the examination findings, ensure that the directorate is aware of the need for corrective action, determine the specific corrective measures that will be taken, and agree on a time frame for their accomplishment. Refer to Thrift

Activities Regulatory Handbook Section 071, CAMELS Ratings, and Section 320, Meetings with the Board of Directors, for additional guidance.

References

Office of Thrift Supervision Bulletins

TB 69 Revised Rating System; Disclosure of Component Ratings

TB 69-1 Joint Interagency Common Q & A on the Revised UFIRS

OTS Thrift Safety and Soundness Report of Examination Instructions

Overall Conclusions Program

Examination Objectives

- To formulate conclusions regarding the present condition, trends, and future prospects of the thrift.
- To formulate a conclusion on the safety and soundness of the thrift and propose supervisory action, if needed.
- To record thrift management's response to examination findings, conclusions, and proposed corrective action.
- To effectively communicate conclusions and recommendations, both orally and in writing, in the ROE according to the ROE instructions.

Examination Procedures

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1. Review analyses, comments, exceptions, and conclusions contained in the work papers, and perform the following:
 - Resolve any contradictory conclusions. All conclusions must be well supported with facts obtained during the examination.
 - Determine the significance of the findings in relation to safety and soundness and overall regulatory compliance.
 - Discuss findings with appropriate institution personnel and verify/modify conclusions as appropriate.

2. Review the draft CAMELS comments that have been prepared. Discuss with the assisting examiners their overall observations and findings applicable to the CAMELS comments, and determine the reasonableness of their conclusions.

3. Make appropriate revisions to the CAMELS comments to ensure an effective and fair representation that reflects examination results according to ROE instructions. Ensure that significant items noted in the review of work papers are included in comments, if appropriate. Determine that the tone and content of each comment is appropriate, and that conclusions are well supported in the work papers. Ensure that comments are comprehensive, as outlined in the Handbook discussion.

4. Review the preliminary CAMELS component ratings and discuss with the assisting examiners who completed the related programs. Standard criteria set forth by the OTS for determining ratings should be consistently applied. Definitions and instructions pertinent to the rating system should be closely followed to ensure national consistency.

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Overall Conclusions Program

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| 5. Adjust the CAMELS component ratings, if necessary, using the instructions in Thrift Activities Regulatory Handbook Section 071, CAMELS Ratings. Review the CAMELS comments again to ensure that they are consistent with the ratings assigned. | <hr/> <hr/> |
| 6. Develop overall conclusions and prepare the Examination Conclusions and Comments page. | <hr/> <hr/> |
| 7. Weigh the relative importance of the various criteria considered when developing the overall conclusions, and determine the composite rating. The rating instructions in Thrift Activities Regulatory Handbook Section 071 should be followed closely to ensure national consistency. | <hr/> <hr/> |
| 8. Review the Examination Conclusions and Comments page again to determine that the tone and content support the assigned rating. | <hr/> <hr/> |
| 9. Discuss findings with management, typically the CEO. (Use of an agenda is recommended.) Discuss at least the following topics: <ul style="list-style-type: none">• The purpose of the meeting;• All items that might be included in the examination report;• Overall conclusions regarding the institution; and• Management's corrective action responses. | <hr/> <hr/> |
| 10. After the management meeting, make any necessary changes to the ROE to correct any items that were found to be inaccurate, misleading, or misinterpreted. | <hr/> <hr/> |
| 11. If appropriate, include corrective actions on the Matters Requiring Board Attention page. These include specific recommendations for correction of deficiencies listed in the report, or could include recommendations for: supervisory agreements, consent agreements, cease-and-desist actions, receiverships, conservatorships, civil money penalties, and criminal referrals to appropriate agencies. (For suspected violations of criminal statutes, the EIC should refer to Thrift Activities Regulatory Handbook Section 360, Fraud/Insider Abuse.) | <hr/> <hr/> |

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Overall Conclusions Program

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12. Provide any information to the regional office that will be useful for revising the regulatory plan.

13. Prepare the supervisory letter, if necessary, in accordance with regional office policy.

14. Prepare to present findings at a meeting with the board of directors. Refer to Thrift Activities Regulatory Handbook Section 320, Meetings with the Board of Directors, for instructions.

15. Ensure that the *Objectives* of this Handbook Section have been met.

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Introduction

This Handbook Section briefly describes Regulation "G" requirements and offers guidelines to regulators in determining compliance with Regulation "G."

The Federal Reserve Board issued this regulation pursuant to the Securities Exchange Act of 1934 to prevent the excessive use of credit when purchasing or carrying margin stock. The regulation sets out certain requirements for thrifts and others who extend or maintain credit secured directly or indirectly by margin stock. The reporting requirements and lending restrictions apply only to those institutions required to register.

Registration

Any thrift that extends credit, directly or indirectly secured by margin stock, and that meets either of the following two requirements is required to register with the Federal Reserve Board:

- extending margin-stock-secured credit in any calendar quarter equaling \$200,000 or more, or
- maintaining margin-stock-secured credit outstanding at any time during a calendar quarter totaling \$500,000 or more.

Margin stock consists primarily of equity securities, convertible debt, and mutual funds.

To register, a thrift must submit Federal Reserve Form FR G-1 (OMB Control Number 7100-0011) to the Federal Reserve Bank of the district in which the principal office of the thrift is located. This must be done within 30 days after the end of the calendar quarter in which the institution becomes subject to Regulation "G." Registration under Regulation "G" sets both lending restrictions and reporting requirements on institutions.

Lending Restrictions

Institutions subject to Regulation "G" are prohibited from extending credit in excess of the maximum loan value if the purpose of the credit is to buy or

carry margin stock. Credits of this nature are defined by the Regulation as "purpose loans." The maximum loan value of any margin stock, except options, is 50 percent of its current market value. Thrifts subject to Regulation "G" are thus prohibited from lending on more than 50 percent of the current market value of margin stock if the purpose of the loan is to buy or carry margin stock.

Each purpose credit extended to a customer, including revolving credit or multiple draw agreements, is subject to the "single credit rule." This rule provides that; all purpose credit extended to a customer shall be treated as a single credit, all collateral securing such credit shall be considered in determining compliance, and all secured and unsecured purpose credit shall be combined to determine compliance with the withdrawal provisions of the Regulation.

If the proceeds of a margin-stock-secured loan are used for a purpose other than to purchase or carry margin stock, the maximum loan value is determined on a good-faith basis, not exceeding 100 percent of the current market value of the collateral, i.e., the amount that a lender would be willing to lend without regard to any other assets of the borrower. Credits of this nature are defined by the Regulation as "non-purpose loans."

The Regulation allows lenders to permit any withdrawal or substitution of cash or collateral by the customer if the withdrawal or substitution would not cause the credit to exceed the maximum loan value of the collateral or increase the amount by which the credit exceeds the maximum loan value of the collateral.

An exemption from the maximum loan value restrictions is provided by the Regulation for entities meeting the definition of a "plan lender." A plan lender is defined as any thrift organization whose membership is limited to employees and former employees of the organization, that extends or maintains credit to finance the acquisition

of margin stock of the organization, such as an ESOP.

Lenders are prohibited from extending credit if the purpose of the credit is to buy any puts or calls, regardless of whether the credit is margin-stock secured. In addition, Regulation "G" prohibits thrifts from extending or maintaining credit to broker-dealers that is secured directly or indirectly by any margin stock. Thus, thrifts are generally prohibited from lending to service corporations involved in broker-dealer activities, except for emergencies, capital contributions, and the few cases of mutual savings banks specifically authorized to lend to brokers and dealers.

Reporting and Regulatory Requirements

For the year ended June 30 each year, registered lenders are required to file with the Federal Reserve Bank an Annual Report, or Federal Reserve Form FR G-4 (OMB Control Number 7100-0011) showing their lending activities secured by margin stock. This form is designed to obtain the amount of such credit outstanding and extended during a calendar year. This report is filed along with a copy of the institution's balance sheet.

Each credit secured by margin securities must be accompanied by Federal Reserve Form FR G-3 entitled "Statement of Purpose for an Extension of Credit Secured by Margin Securities by a Person Subject to Registration Under Regulation G." (OMB Control Number 7100-0018.) This purpose statement must be completed by both the borrower and the lender for every margin-stock-secured loan extended, except for employee stock purchase plans. The lender is required to obtain and attach to the executed statement a current list of collateral that adequately supports all credit ex-

tended under the agreement. While this form is not filed with either regulator, it must be retained by the institution for three years after the credit is extinguished. Office of Thrift Supervision staff are responsible for monitoring compliance with federally chartered savings thrifts, and Federal Reserve Bank staff are responsible for monitoring compliance with state-chartered savings thrifts.

Deregistration

Thrifts no longer subject to Regulation "G" are able to eliminate their reporting requirement by terminating registration with the Federal Reserve Board. A thrift may deregister with the Federal Reserve Board if during the preceding six months they did not have more than \$200,000 of securities credit outstanding. To deregister, a "Deregistration Statement for Persons Registered Pursuant to Regulation G", or Federal Reserve Form G-2, (OMB Control Number 7100-0011) is filed with the district Federal Reserve Bank.

References

Code of Federal Regulations (12 CFR)

Part 207 Securities Credit by Persons Other-Than Banks, Brokers or Dealers

United States Code (15 USC)

Part 78 Securities Exchange Act of 1934

Federal Reserve Board - Rulings and Interpretations of Regulation G

Margin Securities (Regulation G) Program

Examination Objectives

To determine that the federal savings association has procedures in place to comply with Regulation "G."

To determine that the federal savings association is in compliance with the registration, reporting, and lending requirements of the regulation.

Examination Procedures

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Level I

1. Ascertain whether the institution is subject to Regulation "G." Determine whether the institution has recently registered or deregistered.

2. Ascertain whether the institution has procedures in place to maintain accurate records and ensure compliance with the reporting, lending limitation, and withdrawal requirements of the regulation.

3. Ascertain whether the institution's internal audit program provides adequate coverage to monitor Regulation G and to assure that the data collection, reporting requirements, and lending restrictions are monitored on a regular basis.

4. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

Level II

5. If the institution has recently deregistered, verify that the institution was in fact eligible to deregister.

6. Ascertain whether the two most recent annual reports (FR G-4) are accurate.

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Margin Securities (Regulation G) Program

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7. Verify that violations cited in previous examinations have been addressed and corrective action has been taken.

8. Review a sample of loan files for margin-stock-secured credits to check that loan purpose statements have been maintained and that margin-stock-credit limitations have not been exceeded. Review all loans to thrift service corporations that serve as broker-dealers to determine whether the institution is engaging in the prohibited practice of lending margin-secured credit to registered broker-dealers.

9. Ensure that the *Objectives* of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

Level III

10. If an improper registration or deregistration has been identified, if irregularities are found, or if an organization subject to registration has not registered, report this to the regional director who will then contact the appropriate Federal Reserve Bank.

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Introduction

Meetings between regulatory staff and the board of directors--the individuals ultimately responsible for an institution's affairs--serve a variety of functions. They provide opportunity for interaction, and they facilitate long-term communication, which is especially important when the regulatory process reveals significant adverse information. They help to keep the directors and regulators mutually informed by providing them an opportunity to discuss:

- The examination process and findings;
- The institution, its functions and plans;
- The general financial environment; and
- Industry-related concerns.

They give regulators an opportunity to obtain commitments from the board for corrective action.

Meetings with boards of directors are distinct from management meetings, also known as exit conferences, closing conferences, or exit interviews, near the end of an examination. Management meetings (see Thrift Activities Regulatory Handbook Section 070, Overall Conclusions) are held with members of the executive management team to review technical and overall examination findings and to obtain commitments for corrective action. The examiner in charge (EIC) should notify management of all examination-related items slated for discussion with the board of directors, except for findings that warrant recommendations for removal of management.

Types of Meetings

There are two primary types of meetings between regulators and boards of directors: regular (examination-related) and special (not primarily for presenting examination findings). However, any meeting may serve multiple purposes. For example, a regular meeting can be used to get acquainted with the board of directors and enhance communication as well as present examination findings.

Regular Meetings

Regular meetings may result from regular, special, or limited examinations. Their primary purposes are to present and discuss examination findings and, if necessary, reach agreement on a plan of corrective action. A secondary purpose may be to gather information regarding a new function or plans for the institution. These meetings may also be used to enhance the directors' understanding of the regulatory process and to establish rapport and build lines of communication between regulators and directors.

Examiners should meet with the boards of directors of adversely rated institutions following the conclusion of the examinations. Adversely rated institutions are defined as those with:

- a composite rating of 4 or 5;
- a composite rating of 3 if the rating represents a downgrade from the previous examination;
- a CRA rating of Needs to Improve or Substantial Noncompliance; or
- a Holding Company rating of Unsatisfactory.

Generally, examiners should meet with the boards of directors of all 3-rated institutions; however, the EICs with the concurrence of the field manager, have discretion in determining whether a meeting is necessary or appropriate in those cases in which the 3 rating is not a downgrade from the prior examination.

Meetings with the boards of directors of nonadversely rated institutions are encouraged, especially if the EIC notes adverse trends, increased risk profile, or other matters that need to be brought to the board's attention. If no such issues exist, the EIC should honor any request from management to forgo a meeting with the board.

For nonadversely rated institutions with assets exceeding \$1 billion, meetings with the boards should be held whether or not adverse trends are noted. A request from management to not hold a meeting may be honored after consultation with the field manager.

Regular meetings should normally be held subsequent to the examination, although they may be held during the last week of the examination if the examination results have been discussed with the institution's management. They may also be held in conjunction with the board's next regularly scheduled meeting or at another mutually agreed-upon time. However, whenever possible, they should not be later than 60 days after the examination completion date. When scheduling the meeting, regulators may consider whether receiving a copy of the report of examination (ROE) prior to the meeting would benefit the directors.

The following issues, which warrant the board of director's attention, are among those that should be considered for the meeting agenda:

- A comparison of the institution's policies, practices, and reporting systems with those one would expect to find in a well-managed institution of comparable size and offering similar services;
- Senior management's actions to correct deficiencies in policies, practices, and reporting systems;
- The institution's system of internal control, including its program of internal audit;
- The extent to which senior management and directors are receiving information needed to manage or oversee the institution effectively;
- Any significant concerns or observations regarding the quality of earnings;
- Management's long-term plans;
- Depth in management personnel; and
- The board's involvement in the institution's affairs.

Regulatory staff should be prepared to discuss methods for correcting deficiencies but should not

direct the course of action to be taken. If there are no major deficiencies, regulatory staff can inform the board of directors of the general condition of the institution and obtain the board's view on its future operations. The directors should be encouraged to discuss any matters of interest.

Special Meetings

Special meetings may be conducted for the following reasons:

- To effect a supervisory action, such as a supervisory agreement or cease-and-desist order;
- To gather information in order to act on a proposal, application, or request by the institution;
- To discuss an institution's progress in achieving the interim goals of a corrective action plan;
- To get acquainted, following a change in the composition of the directorate or a change in the regulatory staff assigned to the institution; or
- In response to a request by the directorate to meet with regulatory staff.

Meeting Preparation, Presentation, and Documentation

To ensure a successful meeting, regulatory staff should prepare thoroughly for any meeting with the directorate, be professional in conducting the meeting, and prepare sufficient documentation to ensure appropriate follow-up. When appropriate, regulators should use the following guidelines:

- Preparation
 - Ensure that scheduling and selection of attendees facilitates the meeting's goal (see the discussion below on participation);
 - Choose attendees and determine responsibilities of each;
 - Select a chairperson;
 - Determine a time and location;
 - Develop an agenda (refer to the discussion below);

- Notify all participants of the meeting and its purpose;
- Meet with regulatory staff participants to discuss the agenda and any other related issues;
- Prepare and organize supporting data, including comparative figures and ratios that indicate trends and graphs to illustrate significant points or trends; and
- Prepare any handouts or overheads and arrange for their presentation.
- Presentation
 - Conduct the meeting in a dignified, professional, and objective fashion;
 - Present the agenda (refer to discussion below) and follow it within reason;
 - Remember that the effectiveness of the meeting is directly related to the extent communication is established and credibility maintained;
 - Encourage directors' involvement and questions;
 - Do not attempt to answer questions without being able to offer complete and accurate information. When unable to do so, inform the directors that they will receive a response from the regional office or the Office of Thrift Supervision (OTS) -- Washington and then forward the question appropriately for a timely reply; and
 - Obtain commitments for corrective action from the board of directors, if appropriate.
- Documentation
 - Evaluate and document the results of the meeting (refer to the discussion below).

Participation

Meetings should be held with the entire board to ensure that all directors are aware of regulatory findings and commitments to correct deficiencies. If all directors cannot attend, regulatory staff may

meet with a group, such as the audit, examining, or executive committee, as long as:

- Outside directors are represented;
- A meeting with the full board is not critical (for example, if no material or adverse findings are noted); and
- A meeting with less than the full board is compatible with the goals and circumstances of the meeting.

Honorary directors may attend meetings with regulatory staff to participate in decision making and discuss examinations. However, honorary directors may not vote. Any person or organization connected with the institution, auditor, or holding company representative may attend the meeting upon board resolution. However, regulatory staff may excuse such people if appropriate. As a general rule, state supervisory authorities should attend meetings with the boards of directors of state-chartered institutions.

EICs should participate in regular meetings with the board of directors. This provides them with the opportunity to discuss the strengths and weaknesses noted during the examination and to answer any questions posed by management. In some cases, it may be advantageous for the EIC to attend special meetings as well.

Agenda

To ensure that meetings with boards of directors are clear, concise, and orderly, regulatory staff should prepare a detailed outline of the topics for discussion. The following sample outline is a starting point. It may be used as a guide for regular meetings, but should be considered neither all-inclusive nor limiting as to content or format.

Sample Agenda Outline

- Introductory remarks by regional office representative
 - Introductions
 - OTS policy regarding meeting with the board
 - Purpose of meeting

- Type of examination, scope, and other limitations
- ROE results -- i.e., the regulators' evaluation (including, where appropriate, the adequacy, accuracy, and effectiveness) of:
 - Overall condition of the institution
 - Capital
 - Asset quality, internal loan review, and reserves
 - Management (including quality, depth, and continuity)
 - Earnings
 - Liquidity
 - Funds management
 - ¾ Sensitivity to market risk
 - Internal controls and audit coverage
 - Policies and procedures
 - Reporting systems
 - Management information systems
 - Management reports to the board
 - Reports of the board and committees
 - Thrift Financial Reports
 - Planning process
 - Personnel
 - Compliance systems
 - Legislative and regulatory compliance (identify significant violations)
 - Supervision by board of directors
 - Service corporation and/or holding company examination results
 - Summary
- Corrective action (after discussion with appropriate regulatory staff)
 - Summary of problems
 - Board commitments
- Other matters
- Questions from the board of directors

- Overall conclusions

Documentation

After the meeting, regulatory staff should prepare a post-meeting memorandum to formally record the meeting results, date, time, location, and participant's names and titles. The memorandum should also describe the items discussed, the board of director's reactions to those items, and any commitments for corrective action. If the board has promised corrective action, or if otherwise appropriate, the regulator should send the memorandum to the board for comment/concurrence.

At the conclusion of any meeting conducted by the board of directors (rather than the regulators), regulatory staff should ask for a copy of the minutes. Upon receipt, regulatory staff should review the minutes for accuracy.

A copy of the post-meeting memorandum or minutes, along with the agenda from the meeting, should be filed in the appropriate supervisory file. Regulatory staff should consider and implement any changes to the institution's regulatory plan (see Thrift Activities Regulatory Handbook Section 050) indicated as a result of the meeting and any commitments for future actions arising from it.

Introduction

Under the Depository Institutions Deregulation and Monetary Control Act of 1980, every depository institution that has transaction accounts or nonpersonal time deposits must maintain reserves on those deposits as prescribed by the Federal Reserve Board (FRB). The FRB's Regulation D, Reserve Requirements of Depository Institutions (12 CFR § 204), contains the rules related to reporting deposits and maintaining reserve balances. Depository institutions, whether members of the Federal Reserve System or not, are required to file a periodic report of deposits with the Federal Reserve Bank in the Federal Reserve District in which it is located.

The reports of deposits (i.e., FR 2900 for weekly reporters, FR 2910q for quarterly reporters, and FR 2910a for annual reporters) are used by the Federal Reserve to more precisely define the components of the money supply, set reserve requirements, and, in aggregate, help formulate monetary policy. Errors in reporting or in maintaining proper reserve balances may adversely affect the conduct of monetary policy by the Federal Reserve and result in: (1) higher reserve requirements and a reduction in potential earnings, (2) the assessment of reserve deficiency charges, and (3) a more frequent reporting requirement.

Regulation D is a highly complex regulation that requires careful study to master. It is suggested that the regulation itself be read by all regulators.

This Handbook Section only touches on the highlights of the regulation and focuses on those areas that are frequently misunderstood.

Transaction Accounts

Transaction accounts are defined with great specificity in 12 CFR § 204.2(e). Such accounts include:

- demand deposits,
- certain accounts on which the depository institution has reserved the right to require at least seven days written notice prior to withdrawal or

transfer of any funds. These accounts include those subject to check, draft, or other similar item, those subject to automatic withdrawal, also those that permit a depositor to make more than six withdrawals per month or statement cycle,

- deposits or accounts maintained in connection with an agreement that permits the depositor to obtain credit directly or indirectly through the drawing of a negotiable or nonnegotiable check or similar device, and
- certain other accounts that the FRB has determined by rule or order, to be transaction accounts.

Savings deposits as defined in 12 CFR § 204.2(d) are not transaction accounts.

Nonpersonal time deposits are defined in 12 CFR § 204.2(f). Reserves are no longer required to be held against these deposits.

Eurocurrency liabilities are defined in 12 CFR § 204.2(h). Reserves are no longer required to be held against these liabilities.

Reserve Requirements

Regulation D (12 CFR § 204.9(a)(1)) specifies the reserve requirement ratios for all depository institutions as shown in Table 1.

There is a zero percent reserve requirement on the first \$4.4 million of the institution's transaction accounts subject to the low reserve tranche (\$49.3 million). A three percent reserve requirement is applied on the remainder of the low reserve tranche.

The FRB establishes before the beginning of each year the amount of transaction accounts subject to the three percent ratio requirement. This adjustment is known as the low reserve tranche adjustment. The FRB also establishes on an annual basis the amount of reservable liabilities of each depository institution that is subject to a reserve requirement of zero percent. This is known as the reservable liability exemption. Reservable liabilities include transaction accounts, nonpersonal time deposits, and Eurocurrency liabilities as defined in § 19(b)(5) of the Federal Reserve Act. The reserve ratio on nonpersonal time deposits and Eurocurrency liabilities is zero percent.

Deposit cutoff levels are used in conjunction with the reservable liability exemption to determine the frequency of deposit reporting. Nonexempt institutions are those with total reservable liabilities exceeding the amount exempted from reserve requirements while exempt institutions are those with total reservable liabilities not exceeding the amount exempted from reserve requirements.

Table 1

<u>Category</u>	<u>Reserve Requirement</u>
<i>Net Transaction Accounts</i>	
\$0 - \$4.4 M	0% of amount*
\$4.4 - \$49.3 M	3% of amount
>\$49.3 M	\$1,479,000 + 10% of amount > \$49.3 M
<i>Nonpersonal Time Deposits</i>	0%
<i>Eurocurrency Liabilities</i>	0%

* See 12 CFR 204.3(a)(3) for a technical explanation of the allocation of exemption from reserve requirements.

Specific Rules for Certain Types of Savings Deposit Accounts

Preauthorized or automatic transfers for savings deposits such as passbook and statement savings accounts and money market deposit accounts (MMDAs) are limited to six transfers and with-

drawals, or a combination of such, per calendar month or statement cycle of at least four weeks. Three of these transfers may be made by check, draft, or similar order drawn by the depositor to third parties. Telephone transfers to another account of the same depositor are also restricted to the six-transactions limitation.

MMDAs and other savings deposits should be reported separately where called for according to reporting instructions for the specific reports.

Institutions are required to implement procedures either to prevent transfers in excess of the limitations or to monitor accounts on a periodic basis and contact customers who exceed these limits. Further, proper disclosure to customers of these limitations may serve to ensure compliance.

If the account limitations are exceeded, the account will be either closed and the funds placed in another account that the depositor is eligible to maintain, or the transfer and draft capacities of the account will be taken away.

Frequency of Reporting

The frequency of filing the report of deposits with the Federal Reserve ranges from weekly to annually and is based on the level of total deposits and reservable liabilities. Institutions are screened during the second quarter of each year to determine reporting frequency beginning the following September.

Effective December 17, 1996, nonexempt institutions with total deposits of \$59.3 million or more are required to report weekly while nonexempt institutions with total deposits less than \$59.3 million may report quarterly, in both cases on FR 2900. Similarly, exempt institutions with total deposits of \$48.2 million or more are required to report quarterly on form FR 2910q while exempt institutions with total deposits less than \$48.2 million may report annually on form FR 2910a. Institutions with total deposits below \$4.4 million are excused from reporting if their deposits can be estimated from other sources.

Where Reserve Balances are Maintained

Each depository institution can satisfy its reserve requirements with a combination of vault cash and balances held at a Federal Reserve Bank. Depository institutions may deposit their required reserve balances directly with a Federal Reserve Bank. Depository institutions that are not members of the Federal Reserve alternatively may elect to pass through their required reserve balances to the Federal Reserve through a correspondent -- which may be the District Federal Home Loan Bank. The correspondent will pass through this required reserve balance dollar for dollar to the Federal Reserve Bank in the Federal Reserve District in which the main office of the respondent institution is located. However, every depository institution that maintains transaction accounts or nonpersonal time deposits is required to file its report of deposits directly with the Federal Reserve Bank of its District, regardless of the manner in which it chooses to maintain required reserve balances.

The Federal Reserve Bank that receives the reports shall notify the reporting depository institution of its reserve requirements. If a pass-through arrangement exists, the Reserve Bank will also notify the correspondent that passes reserve balances through to the Federal Reserve of the depository institution's required reserve balance.

Reserve Deficiency Charges

Deficiencies in a depository institution's required reserve balance are subject to reserve deficiency charges. Federal Reserve Banks are authorized to assess charges for deficiencies in required reserves at a rate of two percent per year above the lowest rate in effect for borrowings from the Federal Reserve Bank on the first day of the calendar month in which the deficiencies occurred. Charges are assessed on the basis of daily average deficiencies during each maintenance period.

In satisfaction of a reserve deficiency and any charges accruing, a Federal Reserve Bank may, after consideration of the circumstances, permit a

depository institution to eliminate deficiencies in its required reserve balance by maintaining additional reserves during subsequent reserve maintenance periods.

References**United States Code (12 USC)***Subchapter XIV - Bank Reserves*

§ 461 (19(a) - (c)) Reserve Requirements

Code of Federal Regulations (12 CFR)*Federal Reserve System Rules and Regulations*

Part § 204 Reserve Requirements of Depository Institutions

FRB Amendments/Interpretations of Regulation D

61 FR 60171, November 27, 1996 - Reserve Requirements of Depository Institutions

61 FR 69020, December 1, 1996 - Reserve Requirements of Depository Institutions

62 FR 34613, June 27, 1997 - Reserve Requirements of Depository Institutions and Issue and Cancellation of Capital Stock of Federal Reserve Banks

Chapter V - Office of Thrift Supervision, Department of the Treasury

Part 557	Deposits
§561.9	Certificate Account
§561.16	Demand Account
§561.28	Money Market Deposit Accounts
§561.29	Negotiable Order of Withdrawal Accounts
§561.42	Savings Account

Reserve Requirements (Regulation D) Program

Examination Objectives

To determine that the institution has procedures in place to comply with Regulation D.

To determine that the institution is in compliance with the reporting and reserve balance requirements of the regulation.

Examination Procedures

Wkp.Ref.

Level I

1. Identify whether the institution prepares a report of deposits and submits it to the Federal Reserve Bank in its district.

2. Determine whether the institution has implemented operating procedures and a system of internal controls to ensure compliance with the reporting requirements.

3. Obtain the institution's records detailing charges incurred or instances of returned forms, indicating inadequate compliance with Regulation D. Determine whether the institution has corrected any problem areas.

4. Determine whether the institution's internal audit program provides adequate coverage to assure that the reporting requirements are monitored on a regular basis. If the institution does not have an internal audit function, a program of management reviews or self audits should include the reporting requirements.

5. Identify whether the institution has procedures in place to identify and monitor the monthly transaction limitations on regular passbook accounts and money market accounts to ensure that they do not exceed regulatory limits.

6. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

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Reserve Requirements (Regulation D) Program

Wkp.Ref.

Level II

7. Review the two most recent reports of deposits to determine whether the items listed are accurate and properly classified.

8. Perform a limited review of all line items on the report of deposits.

9. Perform a review and evaluation of the institution's system of internal controls for Regulation D reporting compliance. Typical internal controls include independent review and verification of forms for accuracy prior to submission and the maintenance of proper supporting documentation.

10. Ensure that the *Objectives* of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

Level III

11. If substantive exceptions are noted in examination procedures 1-5, perform a detailed review of all line items on the report of deposits and reconcile the form line items with the general ledger accounts for the specific time period under review.

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Introduction

A succession of highly publicized failures of government securities broker/dealers occurred from the mid-1970s to the mid-1980s (e.g., Drysdale, Lombard-Wall, E.S.M.) causing large losses to investors. Four practices were common to the failed government securities broker/dealers:

- Selling multiple interests in the same securities under several repurchase agreements while maintaining custody of the securities and the pledging of customer securities without transferring title or possession;
- Inadequate collateral given to customers when the broker/dealer engaged in repurchase transactions with customers or excessive collateral demanded when reversing securities from customers;
- Poor recordkeeping; and
- Inadequate capital.

As a result of these failures and improper practices, Congress was impelled to exercise its authority over the largely unregulated government securities market through passage of the Government Securities Act of 1986 (GSA). The stated purpose of the GSA and its implementing regulations is to enhance the protection of investors in government securities by establishing and enforcing appropriate financial responsibility and custodial standards.

The GSA applies to all financial institutions that engage in government securities activities. For the purposes of the GSA, government securities include:

- U.S. Treasury bills, bonds, and notes;
- Discount notes, bonds, certain collateralized mortgage obligations, pass-throughs, master notes, and other obligations of the Government National Mortgage Association (GNMA), the Federal National Mortgage Association (FNMA), the Federal Home Loan Mortgage Corporation (FHLMC), the Student Loan Mar-

keting Association (SLMA), the Farm Credit System (FCS), and the Financing Corporation; and

- FNMA or FHLMC stock.

"Off-exchange" puts, calls, straddles, and "similar privileges" on government securities are considered to be government securities except for the rules addressing custodial holding of securities.

Custodial Holding Requirements

All thrift institutions that hold government securities as fiduciary, custodian, or otherwise for the account of a customer (including a counterparty to a hold-in-custody repurchase agreement) must comply with the requirements relating to the safeguarding and custody of those securities. All government securities held for customers, including those subject to repurchase agreements with customers, must be segregated from the thrift's own assets and kept free from lien of any third party or the thrift. A thrift that holds securities held for a customer through another institution, a custodian institution, must notify that custodian institution that such securities are customer securities. The custodian institution must maintain the customer securities in an account that is designated for customers of the thrift. The thrift must notify the custodian institution that these securities are to remain free of any lien, charge, or claim. In turn, the custodian institution, upon the instruction of the thrift, is required to treat the securities as customer securities and maintain those securities in accordance with 17 CFR § 450. The custodian institution does not have to keep records that identify individual customers of the thrift.

When a thrift maintains customer securities in an account at a Federal Reserve Bank, it is considered to be in compliance with the requirements to hold customer securities free of lien if any lien of the Federal Reserve Bank or other party claiming through it expressly excludes customer securities.

The thrift is not required to maintain customer securities in a separate custody account at the Federal Reserve Bank, although segregation is encouraged. The thrift must segregate the customers' securities on its own records.

A thrift may lend customer securities held in safekeeping to third parties and remain in compliance with the GSA as long as any securities loans are made under a written agreement with the customer and in compliance with OTS and FFIEC guidelines for securities lending.

An institution engaged in safekeeping U.S. Government securities for customers is required to issue to the customer a confirmation or safekeeping receipt for each government security held that identifies the issuer, maturity date, par amount, and coupon rate of the security being confirmed.

Recordkeeping Requirements

The institution must also maintain a recordkeeping system of government securities held for customers that is separate and distinct from other records of the institution. These records must: (1) identify each customer and each government security held for a customer; (2) describe the customer's interest in the security (e.g., pledged to secure a public deposit), and (3) indicate all receipts and deliveries of securities and cash in connection with the securities. A copy of the safekeeping receipt or confirmation given to customers must be maintained. The institution is required to conduct a count at least annually--and document it within seven days--of physical securities and securities held in book-entry form.

An annual reconciliation with customer account records must also be performed. In order to count securities held outside the thrift, such as book entry securities held at a Federal Reserve Bank, the thrift must reconcile its records to those of the outside custodian. Any securities in transfer, in transit, pledged, loaned, borrowed, deposited, failed to receive or deliver, or subject to a repurchase or reverse repurchase agreement must be verified when they have been out of the thrift's possession for longer than 30 days. All custodial holding requirement records must be maintained in an easily accessible place for at least two years and not disposed of for at least six years. This system of rec-

ords must provide an adequate basis for an audit. Additional information on custodial and fiduciary holdings, including examination procedures and an examination checklist, can be found in Trust Activities Handbook Section 300, Operations and Internal Controls.

Hold-In-Custody Repurchase Agreements

All thrift institutions that engage in repurchase transactions and/or forward repurchase transactions ("forward repos") with customers while retaining custody or control of government securities ("hold-in-custody" repurchase transactions) must comply with the GSA requirements relating to written agreements, confirmations, and disclosures. Forward repos are repurchase and reverse repurchase transactions that settle in a next-day or longer timeframe. Repurchase transactions for the purposes of the GSA may be characterized and accounted for by the parties as either a sale and repurchase of a security or as a secured loan. Securities are considered to be retained in custody even when the securities are maintained through an account at another institution and the securities continue to be under the control of the thrift. All hold-in-custody repurchase transactions are required to be conducted pursuant to a specific written repurchase agreement. If the customer agrees to allow substitution of securities in a hold-in-custody repurchase transaction, then authority for the financial institution to substitute securities must be contained in the written repurchase agreement. In all hold-in-custody repurchase agreements where the financial institution reserves the right to substitute securities, the following disclosure statement must be prominently displayed in the written repurchase agreement immediately preceding the provision allowing the right to substitution:

REQUIRED DISCLOSURE

The (seller) is not permitted to substitute other securities for those subject to this agreement and, therefore, must keep the (buyer's) securities segregated at all times, unless in this agreement the (buyer) grants the (seller) the right to substitute other securities. If the (buyer) grants the right to substitute, this means that the (buyer's) securities will likely be commingled with the (seller's) own securities during the trading day. The (buyer) is

advised that, during any trading day that the (buyer's) securities are commingled with the (seller's) securities, they may be subject to liens granted by the (seller) to third parties and may be used by the (seller) for deliveries on other securities transactions. Whenever the securities are commingled, the (seller's) ability to resegment substitute securities for the (buyer) will be subject to the (seller's) ability to satisfy any lien or to obtain substitute securities.

No editing or paraphrasing of the above language of the required disclosure statement is permitted under the regulation, except for inserting the appropriate names for the buyer and seller. Any thrift issuing a hold-in-custody repurchase agreement must disclose to the customer in writing that the funds held pursuant to the repurchase agreement are not a deposit and are not federally insured.

Written confirmations describing the specific securities subject to the transaction must be sent to the customer by close of business on the day on which the trade takes place, as well as on any day on which substitution of securities occurs. Issuance of confirmations on the trade date for forward repo transactions in government securities is especially important since these transactions usually settle in a longer timeframe than normal settlement. Confirmations must identify the specific securities by issuer, maturity, coupon, the money or the par amount, market value, CUSIP or mortgage pool number of the underlying securities, and whether there are any rights of substitutions. Market value is defined as the most recently available bid price for the security, plus accrued interest.

Pooling of securities as collateral for repurchase agreements is no longer permitted. "Blind pooled" hold-in-custody repurchase transactions occur when a seller does not deliver securities and does not identify specific securities as belonging to specific customers. Instead, the financial institution sets aside, or otherwise designates, a pool of securities to collateralize its outstanding repurchase obligations. The regulations require that the written confirmation sent to a customer must identify the specific securities that are the subject of the hold-in-custody repurchase transaction. A specific security identified to a customer must be in an authorized denomination, that is, in a deliverable par amount.

Broker/Dealer Notification Requirements

A much more limited number of thrift institutions are subject to the broker/dealer notification requirements set forth in the GSA. Thrift institutions that are government securities brokers or dealers are required to notify OTS of their status upon becoming a government securities broker or dealer and to comply with applicable requirements relating to those activities.

A thrift institution will generally be considered a government securities broker if it engages in the following government securities activities:

- Representing itself as a government securities broker or inter-dealer broker, or
- Actively soliciting purchases or sales of government securities on an agency basis.

A thrift institution will generally be considered a government securities dealer if it engages in the following government securities activities:

- Underwriting or participating in a selling group for the sale of government securities;
- Advertising or otherwise representing itself to other dealers or investors as a dealer in government securities; or
- Quoting a market for government securities, and in connection with such quotations, standing ready to purchase or sell government securities.

A thrift institution that buys or sells government securities solely for investment for its own account or accounts for which it acts as fiduciary will not generally be considered as a broker or dealer and subject to notification requirements, even if such purchases and sales are made with some frequency. Although still subject to custodial holding (except for savings bond transactions) and hold-in-custody repurchase agreement requirements, a thrift may engage solely in the following government securities activities without filing a written notice or associated requirements:

- Issuing or handling savings bond transactions (exemption from custodial holding requirements permitted);
- Submitting tenders for the account of customers for purchase on original issues of U.S. Treasury securities;
- Engaging in limited government securities dealer activities, such as entering into repurchase or reverse repurchase agreements, or sales or purchases in a fiduciary capacity; or
- Engaging in limited brokerage activities: either effecting fewer than 500 government securities brokerage transactions per year, or effecting brokerage transactions only through another government securities broker or dealer on a fully disclosed basis where its employees perform only clerical, ministerial, or order-taking functions.

Notice by thrift institutions of their government securities broker or dealer activities is to be filed with OTS on Forms G-FIN and G-FIN-4. Once an institution has filed notice of its status as a government securities broker or dealer, any changes to the status of its filing must be reported within 30 days. If a thrift institution ceases its government securities activities, it must file a notice of termination using Form G-FINW. See Appendix A for exhibits of the current G-FIN and G-FINW forms.

References

Code of Federal Regulations (17 CFR)

Chapter IV: Department of the Treasury

Subchapter A: Regulations under Section 15c of the Securities and Exchange Act of 1934

Subchapter B: Regulations under Title II of the Government Securities Act of 1986

Part 450--Custodial Holdings of Governmental Securities by Depository Institutions

PL 99-571 The Government Securities Act of 1986

Form G-FIN (Department of Treasury) - Notice by Financial Institutions of Government Securities Broker or Government Securities Dealer Activities

Form G-FINW (Department of Treasury) - Notice by Financial Institutions of Termination of Activities as a Government Securities Broker or Government Securities Dealer

Department of Treasury Staff Interpretation of Regulations Implementing the Government Securities Act of 1986 - Letter from Bureau of Public Debt dated April 19, 1996, clarifying GSA record-keeping requirements regarding forward repurchase agreement transactions

OTS Trust Activities Handbook Section 300

Government Securities Act Program

Examination Objectives

To determine that the thrift institution has procedures in place to comply with the GSA.

To determine that the thrift institution is in compliance with the custodial holding requirements, hold-in-custody repurchase agreement requirements, and reporting requirements of the regulation.

Examination Procedures

Wkp.Ref.

Level I

1. Ascertain whether the thrift holds government securities as a fiduciary, custodian, or otherwise for the account of a customer. If so, ascertain whether the institution has procedures in place to maintain segregated assets and records and to conduct an annual count of securities.

2. Ascertain whether the thrift engages in repurchase transactions with customers while retaining custody or control of the government securities. If so, ascertain whether the institution has procedures in place for transaction confirmations.

3. Ascertain whether the thrift is currently or has been a government securities broker or dealer. If so, ascertain whether associated GSA reporting requirements have been met.

4. Review and ascertain whether the institution's internal audit program provides adequate coverage to monitor the extent of applicability of the GSA.

5. Review Level II procedures and perform those necessary to test, support, and present conclusions derived from performance of Level I procedures.

Exam Date: _____
Prepared By: _____
Reviewed By: _____
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Government Securities Act Program

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Level II

6. Review a sample of customer confirmations.

7. Verify that customer securities are, in fact, segregated from those of the thrift.

8. Verify that the recordkeeping system contains sufficient information.

9. Review the annual count of securities.

10. If a custodian institution is used, review a sample of transactions to determine whether the custodian has received appropriate notification.

11. Review a sample of repurchase transactions with customers to validate disclosures and confirmations.

12. Ensure that the *Objectives* of this Handbook Section have been met. State your findings and conclusions, as well as appropriate recommendations for any necessary corrective measures, on the appropriate work papers and report pages.

Exam Date: _____
Prepared By: _____
Reviewed By: _____
Docket #: _____

Form G-FINW**General Instructions for Form G-FINW
Termination of Activities as a Government Securities
Broker or Government Securities Dealer****1. When to file**

A financial institution that has filed a Notice of Government Securities Broker or Government Securities Dealer Activities pursuant to section 15C(a)(1)(B) of the Securities Exchange Act of 1934 must file this notice with its appropriate regulatory agency (ARA) when the financial institution ceases to act as a government securities broker or government securities dealer.

A notice of termination activities as a Government Securities Broker or Government Securities Dealer shall become effective for all matters on the 60th day after filing this notice unless the financial institution is otherwise notified by its ARA.

2. How and where to file: Number of copies

Each financial institution must file two copies of the notice with its ARA, one of which will be sent by the ARA to the SEC. Both copies of this Notice filed with the ARA shall be executed with a manual signature in item 5. The Notice shall be signed in the name of the financial institution by a principal officer who was directly engaged in the management, direction, or supervision of the financial institution's government securities broker or dealer activities.

Form G-FIN

Reporting Burden—Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of the collection of information, including suggestions for reducing this burden, to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, D.C. 20503, and to one of the following: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, D.C. 20551; Assistant Executive Secretary (Administration), Room F-400, Federal Deposit Insurance Corporation, Washington, D.C. 20429; Legislative and Regulatory Analysis Division, Office of the Comptroller of the Currency, Washington, D.C. 20219; Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, D.C. 20552; or to Securities and Exchange Commission, 450 Fifth Street, NW, Washington, D.C. 20549.

Notice By Financial Institutions of Government Securities Broker or Government Securities Dealer Activities

(This booklet includes instructions and blank forms)



Board of Governors of the Federal Reserve System



Federal Deposit Insurance Corporation



Office of the Comptroller of the Currency



Office of Thrift Supervision



Securities and Exchange Commission

NOTICE REQUIREMENTS

This notice must be filed by all financial institutions that are government securities brokers or government securities dealers that are not exempt from the notice requirement under regulations of the Department of Treasury. Generally, a financial institution will not be required to file as a government securities broker or dealer if its only government securities activities are to: (1) Buy or sell government securities solely for investment for its own account; (2) Buy or sell government securities for fiduciary accounts; (3) Handle savings bond trans-

actions; (4) Submit tenders for the account of customers for purchase on original issue of U.S. Treasury securities; (5) Enter into repurchase or reverse repurchase agreements; (6) Effect fewer than 500 government securities brokerage transactions per year; (7) Effect brokerage transactions only through another government securities broker or dealer on a fully disclosed basis; or (8) Effect brokerage transactions that do not involve active solicitations.

For further information on the requirements to file this notice, please refer to the instructions.

Form G-FIN

FR G-FIN
OMB No. 7100-0224
Approval expires February 28, 1998

OFFICIAL USE

**Notice of Government Securities Broker or Government Securities Dealer Activities
To Be Filed by a Financial Institution Under Section 15C(a)(1)(B)
of the Securities Exchange Act of 1934**

1. Appropriate regulatory agency (check one):
- A. Comptroller of the Currency
 - B. Board of Governors of the Federal Reserve System
 - C. Federal Deposit Insurance Corporation
 - D. Office of Thrift Supervision
 - E. Securities and Exchange Commission
2. Conducts business as:
- A. Government Securities Broker
 - B. Government Securities Dealer
 - C. Government Securities Broker and Dealer
3. Filing status of notice:
- A. Notice
 - B. Amendment
4. A. Full name of the Financial Institution:
- _____
- B. Address of principal office of Financial Institution:
- _____
- C. Address of principal office where government securities broker or government securities dealer activities will be conducted (if different than item (B)):
- _____
- D. Mailing address if different from (B) or (C):
- _____
- E. Name, title and telephone number of contact person with respect to this notice:
- | | | |
|------|-------|-----------|
| | | |
| Name | Title | Telephone |
5. Does Financial Institution conduct, or will it conduct, government securities broker or government securities dealer activities at any location other than given in Question 4 above? A. Yes B. No
- (If yes, provide addresses and describe activities.)
- _____
- _____
- _____
- _____
- _____

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6. Furnish the name and title of each person who is directly engaged in the management, direction or supervision of any of the financial institution's government securities broker or government securities dealer activities:

Full Name

Last	First	Middle	Title
Last	First	Middle	Title
Last	First	Middle	Title
Last	First	Middle	Title
Last	First	Middle	Title

Note: Attach a separate Form G-FIN-4 (or, if previously filed, a copy of Form MSD-4 or Form U-4) for each person named in response to this item 6.

7. Has any "associated person" (see definition in paragraph A.7. of the instructions) responded "yes" to any question in Item 17 of Form G-FIN-4, or "yes" to one or more questions in Items 23 through 26 of Form MSD-4 or Item 22 on Form U-4?

A. Yes B. No

(If yes, attach a copy of Form G-FIN-4, Form MSD-4, or Form U-4 for all such persons with this Notice.)

Note: The financial institution and the person executing this form are responsible for making an inquiry of all other employers of any associated person during the immediately preceding three years for the purpose of verifying the accuracy of the information furnished on Form G-FIN-4. (See 17 C.F.R. 400.4(c)). Similar requirements are applicable to Form MSD-4 and Form U-4.

8. The financial institution submitting this notice and the person executing it represent that all of the information contained herein is true, current and complete.

Please print name and title of person executing this notice:

First	Middle	Last	Title

Manual Signature	Date

Form G-FIN

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**Instructions for Completing Notice of Government
Securities Broker or Government Securities Dealer
Activities by Financial Institutions**

GENERAL INFORMATION AND INSTRUCTIONS**A. Terms and Abbreviations**

1. "Act" refers to the Securities Exchange Act of 1934, as amended by the Government Securities Act of 1986.
2. "ARA" refers to the financial institution's appropriate regulatory agency, as defined in section 3(a)(34)(G) of the Act. See general instruction (E) below for a listing of appropriate regulatory agencies.
3. "Government securities" are defined in section 3(a)(42) of the Act. In general, this term refers to direct obligations of or obligations guaranteed as to principal or interest by the United States; securities issued or guaranteed as to principal or interest by corporations designated by statute or by the Secretary of the Treasury to constitute exempt securities; and puts, calls, straddles or options on such securities. Although not all inclusive, the following are the more common types of government securities covered by the term: U.S. Treasury bills, bonds, notes; discount notes, bonds, certain collateralized mortgage obligations, pass throughs, master notes, and other obligations of the Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA), Federal Home Loan Mortgage Corporation (FHLMC), Student Loan Marketing Association (SLMA), Federal Home Loan Banks and Farm Credit Banks; securitized Small Business Association (SBA) loans; and FNMA stock.
4. "Government securities broker" is defined in section 3(a)(43) of the Act. In general, this term refers to a financial institution that is regularly engaged in the business of effecting transactions in government securities for the account of others.
5. "Government securities dealer" is defined in section 3(a)(44) of the Act. In general, this term refers to a financial institution engaged in the business of buying and selling government securities for its own account but does not include a financial institution insofar as it buys or sells securities for its own account but not as a part of its regular business or in a fiduciary capacity.
6. "Financial institution" is defined in Section 3(a)(46) of the Act. In general, the term refers to any national or State chartered bank or trust company which is supervised and examined by a State or Federal bank supervisory agency, a foreign bank, and any other institution whose deposits were formerly insured by the Federal Savings and Loan Insurance Corporation.
7. "Associated person" is defined by Treasury regulation (17 C.F.R. 400.3(c)) to mean a person directly engaged in any of the following activities in either a supervisory or non-supervisory capacity: underwriting, trading or sales of government securities; financial advisory or consultant services for issuers in connection with the issuance of government securities;

other communications with public investors, or research or investment advice other than general economic information or advice, with respect to government securities in connection with the activities described above. The term is further defined in Section 400.3(c) to cover persons engaged in the following activities in a supervisory capacity: processing and clearance activities with respect to government securities and maintenance of records involving any of the activities described in this paragraph.

This definition does not include directors and senior officers of the financial institution who may from time to time set broad policy guidelines affecting the financial institution as a whole, but are not directly involved in the conduct of the financial institution's government securities business on a day-to-day basis. It also does not cover persons whose functions are solely clerical or ministerial, persons who are acting in a fiduciary capacity, or persons who act solely as order takers without giving investment advice or receiving transaction-based compensation.

B. Who Must File?

Under Section 15C(a)(1)(B) of the Act, any financial institution that is a government securities broker or government securities dealer within the foregoing definitions must file with its ARA a written notice, on the form prescribed herein, except as described below.

A financial institution that buys and sells securities solely for investment for its own account or for accounts for which it acts as a fiduciary will not generally be classified as a dealer, even though such purchases and sales are made with some frequency. Virtually every financial institution purchases government securities for investment; and purchases and sales may occur to accommodate changes in the financial institution's financial position or to reflect investment decisions. The legislative history of the Act indicates that Congress did not intend to require financial institutions engaged in such investment-type activity to register as dealers.

The Department of the Treasury has exempted financial institutions that engage solely in the following activities:

- (1) Acting as issuing agent, payment agent or forwarding agent for U.S. Savings Bonds (17 C.F.R. 401.1);
- (2) submission of tenders for the account of customers for purchase on original issue of U.S. Treasury securities (17 C.F.R. 401.2);
- (3) the sale and subsequent repurchase and the purchase and subsequent resale of government securities pursuant to a repurchase or reverse repurchase agreement (17 C.F.R. 401.4); or
- (4) sales or purchases in a fiduciary capacity (17 C.F.R. 401.4).

In general, government securities activities that may bring a financial institution within the definition of government securities dealer include the following: (1) underwriting or participating in a

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selling group for the sale of government securities; (2) advertising or otherwise holding itself out to other dealers or investors as a dealer in government securities; or (3) quoting a market for government securities, and in connection with such quotations, standing ready to purchase or sell government securities.

The Department of the Treasury also has exempted (17 C.F.R. 401.3) any financial institution from the definition of government securities broker unless it (1) holds itself out as a government securities broker or interdealer broker; or (2) actively solicits individual purchases or sales of government securities on an agency basis. In addition, a financial institution will be exempt if it (a) effects less than 500 brokerage transactions per year or (b) except for U.S. Savings Bonds and submissions of tenders for U.S. Treasury securities (as described above), effects all brokerage transactions through a government securities broker or dealer who is clearly identified as the entity providing the brokerage services, and who meets the other conditions of the exemption.

A branch or agency of a foreign bank that engages in government securities transactions solely with non-U.S. citizens that are resident outside the United States is also exempt (17 C.F.R. 401.6).

C. When to file

A financial institution that was acting as a government securities broker or government securities dealer on July 25, 1987, was required to file a notice with its ARA on or before that date. Any financial institution that proposes to act as a government securities broker or government securities dealer after that date shall file the notice before it commences operations.

D. Amendments

In the event any of the information previously submitted on this notice becomes incomplete, inaccurate or no longer applicable, the notice must be amended. This amendment must be filed within 30 calendar days of the notice becoming inaccurate (17 C.F.R. 400.5(b)).

Items 1, 2, 3, 4, and 8 of the notice shall be completed for each amendment. Otherwise, only those items which are being amended need to be completed.

E. How and where to file: Number of copies

Each financial institution must file two copies of the notice and each amendment with its ARA, one of which will be sent by the ARA to the SEC. Retain one exact copy for your records. A financial institution may determine the name and address of its ARA from the following:

1. A national bank, a bank operating in the District of Columbia that is examined by the Comptroller of the Currency, or a Federal branch or Federal agency of a foreign bank, files with the:

Office of the Comptroller of the Currency
Administrator of National Banks
Compliance Programs
Washington, D.C. 20219

2. A State member bank of the Federal Reserve System, a foreign bank, an uninsured State branch or a State agency of a foreign bank, a commercial lending company owned or controlled by a foreign bank, or an Edge corporation files with the:

Board of Governors of the
Federal Reserve System
Division of Banking Supervision & Regulation
Securities Regulation Section
Washington, D.C. 20551

3. A bank insured by the Federal Deposit Insurance Corporation (other than a bank which is a member of the Federal Reserve System or a Federal savings bank) or an insured branch of a foreign bank files with the:

Federal Deposit Insurance Corporation
Division of Bank Supervision
Securities Analysis Unit
Washington, D.C. 20429

4. A Federal savings and loan association, Federal savings bank, or an institution formerly insured by the Federal Savings and Loan Insurance Corporation, files with the:

Office of Thrift Supervision
Office of the General Counsel
Corporate and Securities Division
1700 G Street, N.W.
Washington, D.C. 20552

5. A State chartered bank or a State chartered trust company that is not a member of the Federal Reserve System and whose deposits are not insured by the Federal Deposit Insurance Corporation, or any other financial institution not described in the preceding paragraphs, files with the:

Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

F. Privacy Act Notice

Collection of the information to be supplied on this form is authorized by section 15C(a)(1)(B) of the Securities Exchange Act of 1934, 15 U.S.C. 78o-5(a)(1)(B). Disclosure is mandatory for all financial institutions that act as government securities brokers or government securities dealers that are not exempted from filing under Treasury Department regulations (see 17 C.F.R. Part 401). The principal purpose of this notice is to identify to the appropriate regulatory agencies those financial institutions that act as government securities brokers or government securities dealers and are subject to regulation under the Act. Information supplied on this form will be included routinely in the public files of the appropriate regulatory agencies and will be available for inspection by any interested person. In addition, the Securities and Exchange Commission will maintain copies of all G-FIN notices in the public files, and will make them available for public inspection by any interested person. Financial institutions that do not provide the information solicited on this form may not lawfully act as government securities brokers or government securities dealers unless exempt from the notice requirement by Treasury Department regulation (17 C.F.R. Part 401).

Form G-FINW

Reporting Burden—Public reporting burden for this collection of information is estimated to average 15 minutes per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of the collection of information, including suggestions for reducing this burden, to the Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, D.C. 20503, and to one of the following: Secretary, Board of Governors of the Federal Reserve System, 20th and C Streets, NW, Washington, D.C. 20551; Assistant Executive Secretary (Administration), Room F-400, Federal Deposit Insurance Corporation, Washington, D.C. 20429; Legislative and Regulatory Analysis Division, Office of the Comptroller of the Currency, Washington, D.C. 20219; Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, D.C. 20552; or to Securities and Exchange Commission, 450 Fifth Street, NW, Washington, D.C. 20549.

Notice By Financial Institutions of Termination of Activities as a Government Securities Broker or Government Securities Dealer

(This booklet includes instructions and blank forms)



Board of Governors of the Federal Reserve System



Federal Deposit Insurance Corporation



Office of the Comptroller of the Currency



Office of Thrift Supervision



Securities and Exchange Commission

Form G-FINW

FR G-FINW
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Approval expires February 28, 1998

OFFICIAL USE

Notice by Financial Institutions of Termination of Activities as a Government Securities Broker or Government Securities Dealer

1. Appropriate regulatory agency (check one):

- A. Comptroller of the Currency
- B. Board of Governors of the Federal Reserve System
- C. Federal Deposit Insurance Corporation
- D. Office of Thrift Supervision
- E. Securities and Exchange Commission

2. (a) Full name of the Financial Institution:

(b) Address of principal office of Financial Institution:

(c) Mailing address if different from (b):

3. Furnish the name and address of the person who has or will have custody or possession of the financial institution's books and records with respect to the financial institution's activities as a government securities broker or government securities dealer:

Full Name

Last First Middle

Address

4. Furnish the address of the place where such books and records will be located:

5. The financial institution submitting this notice of termination of activities and the person executing it represent that all of the information contained herein is true, current and complete.

Please print name and title of person executing this notice:

First Middle Last Title

Manual Signature Date