

Recent Developments Affecting Depository Institutions

by Lynne Montgomery*

REGULATORY AGENCY ACTIONS

Interagency Actions

Guidance on Loan-Loss Reserves

Federal bank and securities regulators announced on November 24, 1998, a joint agreement to work with the public accounting and banking industries to develop new guidance to ensure the adequacy of banks' loan-loss reserves and prevent inappropriate earnings manipulation. The agreement states that institutions should link loan-loss reserves to specific credits that are likely to be delinquent and should include a "margin for imprecision" that reflects the uncertainty associated with estimating credit losses in their loan portfolios. The joint release stresses that, although management's process for determining allowance adequacy is judgmental, it must not be used to manipulate earnings or mislead investors, funds providers, regulators, or other parties. The Securities and Exchange Commission (SEC), the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) issued the joint statement.

BBR, 11/30/98, p. 817.

Year 2000 Guidelines

Federal bank and thrift regulators published a notice in the *Federal Register* on October 15, 1998, which states that the regulators are establishing interagency safety-and-soundness standards for depository institutions preparing their computer systems for

the century date change. The joint Year 2000 safety-and-soundness guidelines are based on eight existing interagency Y2K bulletins issued by the Federal Financial Institutions Examination Council since 1996; however, the interagency Y2K guidelines will now be legally enforced. The new standards were issued jointly by the FDIC, the Federal Reserve Board, the OCC, and the OTS and are effective immediately. *BBR, 10/19/98, p. 584.*

Common Form for Merger Applications

On November 4, 1998, the OCC, the OTS, and the FDIC submitted a uniform bank merger application form to the Office of Management and Budget for review. If approved, the new Interagency Bank Merger Act application form would be used by institutions seeking approvals to merge, consolidate, or combine. The action is part of the regulatory agencies' continuing effort to promote consistency and reduce regulatory burden. *NR 98-113, OCC, 11/4/98.*

Federal Deposit Insurance Corporation

Director Neely Resigns

FDIC Board member Joseph H. Neely resigned his position as a director, effective October 1, 1998. Mr. Neely returned to Mississippi to pursue private-

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

sector consulting work. He served on the FDIC Board since January 1996, and he led the FDIC's regulatory review initiative, a comprehensive effort mandated by Congress to streamline and update federal agencies' regulations and policy statements. His six-year term was due to expire in January 2002. *BBR*, 9/14/98.

Assessment Rates

The FDIC Board of Directors voted on October 27, 1998, to leave the current assessment rate schedules for the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) unchanged for the first half of 1999. Every six months the FDIC decides whether to adjust the federal deposit insurance premium scale for banks and thrifts on the basis of projected changes in expected insurance losses, growth in insured deposits, and changes in the funds' net income. The FDIC is required to maintain a minimum reserve ratio of 1.25 percent, or \$1.25 for every \$100 of insured deposits, in the BIF and the SAIF to cover the costs of resolving failed banks and thrifts. In addition, the FDIC must administer the insurance funds under a risk-based assessment system, charging the weakest institutions a higher premium for deposit insurance. The FDIC forecasts the BIF reserve ratio to range between 1.38 and 1.44 percent by June 30, 1999. *BBR*, 11/2/98, p. 671.

Third-Quarter 1998 Financial Results

The BIF earned \$808 million for the first nine months of 1998, and the SAIF earned \$363 million for the same period. Both funds closed the third quarter with record balances, the BIF with \$29.1 billion and the SAIF with \$9.7 billion. The continuing low numbers of bank and thrift failures contributed to the strong results. Only three BIF-insured banks failed during the first nine months of 1998, and there were no failures of SAIF-insured thrifts. Revenue for the BIF totaled \$1.3 billion, including \$1.25 billion in interest on investments in U.S. Treasury securities and \$16 million in deposit insurance assessments. The SAIF earned \$431 million in revenue during the first three quarters of 1998, consisting of \$421 million in interest on investments in U.S. Treasury securities and \$10 million in deposit insurance assessments.

The FSLIC Resolution Fund (FRF) assets in liquidation were reduced by 32 percent over the nine-month period, to a balance of \$1.6 billion on

September 30, 1998. Federal Financing Bank borrowings for the FRF, including accrued interest, were fully repaid in August 1998. *PR-75-98, FDIC*, 11/5/98.

Real-Estate Survey—October 1998

The October 1998 issue of the *Survey of Real Estate Trends* reported that the nation's residential and commercial real-estate markets remained largely unchanged from the previous three-month period. The survey, which was conducted in late October, polled 295 senior examiners and asset managers from federal bank and thrift regulatory agencies about developments in their local markets in the preceding three months. Results of the survey hinted that the gains in commercial real-estate markets that had been observed almost continuously since 1996 appeared to have leveled off. Respondents were less positive about the strength of housing markets in October than in recent surveys, with 36 percent noting better conditions than three months earlier, compared to 61 percent in July. However, most of this difference represented a switch to reports of no change (53 percent, compared to 35 percent in July), and there was only a slight uptick in reports of worsening conditions.

The national composite index used by the FDIC to summarize results for both residential and commercial real-estate markets was 62 in October, down from 77 in July and from 71 in October 1997. Index readings for residential and commercial markets were down in every region. Index scores above 50 indicate improving conditions, while index scores below 50 indicate declining conditions. *Survey of Real Estate Trends, FDIC, October 1998*.

Report on Underwriting Practices

The October 1998 issue of the *Report on Underwriting Practices* reported a slight increase in the risk associated with loan underwriting practices at FDIC-supervised banks. The FDIC examiners reported greater concerns about some current underwriting practices, such as written lending policies differing from actual practices, as well as concerns about the risk in loan administration. The survey of loan underwriting practices is aimed at providing early warnings of potential problems in underwriting practices at FDIC-supervised, state-chartered nonmember banks. The focus of the survey is threefold: material changes in underwriting standards for new loans, degree of risk in current practices, and specific

aspects of the underwriting standards for new loans. The October report includes surveys from 1,104 FDIC-supervised banks that were examined during the six months ending September 30, 1998. *Report on Underwriting Practices, FDIC, October 1998.*

Updated Trust Exam Manual

The FDIC revised its Trust Examination Manual, simplifying and clarifying the materials that FDIC examiners use to evaluate the safety and soundness of depository institutions' trust departments. The new trust guidance includes revised principles of trust department management, which are intended to reflect current banking and fiduciary practices. The FDIC advises that the institutions' boards of directors should ensure that trust departments conduct their activities away from all other areas of the bank. In addition, trust assets should be separate from other bank assets, and the assets of each trust account should be separate from other trust assets. The institution should maintain separate financial books and records for the trust department's fiduciary activities. An institution's board of directors should also designate a qualified officer to administer the trust department's daily operations, and name a trust committee consisting of at least three officers to oversee the trust department. The guidance also sets forth numerous minimum responsibilities for the trust committee. *FDIC FIL-100-98, 9/10/98; BBR, 9/21/98, p. 405.*

Year 2000 Disclosure

On October 8, 1998, the FDIC sent an advisory letter to depository institutions recommending that the institutions follow guidance issued by the Securities and Exchange Commission to provide appropriate disclosure of Year 2000 issues in public documents that report on the institution's financial results. The SEC guidance, titled *Statement of the Commission Regarding Disclosure of Year 2000 Issues and Consequences by Public Companies, and Municipal Securities Issuers*, went into effect on August 4, 1998. *BBR, 10/26/98, p. 636.*

New Application Procedures

On November 5, 1998, the FDIC adopted a revised regulation that expedites the processing of applications filed by well-managed, well-capitalized banks and savings associations that want to sell real estate, underwrite securities or engage in a variety of other activities. Institutions that meet specific eligi-

bility requirements will merely have to notify the FDIC of their intent to establish a majority-owned securities or real-estate subsidiary. If the FDIC does not object within 30 days, the applicant can begin operations. *PR-76-98, FDIC, 11/5/98.*

Semiannual Agenda of Regulations

The FDIC published its semiannual agenda of regulations in the *Federal Register* on November 13, 1998, to inform the public of the Corporation's regulatory actions and encourage participation in the rule-making process. Many of the actions are the result of the FDIC Board's ongoing efforts to reduce the regulatory burden on banks, simplify rules, improve efficiency and comply with the Riegle Community Development and Regulatory Improvement Act of 1994. The agenda contains 26 regulatory actions. Five actions have been completed and the remainder are in various stages of the rulemaking process. *PR-77-98, FDIC, 11/13/98.*

Federal Reserve Board

Interest Rates

On September 29, 1998, the Federal Open Market Committee voted to trim the targeted federal funds rate by 25 basis points, which reduced the rate from 5.5 percent to 5.25 percent. This was the first time the Federal Reserve Board eased the stance of monetary policy since January 31, 1996. Rates were further reduced on October 15, 1998, when the Federal Reserve Board approved a 25-basis-point reduction in the discount rate from 5 percent to 4³/₄ percent, which dropped the federal funds rate down to 5 percent. The Board of Governors approved an additional 25-basis-point reduction in the discount rate on November 17, 1998, which resulted in a discount rate of 4¹/₂ percent. The federal funds rate declined to 4³/₄ percent. *FR-PR 9/29/98, 10/15/98 and 11/17/98.*

Reduced Service Fees

On November 4, 1998, the Federal Reserve Board voted to cut the fees for 1999 that regional Federal Reserve Banks charge member institutions for electronic funds transfer and payment clearing services. According to its 1999 fee schedules, the Federal Reserve Banks will reduce the price index for Fedwire funds transfers by almost 30 percent, and reduce the fee for electronic securities transfers by approximately 25 percent. In addition, the price

index for automated clearinghouse services was reduced slightly in an attempt to increase banks' use of the electronic payment system. The Federal Reserve Board increased the fees for processing paper checks by 3.7 percent over 1998 levels, in order to give the banks incentive to use electronic services. *BBR, 11/9/98, p. 710.*

New Threshold for Reserves

On November 24, 1998, the Federal Reserve Board adjusted its policies for reserve requirements. The new policies state that banks do not have to hold reserves against the first \$4.9 million of deposits and other liabilities subject to reserve requirements, which is an increase from the \$4.7 million threshold. Additionally, the new policies require banks to hold 3 percent in reserves on deposits between \$4.9 million and \$46.5 million, and all remaining deposits are subject to a 10 percent reserve requirement. *AB, 11/25/98.*

Office of the Comptroller of the Currency

Hawke Named Comptroller

On December 7, 1998, President Clinton named John D. Hawke, Jr. to serve as Comptroller of the Currency. The President assigned Mr. Hawke to a recess appointment, which allows Mr. Hawke to serve one year without Senate confirmation. Mr. Hawke has served as Treasury Undersecretary for Domestic Finance since 1995. *The Washington Post, 12/8/98.*

Expanded Reinsurance Activity

According to an OCC decision made available on October 8, 1998, a national bank may expand the activities of its mortgage reinsurance operating subsidiary to include reinsuring mortgage insurance on loans serviced by the bank or its affiliates. Mortgage insurance protects a lender against default by the mortgagor. Reinsurance is a process by which an original insurer reduces its underwriting risk by passing all or part of this risk to another insurance company. The decision was made in response to a request from Mellon Bank. *BBR, 10/19/98, p. 601.*

Community Bank Supervision Handbook

The OCC issued new guidance to examiners on September 3, 1998, to make examinations of national banks with assets of less than \$1 million more risk-focused and less burdensome to banks. The

Community Bank Supervision handbook combines two existing handbooks, *Community Bank Procedures for Noncomplex Banks* and *Community Bank Risk Assessment System*. The new handbook will help alleviate unnecessary regulatory burden and make exams more efficient by focusing examiner attention on key areas of risk. *BBR, 9/14/98, p. 356.*

Fees on International Loans

On October 26, 1998, the OCC released a final regulation requiring national banks to use generally accepted accounting principles for fees on international loans. The rule, which is effective on January 1, 1999, applies to fees that banks charge when they restructure international loans. The rule prohibits banks from charging fees that exceed the administrative costs of restructuring the loan, unless that fee is amortized over the life of the loan. *BBR, 11/2/98, p. 677.*

Office of Thrift Supervision

New Receivership

On October 8, 1998, the Office of Thrift Supervision placed New West Federal Savings and Loan Association in receivership and appointed the FDIC as receiver. New West was created in 1988 to liquidate the nonperforming assets of the failed American Savings, Stockton, California. New West's assets total \$18.4 million. The institution has no deposits and had fulfilled its task of self-liquidation. *OTS 98-77, 10/8/98.*

No Changes to 1999 Thrift Report Form

The OTS announced on November 24, 1998, that it will make no changes to the 1999 quarterly Thrift Financial Report form (TFR) in order to allow the thrift institutions to concentrate on Year 2000 compliance issues. The OTS had proposed to reorganize the TFR's equity section and to collect additional information on the TFR, such as high loan-to-value lending data. However, the OTS decided to postpone any changes. *OTS 98-85, 11/24/98.*

New Assessment Rates

The OTS adopted a revised formula to bring the assessments on savings institutions more in line with the actual cost of regulating them. The new assessment formula will be based on three components: a thrift's size, its condition, and the complexity of its operations. The new size component retains the cur-

rent economies of scale approach, but also builds some of OTS' fixed supervisory costs into the base assessment level. Under the new formula, institutions with a CAMELS rating of 4 or 5 will continue to pay a 50 percent premium over the asset-based assessment because they require more supervision. However, for the first time, institutions with a CAMELS rating of 3 will be required to pay a 25 percent premium. In addition, the OTS will charge a higher assessment to large thrifts that are involved in complex activities. The OTS estimates that over 90 percent of the thrifts it supervises will pay the same or a lower assessment under the new schedule. The new formula is effective for the first semiannual assessment of 1999. *OTS 98-88, 11/30/98.*

Derivatives Rule and Risk Management Guidance

On December 1, 1998, the OTS adopted new comprehensive guidance to assist savings associations in managing their risk. The guidance, which covers interest-rate risk, investment securities, and use of financial derivatives, is published in the Thrift Bulletin 13a. This bulletin replaces seven existing OTS thrift bulletins. The OTS also adopted a new rule that replaces three outdated regulations concerning forward commitments, futures transactions, and financial options transactions. The new rule establishes requirements applicable to all derivative instruments and is designed to work in conjunction with the new bulletin. The goal of the new rule is to ensure the safe-and-sound management of the risks associated with financial derivatives and reduce regulatory burden. The rule is effective on January 1, 1999, and the bulletin is effective upon publication. *OTS 98-90, 12/1/98.*

National Credit Union Administration

New Conversion Rule

On November 19, 1998, the National Credit Union Administration approved an interim final rule that revised the agency's regulations on the conversion of federal credit unions to mutual savings banks. The revisions are intended to simplify the charter conversion process and reduce regulatory burden for insured credit unions that choose to convert. Under the new rule, conversion to a mutual savings bank requires the approval of the credit union's members, but credit unions no longer need prior NCUA

approval. However, a credit union must provide the NCUA with notice of its plans to convert at least 90 days before the membership vote. The new rule was mandated by the Credit Union Membership Access Act. *BBR, 11/30/98, p. 833.*

Federal Housing Finance Board

Board Appointee

On October 21, 1998, President Clinton announced the nomination of Douglas M. Miller to the Federal Housing Finance Board. Mr. Miller previously served as Chief of Staff and Administrative Assistant to former Senator Larry Pressler (R-SD) from 1991 to 1997, and also served as Legislative Director and Legislative Assistant from 1979 to 1991. If approved, Mr. Miller would replace Art Agnos, who is the Department of Housing and Urban Development's designee on the Board. *BBR, 10/26/98, p. 647.*

Mortgage Pilot Program Expanded

On September 23, 1998, the Federal Housing Finance Board authorized the expansion of a Mortgage Partnership Finance Program in a manner that would allow any Federal Home Loan Bank to offer a Mortgage Partnership Finance Program to its members. The program, which was piloted in Chicago in late 1996, allows FHLBank members to sell loans to the FHLBank rather than to Fannie Mae or Freddie Mac, and thus avoid paying guarantee fees to Fannie Mae or Freddie Mac. The FHLBank can sell participation interests in the program to other FHLBanks. The program is capped at \$9 billion for all 12 FHLBanks. *BBR, 9/28/98, p. 473.*

Community Lending Rules Approved

On October 28, 1998, the Federal Housing Finance Board approved two final rules that extend community lending options for the Federal Home Loan Bank System. The rules establish a framework for Community Investment Cash Advance (CICA) programs and provide guidance for issuing standby letters of credit. In 1989, Congress gave the FHLBanks the authority to make advances to support community investment with CICAs; however, there were no standards for what types of loans the FHLBanks may support under this authority. Under the new regulation, FHLBanks will develop and adopt an annual Community Lending Plan, which requires each FHLBank to identify and address

credit needs and market opportunities. The new rule will help spread out advances to support more economic development and housing credit needs.

The Finance Board adopted a second rule that provides guidance on existing policies to permit expanded use of standby letters of credit by the 12 FHLBanks. Standby letters of credit are issued by FHLBanks to a member to serve as a form of guarantee that the member will fulfill its obligations

under a contract with a third party. The new rule expands the types of collateral the FHLBanks can accept for letters of credit to include items such as secured small-business loans and investment-grade bonds. However, the expanded letters of credit are restricted to those that support the FHLBanks' mission of economic development and housing. *BBR*, 11/2/98, p. 685.

STATE LEGISLATION AND REGULATION

Louisiana

On October 20, 1998, the OCC granted national banks in Louisiana the power to sell insurance from offices in big cities. The OCC ruling expands the powers awarded to national banks in 1997, which let banks sell insurance statewide as long as the insurance subsidiary was based in a place with 5,000 or fewer residents. The new ruling marks the first time the OCC has explicitly ruled that banks may open insurance agency offices outside of small towns. The OCC based its ruling on a Louisiana law that specifically granted bank insurance affiliates the same rights as other insurance agencies. *AB*, 11/12/98.

Pennsylvania

A proposed bill would require the FDIC to insure all Pennsylvania building-and-loan institutions. Pennsylvania's building-and-loan institutions are currently insured by the Pennsylvania Savings Association Insurance Corporation, a private entity created in 1979. However, regulators argue that private insurance is less secure than federal deposit insurance. The bill would give building-and-loan institutions 30 months to either get FDIC insurance, merge with an institution that already has FDIC insurance, or liquidate. *AB*, 12/4/98.

BANK AND THRIFT PERFORMANCE

Second-Quarter 1998 Results for Commercial Banks and Savings Institutions

Insured commercial banks posted record profits in the second quarter of 1998, with net income for the three-month period at an all-time high of \$16.1 billion. Strong growth in noninterest revenues, especially income from trust activities and other fees, attributed to much of the increase in banks' second-quarter earnings. Banks' annualized return on assets (ROA) was 1.25 percent in the second quarter, compared to 1.26 percent in the first quarter and 1.24 percent in the second quarter of 1997. The number of problem banks declined from 67 to 64 during the quarter, while assets of problem banks remained at \$5 billion. There was one failure of an insured commercial bank during the second quarter.

FDIC BIF-insured mutual savings institutions posted earnings of \$2.8 billion in the second quarter of 1998, up from the previous record of \$2.6 billion set in the second quarter of 1996. The annualized ROA rose to 1.09 percent in the second quarter, compared to 1.01 percent in the first quarter and 0.95 percent in the second quarter of 1997. The number

of problem thrifts increased by 2 to 18 at the end of the second quarter 1998, and assets of problem thrifts rose from \$2.3 billion to \$2.9 billion. *FDIC Quarterly Banking Profile, Second Quarter 1998*.

Second-Quarter 1998 Results for Thrifts

The nation's thrift industry earned \$2.1 billion in the second quarter of 1998, which was up from \$1.87 billion in the first quarter of 1998 and \$1.69 billion in the second quarter of 1997. Profitability and capital levels also increased in the second quarter, while troubled assets and delinquent loans decreased. The equity capital to assets ratio rose from 8.40 percent in the first quarter to 8.56 percent in the second quarter of 1998.

The thrift industry's ROA was 1.07 percent in the second quarter, up from 0.97 percent in the first quarter and 0.89 percent in the second quarter of 1997. The number of problem thrifts increased to 18, compared to 14 institutions in the first quarter of 1998 and 25 in the second quarter of 1997. The OTS attributed the strong industry earnings to higher fee income, improved asset quality, gains on sales of

mortgage loans to the secondary market, and a stable net interest margin. *OTS 98-68, 9/2/98.*

Third-Quarter 1998 Results for Commercial Banks and Savings Institutions

The commercial banking industry earned \$15 billion in the third quarter of 1998, following the record \$16.1 billion in profits earned in the previous quarter. The earnings decline was caused by weaknesses in the overseas operations and the trading activities of a few of the largest banks. The ROA fell to 1.15 percent in the third quarter, down from 1.25 in the second quarter of 1998 and from 1.22 percent in the third quarter of 1997. The number of problem banks increased from 64 to 70 during the quarter, and assets of problem banks rose from \$5.0 billion to \$5.4 billion. Two commercial banks failed during the quarter.

FDIC BIF-insured mutual savings institutions reported \$3.0 billion in net income for the third quarter of 1998, surpassing the previous industry record of \$2.8 billion set in the second quarter. The industry's average annualized return on assets was 1.14 percent, the second consecutive quarterly record for this profitability measure. For the eighth consecutive quar-

ter, there were no savings institution failures. The number of problem thrifts remained unchanged at 18 and assets for this group were stable at \$2.9 billion. *FDIC Quarterly Banking Profile, Third Quarter 1998.*

Third-Quarter 1998 Results for Thrifts

The thrift industry earned a record \$2.23 billion in the third quarter of 1998, passing the previous record of \$2.10 billion in the second quarter. The industry's equity capital also reached a new high, while its ratio of troubled assets to total assets declined to a new low. The equity capital to total assets ratio reached a record high of 8.58 percent in the third quarter, up from the previous record of 8.56 percent in the second quarter. Ninety-eight percent of OTS-supervised thrifts met or exceeded the requirements for the highest capital category, "well-capitalized."

The thrift industry's ROA was 1.13 percent in the third quarter, which exceeded the previous record of 1.07 percent in the second quarter of 1998 and was up from 0.71 percent in the third quarter of 1997. The number of problem thrifts remained at 18 in the third quarter of 1998, which is the same as in the second quarter. In the third quarter of 1997, the OTS reported that there were 23 problem thrifts. *PR 98-91, OTS, 12/2/98.*

RECENT ARTICLES AND STUDIES

On June 11, 1998, the Federal Reserve Board released a report entitled *Annual Report to the Congress on Retail Fees and Services of Depository Institutions*. The report concludes that banks operating in multiple states generally charged significantly higher fees than those operating in a single state. The Independent Bankers Association of America (IBAA) analyzed the data and suggested that the size of a bank is a greater factor in fee assessment than geography. According to a September 1998 IBAA analysis of the Federal Reserve Board's report to Congress, fees and minimum balance requirements at large banks were 20 to 79 percent higher than at small banks in 1997. The studies define small banks as having less than \$100 million in assets, and large banks as having more than \$1 billion in assets. *BBR, 9/21/98, p. 406.*

A study published by the Federal Reserve Bank of Dallas reports that the recent trend of mergers among financial-services institutions shows that the industry is creating new opportunities from breakthroughs in technology and deregulation, and as a

result, new forms of competition are emerging in the industry. The report, entitled *Bank Mergers: Creating Value or Destroying Competition*, states that technology is creating incentives to merge because advancements in communications have created a wider array of service products. Although mergers have reduced the number of institutions in the marketplace, an increased variety of financial-services offerings and reduction in geographic restrictions have kept competition strong within the industry, the study said. *BBR, 11/30/98, p. 822.*

A paper entitled *Bank Diversification: Laws and Fallacies of Large Numbers* states that bigger banks are not necessarily safer than smaller institutions. The paper states that banks do not become less risky as they grow larger because any single failure becomes more harmful to the economy. Instead, banks become less likely to fail. The paper was written by Joseph G. Haubrich, an economist at the Federal Reserve Bank of Cleveland. *AB, 12/11/98.*

A paper written by Kevin T. Jacques of the OCC and Raj Aggarwal of John Carroll University reports

that prompt corrective action rules have caused banks to increase capital and operate more safely. The authors report that equity capital held by U.S. banks rose 28 percent in the two years after Congress adopted the Federal Deposit Insurance Corporation

Improvement Act of 1991, which authorized regulators to seize banks when capital falls below two percent. The paper is entitled *Assessing the Impact of Prompt Corrective Action on Bank Capital and Risk*. *AB*, 11/13/98.

INTERNATIONAL DEVELOPMENTS

Japan

On October 12, 1998, Japan's Parliament approved legislation that is intended to revive the banking system. The legislation allows the Government to deal with large, failing banks by nationalizing them, liquidating them or transforming them into publicly owned "bridge banks," which take over the good loans and try to collect on the bad loans. Under the new law, the Government would establish a public institution to resell the good assets and deal with the bad ones in a process similar to that of the Resolution Trust Corporation, which was established to help resolve the savings-and-loan crisis in the early 1990s.

Japanese Prime Minister Keizo Obuchi appointed a new minister to oversee the cleanup of the financial sector. Hakuo Yanagisawa was appointed to the new ministerial post and will oversee the use of up to 60 trillion yen of public money to rebuild the banking system.

On October 23, 1998, Prime Minister Obuchi announced that Japan would nationalize its tenth-largest bank, Long-Term Credit Bank of Japan Ltd. (LTCB), in order to protect the stability of the financial system. Under the nationalization plan, the Government will buy out all of LTCB's shares at a price near zero and provide funds to keep the bank operating. All of LTCB's deposits, debentures and financial market obligations will be guaranteed with government money, and a new board of directors will be appointed.

The Government announced another bank nationalization on December 13, 1998, when it took over Nippon Credit Bank Ltd. Regulators are working out a plan for disposing of Nippon Credit's assets. Nippon Credit had approximately \$27 billion in problem loans and liabilities that exceeded assets by \$787 million. *The New York Times*, 10/13/98; *WSJ*, 12/14/98.

Russia

Russia's three major commercial banks, Onexim-bank, Bank Menatep, and Most Bank announced that they would merge into a new bank by January 1,

1999. Russia's Central Bank welcomed the merger by the former archrivals, and stated that the merger is a "factor of stability for the entire Russian banking system." The recent financial turmoil in Russia is expected to cause additional bank mergers. There are currently 1,600 commercial banks in Russia, compared to 2,500 only a few years ago. *BBR*, 8/31/98, p. 342.

A statement issued on November 21, 1998, announced that Russia's Cabinet and Central Bank have set up a new federal agency with wide-ranging powers for restructuring the country's ailing banking system. The Agency for Restructuring Credit Organizations (ARKO) will oversee bankruptcy procedures to be launched against failing banks, serve as the government's vehicle for strengthening the banking sector, and shape a market for debts of credit organizations and their debtors. ARKO will have the right to acquire controlling stakes in failed banks, manage and sell their equity stakes, fire and hire bank managers, and attract financial resources by issuing securities both for the operation of banks under its control and for its own needs. The agency will be managed jointly by the Cabinet and the Central Bank. *BBR*, 11/30/98, p. 845.

Basle Committee

The Basle Committee on Banking Supervision issued a paper on September 22, 1998, entitled *Framework for Internal Control Systems of Banking Organizations*. In the paper, the Basle Committee presents the first internationally accepted framework for supervisors to use in evaluating the effectiveness of the internal controls over all on- and off-balance-sheet activities of banking organizations. The paper describes elements that are essential to a sound internal control system, recommends principles that supervisors can apply in evaluating such systems, and discusses the role of bank supervisors and external auditors in this assessment process. The internal control framework described in the paper is designed for international banking organizations. The Com-

mittee issued two additional guidance papers on September 22, 1998, which dealt with transparency and operational risk management. *FR-PR 10/22/98.*

The Basle Committee issued a fourth paper on October 14, 1998, which provides guidelines to encourage banks to disclose more about their credit risks and to adopt more universal accounting techniques for assessing loans. While most of the “sound practices” recommended by the Committee follow generally accepted U.S. standards, the public disclosure guidance is new for many countries. The report stipulates that not all banks need make all the disclosures. An institution may not necessarily provide all the disclosures recommended if a particular disclosure item is not relevant to the assessment of the bank. On the other hand, banks relying on capital markets and larger institutions with complex operations would be expected to make more extensive disclosures. *BBR, 10/19/98, p. 607.*

On October 28, 1998, the Basle Committee issued an interpretation on instruments that are eligible for Tier 1 regulatory capital treatment under the Basle capital framework of the Basle Accord. The Basle Accord was endorsed by the G-10 Governors in 1988 and applies to internationally active banks. The Committee’s interpretation stresses the importance of ensuring that the predominant form of Tier 1 capital in the Basle Accord framework is in the form of common shareholders’ funds. The interpretation also states that minority interests in equity accounts of consolidated subsidiaries that take the form of spe-

cial-purpose vehicles may be included in Tier 1 capital provided they meet certain criteria, including permanence and the ability to absorb losses within the bank on a going-concern basis. The interpretation also stresses the need for banks to disclose periodically each component of Tier 1 capital. The FDIC and the OCC will work with the other U.S. banking agencies to determine how the Basle Committee interpretation will be applied to U.S. banks. *PR-72-98, FDIC, 10/28/98.*

Mexico

On September 14, 1998, the Mexican political parties agreed on basic principles for resolving the deadlock over FOBAPROA, a 1995 bank bailout fund that rescued the Mexican banking system by buying non-performing loans from struggling Mexican banks. Mexican President Ernesto Zedillo Ponce de Leon is seeking to convert the liabilities of FOBAPROA into public-sector debt, which ultimately would be paid by Mexican taxpayers. But opposition parties in the Mexican congress have blocked movement on the issue, saying that banks managed by corrupt or incompetent bankers should pay for the bailout. The inability to resolve the bank bailout issue has weighed heavily on Mexican markets and contributed to a depreciation of the peso. The new agreement is too vague to be considered a solution to FOBAPROA, but it shows willingness on the part of Mexico’s government to punish corrupt bankers. *BBR, 9/28/98, p. 484.*