

Recent Developments Affecting Depository Institutions

by Lynne Montgomery*

REGULATORY AGENCY ACTIONS

Interagency Actions

FFIEC Issues Year 2000 Guidance

On April 10, 1998, the Federal Financial Institutions Examination Council issued guidance to help financial institutions prepare testing procedures to address computer-related problems linked to the century date change. The Exam Council declared that testing is the most important phase in Year 2000 preparations. In addition to the institution's own systems, banks and thrifts are required to look at services and products provided by vendors. The Exam Council outlined the general internal and external systems that should be examined and also set several deadlines for institutions to meet in the Y2K testing process. The Exam Council explained that noncompliance with the Y2K guidance and deadlines could threaten the safety and soundness of the institution. *BBR, 4/20/98, p. 634.*

New Approach to Evaluating Investment Risks

The Federal Financial Institutions Examination Council issued a policy statement on investment securities and end-user derivative activities, which requires depository institutions to focus on how combinations of risk affect the institution's overall financial health. The policy statement was published in the *Federal Register* on April 23, 1998. The new approach eliminates three tests that bank regulators

have used since 1992 to measure investment risks. The banking agencies were concerned that the 1992 policy placed too much emphasis on the type of instrument involved, rather than the investment's risk characteristics and how they affected the institution's total risk profile. The new policy statement emphasizes that senior managers and directors should understand how the risks of an institution's investment portfolio affect the entire organization. The policy statement advises that determining whether a security or mortgage derivative product is an appropriate investment depends on a variety of factors, including the institution's capital level, the security's effect on the aggregate risk of the portfolio, and the management's ability to measure and manage the risks. *BBR, 4/27/98, p. 668; FIL-45-98, FDIC, 4/28/98.*

Regulators Approve Uniform Application

On May 6, 1998, the Conference of State Bank Supervisors announced that state and federal banking regulators approved a Uniform Interstate Application/Notice Form. State-chartered banks operating in more than one state will be permitted to file a single application with federal and state regulators to set up, relocate, or discontinue a branch, an automated teller machine, or other place of business.

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

The uniform application will ease the regulatory burden for state-chartered banks. The application was developed by the State Federal Working Group, which consists of senior regulators representing the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), and the Conference of State Bank Supervisors. *BBR*, 5/11/98, p. 756.

Revised Policy on Civil Money Penalties

Effective June 3, 1998, the Federal Financial Institutions Examination Council issued a revised interagency policy on the criteria agencies should use when assessing fines on depository institutions for violations of laws, regulations, and other misconduct. The revised joint policy replaces an existing civil money penalty policy statement, which was adopted in 1980. The updated policy statement eliminates unnecessary references to interagency coordination of civil money penalty proceedings and specifies that the amount of a fine should be sufficient to deter future misconduct. The revised policy also requires federal regulators to consider five statutory factors when deciding whether to impose fines, including: the financial resources of the institution; good faith; the seriousness of the violation; history of previous offenses; and other factors that may require corrective action. Further, the revised policy lists the type of violations that may warrant civil money penalties. *BBR*, 6/8/98, p. 921.

New Capital Limits for Servicing Assets

The Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), the FDIC, and the Office of Thrift Supervision (OTS) issued a final rule on August 4, 1998, which amends capital adequacy standards for banks, bank holding companies, and savings associations. The final rule increases the maximum amount of mortgage servicing assets and purchased credit-card relationships (PCCRs) that depository institutions may include in regulatory capital calculations. The final rule increases the Tier 1 capital limit for mortgage servicing assets and PCCRs from 50 percent to 100 percent of Tier 1 capital. The rule is effective as of October 1, 1998. *BBR*, 7/13/98, p. 55-56; *FRB-PR*, 8/4/98.

New Risk-Based Capital Standards

The Federal Reserve Board, the OCC, the FDIC, and the OTS amended their risk-based capital standards for banks, bank holding companies and thrifts regarding the capital treatment of unrealized holding

gains on certain equity securities. These gains have been reported as a component of equity capital under U.S. generally accepted accounting principles (GAAP), but have not been included in regulatory capital under the banking agencies' capital standards. The final rule, which is effective October 1, 1998, permits institutions to include up to 45 percent of the pre-tax net unrealized holding gains on certain available-for-sale equity securities in supplementary capital (Tier 2). The final rule will make the capital treatment of these unrealized gains consistent with the international standards of the Basle Accord. *FRB-PR*, 8/26/98.

Federal Deposit Insurance Corporation

Tanoue Sworn in as Chairman

Donna A. Tanoue was sworn in as the 17th Chairman of the FDIC on May 26, 1998. Before her appointment to the FDIC, Ms. Tanoue was an attorney with the law firm of Goodsell Anderson Quinn & Stifel in Honolulu. She also served as Hawaii's financial institutions commissioner during the banking crisis in the mid-1980s, where she engineered a rescue package for Hawaii's underfunded thrift insurance corporation. Ms. Tanoue replaces FDIC Acting Chairman, Andrew C. Hove, Jr., who will resume his position as the agency's Vice-Chairman. *PR-35-98*, *FDIC*, 5/26/98.

Semiannual Agenda of Regulations

On April 27, 1998, the FDIC published its semi-annual agenda of regulations in the *Federal Register* to inform the public of projected new rulemakings, as well as existing regulations under review and completed rulemakings. 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. Six actions have been completed and the others are in various stages of the rulemaking process. *PR-29-98*, *FDIC*, 4/29/98.

Assessment Rates

The FDIC Board of Directors voted to maintain the current deposit insurance assessment rates for the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) through year-end 1998. Insurance premiums for the BIF and the SAIF

range between zero and 27 basis points, depending on the institution's supervisory rating. The healthiest banks and thrifts pay nothing for deposit insurance. Currently, approximately 95 percent of all federally insured banks and 91 percent of all federally insured savings associations pay no deposit insurance premiums. Federal law requires the FDIC to maintain a minimum reserve ratio of 1.25 percent (reserves as a percent of insured deposits) for both the BIF and the SAIF. The FDIC estimates that the BIF reserve ratio will be 1.43 percent and the SAIF ratio will be 1.45 percent by December 31, 1998. *BBR*, 5/4/98, p. 705; *FIL-66-98*, *FDIC*, 6/19/98.

Bank Failures

The Michigan Commissioner of the Financial Institutions Bureau closed Omnibank in River Rouge, Michigan, on April 9, 1998, and the FDIC was named receiver. The deposits of Omnibank were assumed by ShoreBank, Detroit, in Detroit, Michigan, which is a newly chartered bank subsidiary of Shorebank Detroit Corporation. ShoreBank paid the FDIC a premium of \$154,000 to receive the failed bank's deposits and to purchase \$41.8 million in assets. In addition, ShoreBank will participate in a five-year loss-sharing arrangement on approximately \$23.8 million of the assets that it purchased from the receivership. The FDIC estimates that this transaction will cost the BIF approximately \$3.1 million. Omnibank is the first FDIC-insured failure since November 1997. *PR-24-98*, *FDIC*, 4/9/98.

On July 23, 1998, the Colorado State Bank Commissioner closed BestBank in Boulder, Colorado, and the FDIC was named receiver. The FDIC approved the assumption of the insured deposits of BestBank by The Pueblo Bank and Trust Company in Pueblo, Colorado. The Pueblo Bank also purchased \$47.2 million of the failed bank's assets. The former office of BestBank was reopened on July 27, 1998, as a branch of Pueblo Bank and Trust. This was the first bank failure in Colorado since 1993. *PR-50-98*, *FDIC*, 7/25/98.

Montana's Commissioner of Financial Institutions closed Q Bank of Fort Benton, Montana, on August 7, 1998, and the FDIC was named receiver. The FDIC approved the assumption of the insured deposits of Q Bank by Heritage State Bank in Fort Benton, Montana, which is a newly chartered banking subsidiary of United Financial Corporation in Great Falls, Montana. Heritage State Bank paid a

premium of \$445,000 for the right to receive the insured deposits and will purchase \$2.5 million of the failed bank's assets. The FDIC estimates the cost of the transaction to the BIF will be approximately \$1.3 billion. Q Bank is the third failure of an FDIC-insured bank this year and the first in Montana since March 1992. *PR-54-98*, *FDIC*, 8/7/98.

Simplified Deposit Insurance Rules

On April 28, 1998, the FDIC Board of Directors approved final revisions clarifying certain aspects of the deposit insurance regulations. The revised deposit insurance regulations, which are effective July 1, 1998, make three significant revisions to the insurance rules. The revised regulations give the FDIC more flexibility to insure deposits made by third-party agents on behalf of account owners. The regulations also clarify the insurance coverage of living trust accounts and provide a six-month grace period following the death of a depositor for beneficiaries to restructure inherited accounts in order to maximize deposit insurance coverage. *BBR*, 5/4/98, p. 704-705; *PR-26-98*, *FDIC*, 4/28/98.

Interstate Banking Interest Charges

The FDIC published a legal opinion in the *Federal Register* on May 18, 1998, clarifying how interest charges are applied when a state-chartered bank operates across state lines. The FDIC opinion gives state banks the same flexibility that national banks have under Section 85 of the National Bank Act, which permits a bank to charge interest allowed by its home state to out-of-state borrowers. The opinion addresses three main issues, including: where interstate state banks are located for purposes of federal law; which state's interest provisions should govern the interest charged on the loan; and the need for disclosures to customers regarding which state's law will cover the loan. *PR-33-98*, *FDIC*, 5/13/98; *BBR*, 5/25/98, p. 851-852.

Midyear 1998 Financial Results (Unaudited)

The Bank Insurance Fund (BIF) reported \$637 million in net income for the first half of 1998, and the Savings Association Insurance Fund (SAIF) earned \$242 million for the same period. Both funds closed the second quarter of 1998 with record balances, the BIF with \$28.9 billion and the SAIF with \$9.6 billion. The strong results are attributed to the continuing low numbers of bank and thrift failures. Revenue for the BIF totaled \$858 million for the first six months ending June 30, 1998, including \$827 mil-

lion in interest on investments in U.S. Treasury securities and \$8 million in deposit insurance assessments. The SAIF earned \$282 million in revenue, consisting of \$278 million in interest on investments in U.S. Treasury securities and \$4 million in deposit insurance assessments.

The FSLIC Resolution Fund (FRF) assets in liquidation were reduced by 24 percent, to \$1.8 billion. Federal Financing Bank borrowings for the FRF were reduced by \$492 million, to \$357 million, during the six-month period. *PR-58-98, FDIC, 8/25/98.*

Real-Estate Survey—April 1998

The April 1998 issue of the *Survey of Real Estate Trends* continued to report favorable conditions for residential and commercial real-estate markets. The survey polled 302 senior examiners and asset managers from the federal bank and thrift regulatory agencies about developments in their local markets in the preceding three months. Sixty-three percent of those surveyed in late April described local housing markets as improving, up from 49 percent in the January survey. More than half of the respondents (56 percent) cited better conditions for commercial markets in the last three months compared to 49 percent in the January survey.

The national composite index was 79 in April, up from 72 in January and 71 in April 1997. Index scores above 50 reflect improving conditions, while index scores below 50 indicate declining conditions. Every region showed an increase in the index between January and April. *Survey of Real Estate Trends, FDIC, April 1998.*

Real-Estate Survey—July 1998

The July 1998 issue of the *Survey of Real Estate Trends* also reported favorable conditions for residential and commercial real-estate markets. The July survey polled 299 examiners and asset managers. Sixty-one percent observed that local housing markets had improved during the preceding three months, compared with 63 percent in the April survey and up from 51 percent in July 1997. Assessments of commercial market conditions remained positive in July, although the frequency of favorable reports was slightly less than three months earlier. Fifty-two percent reported improvements, compared with 56 percent in the April survey.

The national composite index was 77 in July, a slight decrease from the April index of 79, but improved from the July 1997 index of 74. *Survey of Real Estate Trends, FDIC, July 1998.*

Report on Underwriting Practices

The April 1998 issue of the *Report on Underwriting Practices* reported that banks' underwriting practices have weakened during the last year. The weakened standards are most evident in commercial real-estate and construction lending; however, the FDIC examiners noted early signs of adverse trends for all major types of loans. Implemented in early 1995, the survey of underwriting practices is aimed at providing early warnings of potential problems in underwriting practices at FDIC-supervised, state-chartered non-member 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.

Report on Underwriting Practices, FDIC, April 1998.

Expedited Application Procedures

The FDIC Board of Directors voted on July 7, 1998, to expedite the processing of applications filed by well-managed, well-capitalized institutions and to simplify and streamline its application rules. The revised Part 303 of the FDIC's rules applies expedited processing procedures to applications for deposit insurance, mergers, branches, trust powers, stock buy-backs, and certain international banking activities. The revised rule, which is effective October 1, 1998, reduces regulatory burden for well-managed institutions and permits the FDIC to focus resources on applications that present a significant issue or risk.

PR-45-98, FDIC, 7/7/98.

Federal Reserve Board

Phillips Resigns

Federal Reserve Governor Susan Phillips resigned from her post on the Board of Governors as of June 30, 1998. Ms. Phillips accepted the post of dean in the School of Business and Public Management at The George Washington University. Ms. Phillips had served on the Board of Governors since 1991. *BBR, 5/11/98, p. 757.*

Interest Rates

The Federal Reserve Open Market Committee again voted to leave short-term interest rates unchanged on August 18, 1998. The Federal Reserve Board has kept the interest rates constant since March 1997. *BBR, 8/24/98, p. 292.*

Loan Quality Assessment Project

In a supervisory letter released on June 30, 1998, the Federal Reserve Board reported that banks have eased lending standards for commercial loans significantly since 1995 in response to intense competition for loan customers. However, the Board notes that the overall quality of banks' business loans has not deteriorated greatly, because of strong economic conditions. The Board's report on lending standards is based on the results of a recent study, the Loan Quality Assessment Project, which compared several hundred commercial and industrial loans made in late 1995 with loans made in late 1997. The Loan Quality Assessment Project found that banks have relaxed the terms of commercial loans to attract customers by cutting interest-rate spreads, extending loan maturities, easing collateral requirements, or waiving financial covenants. *FRB-PR, 6/30/98; BBR, 7/6/98, p. 5.*

Guidance for Assessing IT-Related Risks

The Federal Reserve Board announced that bank examiners would be required to consider the risks associated with an institution's use of information technology when developing safety-and-soundness assessments under the risk-focused supervisory process. In an April 20, 1998 letter to all Federal Reserve-supervised institutions, the Federal Reserve Board outlined a framework for examiners to use in evaluating how banks manage their information technology risks, and reiterated its commitment to continuing examiner training in the information technology area. The Federal Reserve Board's information technology framework includes five elements: the institution's management processes, system design and structure, security, and the integrity and availability of the information delivered to end-users. *BBR, 5/4/98, p. 712.*

Relaxed Limits on Insurance Sales

As of May 1998, the Federal Reserve Board granted bank holding companies greater flexibility to sell life insurance and annuity products through their securities dealer subsidiaries on behalf of affiliated insurance agencies. The insurance activities may be conducted only in states that permit insurance sales under the Bank Holding Company Act, and the insurance activities must be conducted according to the federal banking agencies' joint policy on the retail sales of nondeposit investment products. Additionally, the bank holding companies must sep-

arate the insurance activities from areas in which insured deposits are accepted. *BBR, 7/6/98, p. 20.*

Regulation Y

The Federal Reserve Board revised its leverage capital rules for bank holding companies (Regulation Y), effective June 30, 1998. The revisions allow the most highly rated bank holding companies to maintain a minimum Tier 1 leverage ratio of 3 percent, while requiring all other bank holding companies to maintain a Tier 1 leverage ratio of 4 percent. The Tier 1 leverage ratio is defined as the proportion of core capital to total assets. Before the revisions, all but the highest-rated bank holding companies were required to maintain a minimum level of core capital equal to 3 percent of total assets, plus an additional 100 to 200 basis points. The revised final rule also provides that higher capital ratios would be required for bank holding companies that have significant financial, operational, or managerial weaknesses that make them more risky. *BBR, 6/8/98, p. 920-921.*

Regulations H and P

On July 7, 1998, the Federal Reserve Board announced final revisions to Regulation H, updating and clarifying its procedures for state-chartered banks to join the Federal Reserve System. The new Regulation H is intended to reduce the regulatory burden for state banks and replaces the entire existing regulation, except for the appendices to the rule, which remain unchanged. Under the new Regulation H, well-capitalized and well-managed institutions could qualify for faster consideration of Federal Reserve membership and branch applications. As part of the process of revising Regulation H, the Federal Reserve Board rescinded Regulation P. Regulation P, which was folded into the new Regulation H, implemented the Bank Protection Act of 1968 and required federal banking regulators to establish minimum standards for banks' security systems. The new Regulation H is effective beginning on October 1, 1998. *FRB-PR, 7/7/98; BBR, 7/13/98, p. 49-50.*

Regulation DD

On July 27, 1998, the Federal Reserve Board made final an interim rule amending Regulation DD, Truth in Savings, regarding the disclosure of the annual percentage yield (APY). The rule permits institutions to disclose an APY equal to the contract interest rate for certain time accounts. The rule

applies only to time accounts with maturities greater than one year. *FRB-PR*, 7/27/98.

Office of the Comptroller of the Currency

Comptroller Nomination

The White House announced on July 16, 1998, that President Clinton intends to nominate Treasury Undersecretary for Domestic Finance John D. Hawke, Jr. to be the next Comptroller of the Currency. If confirmed by the Senate, Mr. Hawke would succeed Eugene A. Ludwig, who departed after his five-year term expired in April 1998. Former OCC Chief Counsel, Julie L. Williams, has been serving as acting comptroller since April. Mr. Hawke has served as Treasury Undersecretary for Domestic Finance since 1995. *BBR*, 7/20/98, p. 96.

Loan Underwriting Survey

On July 13, 1998, the OCC announced that banks' commercial lending standards have slipped for the fourth year in a row, as heavy competition and pressure to increase loan volume are causing banks to grant more generous concessions to business borrowers. The findings are based on the results of the OCC's fourth annual survey of national banks' loan underwriting standards. As a result, the OCC is implementing a series of new supervisory initiatives intended to reverse the trend of sliding commercial and consumer credit practices. The new initiatives build on existing programs that have already been implemented to help national banks deal with an increase in problem loans that could result from an economic downturn. *NR 98-70, OCC*, 7/13/98; *BBR*, 7/20/98, p. 95.

Bank Municipal Securities Dealers

Effective June 29, 1998, the OCC adopted final revisions to its municipal securities dealers' regulation. The final rule clarifies that national bank subsidiaries, which conduct municipal securities activities, are subject to the Municipal Securities Rulemaking Board and must register with the National Association of Securities Dealers. As a result, these national bank subsidiaries are exempt from the OCC's municipal securities dealers' regulation. *BBR*, 6/1/98, p. 883.

Bank Can Take Fee for Insurance Referrals

On February 27, 1998, the Chief Counsel for the Office of the Comptroller of the Currency ruled that a national bank would be permitted to collect a find-

er's fee for referring bank customers to a group of independent insurance agencies. The ruling is significant because it allows national banks to collect fee revenue in addition to their existing authority to sell insurance as agent. *BBR*, 4/20/98, p. 651.

New Supervision Handbooks

A new version of the OCC's Large Bank Supervision handbook was issued on July 22, 1998, in order to help examiners develop more detailed and meaningful risk profiles of the nation's largest national banks. The manual, which is aimed at the 80 national banks with assets of more than \$1 billion, applies supervision by risk to all aspects of the supervisory process so that risks are properly assessed and evaluated across the entire organization, regardless of its size, complexity or geographic reach. *NR-98-75, OCC*, 7/22/98.

On August 24, 1998, the OCC issued another new manual that is designed to help examiners evaluate the internal control systems that national banks use to guard against fraud and financial mismanagement. *NR-98-87, OCC*, 8/24/98.

Credit-Card Suspension Agreements

In an interpretive letter made available on June 23, 1998, the OCC gave a national bank permission to enter into credit-card debt suspension agreements. A suspension agreement states that, in exchange for a monthly fee paid by the cardholder, the bank will agree to freeze the cardholder's account for a specified period if certain temporary hardship circumstances occur. During the freeze, the cardholder is not charged interest, fees, or penalties. *BBR*, 6/29/98, p. 1066.

Office of Thrift Supervision

Simplified Rule on ARMs Disclosure

On July 17, 1998, the OTS finalized a rule giving thrifts two options when disclosing potential interest payments to borrowers of adjustable-rate mortgage loans. The OTS's new rule requires thrifts to follow the provisions of the Federal Reserve Board's Regulation Z. Regulation Z requires institutions to either: (1) provide a borrower with a 15-year historical example showing how interest-rate changes would affect loan payments and loan balances on a \$10,000 loan, or (2) disclose the maximum interest rate and payment possible for a \$10,000 loan. *OTS 98-50*, 7/16/98.

Limits on Repurchase Transactions

The OTS approved a final rule on August 12, 1998, that prohibits reverse repurchase agreements between savings associations and their nonbank affiliates. In a reverse repurchase agreement, a depository institution buys securities from another party and agrees to sell them back later at a higher price. The final rule clarifies that the OTS will treat reverse repurchase agreements as loans or other extensions of credit for the purposes of the Home Owners' Loan Act. Therefore, thrifts will be barred from entering into these agreements with nonbank affiliates because reverse repurchase agreements are extensions of credit. Exemptions from the ban are possible if several conditions are met. The final rule takes effect on October 1, 1998. *BBR, 8/24/98, p. 301.*

One-Member, One-Vote Rule Adopted

Under a final rule announced by the OTS on August 27, 1998, mutual depository institutions with a one-member, one-vote provision in their current charters will be able to retain that authority when converting to a federal savings association. In addition, any existing federal mutual savings association will be able to adopt a one-vote-per-member provision if it desires. The new rule applies to all mutual-type institutions, including credit unions that wish to become thrifts. The rule expands the range of votes a federal mutual savings association may allow a member to cast on issues requiring membership action from the current 50 to 1,000 votes to 1 to 1,000 votes per member. *OTS 98-64, 8/27/98.*

National Credit Union Administration

Credit Union Membership Access Act

The Credit Union Membership Access Act was signed by President Clinton on August 7, 1998. The Act permits federal credit unions to offer membership to multiple groups of less than 3,000 persons, and grandfathers all existing members and groups as of the date of enactment of the bill. Other provisions impose statutory limits on member business lending and prompt corrective action requirements on the NCUA. H.R. 1151 was introduced in 1997 after a federal appeals court ruled against the National Credit Union Administration's multiple-group membership policy. The Federal Credit Union Act requires members of federal employment-based credit unions to share a common bond. The NCUA interpreted that requirement to allow multiple fields of membership, each with its own common bond;

however, the U.S. Court of Appeals for the District of Columbia Circuit ruled in 1996 that each federal occupational credit union must share just one common bond. The NCUA appealed to the Supreme Court, but the Supreme Court also ruled against the NCUA in February 1998. After the ruling, Congress quickly initiated the Credit Union Membership Access Act to give the NCUA relief from the "one common bond" ruling. *NCUA PR, 8/4/98 and 8/7/98; BBR, 8/3/98.*

Federal Housing Finance Board

Amended Rule for FHLBank System Membership

On April 9, 1998, the Federal Housing Finance Board approved a rule that will make it easier for banks with assets of less than \$500 million to qualify for membership in the Federal Home Loan Bank System. Previous regulations required FHLBank System members to have at least 10 percent of their loans in home mortgage loans. A home mortgage loan for certain combination properties is defined as a mortgage loan where the appraised value of the residence on the property equals at least 50 percent of the appraisal value of the entire property. As a result of this 50 percent test, many institutions found it difficult to make enough home mortgage loans to qualify for membership in the FHLBank System. The new rule allows institutions with assets of \$500 million or less to ignore the 50 percent test for combination properties. The new rule states that combination property loans will be considered as residential property loans, as long as there is a permanent residential structure that is an integral part of the property. *BBR, 4/13/98, p. 612.*

New Financial Disclosure Requirements

On June 24, 1998, the Federal Housing Finance Board approved a final policy statement expanding financial disclosures by the Federal Home Loan Bank System. The final policy statement, *Disclosures in the Combined Annual and Quarterly Reports of the Federal Home Loan Bank System*, requires that the reports be prepared in a manner that is consistent with the disclosure requirements of the Securities and Exchange Commission. The Finance Board also adopted a final rule requiring that the financial statements of the individual FHLBanks are consistent with the combined annual and quarterly reports presented by the Finance Board and are provided to the Finance Board in a timely manner. *BBR, 6/29/98, p. 1064.*

STATE LEGISLATION AND REGULATION

Illinois

On July 30, 1998, Illinois Governor James Edgar signed the so-called banking industry omnibus bill, Senate Bill 1528. The legislation will permit state-chartered banks in Illinois to compete more efficiently with national banks and insured savings associations through expanded "wild card" provisions. The legislation also establishes standards for information sharing between bank affiliate organizations, creates a safe harbor from liability in certain electronic transactions, and streamlines motor vehicle repossession rules. All aspects of the bill became effective on July 30, except for the auto repossession provision which becomes effective January 1, 1999.

BBR, 8/24/98, p. 289.

Kansas

The Kansas legislature approved a bill on May 8, 1998, that requires all banks located in the state that have nonbank affiliates to file consolidated tax returns. Both state- and federally chartered banks must file consolidated state tax returns or combined reports with any subsidiaries that own, hold, or manage any portion of their securities portfolios. In order to keep the Kansas State tax burden in line with that of other states, the bill also includes a provision to reduce the base tax rate on net income of banks and savings-and-loan associations.

BBR, 5/18/98, p. 814.

Massachusetts

On May 22, 1998, Massachusetts Acting Governor Paul Celluci signed legislation that permits state-chartered banks to sell insurance and annuity products beginning on September 1, 1998. Massachusetts is one of the last states to offer this authority to banks.

BBR, 6/1/98, p. 883-884.

Mississippi

Effective July 1, 1998, a new state law permits Mississippi-chartered trust operations to branch into other states. The law requires the trust operations to notify the state banking commissioner before setting up branches across state lines. Out-of-state trust operations will be permitted to enter Mississippi after getting approval from banking regulators in their home state.

American Banker, 6/17/98.

New York

The New York State Banking Board approved final regulations on June 4, 1998, that allow state-chartered banks and trust companies located in places with populations of 5,000 or less to sell insurance directly to customers. The regulations require that all credit and insurance transactions be completed separately. In addition, all insurance sold by banks and trusts will be subject to state Insurance Department regulations.

BBR, 6/15/98, p. 967.

On June 19, 1998, the New York legislature approved a bill to extend the state's "wild card" banking law for two more years and expand the scope of the law to cover thrifts. The state's original wild card banking law, which was enacted last year, allows the New York State Banking Board to grant state-chartered banks the same powers as federally chartered institutions. It also establishes safeguards to prevent banks from tying banking and insurance products together. The latest bill extends the expiration date of the wild card law until September 10, 2000. The new bill also authorizes the New York State Banking Board to adopt regulations granting state-chartered thrifts any insurance powers that have been granted to state-chartered commercial banks under the wild card law.

BBR, 6/29/98, p. 1052.

An additional regulation was published in the *Federal Register* on June 24, 1998, which permits New York State banking institutions to create banking development districts in areas that have traditionally been underserved by banks. The districts can be established through a joint application by a local government and a commercial bank, trust company, or national bank.

BBR, 7/6/98, p. 19.

Oklahoma

On June 5, 1998, a bill was signed that amends Oklahoma's Consumer Credit Code and allows banks and other companies to issue credit cards and impose a variety of fees on the credit-card holders. The new law, which becomes effective November 1, 1998, removes legislative limits on credit-card charges and allows Oklahoma-based companies to charge fees for membership, transactions, cash advances, documents, and for stopping payments on checks by the users of the credit cards. The new law gives

Oklahoma businesses an advantage when competing with out-of-state lenders. *BBR*, 6/15/98, p. 971.

Texas

In May 1998, the Texas Banking Commissioner announced that state banks would be allowed to branch and merge interstate. The announcement was made in response to a court decision allowing Nations-Bank Corporation to fold its Texas operations into its North Carolina headquarters. *American Banker*, 5/15/98.

West Virginia

On April 1, 1998, Governor Cecil Underwood signed a law that permits mobile branch banking in West Virginia. The law limits mobile banks to a radius of 30 miles from the bank's permanent main office or a fixed branch office, and it does not allow any mobile bank within 2,000 feet of another bank's main office or branch office. The law became effective on June 12, 1998. *BBR*, 4/13/98, p. 604.

BANK AND THRIFT PERFORMANCE

First-Quarter 1998 Results for Commercial Banks and Savings Institutions

Insured commercial banks continued to produce record profits in the first quarter of 1998, earning net income of \$15.9 billion, which was \$621 million higher than the previous record set in the fourth quarter of 1997. The FDIC attributed much of the increase in banks' first-quarter earnings to the continued strong growth in noninterest income, especially from trust activities and other sources of fees. Revenues also received a one-time gain from sales of securities and other assets. Banks' annualized return on assets (ROA) was 1.26 percent in the first quarter, up from 1.24 percent in the fourth quarter of 1997 and 1.25 percent in the first quarter of 1997. The number of problem banks decreased from 71 in the fourth quarter of 1997 to 67 in the first quarter of 1998. Problem banks had assets of \$4.8 billion. There were no failures of insured commercial banks in the first quarter.

FDIC BIF-insured mutual savings institutions earned \$2.6 billion in the first quarter of 1998, up by \$178 million from one year earlier. The savings industry reported an average annualized ROA of 1.03 percent in the first quarter, which matches the ROA in the first quarter of 1997. The number of problem thrifts declined to 16 in the first quarter from 21 at

the end of 1997. However, assets of problem thrifts rose to \$2.3 billion from \$1.7 billion at year-end 1997. *FDIC Quarterly Banking Profile, First Quarter 1998.*

First-Quarter 1998 Results for Thrifts

The nation's thrift industry earned \$1.87 billion in the first quarter of 1998, which was up from \$1.66 billion in the fourth quarter of 1997 and \$1.73 billion in the first quarter of last year. Profitability and capital levels also increased in the first quarter, while troubled assets and delinquent loans decreased. The equity capital to assets ratio rose to 8.40 percent at the end of the first quarter, compared with the previous quarter's record of 8.32 percent. All but one of the OTS-supervised thrifts met or exceeded minimum capital requirements, and 98 percent of the thrifts were in the highest capital category (well-capitalized) at the end of March 1998.

The thrift industry's ROA was 0.97 percent in the first quarter, up from 0.87 in the fourth quarter of 1997. The number of problem thrifts fell to 14 in the first quarter, down from 18 in the fourth quarter and 30 one year ago. The OTS attributed the strong financial performance of the thrift industry to an increased demand for single-family mortgage loans because of the robust economy and low, stable interest rates. *OTS 98-45, 6/3/98.*

RECENT ARTICLES AND STUDIES

A working paper, entitled *Capitalization of the Bank Insurance Fund*, concludes that the current funding arrangement of the Bank Insurance Fund (BIF) is sufficient to maintain FDIC solvency, assuming that the prior history of losses is a good indicator of future losses. The study simulates the BIF's future reserve levels and examines the implications of different assessment rates and required reserve ratios. The working paper was written by

Kevin Sheehan, a financial economist in the Division of Research and Statistics at the FDIC. *Working Paper Series, 98-1, FDIC.*

A working paper published in June 1998 by the Swiss-based Bank for International Settlements (BIS) concludes that the separation of commercial banking and securities activities cannot be justified either on bank safety-and-soundness or conflict-of-

interest grounds. The paper, entitled *Commercial Banks in the Securities Business: A Review*, was written for the BIS by former Federal Reserve Bank of Cleveland official Joao Santos. The working paper notes that the advantages of allowing “universal banking,” both banking and securities services offered under one roof, include improved information on companies they underwrite and economies of scope that allow consumers to save time and money by purchasing an array of financial services from a single provider. *BBR*, 7/6/98, p. 37.

The Federal Reserve Bank of Chicago released a report on April 28, 1998, entitled *1996 CRA Small Business Lending Profile*. The report revealed that low- and moderate-income neighborhoods in the Midwest are receiving a smaller share of small-business loans than their broader metropolitan areas. The report analyzes data collected under the Community Reinvestment Act and evaluates five metropolitan areas, including Chicago, Des Moines, Detroit, Indianapolis, and Milwaukee. *BBR*, 5/4/98, p. 714.

The Federal Reserve Board released a study on May 29, 1998, which declared that banks’ internal credit risk models will not completely replace international risk-based capital standards any time soon, but may enhance current supervisory and regulatory policies. The final report, entitled *Credit Risk Models at Major U.S. Banking Institutions: Current State of the Art and Implications for Assessments of Capital Adequacy*, concluded that the internal models used to

measure risk and to allocate capital have significant shortcomings that make them unreliable substitutes for existing risk-based capital rules. The study states that difficulties regarding model construction, data availability, and model validation procedures limit the use of banks’ internal models in the regulatory process. *FRB PR* 5/29/98; *BBR*, 6/8/98, p. 920.

A paper, entitled *The Evolution of Bank Lending to Small Business*, concludes that the recent wave of bank mergers may actually increase the amount of credit available to small businesses. The paper reports that mergers among community banks produce larger institutions, which means they may make larger loans and still remain within government-set limits on loans to any single borrower. Joe Peek of Boston College and Eric S. Rosengren of the Federal Reserve Bank of Boston performed the study. *American Banker*, 5/8/98.

Deposit Insurance Reform in the FDIC Improvement Act: The Experience to Date reports that a 1991 law meant to restore the industry’s health and avoid banking crises appears to be working. The Federal Deposit Insurance Corporation Improvement Act appears to be preventing banks from taking excessive risks and encouraging regulators to sanction financially troubled institutions. Two economists authored the paper, George Benston of Emory University and George Kaufman of Loyola University. *American Banker*, 8/28/98.

INTERNATIONAL DEVELOPMENTS

International Deposit Insurance Conference

The FDIC sponsored an International Deposit Insurance Conference in September 1998, in order to discuss the role of deposit insurance in sustaining public confidence in the world’s banking systems. The Conference brought together top government officials from 63 countries, including the leaders of deposit insurance agencies in more than 20 nations. *PR-61-98, FDIC*, 9/1/98.

Deposit Insurance for Russian Banks

In an effort to restore confidence in Russia’s banking system, the Central Bank announced plans to insure deposits held by individuals at commercial banks. On August 20, 1998, Central Bank Chairman Sergei Dubinin announced the proposed insurance

plan and stated that it would cover all bank deposits established before August 1, 1998. The insurance would work through Russia’s largest commercial bank, Sberbank, in which the government holds a controlling stake. *BBR*, 8/24/98, p. 308.

Basle Committee

The Basle Committee on Banking Supervision announced on April 7, 1998, that they amended their rules regarding the capital that banks must keep on hand to cover risk resulting from loans to securities firms. The changes affect the Committee’s 1988 Basle Capital Accord, which is an international agreement that sets minimum capital requirements for banks. The amendment reduces the risk weight on a bank’s credit exposure for claims on regulated securities firms to 20 percent from 100 percent. The

amendment applies only to claims on regulated securities firms and not holding companies that may own the securities firms. The Basle Committee on Banking Supervision is a group of senior supervisors and central bank officials from nine western European countries and the United States, Canada, and Japan. *PR-23-98, FDIC, 4/8/98; BBR, 4/13/98, p. 620.*

European Union

On April 30, 1998, the European Parliament approved changes to European Union legislation involving capital adequacy and solvency requirements for banks, credit institutions, and investment firms. The changes will be effective upon publication of three new directives. Governments will have up to 24 months to confirm that their national laws comply with the new European Union requirements. The first directive introduces changes to Directive 89/647/EEC, which establishes a solvency ratio for credit institutions. The second proposal includes amendments to the 1989 solvency directive, as well as Directive 77/780/EEC, which sets rules for establishing and operating credit institutions, and Directive 93/6/EEC on capital adequacy of investment firms and credit institutions. The amendments to these directives involve updated capital requirements, including requirements for credit risks inherent in derivatives, as well as extending the exchange of information between European Union bank supervisors and nonbanking supervisory authorities in third countries. The third directive updates the 1993 capital adequacy directive regarding commodities and commodity directives. *BBR, 5/18/98, p. 828.*

Eleven Countries Establish Economic and Monetary Union

On May 3, 1998, eleven European Union countries received confirmation that they qualified for the Economic and Monetary Union. The eleven coun-

tries—Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, and Spain—will convert to a single currency, the Euro, on January 1, 1999. Once the 11 countries convert to the Euro, the legacy currencies will become denominations of the Euro. Belgium, France, and Germany will redenominate their existing government debt into Euros. On January 1, 2002, Euro notes will be issued, and the legacy currencies will be withdrawn from circulation. *BBR, 5/11/98, p. 781; BBR, 6/8/98, p. 949.*

Indonesia

On April 4, 1998, the new Indonesian Bank Restructuring Agency made its first moves to rebuild the country's battered banking system by closing seven small banks and taking control of seven large banks. The Indonesian Bank Restructuring Agency was created in January 1998 to repair the country's banking system. *The Wall Street Journal, 4/6/98.*

Statement of Cooperation

In April 1998, the Office of Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Superintendencia de Bancos de Chile entered into a Statement of Cooperation that will facilitate the supervision of financial institutions operating in each other's country. The Statement of Cooperation provides for the sharing of supervisory information to facilitate the performance of each agency's duties and to promote the safe and sound functioning of financial institutions in their respective countries. The arrangement provides for cooperation during the authorization process as well as in the supervision of ongoing activities of financial institutions operating in each other's country. The statement supercedes an earlier one established between the Superintendencia and the Federal Reserve in March 1997. *NR-98-40, OCC, 4/16/98.*