

## Operations and Accomplishments

To achieve its strategic goals and accomplish its mission, the OCC separates its activities into three major program areas: supervise, regulate, and charter. The OCC formulates its budget and tracks costs and full-time equivalents<sup>2</sup> (FTE) by these programs. The OCC's most significant accomplishments and activities for FY 2004 are discussed by program.

### Supervise Program

This program encompasses the supervision of national banks and their subsidiaries, federal branches and agencies<sup>3</sup> of foreign banks, national trust companies, bank data software vendors, and data processing service providers. This program also consists of activities to identify, analyze, and respond to emerging systemic risks and trends that could affect an individual national bank or the entire national banking system. The Committee on Bank Supervision establishes and oversees areas of emphasis for the OCC's supervisory activities. The committee is comprised of the Chief National Bank Examiner and the senior deputy comptrollers for Large Bank Supervision and Mid-size/Community Bank Supervision. These activities support the OCC's strategic goals of a safe and sound national banking system and fair access to financial services and fair treatment of bank customers.

The supervise program, by far the largest program, is the core for accomplishing the OCC's mission. The OCC for FY 2004 devoted 2,212 FTEs or 82 percent of total FTEs to the supervise program, while the cost of the program was \$392.1 million.

Two business lines reside within the supervise program, large banks and mid-size/community banks. The mid-size/community bank business line consists of mid-size banks, credit card banks, community banks, and federal branches and agencies. The business line approach recognizes that institutions of varying sizes and complexity present different risks and require unique supervision philosophies.

The OCC's large bank program is responsible for supervising the 25 largest and most complex national banking companies, using teams of dedicated onsite examiners. During FY 2004, areas of supervisory emphasis for the large bank program included credit quality and credit risk management, corporate governance, assessing the impact of Basel II, the integrity of banks' financial statements, ensuring adherence to accepted accounting practices, allowance for loan and lease loss reserve procedures and adequacy, and operational related vulnerabilities.

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<sup>2</sup>Full-time equivalent is the number of paid hours accumulated during an entire fiscal year by a full-time position (40 hours per week). Generally, this is between 2,080 and 2,096 hours depending on the number of paid days that fall within a given year.

<sup>3</sup>Federal branches and agencies are branches and agencies licensed by the OCC and operated by foreign banking organizations. Federal agencies are offices that engage in the business of banking but do not accept deposits or exercise fiduciary powers.

There are 27 banking companies in the OCC's mid-size bank program and 21 companies in the OCC's credit card bank program. During FY 2004, areas of supervisory emphasis for the mid-size and credit card bank programs included commercial real estate, BSA/AML reviews, emerging credit risks, consumer compliance, and the effectiveness of risk management programs and controls.

The vast majority of banks in the OCC's community bank program have less than \$1 billion in total assets. Banks are assigned to an OCC portfolio manager who oversees the supervisory strategies for the banks. These strategies combine onsite examinations and off-site analysis to monitor bank performance. During FY 2004, areas of supervisory emphasis for the community bank program included credit quality, adequacy of the allowance for loan and lease losses, liquidity monitoring and contingency plans, interest rate risk monitoring and controls, and banks' increasing reliance on noninterest income.

The supervise program is further divided into three subprograms: examining, enforcing, and ensuring fair access and fair treatment. These are discussed in more detail as follows.

### ***Examining***

At the beginning of FY 2004, the OCC completed the transition to a continuous supervision process in the community bank program. This process had previously been adopted in the large bank, mid-size, and credit card bank programs. Under this process, a supervisory strategy is developed based on the risk profile and condition of each banking institution. The strategy includes a variety of supervisory activities, both examinations and off-site analyses, to be completed throughout a supervisory cycle. Examination activities include safety and soundness, consumer compliance, information technology, and asset management examinations. The supervisory cycle conforms to either a 12- or 18-month time frame, depending on the size, complexity, and condition of the bank. All large and mid-size banks, credit card banks, and federal branches are on a 12-month supervisory cycle. At the end of each bank's cycle, OCC examiners certify the completion of the supervisory strategy and onsite activities, assign CAMELS ratings, and communicate their findings to the bank.

The OCC completed and certified 1,642 supervisory strategies during FY 2004. Included in this number are strategy certifications for all large, mid-size, and credit card banks; all federal branches and agencies; and more than 82 percent of community banks. In addition to strategy certification activities, the OCC conducted 486 CRA examinations, which are on either an 18- or 36-month cycle.

The supervisory strategy certifications completed during FY 2004 show that national banks continued to operate in a safe and sound manner as shown by assigned CAMELS ratings and assessments of capital levels. For the past four years, 98 or 99 percent of all national banks have been well-capitalized. Similarly, 94 or 95 percent of all national banks received a CAMELS rating of 1 or 2 each year, since FY 2001. The OCC also exceeded all of its customer service standards for examination activities. The customer service results were based on 690 examination surveys completed by banks for the period, July 2003 through June 2004, a 40 percent response rate. The survey is based on a five-point scale, in which 1 indicates complete agreement and 5 indicates complete disagreement with the survey statements.

Table 1 shows the results of the examining performance measures.

**Table 1: Examining Performance Measures, FY 2001 – FY 2004**

Performance Measures	FY 2001	FY 2002	FY 2003	FY 2004 Target	FY 2004 Actual <sup>4</sup>
Percentage of national banks that are well-capitalized	98%	99%	99%	95%	<b>99%</b>
Percentage of national banks with composite CAMELS rating of 1 or 2	94%	95%	94%	90%	<b>94%</b>
Average survey response that the examiner-in-charge and the examination team were knowledgeable	N/A	N/A	1.26	≤ 1.5	1.34
Average survey response that the examiner's requests for information before and during the examination were reasonable and justified by the examination scope	1.36	1.36	1.31	≤ 1.75	1.36
Average survey response that the examination team conducted the examination in a professional manner	1.21	1.21	1.20	≤ 1.75	1.25
Average survey response that during exit and board meetings, the examiner-in-charge and examination team clearly and effectively communicated their findings and concerns	1.33	1.32	1.27	≤ 1.75	1.37
Average survey response that the report of examination clearly communicated examination findings, significant issues, and the corrective actions (including time frames) management needed to take	1.31	1.30	1.26	≤ 1.75	1.30
Average survey response that ongoing communication by the examiner-in-charge with senior management and the board was appropriate	1.29	1.29	1.25	≤ 1.75	1.30

### Commercial Real Estate Review

The OCC completed a review of commercial real estate lending across mid-size banks during FY 2004. The review identified some fundamental weaknesses related to systems and controls for commercial real estate lending as well as best practices related to commercial real estate lending and the management of concentrations of credit. As an outgrowth of this review, the OCC and other federal bank regulatory agencies issued guidance reminding banks about the existing standards for independence outlined in the real estate appraisal and lending regulations, and the Interagency Appraisal and Evaluation Guidelines.

### On-the-Job Bank Examination Training for Newly Hired Bank Examiners

In FY 2003 the OCC embarked on a recruitment program for entry-level bank examiners. This initiative is critical to the OCC in light of the number of examiners who are expected to retire over the next five years, as well as the need to deploy more experienced examiners to supervise the new mid-size and large banks entering the national banking system. Newly hired bank examiners join a training team led by experienced examiners and receive on-the-job experience examining banks for their first six to eight months with the OCC. During FY 2004, 19 training teams with 74 entry-level bank examiners hired in June 2003 and January 2004 completed their training team assignments and were placed in permanent field office locations in the community bank line of business. During June 2004, nine new training teams commenced their on-the-job examiner training. This group of 40 examiners is expected to join community bank field offices in the first half of FY 2005. Additional details on this initiative are included in the *Human Capital* section of this report.

<sup>4</sup>Performance numbers shown in bold italics are estimates. Some performance data is obtained from quarterly call reports from banks. The September 30, 2004 call reports are not due until 30 or 45 days after the end of the period. Additionally, examinations concluded late in the fiscal year are not finalized for 30 to 60 days. As a result, complete fiscal year data is not yet available and estimates are reported.

## **Enhancements to the Financial Institution Data Retrieval System**

The Financial Institution Data Retrieval System (FINDRS) provides bank supervision staff quick and easy access to a database of information about holding companies, banks, Electronic Data Processing (EDP) servicers, and federal branches. FINDRS information comes primarily from reports of condition by banks and holding companies. Users can create systemic and comparative analysis reports, as well as reports on specific institutions.

During FY 2004, FINDRS added reports on performance and peer averages for bank holding companies and federal branches. Standard reports for groups of banks were also added, such as Asset Mix Indicators, Asset Quality Indicators, Capital Indicators, Earnings Indicators, Interest Rate Risk Indicators, and Liquidity Indicators. The OCC continued to train its supervision staff in the use of FINDRS in FY 2004. During the 18-month period ending July 31, 2004, more than 1,100 persons used the FINDRS application to generate reports.

## **Large Bank Credit Tool**

The Large Bank Credit Tool (LBCT) helps Large Bank examiners assess industry segments in commercial and industrial loan portfolios that are likely to improve or deteriorate over the next 12 months under “consensus” and “pessimistic” economic scenarios. The commercial real estate portion of the LBCT compares a bank’s outlook for its commercial real estate lending products with consensus and pessimistic views from a third party. LBCT allows examiners to plan their supervision more efficiently and helps them identify vulnerable industries and markets for increased supervision. The OCC is currently piloting the use of LBCT and plans to explore further applications in FY 2005.

## **Risk Committees**

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

## **National Bank Appeals**

The national bank appeals process resolves individual appeals and inquiries from national banks. The Ombudsman, with the consent of the Comptroller, has the discretion to stay any agency decision or action pending resolution of an appealable matter. The Ombudsman’s office processed approximately 150 substantive inquiries, including formal and informal appeals, during the year.

## ***Enforcing***

Enforcement activities ensure that corrective action is taken to address violations of laws, rules, regulations, and non-compliance with policies or procedures by national banks, their insiders, and other affiliated parties. Activities include the OCC’s formal enforcement actions, as well as informal actions to support prompt

detection and mitigation of problems before they affect a bank's viability. The OCC conducts investigations, takes administrative actions, and litigates those actions.

During FY 2004, the OCC took formal and informal enforcement actions against national banks and institution-affiliated parties who engaged in violations of laws and regulations or unsafe or unsound banking practices. The actions included temporary cease-and-desist orders, final cease-and-desist orders, removal or prohibition orders, civil monetary penalties (CMPs), and formal agreements. The OCC's Fast Track Enforcement Program helps ensure that bank insiders and employees who have committed criminal acts involving banks, but who are not being criminally prosecuted, are prohibited from working in the banking system. This program resulted in several prohibitions and personal cease-and-desist orders during FY 2004. Table 2 summarizes all enforcement actions completed in FY 2004.

**Table 2: Enforcement Actions, FY 2004**

Type of Enforcement Action	FY 2004	
	Against National Banks	Against Institution-Affiliated Parties
Cease-and-Desist Orders	19	24
Temporary Cease-and-Desist Orders	-	1
Civil Monetary Penalties	4	44
Civil Monetary Penalties Amount Assessed	\$25,061,950	\$553,500
Formal Agreements	40	-
Memoranda of Understanding	10	-
Commitment Letters	10	-
Suspension Orders	-	3
Letters of Reprimand	-	27
12 USC 1818 Removal/Prohibition Orders	-	37
12 USC 1829 Prohibitions	-	238
<b>Total Enforcement Actions</b>	<b>83</b>	<b>374</b>

### Bank Secrecy Act/Anti-Money Laundering

The OCC investigates and brings enforcement actions against national banks that fail to meet BSA/AML requirements to report suspicious transactions. The OCC coordinates with other regulatory and law enforcement authorities to ensure compliance with BSA/AML provisions and detect, track, and prevent domestic and foreign criminals and terrorists who would attempt to use the national banking system to facilitate the financing of their activities. A more comprehensive discussion of BSA/AML initiatives is in the *Partnership and Outreach* section of this report.

The OCC brought enforcement actions against several banks for inadequate BSA/AML compliance programs. Among other requirements, banks were ordered to provide internal controls, auditing, the designation of BSA compliance officers, and employee training programs. For example, the OCC assessed a \$25 million CMP against one bank for numerous BSA/AML violations upon discovering that the bank failed to implement an effective AML program.

## Unfair and Deceptive Acts or Practices

The OCC continues to respond vigorously to abusive, unfair, or deceptive business practices by national banks, thereby promoting fair treatment of bank customers and fair access to financial services for all Americans.

- The OCC brought a cease-and-desist and restitution action against a credit card bank that offered secured credit cards to people with impaired credit histories and encouraged them to charge a \$200 security deposit to the card. After paying various fees, customers who received the bank's minimum credit line of \$260 had only \$2.50 in available credit. Nearly half of the people who enrolled in the program defaulted, damaging their credit ratings. In bringing an enforcement action, the OCC prohibited the bank from charging customer security deposits to credit cards and from charging interest on security deposits, and prohibited the bank from accepting deposits to fund its operations. The bank was required to set aside \$10 million to pay restitution to affected customers.
- The OCC brought a cease-and-desist and restitution action against a bank for violating several consumer protection laws by charging duplicative fees and unearned service fees, failing to provide required consumer disclosures, and other violations. The OCC ordered the bank to make \$288,000 in restitution to affected customers and improve its consumer compliance program.

## Credit Card Bank and Trust Bank Supervision

The OCC addresses supervisory concerns related to Competitive Equality Bank Act (CEBA) credit card banks and trust banks through operating agreements, liquidity reserve deposit accounts (LRDAs), and capital assurance and liquidity maintenance agreements (CALMAs). The OCC uses operating agreements in pending corporate applications by banks to address specific areas of supervisory concern. For example, banks can be required to achieve capital levels that exceed regulatory minimums; maintain sufficient liquid assets, as defined by the operating agreement, to meet the bank's daily liquidity needs; submit and comply with business plans; or establish and maintain a LRDA at a third-party depository institution or Federal Reserve Bank. CALMAs are agreements between the bank and its parent requiring the parent to provide capital and liquidity support to the bank.

"Rent-a-charter" is a practice in which a nonbank company contracts with a national bank, thereby enabling the nonbank company to conduct an aspect of its business through the national charter and prompting the company to claim that its activities enjoy the benefits of a national charter. The OCC brought an enforcement action against an uninsured trust bank that engaged in rent-a-charter activities and failed to maintain proper internal controls, and conducted other unsafe and unsound practices. The OCC and the trust bank entered into a formal agreement, which required the trust bank to maintain appropriate capital and liquidity levels; establish and maintain appropriate management structures, risk controls, and audit processes; and remedy violations of law.

## Actions to Combat Insider Abuse

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

- The OCC initiated an enforcement action against a former bank chief executive officer (CEO) and president who originated highly questionable loans that collectively violated the bank's legal

lending limit. The loans involved nominee borrowers, use of proceeds for purposes other than those identified in loan documentation, and use of proceeds from newer loans to keep other loans current. Funds were disbursed to certain borrowers while record keeping entries concealed the true nature of the transactions. Without admitting or denying liability, this former insider agreed to a consent order prohibiting him from banking, and requiring him to divest himself of his stock in the bank and pay \$50,000 in restitution.

- The OCC brought an enforcement action against a former insider for engaging in unsafe and unsound practices and other misconduct, including preparing a loan application without verifying loan information and without performing a credit analysis, failing to disclose the true purpose of the loan, signing off on the loan under the above-described circumstances, and maintaining insufficient loan documentation. Without admitting or denying liability, this former insider consented to a personal cease-and-desist order and agreed to pay a \$20,000 CMP.
- The OCC initiated an enforcement action against a bank's attorney, who through erroneous legal advice caused the bank to pay an illegal golden parachute package to the spouse of the bank's chairman. Without admitting or denying liability, this attorney consented to the OCC's issuance of a personal cease-and-desist order prohibiting him from providing legal representation, directly or indirectly, to any insured depository institution, requiring him to pay a \$25,000 CMP and \$195,000 in restitution.
- The OCC initiated an enforcement action against a former chairman and CEO of a bank who engaged in unsafe and unsound practices, and breached his fiduciary duty to the bank. He facilitated the bank's purchase of discounted assets at par value in connection with adjusted price trades and enabled the restructuring of certain customers' exposure to avoid delinquency without recognizing Allocated Transfer Risk Reserves (ATRRs) on the exposure. This caused the bank to overstate its earnings and conceal losses, while exposing it to additional losses. Further, this insider negotiated unsafe and unsound terms for a loan and approved the loan based on grossly insufficient credit analysis and documentation. Without admitting or denying liability, this former insider consented to an OCC order prohibiting him from banking, requiring him to pay a \$40,000 CMP and \$960,000 in restitution.

## **Early Intervention**

The OCC continues to supervise problem banks aggressively, ensuring prompt corrective action, early intervention, and least-cost resolution. To minimize losses to the FDIC bank insurance fund, the OCC uses a program of structured early intervention and resolution strategies for banks that are being rehabilitated and returned to district supervision; going through voluntary liquidation; being sold or merged; or closed. In those circumstances, OCC orders can require the bank to submit a plan to sell, merge, or liquidate at no loss or cost to the bank insurance fund, should certain triggering events occur affecting the bank's condition.

The OCC took responsible action on all banks within 90 days of becoming critically undercapitalized. The OCC also worked diligently to rehabilitate problem banks identified at the end of FY 2003. Of the 121 institutions with a CAMELS rating of 3, 4, or 5 on September 30, 2003, 36 had improved CAMELS ratings by the end of FY 2004. Another 14 of the 121 banks were sold, merged or left the system without loss to the insurance fund during the year. The OCC achieved a 41 percent rehabilitation rate exceeding the performance target of 40 percent. This was an increase over the 32 percent achieved in FY 2003.

## **Ensuring Fair Access and Fair Treatment**

Activities in this subprogram include:

- Conducting risk-based fair lending examinations.
- Educating community and consumer organizations, and facilitating their interactions with the OCC.
- Researching new opportunities for community development financing and publishing best practices.
- Conducting outreach to national banks to assist them in meeting their obligations under the CRA rules.
- Meeting with people and groups protesting banks' corporate applications.
- Reviewing or approving individual bank community development activities.
- Reviewing issues related to fair access to financial services and fair treatment of bank customers.

The OCC completed the integration of compliance risk supervision into ongoing supervision activities for national banks. Overall, consumer compliance ratings for national banks remained at a high level during FY 2004. The OCC's performance in this subprogram is depicted in Table 3.

**Table 3: Ensuring Fair Access and Fair Treatment Performance Measures, FY 2001 – FY 2004**

Performance Measures	FY 2001	FY 2002	FY 2003	FY 2004 Target	FY 2004 Actual
Percentage of national banks with consumer compliance rating of 1 or 2	N/A	N/A	96%	94%	<b>96%</b>
Percentage of community banks that are within one year of their first large bank Community Reinvestment Act examinations in which the OCC offers to provide consultation on community development opportunities	N/A	N/A	100%	100%	100%
Percentage of consumer complaints closed within 60 calendar days of receipt	N/A	N/A	87%	80%	74%

### **Consumer Complaints**

The Customer Assistance Group (CAG) reviews and processes complaints from consumers of national banks and their operating subsidiaries. The CAG has highly trained compliance professionals equipped to deliver responsive customer service. The operation employs state-of-the art call center technology with bilingual call routing (English and Spanish), a Web-based complaint resolution process, and Internet and FAX access 365 days a year.

During FY 2004, the CAG received 66,864 calls, opened 68,026 cases, and closed 68,104 cases. Of the cases closed, 74 percent were completed within 60 calendar days of receipt. This was a decline from 87 percent in FY 2003. Although the number of consumer complaint cases declined by 9 percent from FY 2003, the increase in complexity of written cases and a decline in the number of cases that could be closed over the phone contributed to the CAG missing the performance goal this year. Management expects to meet this goal in FY 2005 by adding staff and increasing the efficient and effective use of technology.

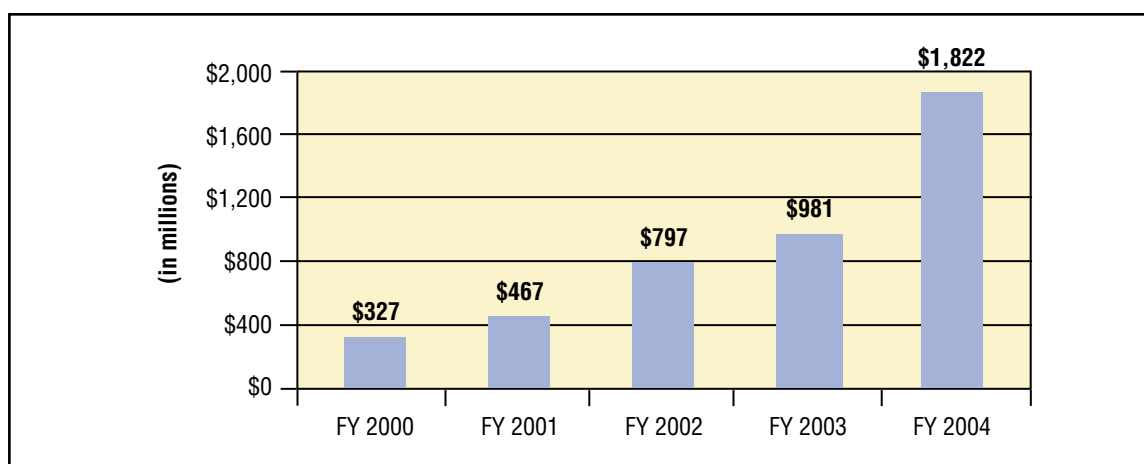


In FY 2004, the CAG improved its procedures for processing consumer referrals from states attorneys general and state departments of banking. The CAG expanded its phone hours by more than 20 percent including inbound call service on Fridays, beginning October 1, 2004. These enhancements strengthen the OCC's ability to provide high quality customer service and financial education to customers of national banks and their operating subsidiaries. Throughout its operation, the CAG has maintained a philosophy of resolving cases on first contact whenever possible.

## Community Affairs

In January 2004, the OCC identified national banks that would receive their first large bank CRA examination in the next 12 months and offered to consult with each bank. The Community Affairs staff conducted 230 bank consultations to those and other national banks during FY 2004. Consultations covered strategies for national banks' responsibilities under CRA, including local and regional investment opportunities; the OCC's regulations for community development investments; federal low-income housing tax credits; and new markets tax credits. Over the past few years, as the number of these bank consultations have increased, there has been significant increases in the amount of investments national banks have made under the OCC's community development investment regulation (12 CFR 24) as exhibited in Figure 2.

**Figure 2: National Bank "Part 24" Community Development Investments, FY 2000 – FY 2004**



In addition, the OCC met with community and consumer organizations, as well as a national civil rights organization about payroll stored value cards, refund anticipation loans, predatory lending, payday lending, financial literacy, and other consumer issues. These meetings provided the OCC with insights about challenges and opportunities for better access to financial services for consumers in disadvantaged communities. Additional activities are discussed in the *Industry and Community Outreach* section of this report.

## OCC Examiners Assist Iraqi Government to Establish Effective Bank Supervision

This year four OCC examiners stepped out of their routine into hazardous duty to help design and implement a bank supervision system in Iraq.



*From left to right; Steven Strasser, Cathryn Fitzgerald, Marty Wiseman, and Steve Lane*

Enduring dangerous conditions for six months, Steven Strasser and Marty Wiseman of Operational Risk Policy, and Cathryn FitzGerald and Steve Lane of Large Bank Supervision helped establish the foundation for a modern Iraqi banking system in vital areas:

- In consultation with the Iraqis, updated the Basel Core Assessment initiated by the Treasury's Iraqi task force and provided management training to convert assessment recommendations into a strategic planning process.
- Using OCC community bank examination procedures, created a risk-based training module designed to provide tools and techniques to the Iraqi Central Bank supervisors. All full time supervisors participated in two one-week seminars.
- Supplied guidance on appropriate methodology and approach in supervising insolvent banks, including appointing conservators.
- Furnished the Central Bank of Iraq Governor and the deputy governors with recommendations for an organizational restructure of the Supervision Department and qualifications for bank supervision management and staff.
- Consulted with Coalition counsel regarding a Commercial Bank Law, Central Bank of Iraq Law and the Anti-Money Laundering Anti-Terrorist Financing Act of 2004.
- Helped in the development of implementing regulations for the Commercial Bank Law and the Central Bank of Iraq Law and provided guidance to Central Bank senior management on implementation.
- Developed and conducted two one-week blocks of training for approximately 50 Iraq bank supervisors on risk-based supervision principles.
  - Introduced the concept of “CAMELS” ratings and a process to rate the banks.
  - Created a merit selection process for external training opportunities, including an IMF-sponsored event in Bahrain based on testing of knowledge gained from the bank supervision training.
- Provided recommendations to improve bank reporting and analysis. Prepared data analysis of banks' condition based on bank reported data to include trend and ratio analysis of key balance sheet and income data.
- Met with the Iraq Private Bankers Association to educate Iraqi bankers on new bank supervision techniques they could anticipate from the Central Bank of Iraq (CBI) and recommendations to forge closer working and training alliance with the CBI on basic risk-based bank supervision techniques and analysis.

## Regulate Program

The regulate program establishes regulations, policies, operating guidance, and interpretations of general applicability to national banks. These regulations, policies, and interpretations set systemwide standards, define acceptable banking practices, provide guidance on risks and responsibilities facing national banks, or prohibit (or restrict) banking practices deemed to be imprudent or unsafe. This program also includes establishing examination policies, handbooks, and interpretations for examiners, as well as representing and defending the OCC's regulatory authorities and interpretations in administrative, judicial, and congressional hearings. These activities support the strategic goal of a flexible legal and regulatory framework that enables the national banking system to provide a full competitive array of financial services.

The OCC devoted 368 FTEs or 14 percent of total FTEs to the regulate program, which cost \$63.6 million in FY 2004.

For the past two years, the OCC issued 87 percent of external legal opinions within the established time frames, exceeding the goal of 85 percent. In addition, the OCC issued nine final rules, four interim rules, eight notices of proposed rulemaking, and one advance notice of proposed rulemaking.

Among the most significant rulemakings completed this year were:

- *Bank Activities and Operations; Real Estate Lending and Appraisals (12 CFR 7 and 34), 69 Fed. Reg. 1904 (January 13, 2004) (the Preemption Rule)*. The final Preemption Rule adds provisions to OCC regulations that address the applicability of certain types of state laws to national banks' lending and deposit-taking activities. The rule also contains a general statement that state laws are preempted if they "obstruct, impair, or condition" national banks' ability to exercise fully the powers authorized to them under federal law. The rule preempts only the types and features of state laws that pertain to making loans and taking deposits specifically listed in the regulation. The rule does not apply to other types of state laws. The OCC may determine on a case-by-case basis whether state laws not listed in the regulation are preempted under the pre-existing, judicially established standards for federal preemption under the "obstruct, impair, or condition" phrasing of the rule.
- *Bank Activities and Operations (12 CFR 7), 69 Fed. Reg. 1895 (January 13, 2004) (the Visitorial Powers Rule)*. A federal statute, 12 USC 484, says the OCC has exclusive visitorial authority with respect to national banks unless federal law provides otherwise. Longstanding OCC regulations implement this visitorial powers statute by providing that state officials are not authorized to inspect, examine, or regulate national banks, except when another federal law authorizes them to do so. The final Visitorial Powers Rule clarifies that the scope of the OCC's exclusive visitorial authority applies to the content and conduct of national banks' banking activities. The rule also clarifies that the preservation of visitorial powers "vested in the courts of justice" does not grant state regulatory or law enforcement officials new authority, in addition to what they otherwise have, to exercise visitorial powers over national banks.
- *Lending Limits Pilot Program (12 CFR 32), 69 Fed. Reg. 51355 (August 19, 2004)*. This final rule extends and expands the lending limits pilot program that authorizes special lending limits for 1-4 family residential real estate loans and small business loans. Under the pilot program, eligible national banks with main offices in states that prescribe a higher lending limit for residential real estate loans or small business loans than the current federal limit may apply to take part in the program and use the higher limit. The pilot program originated in 2001 and was scheduled

to expire in June 2004. The final rule extends the program for three years, until June 2007, and expands it to include certain agricultural loans.

- *Rules, Policies, and Procedures for Corporate Activities; International Banking Activities (12 CFR 5 and 28) 68 Fed. Reg. 70691 (December 19, 2003)*. This final rule clarifies certain regulatory definitions and simplifies approval procedures for foreign banks seeking to establish federal branches and agencies in the U.S. These changes make the treatment of federal branches and agencies of foreign banks conform to that of their domestic national bank counterparts.

## **Legal Opinions**

Orders and legal opinions issued during FY 2004 included:

- *Letter to the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI)*. This letter clarifies the scope of the final Preemption Rule by confirming that 1) the Uniform Commercial Code (UCC) does not “obstruct, impair, or condition” the ability of national banks to exercise fully the powers granted by federal law; and 2) those powers are implemented and supported by the UCC, which provides a uniform law of general applicability on which parties rely in their daily commercial transactions. (June 10, 2004).
- *Letter to Wachovia Bank, NA*. This letter confirms certain aspects of Wachovia Bank, NA’s fiduciary powers and concludes that the bank has the authority to implement a national fiduciary program. The letter also confirms that pursuant to the OCC’s regulations at 12 CFR 9.7(e)(2), any state law, other than a law made applicable by 12 USC 92a, that limits or establishes preconditions on the exercise of the fiduciary powers that are to be exercised as part of the bank’s program are not applicable to the bank. Finally, the letter notes that while a national bank may have the federal authority to act in various fiduciary capacities in a given state, that authority does not determine whether a state instrumentality has authority under its governing state statutes to contract with the national bank for fiduciary services. Interpretive Letter No. 995 (June 22, 2004).
- *Letter to National Association of State Treasurers (NAST) and the National Association of Unclaimed Property Administrators (NAUPA)*. This letter clarifies the scope of the final Preemption and Visitorial Powers Rules by confirming that the OCC’s preemption and visitorial powers rules do not change existing standards, established by U.S. Supreme Court precedent and federal statute, that govern the applicability and enforcement of state unclaimed property and escheat laws. (September 28, 2004).
- *Reinsuring Mortgage Insurance*. The OCC decided that national banks could collectively own with other financial institutions a mortgage reinsurance company that provides mortgage reinsurance on the loans of the participating financial institutions and their affiliates and subsidiaries. The national bank participants could make a non-controlling investment in the mortgage reinsurance company using the notice procedure under the OCC’s regulations at 12 CFR 5.36(e), if the bank otherwise qualifies under the criteria of that section. Interpretive Letter 985 (January 14, 2004).
- *Branch Names*. The OCC opined that a national bank’s proposal to operate branches in a retail store under a separate trade name that incorporated the names of the store and the bank would be consistent with the Interagency Statement on Branch Names. The opinion was based upon the bank’s representations that it would take certain steps to avoid customer confusion. Interpretive Letter 977 (October 24, 2003).

- *Lending Limits.* The OCC opined that, when a Native American tribe and its individual members dependent on the same business enterprises as sources of income but the individual members did not control the tribe, loans to tribe members generally would not be combined with loans made to other tribe members or to the tribe itself for purposes of the loan combination rules applicable to national banks. Interpretive Letter 979 (December 18, 2003).
- *Branching.* The OCC concluded that the installation of UPS drop boxes capable of receiving deposits at nonbranch offices of a national bank will not cause those offices to be considered branches because the drop boxes are owned by an independent third party and can be used by the general public for nonbanking transactions. Interpretive Letter 980 (December 24, 2003).
- *Stock Warrants.* The OCC opined that a national bank could convert stock warrants acquired in addition to, or in lieu of, loan interest into shares of stock and immediately sell them when there was no market for the warrants. Interpretive Letter 992 (May 10, 2004).
- *Interest on Loans.* The OCC concluded that 12 USC 85 permits national banks to charge loan prepayment fees when a state parity statute permits state banks to do so. Interpretive Letter 1004 (August 4, 2004).

### ***Supervisory Guidance, Policies, and Examination Handbooks***

The OCC issued supervisory guidance, policies, and examination handbooks on various issues and risks affecting national banks, including:

- *Secured Credit Cards.* The OCC advised national banks that, in light of consumer protection and other concerns, national banks should not offer secured credit card products (or similar unsecured products) that charge security deposits or fees to the credit card account if that practice would substantially reduce the available credit and card utility for consumers. The OCC also described the compliance, credit, and other risks presented by more traditional secured credit card products, and enumerated recommended practices for issuers of secured credit cards in areas, such as product marketing, product structure and terms, and credit risk management. (OCC Advisory Letter 2004-4).
- *Credit Card Marketing and Account Management Practices.* The OCC also alerted national banks to three specific credit card marketing and account management practices that the OCC regards as unacceptable because they may constitute unfair or deceptive acts or practices, or could otherwise expose a bank to compliance and reputation risk. These include failure to disclose the circumstances under which the issuer might unilaterally increase the cost of credit to the cardholder, marketing programs that promote credit limits that are seldom granted, and the use of promotional rates in solicitations without clearly disclosing the significant restrictions on the applicability of those rates. (OCC Advisory Letter 2004-10).
- *Risk Management of New, Expanded, or Modified Bank Products and Services.* This guidance outlines the risk management processes that banks should have in place to help ensure that potential new, expanded, or modified products or services provide appropriate risk-versus-return profiles and are consistent with a bank's strategic direction. Failure to conduct appropriate due diligence and risk management could result in credit losses, compliance issues, litigation exposure, unfavorable returns, and diminished reputation in the marketplace. (OCC Bulletin 2004-20).

- *Embedded Options and Long-Term Interest Rate Risk.* Banks that have invested a significant portion of their earning assets in products with embedded options (e.g., prepayment options on many residential mortgages) may be highly vulnerable to rising rates. This guidance alerts banks to the importance of measuring the cash flow and valuation risks for assets and liabilities with embedded options and discusses steps that banks can take to manage interest rate risk effectively. (OCC Bulletin 2004-29)
- *Tax Lien Certificates.* The OCC issued guidance on appropriate risk management practices for banks that purchase tax lien certificates. The guidance notes that purchase of tax lien certificates exposes banks to credit, operational, liquidity, and reputation risks. Because tax lien certificates arise through the nonpayment of taxes, the guidance instructs that such loans generally warrant a “substandard” rating and should be reported as “Other Assets” in a bank’s Report of Condition and Income. (OCC Bulletin 2004-39).
- *Electronic Record Keeping and Payroll Card Systems.* These advisory letters provide national banks with general background information on these emerging technologies, and discuss compliance and regulatory issues that banks should consider before implementing such systems or products. (OCC Advisory Letters 2004-9 and 2004-6).
- *Related Organizations Handbook.* This booklet in the *Comptroller’s Handbook* series has been revised to emphasize and clarify the OCC’s expectations for robust corporate practices and risk management systems governing related organizations. It also includes revisions to reflect provisions of the Gramm-Leach-Bliley Act of 1999 (GLBA) and the Federal Reserve’s Regulation W.
- *Revised Booklet on Detecting Red Flags in Board Reports.* The OCC updated this booklet, along with a “pocket guide” version to help bank directors meet their fiduciary responsibilities and comply with the corporate governance provisions of the Sarbanes-Oxley Act of 2002.

The OCC also issued supervisory guidance and examination procedures in partnership with other federal financial regulators. These initiatives are discussed in the *Partnership and Outreach* section of this report.

## **Litigation Activities**

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

- *Challenge to denial of golden parachute payments.* A U.S. District Court granted the OCC and FDIC summary judgment in a challenge to the agencies’ denial of a national bank’s request for permission to make a severance payment and annual split-dollar insurance premium payments to a terminated senior executive officer. The former executive officer challenged the interpretation of the golden parachute statute and regulations on which the agencies based their findings that the payments at issue were golden parachute payments and that reasonable grounds existed for the denial. The court found that the agencies’ interpretation and implementation of the law were reasonable. *Knyal v. OCC, FDIC*, No. C 02-2851 PJH (N.D. Cal., November 25, 2003).
- *Preemption of state law restrictions on activities of mortgage operating subsidiary.* A U.S. District Court, in granting the bank’s motion for summary judgment, held that 12 CFR 7.4006 preempts the

Connecticut Banking Commissioner from enforcing against a national bank operating subsidiary state laws that require businesses to obtain a state license to engage in making first and second mortgages. *Wachovia Bank, NA v. Burke*, No. 3:03CV0738 JCH (D. Conn. 2004, May 25, 2004).

- *Decisions that federal law authorizes a national bank to charge document preparation fees.* A state court in Michigan held that a national bank had a right to charge loan documentation fees without being subject to the restrictions on such fees imposed by Michigan law. *Brannam v. The Huntington Mortgage Co.*, Case No. 00-40439-CH (Cir. Ct., Muskegon City, Mich., February 2004).
- A state appellate court in Illinois upheld the dismissal of 37 cases, consolidated for appeal, in which the plaintiffs sought to recover restitution or damages for document preparation fees that they had paid in connection with obtaining real estate mortgages. The OCC had filed a “friend of the court” brief with a lower court in support of the bank’s position that federal law authorizes a national bank to charge document preparation fees. Although the appellate court dismissed the cases on a different ground, this did not vacate the decision of the trial court. *Jenkins v. Concorde Acceptance*, Consol. Appeal No. 02-2738 (App. Ct., Ill., December 31, 2003).
- *The Fair Credit Reporting Act (FCRA) preempts state laws that impose restrictions on information sharing with affiliates.* The defendant municipalities withdrew their appeal to the Ninth Circuit of a U.S. District Court decision holding that provisions of the FCRA preempt ordinances that impose restrictions on the sharing of confidential consumer information between financial institutions and their affiliates. The municipalities repealed the ordinances that were the subject of the litigation and asked the Ninth Circuit court to vacate the district court’s order. The Ninth Circuit granted the motion, and the district court vacated its decision. *Bank of America v. Daly City*, Nos. C 02-4343 and C 02-4943 (N.D. Cal. 2003).

## Charter Program

The charter program involves activities related to chartering national banks, as well as evaluating the permissibility of structures and activities of national banks and their subsidiaries. The program includes the review and approval of new national bank charters, federal branches and agencies, mergers, acquisitions, conversions, business combinations, corporate reorganizations, changes in control, operating subsidiaries, branches, relocations, and stock and debt issues. The charter process incorporates conditions and agreements needed to support the safe and sound operation of the resulting entities. These activities support the strategic goal of a flexible legal and regulatory framework that enables the national banking system to provide a full competitive array of financial services.

The OCC devoted 98 FTEs or 4 percent of total FTEs to the charter program, which cost \$16.4 million in FY 2004.

The OCC exceeded all FY 2004 performance targets and customer service standards for its licensing operations. The customer service results were based on 732 licensing surveys completed by banks during the year, which was a 35 percent response rate. The survey is based on a five-point scale, in which 1 indicates outstanding and 5 indicates significantly deficient. The OCC also followed up with every applicant that rated the overall licensing process 3 or worse. This follow-up helps the OCC understand the applicant’s concerns and make the appropriate modifications to its licensing process. The licensing and customer service performance measures and results are presented in Table 4.

**Table 4: Licensing and Customer Service Performance Measures, FY 2001 – FY 2004**

Performance Measures	FY 2001	FY 2002	FY 2003	FY 2004 Target	FY 2004 Actual
Percentage of licensing applications filed electronically	N/A	N/A	8%	15%	34%
Percentage of licensing applications completed within established time frames	96%	96%	97%	95%	96%
Average survey rating of OCC's timeliness on licensing applications	1.15	1.19	1.16	≤1.5	1.20
Average survey rating of the knowledge of OCC's licensing staff	1.17	1.19	1.14	≤1.5	1.20
Average survey rating of the professionalism of OCC's licensing staff	1.10	1.12	1.09	≤1.5	1.10
Average survey rating of the overall licensing services provided by OCC	1.16	1.17	1.14	≤1.5	1.20

### Licensing Decisions

A responsive and efficient licensing operation is essential to meet the needs of banks that are part of, or seek to become part of, the national banking system. The OCC received 2,592 applications and 70 After-the-Fact notices during FY 2004. Table 5 shows the corporate applications received in FYs 2003 and 2004. Corporate applications increased by more than 400 (20 percent) over FY 2003. Of the 2,477 decisions issued on applications during FY 2004, 96 percent were completed within the established time frames. The OCC has maintained this high level of responsiveness (96 or 97 percent) for the last four years. Table 6 shows the timeliness of the OCC's actions by type of application for FYs 2003 and 2004. The OCC exceeded its goal for timely decisions while providing a consistently high quality of services as rated by applicants.

**Table 5: Corporate Application Activity, FY 2003 and 2004**

	Applications Received		FY 2004 Decisions			
	FY 2003	FY 2004	Approved	Conditionally Approved [4]	Denied	Total
Branches	1,439	1,765	1,794	4	0	1,798
Capital /Sub Debt	119	136	45	3	0	48
Change in Bank Control	16	16	13	0	1	14
Charters	29	31	9	27	2	38
Conversions [1]	19	21	15	3	0	18
Federal Branches	4	4	1	1	0	2
Fiduciary Powers	37	22	11	2	0	13
Mergers [2]	61	90	90	6	0	96
Relocations	236	288	283	0	0	283
Reorganizations	115	137	114	8	1	123
Stock Appraisals	0	1	0	0	0	0
Subsidiaries [3]	85	81	41	3	0	44
Total	2,160	2,592	2,416	57	4	2,477

[1] Conversions are conversions to national bank charters.

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

[3] This count does not include 109 After-the-Fact notices received in FY 2003 and 70 After-the-Fact notices received in FY 2004.

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



**Table 6: OCC Licensing Actions and Timeliness, FY 2003 and 2004**

		FY 2003			FY 2004		
		Number of Decisions	Within Target		Number of Decisions	Within Target	
Application Type	Target Time Frames in Days [1]		Number	%		Number	Number
Branches	45 / 60	1,313	1,285	97.9%	1,798	1,769	98.4%
Capital /Sub Debt	30 / 45	93	89	95.7%	48	46	95.8%
Change in Bank Control	N/A / 60	10	10	100.0%	14	14	100.0%
Charters [2]		15	8	53.3%	38	22	57.9%
Conversions	30 / 90	18	13	72.2%	18	14	77.8%
Federal Branches	N/A / 120	5	5	100.0%	2	2	100.0%
Fiduciary Powers	30 / 45	12	12	100.0%	13	7	53.9%
Mergers	45 / 60	72	62	86.1%	96	86	89.6%
Relocations	45 / 60	230	227	98.7%	283	278	98.2%
Reorganizations	45 / 60	100	92	92.0%	123	100	81.3%
Stock Appraisals	N/A / 90	0	0	N/A	0	0	N/A
Subsidiaries	30 / 60	50	50	100.0%	44	44	100.0%
Total		1,918	1,853	96.6%	2,477	2,382	96.2%

Note: Most decisions (97 percent in FY 2003 and 99 percent in FY 2004) were made in the district offices, International Banking and Finance, and Large Bank Licensing under delegated authority. Decisions include approvals, conditional approvals, and denials.

- [1] Those filings that qualify for the “expedited review” process are subject to the shorter time frames listed. The longer time frame is the standard benchmark for more complex applications. New time frames commenced in 1997 with the adoption of the revised Part 5. The target time frame may be extended if the OCC needs additional information to reach a decision, permits additional time for public comment, or processes a group of related filings as one transaction.
- [2] For independent charter applications, the target time frame is 120 days. For holding-company-sponsored applications, the target time frame is 45 days for applications eligible for expedited review, and 90 days for all others.

## Electronic Filing of Applications

During FY 2004, the OCC continued to offer a wider array of applications and notices on e-Corp. In February 2004, the OCC added seven capital applications and one capital notice. In August 2004, Licensing added two investment in subsidiaries and equities applications, and six notices. e-Corp is available free to all national banks on the National BankNet (OCC's secure extranet site for national banks). The e-Corp application process uses simple, yet innovative, interactive features to make the submission of licensing applications easier. This includes the ability to sign electronically, and submit, e-Corp applications and notices on-line.

e-Corp went live on March 3, 2003, when branch and relocation applications were made available. At the end of FY 2004, 15 types of applications and 12 types of notices were available on e-Corp, making the vast majority of common filings available electronically. Filing electronically is optional. Thirty-four percent of all applications were filed electronically, more than twice the target number for FY 2004, and a four-fold increase from the 8 percent in FY 2003.

## Other Licensing Accomplishments

The OCC publishes the 23-booklet *Comptroller's Licensing Manual* electronically. The OCC updates the electronic manual regularly as changes occur, an option not available with the printed format. During FY 2004, seven Manual booklets were revised, posted to the OCC's Web site, and made available on compact disc (CD) for examiners and the public. The most extensive project was to merge the "Corporate Organization" booklet with the "Charters" booklet.

The OCC continued to improve its licensing procedures through the Field Guidance Project, including a comprehensive review and update of field investigations and guidance on preopening examinations. Comprehensive new guidance for conducting examination activities for conversion proposals was made available in FY 2004 on the OCC's Intranet and to bank examiners on CD-ROM, as well as incorporated into the OCC's automated examination application, Examiner View (EV). In addition, EV added new templates for field investigation and preopening reports.

## Change in Bank Control

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

The OCC's CBCA activity is reflected in Table 7. The OCC received 16 CBCA notices and acted on 14 notices in FY 2004.

**Table 7: Change in Bank Control Act [1], 2001–9/30/2004**

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

[1] Notices processed with disposition.

[2] Includes one Notice with no activity and considered abandoned by the OCC.

\*Fiscal Year

## **Community Reinvestment Act**

Consistent with 12 CFR 5, the “Public Notice and Comments” booklet (February 2003) details the OCC’s procedures for handling CRA issues in applications, including the treatment of adverse comments from the public. During FY 2004, the OCC received adverse comments from the public on four CRA-covered applications. The OCC also reviewed and publicly addressed CRA issues raised in another application. On the OCC’s Web site, the OCC’s monthly Interpretations and Actions listed the decisions on applications presenting CRA issues, as shown in Table 8.

**Table 8: List of Applications Presenting Community Reinvestment Act Issues Decided, FY 2004**

<b>Bank, City, State</b>	<b>Interpretations and Actions</b>	<b>Document Number</b>
Citibank USA, NA, Sioux Falls, SC	November 2003	CRA Decision No. 117
Wells Fargo Bank, NA, San Francisco, CA	December 2003	CRA Decision No. 118
J.P. Morgan Trust Company, NA, Los Angeles, CA	January 2004	CRA Decision No. 119
Sun National Bank, Vineland, NJ	January 2004	CRA Decision No. 120
PNC Bank, NA, Pittsburgh, PA	January 2004	CRA Decision No. 121
Bank of America Corporation, Charlotte, NC	March 2004	Conditional Approval No. 577
HSBS Bank and Trust Company (Delaware), NA, Wilmington, DE	July 2004	CRA Decision No. 122

## **Partnership and Outreach**

In addition to the activities discussed under each program area, the OCC works with other regulators, the industry, community groups, and consumer organizations to promote the OCC’s mission and accomplish its strategic goals and objectives in an effective and efficient manner.

### **Financial Regulators**

Primarily through the FFIEC, the OCC works closely with the other federal banking agencies (Board of Governors of the Federal Reserve System [FRB], Federal Deposit Insurance Corporation [FDIC], Office of Thrift Supervision [OTS], and National Credit Union Administration [NCUA]) to coordinate supervisory policies, regulations, regulatory reporting requirements, and examiner training on issues that cut across the banking system. These efforts reduce regulatory burden by promoting greater uniformity, consistency, and efficiency in the supervision of insured depository institutions.

The OCC also works with other state, federal, and international regulators and supervisors on matters of mutual interest.

The OCC has entered into information-sharing agreements with insurance departments in 48 states and the District of Columbia and meets regularly with the National Association of Insurance Commissioners.

The OCC works closely with the Securities and Exchange Commission (SEC) on securities, brokerage, and accounting and disclosure issues, and with the Federal Trade Commission (FTC) on consumer protection and privacy issues. In FY 2004, the OCC continued to consult with the SEC on revisions to SEC rules implementing the bank broker-dealer provisions of the GLBA, and to work with the SEC and state regulators on other matters of mutual interest. For example, the OCC worked closely with the SEC and the New York attorney general in taking enforcement action against an uninsured trust bank engaged in illegal late trading

and market timing. The OCC, FDIC, FRB, OTS, and SEC also issued for public comment a proposed statement on complex structured finance activities. The statement describes the types of internal controls and risk management procedures that can assist financial institutions to identify and address the reputation, legal, and other risks associated with complex structured transactions.

The OCC is a member of the administration's Financial and Banking Infrastructure Information Committee (FBIIC) and, as discussed later, has joined other federal regulators to combat money laundering and terrorist financing activities. Throughout FY 2004, OCC staff assisted FBIIC's efforts to identify and address the financial sector's vulnerabilities to terrorism.

On the international front, the OCC is participating in efforts by the Basel Committee on Banking Supervision to update and revise the Basel Capital Accord to make the capital standards required of internationally active banks more comprehensive, risk sensitive, and reflective of advances in banks' risk measurement and management practices (Basel II).

The OCC worked closely with other regulators to address emerging risks and issues facing the industry, reduce regulatory burden, and enhance regulatory efficiency. These efforts included:

- *Basel II Implementation and Revisions to Risk-Based Capital Standards.* In June 2004, the Basel Committee issued its "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Framework). This Framework forms the basis upon which the U.S. banking agencies and representatives of the other Basel Committee member countries will develop proposed revisions to existing capital adequacy regulations and standards. The OCC continues to work closely with the other federal banking agencies (FDIC, FRB, and OTS) on implementation issues associated with the proposed Basel II Framework. These efforts have included outreach meetings with industry participants to discuss and receive feedback on the Framework; continued work on supervisory guidance for portfolios and risk exposures that outlines the key components of the measurement and management structures that banks subject to the revised Framework will need to meet; benchmarking exercises to assess banks' progress in developing and implementing operational risk measurement techniques that would be consistent with the Framework's requirements; and impact studies to assess the potential effect of the Framework.

In addition to these efforts, the banking agencies issued final rules in FY 2004 to amend their risk-based capital standards for certain asset-backed commercial paper programs.

- *Initiatives to Enhance Consumer Safeguards.* Throughout FY 2004, the OCC partnered with other federal regulators to enhance consumer protection safeguards. The agencies issued proposed rules under the Fair and Accurate Credit Transactions Act regarding affiliate marketing and protection of consumer information and sought public comment on, and continued the development of, simplified privacy notices. To help consumers combat identity theft, the FFIEC agencies prepared and made available a deposit statement stuffer that explains Internet "phishing" and steps that consumers can take to protect themselves. To combat predatory and abusive lending practices, the FFIEC-member agencies partnered with the FTC, Office of Federal Housing Enterprise Oversight, Department of Housing and Urban Development, and Department of Justice, to publish a brochure on predatory lending. The brochure, "Putting Your Home on the Loan Line is Risky Business," cautions consumers about predatory lending and tells them how they can guard against such practices. The brochure was in English and Spanish. The FFIEC-member agencies also issued for comment proposed supervisory guidance on overdraft protection programs.

- *Expanded Guidance on Technology-Related Risks.* During FY 2004, the federal banking agencies completed their revisions of the 1996 *FFIEC Handbook on Information Systems*. The 1996 handbook was replaced by a series of 12 booklets addressing topics such as business continuity planning, information security, electronic banking, outsourcing, retail and wholesale payment systems, audit, and management.
- *Initiatives to Reduce Unnecessary Regulatory Burden and Enhance Efficiency.* The OCC continues to work with the other FFIEC-member agencies on a multi-year project to review their regulations to identify outdated, unnecessary, or burdensome regulatory requirements imposed on insured depository institutions by the Economic Growth and Regulatory Paperwork Reduction Act. During FY 2004, the agencies requested public comment about possible relief in consumer protection rules related to lending and account/deposit relationships. The agencies also hosted outreach meetings with bankers and community groups in New York, Nashville, Seattle, Chicago, Washington, D.C., and San Francisco to solicit input on burden reduction. In June 2004, the agencies testified about regulatory reform before the Senate Committee on Banking, Housing and Urban Affairs.

The OCC, the FDIC, and the FRB also continued work on their project to create a shared central depository for collecting, validating, storing, and distributing call report information. When completed, this project will provide enhanced data quality and expedited data sharing.

- *Joint Examination Programs.* The banking agencies continued their joint supervisory programs, including the SNC Program, the Interagency Country Exposure Review Committee, and the interagency examination program for multi-regional data processing servicers. The SNC program is governed by an interagency agreement between the FRB, FDIC, and the OCC, to provide uniformity and efficiency in analyzing and rating large, complex credits. A SNC is defined as any loan or formal loan commitment extended to a borrower by a supervised institution, or any of its subsidiaries and affiliates, that aggregates \$20 million or more and is shared by three or more institutions under a formal lending agreement. The program benefits the regulatory agencies and the banks by: 1) eliminating the redundancy of reviewing the same credit in multiple institutions; 2) ensuring that credits are reviewed in a uniform and consistent manner; 3) maximizing resources; and 4) limiting disruptions to banks' operations. The FY 2004 SNC review covered 7,490 credits with commitments totaling \$1.5 trillion.
- *Updated Supervisory Guidance.* The federal banking agencies issued supervisory guidance throughout the year to bankers on risks posed by bank activities and methods banks can use to manage those risks. In addition to the items previously discussed, interagency guidance was issued on:
  - Safety and soundness and legal issues involved in providing financial support to investment funds advised by the institution or its subsidiaries or affiliates.
  - Appropriate accounting treatment for deferred compensation agreements.
  - Revisions to the agencies' uniform agreement on the classification of securities to reflect changes in accounting standards and bank risk management practices.

## **Bank Secrecy Act and Anti-Terrorist Financing Activities**

The OCC works closely with other federal financial regulators and criminal law enforcement agencies to combat money laundering and terrorist financing. Some of these interagency groups are mentioned below. At the request of law enforcement authorities, the OCC also provides expertise and assistance in criminal investigations involving bank fraud and other white-collar crime. OCC examiners and staff are frequent instructors and speakers at BSA/AML schools and industry conferences.

The OCC also continues to play an important role in improving the AML and terrorist financing controls in banking throughout the world. For the past several years, the OCC has provided examiners to assist with U.S. government-sponsored international AML and terrorist financing assessments. The OCC maintains a cadre of specially trained examiners that has provided assistance to the Treasury Department and the State Department on these assessments around the world, including South and Central America, the Caribbean, the Pacific-rim nations, the Middle East, Russia, and the former Eastern Bloc nations.

### **Interagency Groups to Combat Money Laundering and Terrorist Financing**

#### **Suspicious Activity Reports Owners Group**

- Administers the bank SAR database and SAR form, which is jointly owned by the banking agencies and the Financial Crimes Enforcement Network (FinCEN).
- Coordinated by FinCEN and/or the federal banking agencies.

#### **Bank Secrecy Act Advisory Group**

- Created by statute to coordinate BSA/AML-related matters among federal and state regulatory agencies, law enforcement, and the private sector.
- Headed by Treasury and meets twice a year.
- Includes various subcommittees (one addressing examination procedures and consistency) that meet more frequently; the OCC chairs the subcommittee on SAR confidentiality.

#### **Bank Fraud Working Group**

- Addresses criminal matters of mutual interest to bank regulators and law enforcement.
- Meets monthly under the direction of the U.S. Department of Justice's Fraud Section.
- Includes more than 13 agencies – bank regulators, SEC, Federal Bureau of Investigation, Internal Revenue Service–Criminal Investigations, U.S. Secret Service, and other law enforcement authorities.

#### **Financial Action Task Force (FATF)**

- Sponsored by the Organization for Economic Cooperation and Development (OECD) for international AML policy and coordinating body.
- Headed by Treasury with outreach to the bank regulators for input and participation as necessary.
- Issues position papers and recommendations for governments' efforts to fight money laundering and terrorist financing.

#### **FFIEC BSA Working Group**

- Formed recently at the request of FFIEC-member agency principals.
- Addresses the coordination of updated interagency BSA/AML examination procedures and training and ancillary matters.

The OCC and other federal banking agencies revised the examination procedures for key sections of the USA PATRIOT Act (Act). These procedures will be incorporated into the OCC's revised "Bank Secrecy Act" booklet in the *Comptroller's Handbook*. The OCC is coordinating its handbook revisions with the other federal regulators. The OCC took the lead in drafting the January 2004 interagency "Frequently Asked Questions" (FAQs) regarding the application of section 326 of the Act that requires banks to have a customer identification program. A second set of interagency FAQs is scheduled to be issued by the end of Calendar Year (CY) 2004. In June 2004, the OCC and other federal banking agencies issued an interagency advisory providing guidance to the banking industry about accepting accounts from foreign governments, embassies, and political figures. Interagency guidance was also issued on recent rulings affirming the statutory safe harbor provision for financial institutions and their employees in reporting known or suspected criminal offenses or suspicious activities pursuant to the 1992 Annunzio-Wylie Anti-Money Laundering Act.

The OCC's QM Division initiated a review and evaluation of the approach to, and effectiveness of, its BSA/AML supervision programs. The OCC also approved the development of an enhanced database of national bank-filed SARs and a revised risk assessment process to better identify high-risk banks.

Throughout FY 2004, the OCC also continued its efforts with FinCEN and the other agencies to explore better ways to use BSA information in the OCC's examination process and to enhance information sharing among the agencies in this critical area. In September 2004, the OCC and other federal banking agencies entered into a Memorandum of Understanding (MOU) with FinCEN to establish information sharing procedures for certain BSA-related activities. Through this MOU, the agencies intend to improve interagency coordination on BSA examination and compliance.

### ***Industry and Community Outreach***

The OCC maintains open communications with key constituents that are affected by, and interested in, the OCC's mission. The Comptroller and senior managers seek input and feedback on issues facing the banking industry through outreach meetings with industry groups and trade associations. "Meet the Comptroller" roundtables are creative responses to the need for continuing dialogue between bankers and senior OCC officials.

The OCC's outreach efforts during FY 2004 included four telephone seminars for bankers in which bankers listen to agency experts discuss experiences and policy imperatives, and interact with them during question-and-answer sessions. Seminar topics were Rural Economic Development Lending Opportunities for Community Banks, Condition of the Banking Industry, Outsourcing Technology Services, and Financing Minority Businesses. More than 3,000 listeners participated in these telephone seminars during the year.

The OCC also conducted workshops on Understanding OCC's Risk Assessment Process for about 275 community bank directors. The goal was to enhance understanding of risk-based supervision; increase familiarity with major risks in commercial banking; learn the types of questions to ask managers, auditors, and examiners; and review common ways to identify, measure, monitor, and control risk. Additionally, the OCC developed a new program, Credit Risk: A Directors Focus, attended by about 175 community bank directors. The program aimed to increase directors' knowledge of effective credit risk management processes, help them assess and control their bank's risk profile, and improve their ability to evaluate the quality of their management information systems. Other outreach activities were discussed under the *Community Affairs* section of this report.