

Recent Developments Affecting Depository Institutions

by Lynne Montgomery*

REGULATORY AGENCY ACTIONS

Interagency Actions

Financial Institutions Help Identify Child-Support Debtors

Beginning July 1, 1999, financial institutions must help state and local authorities identify accounts held by “deadbeat parents.” The “data match program” is part of a 1996 welfare reform law and requires banks, thrifts, credit unions, and brokerages to match account holders’ Social Security numbers against a database of child support debtors provided quarterly by the government. The first copy of the national database was sent to participating banks at the end of June 1999. After receiving the government’s quarterly list of debtors, financial institutions will have 45 days to report back any matches with demand deposit, savings, time deposit, checking, or money-market account holders. The state agencies will then decide whether to place liens on the accounts. *AB, 7/1/99.*

Federal Deposit Insurance Corporation

Bank and Thrift Failures

On July 9, 1999, the Office of Thrift Supervision (OTS) closed Oceanmark Bank, a FSB, in North Miami Beach, Florida, and the Federal Deposit Insurance Corporation (FDIC) was named receiver. The failed institution had total deposits of \$64.2 mil-

lion and total assets of approximately \$70.6 million. All the deposits were purchased by Third Federal Savings and Loan Association of Florida in North Miami Beach, Florida, for a premium of \$12.5 million. The acquirer also purchased \$6.3 million of Oceanmark’s assets. The FDIC retained the remaining assets for later disposition. The FDIC estimates this transaction will cost the Savings Association Insurance Fund (SAIF) \$4.4 million. This was the first failure of a SAIF-insured institution in the United States since August 1996. *PR-39-99, FDIC, 7/9/99.*

The Office of the Comptroller of the Currency (OCC) closed East Texas National Bank of Marshall in Marshall, Texas, on July 9, 1999, and the FDIC was appointed as receiver. The OCC declared that the failed bank was “critically undercapitalized,” that is, tangible equity capital was less than 2 percent of its total assets. The bank’s asset quality had deteriorated as a result of poor credit underwriting and loan administration practices by management and inadequate supervision by the bank’s board of directors. The FDIC entered into an agreement with Fredonia State Bank in Nacogdoches, Texas, to assume all of the failed bank’s \$113.0 million in total deposits.

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Reference sources: *American Banker* (AB); *The Wall Street Journal* (WSJ); *BNA’s Banking Report* (BBR); and *Federal Register* (FR).

Fredonia State Bank also purchased \$127.3 million of the assets at a discount of \$5.5 million. The FDIC retained the remaining \$13.6 million in assets for later disposition. The FDIC estimates this transaction will cost the Bank Insurance Fund (BIF) \$6.2 million. This was the third bank failure of a BIF-insured institution in the United States this year. *PR-38-99, FDIC, 7/9/99.*

The First National Bank of Keystone in Keystone, West Virginia, was closed by the OCC on September 1, 1999, and the FDIC was named receiver. The OCC found evidence of fraud that resulted in the depletion of the bank's capital. As of June 30, 1999, the failed bank reported approximately \$1.1 billion in assets and \$880.9 million in deposits. Ameribank, Incorporated in Welch, West Virginia, assumed approximately \$135.0 million of the local insured deposits at a discount of \$105,000. Ameribank also purchased \$74.1 million in assets, and the FDIC retained the remaining assets for future disposition. The remaining out-of-area insured deposits, which are primarily brokered deposits, will be paid directly by the FDIC. This was the fourth failure of a BIF-insured institution in the United States this year. *PR-49-99, FDIC, 9/11/99; PR-52-99, FDIC, 9/3/99.*

On September 10, 1999, the OCC closed Peoples National Bank of Commerce in Miami, Florida, and appointed the FDIC as receiver. The OCC declared that the failed bank was "critically undercapitalized" and was in an unsafe and unsound condition to transact business. The bank suffered from poor lending practices, improper record keeping and accounting, and ineffective board and management supervision. As of June 30, 1999, the failed bank had total assets of \$37.6 million and total deposits of \$36.1 million. The FDIC entered into an agreement with Boston Bank of Commerce, a minority-owned bank based in Boston, Massachusetts, to assume all of the failed bank's deposits and approximately \$34.0 million of the failed bank's assets at a discount of \$1.8 million. The FDIC as receiver retained the remaining \$3.6 million in assets for later disposition. This was the fifth bank failure of a BIF-insured institution in the United States in 1999. The FDIC estimates the cost of this transaction to the BIF will be approximately \$2.2 million. *PR-55-99, FDIC, 9/10/99.*

Real-Estate Survey – July 1999

The July 1999 issue of the *Survey of Real Estate Trends* reported that the nation's commercial and residential real-estate markets continued to show improvement in the early summer. The quarterly survey polled 293 senior examiners and asset managers from the FDIC, the Federal Reserve System, the OCC, and the OTS. Survey respondents noted robust home sales and higher home sale prices despite recent rises in mortgage interest rates. Forty-five percent of the survey respondents said local housing market conditions were improving, while only 3 percent noted deterioration. The respondents also indicated that improvements in commercial markets reported in the April survey continued into the summer. Thirty-five percent of the July respondents noted gains in local commercial markets, up from 33 percent in April.

The national composite index used by the FDIC to summarize results for both residential and commercial real-estate markets remained at 69 in July, unchanged from the April index. Index scores above 50 indicate improving conditions, while index scores below 50 indicate declining conditions. *Survey of Real Estate Trends, FDIC, July 1999.*

Financial Results for Second-Quarter 1999

The FDIC reported that the Bank Insurance Fund (BIF) earned \$219 million during the first six months of 1999, and the Savings Association Insurance Fund (SAIF) earned \$226 million for the same period. The BIF closed the second quarter of 1999 with a fund balance of \$29.8 billion. The SAIF closed the quarter with an unrestricted fund balance of \$9.1 billion and \$978 million in the restricted SAIF Special Reserve, which was established on January 1, 1999, and contains the amount by which the SAIF exceeds the Designated Reserve Ratio of 1.25 percent. Revenue for the BIF totaled \$902 million for the first six months of 1999, including \$857 million in interest on investments in U.S. Treasury obligations and \$16 million in deposit insurance assessments. The SAIF earned \$292 million in revenue during the first half of 1999, consisting of \$286 million in interest on investments in U.S. Treasury obligations and \$6 million in

deposit insurance assessments. The low numbers of bank and thrift failures contributed to the strong financial results.

The FSLIC Resolution Fund (FRF) assets in liquidation were reduced by \$1.092 billion during the previous twelve months, with a remaining balance of \$714 million on June 30, 1999. The FRF was established in 1989 to assume the remaining assets and obligations of the former Federal Savings and Loan Insurance Corporation. On January 1, 1996, the former Resolution Trust Corporation's financial operations were merged into the FRF. *PR-47-99, FDIC, 8/31/99.*

New Deposit Insurance Guide for Employees

On August 24, 1999, the FDIC released a revised version of its deposit insurance guide for employees of insured financial institutions. The revised publication, *The Financial Institution Employee's Guide to Deposit Insurance*, is a comprehensive guide that explains federal deposit insurance rules in a nontechnical manner. The publication includes instructional materials to assist in developing training programs for staff at financial institutions, operations and savings officers, and others who require knowledge of the federal deposit insurance system. *FIL-76-99, FDIC, 8/25/99; BBR, 8/30/99, p. 335.*

Federal Reserve Board

Interest Rates

On June 30, 1999, the Federal Open Market Committee voted to raise the targeted federal funds rate by 25 basis points, increasing the rate from 4.75 percent to 5.0 percent. At that time, the Committee voted to keep the discount rate unchanged. At the Federal Open Market Committee meeting on August 24, 1999, the policymakers voted to increase the federal funds rate an additional 25 basis points, raising the rate from 5.0 percent to 5.25 percent. The discount rate was also increased by 25 basis points, bringing the rate to 4.75 percent. The federal funds rate is the fee that banks charge each other for overnight loans, and the discount rate is the fee charged to financial institutions for borrowing from their district Federal Reserve Banks. *BBR, 7/5/99, p. 24-25; BBR, 8/30/99, p. 330-331.*

President Clinton Announces Two Nominations for Federal Reserve Board

On August 5, 1999, President Clinton announced his plan to nominate Carol J. Parry to fill one of the two vacant positions on the Board of Governors of the Federal Reserve System. Ms. Parry was formerly an executive vice president of Chase Manhattan Bank and was also a member of the bank's Policy Council. Ms. Parry has a background in lending to low- and moderate-income communities. If confirmed by the Senate, Ms. Parry's term on the Board of Governors would expire January 31, 2012. She will fill the seat vacated by former Federal Reserve Governor Susan Phillips. *BBR, 8/9/99, p. 222-223.*

On August 6, 1999, President Clinton announced his plan to nominate Roger W. Ferguson Jr. to be vice chairman of the Federal Reserve Board. Although Mr. Ferguson is already a Board member, his term was slated to expire on January 31, 2000. If the Senate approves his nomination, he would serve a 14-year term that would expire on January 31, 2014. *BBR, 8/23/99, p. 279.*

New Approach for Oversight of Large Banking Organizations

On June 24, 1999, the Federal Reserve Board issued guidance to supervisory staff and bankers on the oversight of large, complex banking organizations. The guidance calls for bank supervisors to use key risk-management processes and closely monitor the risk profiles of large, complex banking organizations. The guidance requires the regulators to form supervisory teams to focus more closely on the banking organizations' business and risks. Each team of regulators should have specialized skills and experience suited to the assigned institution, and the team should designate a senior supervisor as the central point of contact for the institution. In addition, each team should update its supervisory plan at least quarterly by continually reviewing the institution's current information, such as management reports and internal and external audits. To minimize duplicative regulatory effort, the guidance calls for close consultation with other domestic banking agencies, state insurance commissioners, securities regulators and foreign bank

supervisors. The Federal Reserve Board stressed the need for a different approach to supervision of large, complex banks because these institutions account for a considerable and growing share of total banking assets. In addition, these banking organizations are entering into more nontraditional activities, such as securities underwriting, and they are growing nationally and internationally. *BBR, 6/28/99, p. 1150.*

Liquidity Facility Established for Year 2000 Cash Problems

On July 20, 1999, the Federal Reserve Board approved a proposal to set up a special lending program to ensure that banks have enough liquidity to meet high cash demands caused by the century date change. The Century Date Change Special Liquidity Facility will be available from October 1, 1999 through April 7, 2000, to make extra loans to banks and other depository institutions experiencing liquidity problems. The Federal Reserve will charge interest at a rate equal to 1.50 percentage points above the fed funds rate. *PR-FRB, 7/20/99; BBR, 7/26/99, p. 125.*

Deposit Reporting Schedules Unchanged

In order to help banks manage the upcoming century date change, the Federal Reserve Board announced on July 15, 1999, that it will not change its deposit reporting schedules this year. Regulation D stipulates reserve requirements for depository institutions and also requires some institutions to file reports on deposit data on an annual, quarterly, or weekly basis. Each September, the Federal Reserve staff reviews the institutions' deposit levels and reserve liabilities, and then assigns the institutions to a reporting schedule. The reporting schedules are determined by the size of the institution, with the larger institutions filing reports more frequently. Normally, institutions may be required to switch to a new reporting category in September, depending on growth in their level of deposits and reservable liabilities. Holding the reporting schedules constant this

year ensures that depository institutions will not need to alter their deposit data processing, and allows institutions to focus on century date issues. *PR-FRB, 7/15/99; BBR, 7/26/99, p. 127.*

Regulation DD

On August 31, 1999, the Federal Reserve Board published an interim rule to Regulation DD, which implements the Truth in Savings Act. The interim rule, which is effective September 1, 1999, permits depository institutions to deliver disclosures on periodic statements to a consumer's e-mail account or post them on a Web site, if the consumer agrees. Under an earlier interim rule published by the Federal Reserve Board in March 1998, periodic statements and other disclosures required under Regulation E (which implements the Electronic Fund Transfer Act) may be delivered electronically if the consumer agrees. Institutions commonly provide a single periodic statement that complies with Regulations E and DD. Therefore, this interim rule for Regulation DD should allow depository institutions to deliver deposit account statements electronically under a single set of procedures, and avoid the cost of printing and mailing the information. *PR-FRB, 8/31/99.*

Office of the Comptroller of the Currency Information-Sharing Accord

On September 15, 1999, the OCC announced that it had reached an agreement with state insurance regulators from Alabama, Arizona, Arkansas, Connecticut, Indiana, Maryland, and West Virginia, to share information about customer complaints that may arise in connection with sales of insurance by banks. The agreement calls for the OCC and the insurance departments to send copies of complaints to each other and also to communicate on other matters, including regulatory and policy initiatives. The OCC now has agreements with 16 state insurance regulators. The agreements enhance consumer protection and ensure compliance with appropriate insurance sales standards. *PR-99-80, OCC, 9/15/99.*

Office of Thrift Supervision

Final Rule on Surety and Guarantee Obligations

The OTS issued a final rule on August 26, 1999, which clarifies a federal savings association's authority under Section 5(b)(2) of the Home Owners' Loan Act. The final rule states that a federal savings association's authority to act as surety also includes the ability to act as a guarantor. Surety agreements bind the surety, along with its principal, to pay funds to a third party. Guaranty agreements bind the guarantor to pay the third party on the principal's behalf only if the principal fails to perform its side of the contract with the third party. The rule also reduces minimum collateral requirements on suretyship and guaranty agreements from 110 percent to 100 percent of the surety or guarantee, provided the collateral is cash or a similar safe obligation.

In addition, the new rule clarifies that a federal savings association may issue letters of credit, eliminating confusion regarding the scope of activities authorized for federal savings associations that was caused by the deletion of a regulation in 1996. *OTS 99-57, 8/26/99; BBR, 8/30/99, p. 342.*

Federal Housing Finance Board

Risk-Split Pilot Program

On August 19, 1999, the Federal Home Loan Bank of New York won approval for a pilot program that will split the credit and interest-rate risk between private-sector mortgage lenders and the Home Loan Bank. Under the pilot program, named the Community Mortgage Asset, the Home Loan Bank will purchase single-family mortgages at market value from member banks and thrifts, and will package these mortgages into pools. For the first seven years, member banks and thrifts will receive 97 percent of the principal payments and 48.5 percent of the interest payments. After seven years, the Home Loan Bank will take on 97 percent of the risk as well as collect that much of the cash flow. Member banks and thrifts will collect just 3 percent of the cash flow, but will only be liable for 3 percent of any losses. The pilot qualifies as an acceptable investment by Home Loan Banks under a July 28, 1999, proposal by the Federal Housing Finance Board. That proposal limits Home Loan Banks' investments and curtails purchases of mortgage-backed securities by the year 2005. The intent of the proposal is to get the Home Loan Banks focused on their mission of financing affordable housing. *AB, 8/20/99.*

STATE LEGISLATION AND REGULATION

Florida

Effective July 1, 1999, insurance agents in Florida are permitted to sell insurance products on the premises of financial institutions, repealing a law that banned agents from engaging in such activities except in towns with populations of 5,000 or fewer. The new law provides a number of consumer safeguards relating to disclosure and advertising, includ-

ing a requirement of written disclosure to customers stating that their choice of insurance would not affect credit decisions. Financial institutions are also required to provide written disclosure to their customers stating that the insurance products are not guaranteed deposits and may involve investment risk. *BBR, 7/5/99, p. 18.*

BANK AND THRIFT PERFORMANCE

Second-Quarter 1999 Results for Commercial Banks and Savings Institutions

FDIC-insured commercial banks earned \$17.0 billion during the three months from April through June 1999, which represents the second-highest quarterly earnings ever reported by the industry. The earnings

were \$1 billion lower than earnings in the first quarter of 1999, primarily because of higher expenses at one large institution that was acquired during the second quarter. Noninterest expenses were \$1.2 billion higher than in the first quarter and merger-related expenses at that one institution caused all but \$52 million of the increase. Banks' annualized return on

assets (ROA) was 1.25 percent in the second quarter, which is the same as in the second quarter of 1998, but down from 1.32 percent in the first quarter of 1999. The number of problem banks dropped to 62 from 64 in the first quarter of 1999. There was one bank failure during the quarter.

FDIC-insured savings institutions reported profits of \$2.9 billion in the second quarter, which is the second-highest quarterly total in the industry's history. Strong growth in noninterest income and lower

expenses for future loan losses were two of the main sources of improved earnings. The industry's ROA for the second quarter was 1.03 percent, an improvement from the 0.98 percent average of the first quarter of 1999, but below the 1.09 percent average in the second quarter of 1998. The number of problem thrifts decreased from 16 institutions at the end of the first quarter to 14 institutions at the second-quarter end. *The FDIC Quarterly Banking Profile, Second Quarter 1999.*

RECENT ARTICLES AND STUDIES

According to an FDIC study released to the House and Senate Banking Committees on September 7, 1999, consolidation in the banking industry during the 1990s has made the Bank Insurance Fund (BIF) two-thirds more likely to fail than it was at 1990 bank consolidation levels. The study concludes that the consolidation that took place between 1990 and 1997 increased the risk of BIF insolvency by approximately 50 percent, and megamergers that took place between year-end 1997 and midyear 1999 increased the risk of insolvency further. The paper was written by Robert Oshinsky, a financial economist in the FDIC's Division of Research and Statistics. *Working Paper 99-3, FDIC, 9/7/99; AB, 9/8/99.*

A companion study released by the FDIC on September 7, 1999, and also written by Robert Oshinsky, concludes that a merger of the BIF and the SAIF would reduce the chances of either fund becoming insolvent. The study reports that a larger, combined insurance fund would be less at risk than either the BIF or the SAIF separately. The study is

entitled *Merging the BIF and the SAIF: Would a Merger Improve the Funds' Viability?* *Working Paper 99-4, FDIC, 9/7/99.*

An August 1999 study from the Federal Reserve Bank of New York concludes that large companies have come to rely less on banks for their day-to-day credit needs, however they still utilize banks when economic conditions are bad. The report, entitled *Are Banks Still Important for Financing Large Businesses?*, was written by Marc R. Saidenberg and Philip E. Strahan. They found that, as securities markets have grown over the past 25 years, businesses depend less on banks. More companies use commercial paper instead of bank loans because the rates are usually better. The share of credit extended to non-financial businesses from bonds and commercial paper grew from approximately 45 percent in the mid-1970s to approximately 55 percent in the mid-1990s. In addition, banks' share of assets held by financial intermediaries declined approximately 50 percent in the past 15 years. *BBR, 8/23/99, p. 279.*

INTERNATIONAL DEVELOPMENTS

Basel Committee

On July 27, 1999, the Basel Committee on Banking Supervision released four papers providing guidance to banks and banking regulators on credit risk. The guidance is part of the Basel Committee's ongoing effort to improve risk-management procedures in banks and create a sounder global banking system. The first paper, *Sound Practices for Loan Accounting and Disclosure*, was issued in final form and addresses a range of issues facing banks and bank supervisors in the accounting for loans and loan losses. The Basel

Committee is seeking comment on the three other papers. One of the three papers, *Principles for the Management of Credit Risk*, offers 17 risk-reduction practices that banks are advised to adopt. The second paper, *Best Practices for Credit Risk Disclosure*, recommends 24 ways for banks to help investors and other market players judge asset quality. The third paper, *Supervisory Guidance for Managing Settlement Risk in Foreign Exchange Transactions*, recommends that banks have a formal process for handling settlement risk. *NR 99-69, OCC, 7/27/99; AB, 7/27/99; BBR, 8/2/99, p. 197.*

Canada

Canadian legislation permitting the direct operation of foreign bank branches took effect on June 28, 1999, allowing foreign banks to set up commercially focused branch operations in Canada. Under the new legislation, foreign banks are able to open full-service or lending branches that would have the same powers as branches of domestic banks except for restrictions on deposit-taking. The full-service branches would be restricted to accepting deposits larger than C\$150,000, and lending branches would not be permitted to accept any deposits or to borrow money other than from other financial institutions. The Bank Act had previously required foreign banks to

operate branches in Canada through a separate Canadian subsidiary. *BBR, 7/5/99, p. 34.*

Mexico

On July 7, 1999, the president of Mexico's bank bailout agency announced that the agency will inject 13 billion pesos (approximately \$1.4 billion) into Banca Serfin in order to recapitalize the bank, which is the third-largest bank in Mexico. The bailout agency, Instituto para la Proteccion al Ahorro Bancaria (IPAB), will assume temporary control of Serfin, and will determine the bank's status and ready it for sale. *BBR, 7/19/99, p. 114.*