

Recent Developments Affecting Depository Institutions

by Lynne Montgomery*

REGULATORY AGENCY ACTIONS

Interagency Actions

Final Rule on Recourse Obligations and Residual Interests

On November 29, 2001, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) issued a final rule that changes their regulatory capital standards to address the treatment of recourse obligations, residual interests, and direct credit substitutes that expose banks, bank holding companies, and thrifts to credit risk. The final rule treats recourse obligations and direct credit substitutes more consistently than the agencies' current risk-based capital standards do; introduces a credit ratings-based approach to assigning risk weights within a securitization; and requires that, for certain types of residual interests that are not deducted from a bank's Tier 1 capital, capital must be set aside on a

dollar-for-dollar basis. The new rule also limits the concentration of credit-enhancing interest-only strips—a form of residual interest that is commonly used in association with securitization of an asset pool—to 25 percent of an institution's Tier 1 capital. The excess will be deducted from Tier 1 capital. The risk-based capital treatment for recourse obligations, direct credit substitutes, and qualifying residual interests is determined by the application of a ratings-based methodology. For all three of these instruments, a risk weight ranging from 20 percent to 200 percent is assigned, depending on the particular instrument's ratings grade. The instruments rated one category below investment grade (BB) are subject to a 200 percent risk weight, whereas those rated AAA or AA receive a more favorable 20 percent risk weight. The new rule also allows an institution to use either its own internal risk-rating system or a qualifying rating-agency program to determine the capital requirements for some unrated recourse obligations and direct credit substitutes. The new rule was effective for covered transactions that settled on or after January 1, 2002. *BBR*, 10/29/01, pp. 672–73; *FR*, Vol. 66, No. 230, pp. 59613–67; *PR-82-2001*, FDIC, 11/29/01.

*Lynne Montgomery is a senior financial analyst in the FDIC's Division of Insurance and Research.
Reference sources: *American Banker* (AB), *BNA's Banking Report* (BBR), and *Federal Register* (FR).

Final Rules on Regulatory Capital Treatment of Nonfinancial Equity Investments

On January 8, 2002, the FDIC, the FRB, and the OCC adopted final rules governing the regulatory capital treatment of equity investments in nonfinancial companies held by banks, bank holding companies, and financial holding companies. The new capital requirements apply symmetrically to equity investments that banks and their holding companies make in nonfinancial companies under the legal authorities specified in the final rules. Among others, these authorities include the merchant banking authority granted by the Gramm-Leach-Bliley Act and the authority to invest in small business investment companies (SBICs) granted by the Small Business Investment Act. Covered equity investments are subject to a series of marginal Tier 1 capital charges, with the size of the charge increasing as the organization's level of concentration in equity investments increases. The highest marginal charge requires a 25 percent deduction from Tier 1 capital for covered investments that aggregate more than 25 percent of an organization's Tier 1 capital. Equity investments through SBICs will be exempt from the new charges to the extent that the aggregate investments do not exceed 15 percent of the banking organization's Tier 1 capital. The new charges do not apply to individual investments made by banking organizations before March 13, 2000; also exempted from coverage are grandfathered investments made by state banks under Section 24(f) of the Federal Deposit Insurance Act. The final rules became effective on April 1, 2002. *PR-2-2002, FDIC, 1/8/02.*

FDIC's Expanded Powers to Review Problem Banks

A new policy approved by the federal bank and thrift regulators on January 29, 2002, gives the FDIC more authority to conduct special examinations of troubled banks and thrift institutions that are viewed as a threat to the deposit insurance funds. The policy allows the FDIC to examine—

without the express permission or invitation of the bank's primary federal supervisor—any institution that has a CAMELS composite rating of 3, 4, or 5 or is considered undercapitalized. Previously, if the FDIC wanted to examine a problem bank that it did not supervise, it had to get permission to do so from the bank's regulator. The policy also allows the FDIC to examine an institution that exhibits "material deteriorating conditions or other adverse developments regardless of current rating," provided the agency gets the primary supervisor's permission. The policy also includes a new exam program that creates a dedicated FDIC examiner for each of the eight largest banking companies. The dedicated examiner must be informed of all developments in the supervision of the banks and will be the main FDIC contact for the supervisory personnel of an institution's primary regulator. *AB, 1/30/02; BBR, 2/4/02, pp. 189–90.*

Publication of Agencies' Guide to Privacy of Information

On February 6, 2002, several federal agencies released a guide to help consumers make informed choices about whether to allow their personal financial information to be shared. "Privacy Choices for Your Personal Financial Information" guides consumers through the choices they face as a result of the privacy provisions of the Gramm-Leach-Bliley Act of 1999. Federal privacy laws give consumers the right to prevent, or "opt out" of, the sharing of their personal financial information. The guide explains the privacy notices that consumers receive from their banks and other financial companies, the choices consumers face, and consumers' right to opt out of information sharing. The agencies that issued the guide include the FDIC, the FRB, the OCC, the OTS, the National Credit Union Administration, the Commodity Futures Trading Commission, the Federal Trade Commission, and the Securities and Exchange Commission. The guide can be accessed at www.consumer.gov or at any of the federal agencies' Web sites. *PR-13-2002, FDIC, 2/6/02.*

Common Form for Charter and Federal Deposit Insurance Applications

On March 11, 2002, the FDIC, the OCC, and the OTS issued a uniform application form, the “Interagency Charter and Federal Deposit Insurance Application,” which will be used by financial institutions to apply for a national bank or federal savings association charter or for federal deposit insurance. The new form is part of an ongoing effort by the regulatory agencies to simplify procedures, eliminate duplicative or outdated policies, and reduce the regulatory burden on financial institutions. *PR-31-2002, FDIC, 3/11/02.*

Lower Risk Weighting for Claims on Securities Firms

On April 9, 2002, the FDIC, the FRB, the OCC, and the OTS issued a final rule amending their risk-based capital standards for banks, bank holding companies, and savings associations to reduce the risk weight applied to claims on, or guaranteed by, qualifying securities firms. The final rule reduces the risk weight applied to certain claims on qualifying securities firms from 100 percent to 20 percent. In addition, consistent with the existing rules of the FRB and the OCC, the FDIC and the OTS amended their risk-based capital standards to permit a zero percent risk weight for certain claims on qualifying securities firms that are collateralized by cash or by securities issued or guaranteed by the U.S. government or by the central governments of the members of the Organization for Economic Cooperation and Development (OECD). The rule became effective on July 1, 2002. *PR-FRB, 4/9/02.*

Guidance on Risks of Parallel-Owned Banking Organizations

On April 23, 2002, the FDIC, the FRB, the OCC, and the OTS issued guidance on the potential risks of parallel-owned banking organizations. The guidance defines parallel ownership as direct or indirect control of both a U.S. depository institution and a foreign bank by one person or by a group of persons who are closely associated in

their business dealings. The definition specifically excludes organizations controlled by companies that are governed by the Bank Holding Company Act or the Savings and Loan Holding Company Act. The guidance describes various risks that may be increased because of the structure of parallel-owned banking organizations (for example, engaging in transactions that prefer the foreign bank member of the group over the U.S. depository institution). The agencies will address these risks by coordinating their supervision of the U.S. banking operations of parallel-owned banking organizations and by enhancing communication and cooperation with foreign bank supervisors. *PR-46-2002, FDIC, 4/23/02; BBR, 4/29/02, p. 732.*

Rule on Branches Used for Deposit Production

On June 6, 2002, the FDIC, the FRB, and the OCC issued a joint final rule banning banks from establishing or acquiring a branch outside their home states primarily for the purpose of generating deposits. The rule implements a provision on out-of-state deposit production that was contained in Section 106 of the Gramm-Leach-Bliley Act of 1999 (GLBA). The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 had prohibited any bank from establishing or acquiring a branch outside of its home state for the purpose of generating deposits, and provided guidelines for determining whether such bank is reasonably helping to meet the credit needs of the communities served by the branch. Section 106 of the GLBA expanded the deposit prohibition to cover any branch of a bank that is controlled by an out-of-state holding company. The new rule became effective October 1, 2002. *PR-FRB, 6/5/02; BBR, 6/17/02, p. 1054.*

Federal Deposit Insurance Corporation

Swearing-in of Powell as Chairman

On August 29, 2001, Donald E. Powell was sworn in as the 18th Chairman of the FDIC. He began his banking career in 1963 with First Federal Savings & Loan of Amarillo, Amarillo, Texas.

Before joining the FDIC, Mr. Powell was president and CEO of The First National Bank of Amarillo, Amarillo, Texas. *PR-57-2001, FDIC, 8/29/01.*

Appointment of Reich as Vice Chairman

On November 15, 2002, John M. Reich was appointed Vice Chairman of the FDIC Board of Directors. Mr. Reich had been a Director of the FDIC since January 16, 2001, and served as Acting Chairman between Chairman Donna Tanoue's resignation in July 2001 and Chairman Powell's assumption of office in August 2001. Before joining the FDIC, Mr. Reich served for 12 years on the Washington staff of former U.S. Senator Connie Mack (R-FL), initially as deputy chief of staff and later as chief of staff. Mr. Reich also spent 23 years as a community banker in Illinois and Florida, the last ten years of which were as president and CEO of the National Bank of Sarasota, Sarasota, Florida. *PR-122-2002, FDIC, 11/15/02.*

Web Page for Database of Unclaimed Funds

The FDIC launched a Web site that allows users to search a database of unclaimed funds from failed financial institutions that were closed by a regulatory agency between January 1, 1989, and June 28, 1993, and for which the FDIC was appointed receiver. The FDIC holds unclaimed funds in two ways: as unclaimed insured deposits of active receiverships and as undeliverable dividend checks. An active receivership is a receivership that the FDIC is still managing—disposing of the assets and administering the liabilities. A dividend check is considered undeliverable when the depositor's address is incorrect or the check has never been cashed. The Web site provides depositors of failed institutions who have not already claimed their funds, or whose dividend checks have been returned to the FDIC as undeliverable, an opportunity to claim their funds. Detailed instructions for searching the database and claiming funds can be found at <http://www2.fdic.gov/funds/index.asp>. *PR-56-2001, FDIC, 8/27/01.*

Report on Underwriting Practices—April and October 2002

The April 2002 issue of the FDIC's semiannual *Report on Underwriting Practices* reported slight increases in the risks associated with current underwriting practices, loan portfolios, and loan administration at FDIC-supervised banks. The frequency of risky practices in all major lending categories rose at least slightly, and in two of the categories—construction lending and commercial real estate lending—increases in the frequency of risky underwriting practices were noteworthy. The April report includes surveys from 1,149 FDIC-supervised banks that were examined during the six months ending March 31, 2002. This survey of loan underwriting practices is aimed at providing an early warning 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. *Report on Underwriting Practices, FDIC, April 2002.*

In the October 2002 issue of the report, the most noteworthy changes reported in underwriting practices were a slight increase in the credit risk of banks' loan portfolios and increases in the riskiness of agricultural and construction lending. The October 2002 issue includes surveys from 1,201 FDIC-supervised banks that were examined during the six months April 1, 2002, through September 30, 2002. *Report on Underwriting Practices, FDIC, October 2002.*

Real Estate Survey—July 2002

The July 2002 issue of the *Survey of Real Estate Trends* reported continued deterioration in the nation's real estate markets during the first six months of 2002, although the rate of deterioration was slower than in the last six months of 2001. Reports of market imbalance strongly emphasized oversupply in the commercial markets, while tight conditions continued to be noted in residential markets. The proportion of respondents who

described single-family markets as tight—33 percent—was double the figure for the previous six-month period, and both sales volumes and home sale prices were reported to be higher than six months earlier. Weakness in local office markets continued to be widespread, with 65 percent of respondents reporting a worsening in office market conditions. However, a majority reported a decrease in speculative office construction. Reports of oversupply in retail and industrial markets were somewhat more frequent than they had been six months earlier: in retail markets, excess supply was observed by 68 percent of respondents, up from 65 percent in the previous survey; in industrial markets, excess supply was observed by 64 percent of respondents, up from 58 percent. The July report summarized the opinions of 252 survey respondents, who consisted of FDIC senior examiners and asset managers as well as bank examiners of the Federal Reserve Banks, the OCC, and the OTS. *Survey of Real Estate Trends, FDIC, July 2002.*

Insurance Funds' Financial Results for First Three Quarters of 2002

The FDIC reported that the Bank Insurance Fund (BIF) had comprehensive income (net income plus/minus current-period unrealized gains/losses on available-for-sale securities) of \$944 million for the nine months ending September 30, 2002, compared with income of \$859 million for the same period in 2001. Although net income declined by \$341 million compared with the previous year's amount, unrealized gains on available-for-sale securities increased by \$426 million. The decline in net income resulted primarily from lower earnings on U.S. Treasury obligations and higher estimated losses for anticipated bank failures and litigation activity. As of September 30, 2002, the BIF balance was approximately \$31.4 billion, up from \$30.4 billion at year-end 2001. The BIF reserve ratio fell from 1.26 percent at December 31, 2001, to 1.23 percent (as amended) at March 31, 2002, as a result of a \$75 billion increase in estimated insured deposits. The deposit growth resulted primarily from a reporting change in the quarterly Call Reports that provide

the source data for estimating insured deposits. This was the first time since 1995 that the reserve ratio fell below the mandated designated reserve ratio of 1.25 percent. The reserve ratio climbed back up to 1.26 percent at June 30, 2002; the increase resulted from an increase in the BIF balance of \$490 million in the second quarter of 2002, and a \$3 billion decrease in the estimated insured deposits.

The Savings Association Insurance Fund (SAIF) reported comprehensive income of \$651 million for the first three quarters of 2002, compared with \$56 million for the same period in 2001. The increase in comprehensive income was due primarily to higher estimated losses in 2001 for actual and expected thrift failures. The SAIF's fund balance as of September 30, 2002, was \$11.6 billion, up from \$10.9 billion at year-end 2001. The SAIF reserve ratio held steady at 1.36 percent between December 31, 2001, and March 31, 2002, but then increased to 1.38 percent at June 30, 2002. *PR-113-2002, FDIC, 10/25/02.*

Bank Failures

Superior Bank, FSB, Hinsdale, Illinois, was closed by the OTS on July 27, 2001, and the FDIC was named conservator. Superior Bank had total assets of approximately \$2.3 billion and total deposits of approximately \$1.6 billion. The FDIC Board of Directors decided the least-cost alternative was to organize a new institution that would operate under FDIC control. The insured deposits and substantially all the assets of Superior Bank were transferred to Superior Federal, FSB (New Superior), which was chartered on July 27, 2001. As part of this transaction, the FDIC provided a \$1.5 billion line of credit to New Superior to support continued banking operations. The FDIC also hired savings bank executive John D. Broderick to serve as president and chief executive officer of New Superior while the FDIC searched for a buyer. On October 31, 2001, the FDIC Board of Directors approved the sale of the branches and deposits of New Superior to Charter One Bank, FSB, Cleveland, Ohio. Charter One agreed to pay the FDIC a premium of \$52.4 mil-

lion to assume \$1.1 billion of the deposits and \$45 million of the assets held by the FDIC in conservatorship. On December 10, 2001, the FDIC and the OTS reached a resolution with the holding companies of Superior Bank on all matters arising out of the operation and failure of Superior. Under the agreement, the holding companies and their owners admitted no liability and agreed to pay the FDIC \$460 million and other consideration. On February 15, 2002, the FDIC sold the servicing rights and the residual interests in \$3.7 billion of securitized subprime mortgage loans to a subsidiary of Bear Stearns & Company for \$471 million. Superior Bank was the first failure of an institution insured by the SAIF—but the third failure of an FDIC-insured institution—in 2001. *PR-52-2001, FDIC, 7/27/01; PR-55-2001, FDIC, 8/20/01; BBR, 8/27/01, p. 336; PR-78-2001, FDIC, 10/31/01; AB, 2/27/02.*

Sinclair National Bank, Gravette, Arkansas, was closed by the OCC on September 7, 2001, and the FDIC was appointed receiver. Sinclair National had total assets of approximately \$30.7 million and total deposits of approximately \$25.7 million. Delta Trust & Bank, Parkdale, Arkansas, paid the FDIC a premium of \$551,000 for the right to assume the insured deposits and to purchase \$4.9 million of Sinclair National's assets. The FDIC retained the remaining \$25.8 million in assets for later disposition. Sinclair National was the third failure of a BIF-insured bank—and the fourth failure of an FDIC-insured institution—in 2001. *PR-63-2001, FDIC, 9/7/01.*

On January 11, 2002, the OCC closed Hamilton Bank NA, Miami, Florida, and the FDIC was named receiver. Hamilton Bank had total assets of approximately \$1.3 billion and total deposits of approximately \$1.2 billion. Israel Discount Bank of New York, New York, New York, assumed all the insured deposits of three branches, and those branches remain open. Israel Discount Bank also assumed the insured transaction deposits (checking, savings, and money market accounts) of Hamilton's other six branches, but the branches were closed. Israel Discount Bank also acquired a nominal amount of Hamilton's assets, which main-

ly consisted of cash. Hamilton was the first failure of a BIF-insured bank in 2002 and the first bank failure in Florida since September 1999. *PR-3-2002, FDIC, 1/11/02.*

The Texas Banking Commissioner on January 18, 2002, closed Bank of Sierra Blanca, Sierra Blanca, Texas, and the FDIC was named receiver. Bank of Sierra Blanca had total assets of approximately \$10.8 million and total deposits of approximately \$9.8 million. The Security State Bank of Pecos, Pecos, Texas, paid a premium of \$218,000 to assume the insured deposits and to purchase \$3.5 million of Bank of Sierra Blanca's assets. The FDIC retained the remaining assets for later disposition. This was the second failure of a BIF-insured institution in 2002 and the first bank failure in Texas since 1999. *PR-5-2002, FDIC, 1/18/02.*

On February 1, 2002, the Ohio Superintendent of Financial Institutions closed The Oakwood Deposit Bank Company, Oakwood, Ohio, and the FDIC was named receiver. The Oakwood Deposit Bank had total assets of approximately \$72.3 million and total deposits of approximately \$60 million. The State Bank and Trust Company, Defiance, Ohio, paid a premium of \$4.1 million to receive the failed bank's insured deposits and to purchase certain assets, including cash, securities at market value, loans fully secured by deposits, and performing and not adversely classified loans. The FDIC retained the remaining assets for later disposition. This was the third failure of a BIF-insured institution in 2002. *PR-11-2002, FDIC, 2/4/02.*

The OCC closed NextBank NA, Phoenix, Arizona, on February 7, 2002, and the FDIC was appointed receiver. The OCC acted after finding that the bank was operating in an unsafe and unsound manner and had experienced a substantial dissipation of assets and earnings. The OCC also found that there was no reasonable prospect for the bank to become adequately capitalized without federal assistance. NextBank, an Internet-only bank, solicited only certificates of deposit of \$100,000 or more and had no checking or savings accounts. NextBank had total assets of \$700 million and total deposits of \$554 million, of

which \$29.4 million exceeded the federal deposit insurance limit. Since there were no bids for NextBank's deposits, the FDIC approved a payoff of the insured deposits. NextBank was the fourth failure of a BIF-insured institution in 2002 and the first bank failure in Arizona since 1992. *PR-16-2002, FDIC, 2/7/02.*

On March 1, 2002, the OCC closed Net First National Bank, Boca Raton, Florida, and the FDIC was named receiver. Net First had assets of approximately \$35 million and total deposits of \$31 million. Bank Leumi USA, New York, New York, paid the FDIC a premium of \$4.55 million to assume the insured deposits of Net First and to purchase approximately \$6 million of the failed bank's assets. The FDIC retained the remaining assets for later disposition. Net First was the fifth failure of a BIF-insured institution—and the second failure in Florida—in 2002. *PR-26-2002, FDIC, 3/1/02.*

New Century Bank, Shelby Township, Michigan, was closed on March 28, 2002, by the Michigan Commissioner of the Office of Financial and Insurance Services, and the FDIC was named receiver. New Century had total assets of \$19 million and total deposits of \$18 million. The FDIC approved a payoff of the insured deposits, since there were no bids for the bank's deposits. New Century was the sixth failure of a BIF-insured institution in 2002 and the first bank failure in Michigan since 1998. *PR-38-2002, FDIC, 3/28/02.*

On June 26, 2002, the Connecticut Bank of Commerce, Stamford, Connecticut, was closed by the Banking Commissioner of the Connecticut Department of Banking, and the FDIC was named receiver. The Connecticut Bank of Commerce had assets of approximately \$399 million and insured deposits of \$213 million. Hudson United Bank, Mahwah, New Jersey, paid the FDIC a premium of \$17.3 million to assume the insured deposits and to purchase certain assets of the failed bank. The FDIC retained the remaining assets for later disposition. Connecticut Bank of Commerce was the seventh failure of a BIF-insured institution in 2002. *PR-74-2002, FDIC, 6/26/02; PR-80-2002, FDIC, 6/28/02.*

Universal Federal Savings Bank, Chicago, Illinois, was closed by the OTS on June 27, 2002, and the FDIC was named receiver. Universal Federal had total assets of approximately \$52 million and insured deposits of \$40 million. Chicago Community Bank, Chicago, Illinois, paid a premium of approximately \$3.1 million to purchase the failed bank's insured deposits and certain assets. The FDIC retained the remaining assets for later disposition. Universal Federal was the first failure of a SAIF-insured institution—but the eighth failure of an FDIC-insured institution—in 2002.

PR-76-2002, FDIC, 6/27/02; PR-81-2002, FDIC, 6/28/02.

AmTrade International Bank of Georgia, Atlanta, Georgia, was closed on September 30, 2002, by Georgia's Commissioner of Banking and Finance, and the FDIC was named receiver. AmTrade was chartered as an international trade bank; its administrative offices were in Atlanta, and its sole deposit-production office was in Miami, Florida. The bank had approximately \$12 million in total assets and \$10.2 million in total deposits. After receiving no bids for the bank's deposits, the FDIC approved a payoff of the insured deposits. AmTrade was the ninth failure of an FDIC-insured institution in 2002 and the first in Georgia since 2000. *PR-100-2002, FDIC, 9/30/02.*

On November 8, 2002, the FDIC closed Bank of Alamo, Alamo, Tennessee, and took possession of the bank in its capacity as receiver. Bank of Alamo had total assets of approximately \$69.4 million and total deposits of \$55.3 million. An estimated \$6 million of deposits in approximately 200 accounts exceeded the federal deposit insurance limit. After receiving no acceptable bids for the bank's deposits, the FDIC approved a payoff of the insured deposits. This was the tenth failure of an FDIC-insured institution in 2002. *PR-120-2002, FDIC, 11/8/02.*

The Farmers Bank & Trust of Cheneyville, Cheneyville, Louisiana, was closed by the Louisiana Commissioner of Financial Institutions on December 17, 2002, and the FDIC was named receiver. Farmers Bank had total assets of approximately \$37 million and total deposits of \$33 million, including approximately \$1.8 million in

deposits that exceeded the federal deposit insurance limit. Sabine State Bank and Trust Company, Many, Louisiana, assumed the insured deposits of Farmers Bank, paying the FDIC a premium of 1.35 percent of these deposits, and purchased approximately \$2.2 million of the failed bank's assets. Farmers Bank was the eleventh and final failure of an FDIC-insured institution in 2002 and the first bank failure in Louisiana since 1997. *PR-131-2002, FDIC, 12/17/02.*

Federal Reserve Board

New Board Term for Ferguson

On July 26, 2001, Roger W. Ferguson, Jr., began a new term as Vice Chairman of the Board of Governors of the Federal Reserve System. Dr. Ferguson joined the Board of Governors on November 5, 1997, when he was appointed to fill an unexpired term that ended in January 2000. President Clinton renominated him for a full term in 2000, but the Senate Banking Committee delayed all confirmation hearings until after the presidential election. On March 5, 2001, President Bush renominated Dr. Ferguson, and the Senate confirmed him on July 19, 2001. Before joining the Board of Governors, Dr. Ferguson had been a partner at the New York-based international management-consulting firm of McKinsey & Company. His new Board of Governors term expires January 31, 2014. *PR-FRB, 7/26/01; BBR, 7/30/01, p. 186.*

Four New Members of Board of Governors

Between December 2001 and August 2002, Susan Schmidt Bies, Mark W. Olson, Donald L. Kohn, and Ben S. Bernanke joined the Board of Governors.

Dr. Bies was sworn in on December 7, 2001, filling the seat previously held by Susan M. Phillips. Before becoming a member of the board, Dr. Bies had served in various positions at First Tennessee National Corporation, Memphis, Tennessee. Her two most recent positions there (from 1995 to 2001) were executive vice president for risk man-

agement and auditor. Dr. Bies's term on the Board of Governors expires January 31, 2012.

Mr. Olson was also sworn in on December 7, 2001, and filled the seat that had been vacated by the resignation of Alice M. Rivlin in July 1999. Mr. Olson served as president and CEO of Security State Bank, Fergus Falls, Minnesota, from 1976 to 1988 and was president of the American Bankers Association from 1986 to 1987. More recently, he was a partner at Ernst and Young LLP, where he started the firm's financial services regulatory practice and managed it until retiring from Ernst and Young in 1999. From 2000 to 2001 he served as staff director of the Securities Subcommittee of the Senate Banking, Housing, and Urban Affairs Committee. His board term expires January 31, 2010.

Dr. Kohn took office on August 5, 2002, filling the seat vacated by Laurence H. Meyer, whose term expired in January 2002. Dr. Kohn began his career with the Federal Reserve System in 1970, when he joined the Federal Reserve Bank of Kansas City as a financial economist. He was subsequently Associate Director of the Division of Research and Statistics (1981–1983), Deputy Staff Director for Monetary and Financial Policy (1983–1987), Director of the Division of Monetary Affairs (1987–2001), Secretary of the Federal Open Market Committee (1987–2002), and Adviser to the Board for Monetary Policy (2001–2002). Dr. Kohn's term on the Board of Governors expires January 31, 2016.

Dr. Bernanke also joined the Board of Governors on August 5, 2002, filling the seat vacated when Edward W. Kelley, Jr., resigned on December 31, 2001. Dr. Bernanke had been a professor of economics and public affairs at Princeton University since 1985 and in 1996 was appointed the Howard Harrison and Gabrielle Snyder Beck Professor of Economics and Public Affairs as well as chair of the Economics Department. He had been a visiting scholar at three Federal Reserve Banks: Philadelphia (1987–1989), Boston (1989–1990), and New York (1990–1991, 1994–1996). He served on the Academic Advisory Panel at the Federal Reserve Bank of New York from 1990 to

2002. Dr. Bernanke's term on the Board of Governors expires January 31, 2004.

www.federalreserve.gov.

State Member Banks' Ownership of Certain Financial Subsidiaries

On August 13, 2001, the FRB adopted a final rule that permits state-chartered banks that are members of the Federal Reserve System to own subsidiaries that engage in certain financial activities, such as general insurance, securities, and travel agency sales. However, bank subsidiaries are barred from real estate investment and development, insurance underwriting, and merchant banking. The rule outlines the criteria that banks must meet to own financial subsidiaries, including sufficient capitalization and strong management. The rule, which implements the financial subsidiaries feature of the 1999 Gramm-Leach-Bliley Act, is intended to establish parity between state member banks and national banks, which were given similar powers in 2000 by the OCC.

AB, 8/14/01; BBR, 8/27/01, pp. 309–10.

Revisions to Regulation K—International Banking Operations

Effective November 20, 2001, the FRB implemented comprehensive revisions to Regulation K, which governs international banking operations. The final rule expands permissible activities abroad for U.S. banking organizations and reduces the associated regulatory burden. The rule also streamlines the application and notice processes for foreign banks operating in the United States, thus reducing their regulatory burden. In addition, the rule implements recent statutory changes authorizing a bank to invest up to 20 percent of capital and surplus in Edge corporations, expands permissible foreign activities of U.S. banking organizations, liberalizes provisions regarding the qualification of foreign banking organizations for exemptions from the nonbanking prohibitions of Section 4 of the Bank Holding Company Act, and implements provisions of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 that affect foreign banks. *PR-FRB, 10/17/01.*

Payments System Risk

The FRB announced on December 11, 2001, that it had revised its Policy Statement on Payments System Risk. The revised policy incorporates, with minor modifications, the FRB's May 30, 2001, interim policy. The revised policy allows certain depository institutions to pledge collateral to the Federal Reserve in order to access additional daylight overdraft capacity above their net debit caps. The policy modifies the net debit cap calculation for U.S. branches and agencies of foreign banks. The policy also modifies the time when electronic check presentments are posted to depository institutions' Federal Reserve accounts for purposes of measuring daylight overdrafts. In addition, the Federal Reserve retains the \$50 million limit on the value of book-entry securities transfers. The revised policy statement became effective December 10, 2001, with the following exceptions: (1) revisions to the criteria used to determine the U.S. capital equivalency measure for foreign banking organizations took effect on February 21, 2002, and (2) the modification of the time for posting electronic check presentments to depository institutions' Federal Reserve accounts took effect on April 1, 2002. *PR-FRB, 12/11/01.*

Amendments to Regulation Z—Truth in Lending

On December 11, 2001, the Federal Reserve Board approved a final rule that amends Regulation Z (Truth in Lending) to curb predatory lending. The amendments broaden the scope of loans subject to the protections of the Home Ownership and Equity Protection Act (HOEPA) of 1994 by adjusting the price triggers that determine coverage under the act. The rate-based trigger is lowered by 2 percentage points for first-lien loans, and the fee-based trigger is revised to include optional insurance premiums and costs of similar credit protection products paid at closing. Certain acts and practices in connection with home-secured loans are prohibited; for example, creditors are restricted from engaging in repeated refinancings of their own HOEPA loans over a short period when the transactions are not in the borrower's interest. The final rule strengthens HOEPA's prohibition against extending credit

without regard to a consumer's repayment ability by requiring creditors to document and verify income for HOEPA-covered loans. Disclosures received by consumers before closing for HOEPA-covered loans include the total amount of money borrowed and whether that amount includes optional credit insurance or costs of similar products paid at closing. Compliance with the amendments became mandatory on October 1, 2002. *PR-FRB, 12/12/01.*

Increase in Home Mortgage Disclosure Act's Threshold for Exemption from Reporting

The FRB raised from \$31 million to \$32 million the asset-size exemption threshold for depository institutions that are required to report data under the Home Mortgage Disclosure Act (HMDA). In 2002, depository institutions with assets of \$32 million or less became exempt from reporting data on their housing-related lending activities. The final rule amends Regulation C, which implements HMDA. HMDA requires most depository institutions to collect, report, and disclose data about applications for, and originations and purchases of, home mortgage loans, home improvement loans, and refinancings. Data reported include the type, purpose, and amount of the loan; the race or national origin, gender, and income of the loan applicant; and the location of the property. The purposes of HMDA include helping regulators (1) determine whether financial institutions are serving the housing needs of their communities, and (2) enforce fair lending regulations. The asset level that releases institutions from reporting data under HMDA is adjusted each year on the basis of changes in inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers. On December 24, 2002, the FRB announced that the asset-size exemption threshold would remain at \$32 million throughout 2003. *PR-FRB, 12/19/01; PR-FRB, 12/24/02.*

Amendments to Regulation C—Home Mortgage Disclosure Act

On February 15, 2002, the FRB published amendments to Regulation C, which implements the

Home Mortgage Disclosure Act (HMDA). The amendments require lenders to disclose pricing data on higher-cost loans, expand the number of nondepository institutions subject to HMDA's reporting requirements, and revise certain regulatory definitions. The amendments also require that a nondepository lender report under HMDA if the lender originated \$25 million or more in home purchase loans, including refinancings, in the prior year. The amendments also require the reporting of some home equity credit lines.

On June 21, 2002, the FRB published additional amendments requiring lenders to report the lien status of applications and originated loans and, in applications taken by telephone, to ask applicants their ethnicity, race, and gender. Compliance with the amendment requiring lenders to ask telephone applicants for monitoring information is mandatory for applications taken on or after January 1, 2003. Compliance with the other amendments will be mandatory for data collected on or after January 1, 2004. *BBR, 1/28/02, pp. 121–22; PR-FRB, 5/2/02; PR-FRB, 6/21/02.*

Final Regulation W

On October 31, 2002, the FRB approved a final Regulation W that comprehensively implements Sections 23A and 23B of the Federal Reserve Act, unifying in one public document the FRB's interpretations of those sections. Sections 23A and 23B and Regulation W restrict (1) loans by a depository institution to its affiliates, (2) asset purchases by a depository institution from its affiliates, and (3) other transactions between a depository institution and its affiliates. The purpose of Sections 23A and 23B and Regulation W is to limit both a bank's risk of loss in transactions with affiliates and its ability to transfer to its affiliates the benefits arising from its access to the federal insurance safety net. The final regulation becomes effective on April 1, 2003. *PR-FRB, 11/27/02.*

Amended Regulation A

On October 31, 2002, the FRB approved a final rule amending Regulation A by revising the

Federal Reserve System's discount window programs, which provide credit to help depository institutions meet temporary liquidity needs. The rule replaces adjustment credit, which is extended at a below-market rate, with a new type of discount window credit called primary credit, which is broadly similar to credit programs offered by many other major central banks. Primary credit is available for very short terms as a backup source of liquidity to depository institutions that are in sound financial condition. Federal Reserve Banks extend primary credit at a rate above the federal funds rate, thus eliminating the incentive for institutions to borrow for the purpose of exploiting the positive spread of money market rates over the discount rate. The Reserve Banks establish the primary credit rate at least every two weeks, subject to review by, and determination of, the Board of Governors, through the same procedure used to set the adjustment credit rate. The final rule includes a provision that could facilitate a reduction in the primary credit rate in a financial emergency. The final rule also establishes a secondary credit program that is available in appropriate circumstances to depository institutions that do not qualify for primary credit. The FRB anticipates that Federal Reserve Banks will establish the secondary credit rate at a level 50 basis points above the primary credit rate. *PR-FRB, 10/31/02.*

Survey on Bank Lending Practices

In its October 2002 issue of the quarterly *Senior Loan Officer Opinion Survey on Bank Lending Practices*, the FRB reported that during the three-month period ending October 2002, both domestic and foreign banks had continued a trend of stricter business lending practices. Although the percentage of domestic banks reporting tightened standards for commercial and industrial (C&I) loans to large and middle-market firms during the period edged down to 20 percent from 22 percent in the July 2002 survey, the percentage that tightened their standards for business loans to small firms during the period jumped from 6 percent in the previous survey period to 20 percent. Both foreign and domestic institutions indicated that the most important reason for tightening stan-

dards and terms on C&I loans was a less-favorable economic outlook. Domestic and foreign institutions reported that the demand for C&I and commercial real estate loans weakened between the July and October surveys. Domestic banks attributed the decline in C&I loans to reduced demand from creditworthy borrowers, whereas foreign institutions reported that their own tighter lending standards played a role in the decline. For the report, the Federal Reserve surveyed loan officers from 55 large domestic banks and 20 foreign banking institutions. The survey focused on changes during the preceding three months in the supply of and demand for bank loans to households and businesses. *Senior Loan Officer Opinion Survey on Bank Lending Practices, FRB, October 2002.*

Office of the Comptroller of the Currency

Change in Deposits Required for Branches of Foreign Banks

On March 4, 2002, the OCC implemented more-flexible capital equivalency requirements for federal branches of foreign banks to reduce costs for institutions that present low levels of risk. Under the existing law, federal branches of foreign banks were required to maintain in trust accounts at other banks a capital equivalency deposit (CED) equal to 5 percent of their liabilities. The CED funds, which are intended to serve as a cushion against losses, could not be withdrawn without OCC permission. The OCC implemented two changes to this law: (1) low-risk branches are permitted to withdraw excess deposits without seeking prior OCC approval, and (2) the liability base over which the CEDs are calculated was redefined to exclude liabilities booked on a federal branch's international banking facility. However, several safeguards were maintained under the new approach. The OCC will continue to require a CED agreement with a foreign bank, and the assets in the account must be free from liens or claims other than those of the OCC. The OCC will continue to have rights to the CED in the event the federal branch goes into receivership. In addition, every federal branch must continue to

maintain a CED of at least \$1 million, even if that amount is more than 5 percent of liabilities. NR 2002-16, OCC, 3/4/02.

Rule Amending Regulations on Banking and Electronic Technologies

On May 17, 2002, the OCC published in the *Federal Register* a final rule that gives national banks guidance on several aspects of their authority to engage in electronic commerce. One provision of the new rule permits national banks to act in the capacity of a “finder” between providers and buyers of financial and nonfinancial products and services that are fostered by new technologies such as the Internet. The rule offers guidance to national banks seeking to conduct new activities electronically by describing the factors the OCC uses to determine if an electronic activity is part of the business of banking. The rule also clarifies that a national bank’s electronic activity will not be exempt from general OCC guidance applicable to the underlying activity conducted through conventional means. And when national banks share electronic space (such as Web pages or Web sites) with other businesses, the rule requires that the bank take reasonable steps to clearly, conspicuously, and understandably distinguish between products and services it offers and those the other business offers. NR 2002-44, OCC, 5/16/02; BBR, 5/20/02, pp. 863–64.

Survey of Credit Underwriting Practices

The OCC’s eighth annual *Survey of Credit Underwriting Practices* reported that underwriting standards for commercial and retail loans tightened during the 12-month period ending March 31, 2002. For the second consecutive year, the majority of surveyed banks tightened commercial loan underwriting standards (67 percent of banks in 2002, compared with 55 percent in 2001). The survey found that most banks made no change to retail underwriting standards, and those that did primarily tightened standards (39 percent of banks). The 2002 survey covered the 62 largest national banks with an aggregate loan portfolio of \$2 trillion, which represents approximately 90 per-

cent of all outstanding loans in national banks. The survey, which is completed by OCC senior examiners, consists of a series of questions about 16 types of commercial and retail lending. The questions focus on the direction of lending standards and the level of inherent risk in the portfolios and products of the banks examined. 2002 *Survey of Credit Underwriting Practices*, OCC, June 2002.

Office of Thrift Supervision

Swearing-in of Gilleran as New Director

James E. Gilleran was sworn in as director of the OTS on December 7, 2001. He served as chairman and chief executive officer of the Bank of San Francisco from 1994 to 2000 and as superintendent of the California State Banking Department from 1989 to 1994. He also served as chairman of the Conference of State Bank Supervisors (CSBS) from 1993 to 1994 and as a member of the CSBS’s Bankers Advisory Council until 2000. Mr. Gilleran replaces outgoing director Ellen Seidman. OTS 01-83, 12/7/01.

Updated Handbook on Trust and Asset Management Services

On August 27, 2001, the OTS published a revised version of the *Trust and Asset Management Handbook*, which helps agency examiners plan and perform exams of thrift institutions’ trust and asset management services. The revision highlights the OTS’s emphasis on a risk-focused approach to examinations. The revised handbook contains a comprehensive review of the products and services, laws and regulations, and risks and fiduciary duties applicable to savings associations that engage in trust and asset management activities. BBR, 9/10/01, p. 377.

Revised Lending Rule

On December 20, 2001, the OTS issued a final rule that (1) allows federally chartered thrift institutions to expand the availability of low-cost credit to small business and agricultural borrowers, and

(2) provides additional flexibility for thrifts that invest in their communities. For loans meeting the definition under the Home Owners' Loan Act of lending to small businesses, the rule increases the dollar limit from \$1 million to \$2 million; for loans to farms, the limit is raised from \$500,000 to \$2 million. The rule provides an additional measure of flexibility for loans to certain individuals who use the loan proceeds for their small enterprises, as long as the proceeds are used for commercial, corporate, business, or agricultural purposes. The rule also permits thrifts to increase the amount of their total capital that they may commit to community development investments; the new limit is the greater of 1 percent of total capital or \$250,000. The rule also provides thrifts with an enhanced ability to invest in state and local government obligations and gives them unlimited authority to invest in such obligations. The rule allows both real property and personal property to be the primary source of security for real estate loans. The final rule became effective January 1, 2002. *BBR, 12/24/01, p. 1010.*

Adjusted Capital Requirements for 1- to 4-Family Mortgages

On May 10, 2002, the OTS adjusted its capital requirements for one- to four-family residential first mortgage loans. Under the new requirements, a one- to four-family loan will qualify for 50 percent risk-weight capital treatment if the loan is underwritten in accordance with prudent underwriting standards, including standards in the Interagency Guidelines for Real Estate Lending. The OTS eliminated the requirement that a loan-to-value ratio of 80 percent or less is necessary for a loan to qualify for the 50 percent risk weight. In addition, the rule eliminates the requirement that a thrift institution deduct from capital the portion of a land loan or nonresidential construction loan exceeding an 80 percent loan-to-value ratio. *OTS 02-26, 5/9/02.*

Amendment to Alternative Mortgage Transaction Parity Act

The Alternative Mortgage Transaction Parity Act, adopted in 1982, grants certain state-chartered

housing creditors parity with federally chartered lenders when making alternative mortgages. An alternative mortgage is a loan with payment features—such as variable rates or balloon payments—that vary from conventional fixed-rate, fixed-term mortgage loans. On September 26, 2002, the OTS announced a final rule that amended its regulations under the Parity Act to make state-chartered housing lenders subject to state, not OTS, rules governing prepayment penalties and late fees. The final rule becomes effective July 1, 2003. *BBR, 9/30/02, p. 528; OTS 02-44, 12/6/02.*

Federal Housing Finance Board

Appointment of Korsmo as Chairman

On November 29, 2001, John T. Korsmo was named a director of the Federal Housing Finance Board, and on December 21, 2001, he was designated the board's chairman. Mr. Korsmo replaces J. Timothy O'Neill, who had served as chairman since June 18, 2001, and remains a director. In 1998 Mr. Korsmo founded Korsmo Consulting Services, Inc., a health-care, political, and sports marketing consulting firm in Fargo, North Dakota. He served as policy and legislative director for North Dakota governor Ed Schafer in 1996 and 1997, and chaired the North Dakota Republican Party from 1993 to 1995. Until 1996, Mr. Korsmo was president and owner of Cass County Abstract Company, in Fargo, and founder and president of Red River Title Services in Moorehead, Minnesota. He was also founder and, from 1983 to 1992, president of the Title Company of Fargo, the first independent escrow and closing company in North Dakota and northwestern Minnesota. *Dow Jones Newswires, 12/19/01.*

Changes to Affordable Housing Program

On September 12, 2002, the Federal Housing Finance Board (FHFB) approved changes to the Affordable Housing Program, giving Federal Home Loan Banks additional tools to help first-time homebuyers. (The Affordable Housing Program provides direct subsidies or loans at subsidized rates to the Federal Home Loan Bank [FHLB]

System's member institutions to finance the purchase, construction, or rehabilitation of affordable housing units. The FHLB System contributes to the program the greater of 10 percent of net earnings or \$100 million per year.) Previous FHFB regulations authorized the Federal Home Loan Banks each year to allocate for homeownership set-aside programs the greater of \$3 million or 25 percent of their Affordable Housing Program contribution. The new rule allows each Federal Home Loan Bank to set aside specifically for first-time homebuyers an additional amount of up to the greater of \$1.5 million or 10 percent of its annual Affordable Housing Program amount. The final rule also increases the maximum subsidy limit per household to \$15,000 for homeownership set-aside programs in general. *FHFB 02-42, 9/12/02.*

National Credit Union Administration

Appointment of Dollar as Chairman

On September 13, 2001, President Bush appointed National Credit Union Administration (NCUA) board member Dennis Dollar as the agency's chairman. Mr. Dollar had served on the NCUA board since October 1997 and had been the acting chairman since February 2001. From 1992 to 1997, he served as the president and CEO of Gulfport VA Federal Credit Union. From 1976 to 1984 he served two terms in the Mississippi House of Representatives. His term on the NCUA board expires in 2003. *NR-NCUA, 09/17/01.*

Appointment of Two New Board Members

On March 22, 2002, Deborah Matz and JoAnn Johnson were confirmed as members of the NCUA Board of Directors. Ms. Matz filled the seat that had been held by Geoff Bacino until his term expired on December 20, 2001. Ms. Johnson filled the seat vacated by Yolanda Townsend Wheat on December 21, 2001.

Ms. Matz had most recently been the executive officer at the Liaison Office for North America of the Food and Agriculture Organization (FAO) of

the United Nations. Before joining FAO, she served in the U.S. Department of Agriculture (1993–2001), where she held numerous high-level positions, including deputy assistant secretary for administration, chair of the loan resolution task force, and chief of staff to the administrators of the Farm Service Agency and the Farmers Home Administration. Ms. Matz had also served nine years as an economist with the Congressional Joint Economic Committee.

Ms. Johnson was a member of the Iowa Senate at the time of her appointment, having been elected to that body in 1994. She chaired the Senate's Ways and Means Committee from 1996 to 2000 and the Commerce Committee from 2000 until resigning her seat to accept the NCUA board position. *NR-NCUA, 1/23/02.*

Exemption of Healthy Credit Unions from Certain Regulations

In a final rule released on November 21, 2001, the NCUA declared that credit unions with high net worth and consistently strong supervisory ratings are exempt from a range of federal regulations. Credit unions that receive a composite safety and soundness rating of 1 or 2 for two consecutive examinations, have a net-worth ratio of 9 percent or higher, and are well capitalized under the NCUA's prompt corrective action regulations are automatically exempt from rules that require quarterly stress-testing of certain securities and from rules that limit how third parties handle investments. In addition, they need not obtain an appraisal for a loan unless the loan amount is \$250,000 or higher. Other credit unions may also be eligible for the exemption; however, they must submit a formal application to the NCUA. The new rule, referred to as "RegFlex," became effective March 1, 2002. *BBR, 11/26/01, p. 867.*

"Access-Across-America" Initiative

On February 25, 2002, Chairman Dollar unveiled a program that focuses on creating economic empowerment by providing access to credit unions in neighborhoods and communities that lack

access to low-cost financial services. The program, labeled “Access Across America,” is designed to establish partnerships between the NCUA and key federal departments and agencies to counter the growing problem of predatory lending as well as to broaden the access of underserved communities to affordable financial services. The NCUA will support underserved areas by charter-

ing new, community-oriented credit unions, particularly in growing Hispanic communities; developing faith-based and campus credit unions; and championing the expansion of financial literacy programs developed by local credit unions in communities across the United States. *NR-NCUA*, 2/25/02.

STATE LEGISLATION AND REGULATION

All States: New Rules on Collateral

New rules governing how banks perfect liens and how borrowers file collateral statements took effect (for most states on July 1, 2001) under a revised Article 9 of the Uniform Commercial Code (UCC). Article 9 of the UCC governs what lenders can accept as collateral and how collateral agreements must be documented. The revised rules set parameters for using personal property as collateral for a loan, and change the filing system for financial statements that detail collateral. Previously the financial statements were filed where the collateral was located, which is often at the local level. Under the new rules, all financial statements have to be filed in just one place: the secretary of state’s office in the debtor’s home state. The new rules became effective for 46 states on July 1, 2001; Alabama, Florida, and Mississippi delayed implementation until January 1, 2002, and Connecticut until October 1, 2002. *AB*, 7/5/01.

California

Governor Gray Davis (D) signed bill A.B. 489 on October 10, 2001, aimed at curbing predatory lending practices by prohibiting licensed persons, such as real estate brokers or mortgage lenders, from engaging in specific acts that harm consumers. The new law is aimed at helping vulnerable people such as senior citizens, immigrants, and low-income families by focusing on the serious abuses practiced by the small minority of lenders that engage in unfair or deceptive practices. The

new law prohibits repeated refinancings of mortgage loans in which lenders extract money for points and fees but provide no benefit to homeowners and leave them worse off financially than they were before the refinancings. In addition, the law prohibits brokers and lenders from steering borrowers toward loans with interest rates and terms that are higher than those for which they could qualify, and prohibits loans that the borrower would clearly not be able to repay. The law also bans incorporating into a loan, to inflate the amount of money being borrowed, points and fees of more than 6 percent of the loan amount to be financed. *BBR*, 10/15/01, p. 587.

Governor Davis also signed legislation on October 10, 2001, requiring credit card issuers to disclose to cardholders in their monthly statements the length of time it would take to pay off their balances if they made only the minimum monthly payments. The new disclosure requirement took effect July 1, 2002. *BBR*, 10/22/01, p. 636.

Colorado

Governor Bill Owens (R) signed H.B. 1259 on June 7, 2002, prohibiting lenders from engaging in certain practices on high-interest loans. The prohibited practices include the following: requiring the entire balance of the loan to be paid just a few years after the loan is issued, charging high fees for early repayment of loans, and refinancing a loan within one year (this prohibition applies only if the refinancing is not in the borrower’s interest). *BBR*, 6/17/02, p. 1053.

Florida

On July 30, 2001, Governor Jeb Bush (R) signed a bill regulating payday loans in Florida. The new law, which became effective October 1, 2001, is designed to prevent fees associated with payday loans from escalating out of control. The law provides a backstop by limiting loans to \$500, capping fees at 10 percent of the loan, and allowing only one payday loan at a time. The law also creates a 60-day grace period in which people who cannot repay loans can seek credit counseling and devise a repayment plan. *Knight-Ridder/Tribune Business News*, 7/31/01.

On April 22, 2002, Governor Bush signed into law a bill (S.B. 2262) that prohibits door-to-door solicitations, the financing of points and fees exceeding 3 percent of a loan amount, and other predatory mortgage lending practices. The Florida Home Loan Protection Act became effective October 2, 2002. *BBR*, 4/29/02, p. 746.

Governor Bush signed into law H.B. 3-E merging the comptroller and treasurer positions into one chief financial officer position as head of a new Department of Financial Services. The Department of Financial Services consists of 13 divisions and offices, including the Office of Financial Institutions and Securities Regulation, which will regulate credit unions, banks, finance companies, and the securities industry. The provisions related to the chief financial officer position became effective January 7, 2003. *BBR*, 6/24/02, p. 1099.

Georgia

On April 22, 2002, Governor Roy E. Barnes (D) signed a bill (H.B. 1361) that cracks down on the lending practices of predatory lenders who cater to the subprime residential housing market. The Georgia Fair Lending Act sets up several triggers; loans above a trigger will be considered high cost and will automatically have certain restrictions. The restrictions include no unreasonable prepayment penalties, no balloon payments, no negative amortization, no penalty interest rates, no excessive advance payments, and no mandatory arbitra-

tion. The law also bans lenders from selling single-premium credit life insurance and prohibits them from charging multiple late fees on a single payment. The law became effective October 1, 2002. *BBR*, 4/29/02, p. 746.

Illinois

By signing H.B. 1089 on August 10, 2001, Illinois Governor George Ryan (R) increased the basic loan limit for a single entity from 20 percent of a bank's unimpaired capital and surplus to 25 percent. The new law, known as Public Act 92-0336, brings Illinois into conformity with lending limits for national banks. *BBR*, 8/27/01, pp. 326-27.

Missouri

On June 27, 2002, Governor Bob Holden (D) signed a bill (S.B. 884) that caps interest rates on payday loans. Under the provisions of the new act, payday loans must have a term of between 14 and 31 days. Although the act stipulates that lenders may charge any simple interest or fees agreed to by the borrower, it caps the total amount of interest and fees at 75 percent of the initial loan amount. In addition, the act limits to six the number of times that a loan can be renewed and requires borrowers to begin repaying the principal of a loan before renewing it for the first time. Borrowers are also prohibited from repaying a loan with proceeds from another loan from the same lender. *BBR*, 7/8/02, p. 59.

New York

On October 3, 2002, Governor George E. Pataki (R) signed legislation to prohibit predatory lending practices in the subprime mortgage lending market. The law prohibits the financing of certain insurance products, restricts the use of balloon payments, and limits the financing of excessive points and fees. Under the law, a home loan is deemed void if a court finds that the lender intentionally violated the law. The law grants borrowers an affirmative defense against foreclosure when a loan has been made in violation of the law. It also allows for a private right of action against a

lender within six years of the origination of a loan. Other provisions of the law require greater disclosure to consumers; one such provision requires that high-cost loans clearly state at the top of mortgage documents that they are high-cost home loans. *BBR*, 10/7/02, p. 551.

North Carolina

In North Carolina, where engaging in the business of money transmission without a license is prohibited, a new law requires that businesses and individuals seeking to obtain a license must demonstrate a certain level of financial worth, post a surety bond, and pay an application fee. The law also requires annual and quarterly reports and license renewal fees, sets out specific requirements for the maintenance of records and a certificate of authority, and contains provisions covering the change in control of a license. Internet sites accessible to North Carolina residents are covered by the prohibitions. However,

banks, credit unions, savings and loan institutions, government entities, and their contractors are exempted from the provisions. The new law became effective October 1, 2001. *BBR*, 10/29/01, p. 697.

Oregon

The National Association of Insurance Commissioners announced on April 30, 2002, that Oregon state insurance regulators and the OTS had signed an information-sharing agreement. The agreement provides for the sharing of nonpublic information on the financial solvency of insurance companies and of any depository institutions the companies own that fall within the jurisdiction of the state insurance commissioner and the OTS. The agreement covers insurance and thrift activities, as well as consumer complaints about the entities involved. Oregon is the 45th state that has signed a sharing agreement. *OTS 02-24*, 4/30/02.

RECENT ARTICLES AND STUDIES

A report issued by the Fannie Mae Foundation in August 2001 says that one-fourth of all lower-income families have no relationship with a bank, savings institution, credit union, or other mainstream financial services provider. America's most financially vulnerable households are turning increasingly to high-cost alternative financial service providers—fringe lenders—to meet their financial service needs. Service fees charged by fringe lenders typically are much higher than those charged by mainstream financial service providers. The report, entitled *Financial Services in Distressed Communities: Framing the Issue, Finding Solutions*, lists several reasons that many lower-income and minority households use fringe lenders, including a lack of physical proximity to mainline financial institutions, a lack of understanding of or trust in financial institutions, and a lack of basic consumer finance education. *Dow Jones Newswires*, 8/2/01.

A pair of studies released on August 29, 2001, conclude that banks that do business exclusively over the Internet are having a hard time compared with those that have traditional branch services. The first study, performed by Jupiter Media Metrix, found that Internet traffic to online-only banks fell 8 percent between July 2000 and July 2001. In contrast, the number of visitors to banks with both branches and online services, known as multichannel banks, climbed 111 percent during the same period. Jupiter analysts concluded that consumers prefer traditional banking and are more likely to conduct online banking with a financial services company that offers easy access to customer service, nearby automated teller machines, and nearby branches. The second study, conducted by Maritz Research, found that 47 percent of U.S. residents prefer banking at their local branches to banking over the Internet. This survey, which polled 1,005

adults randomly selected from around the United States, also found that 18 percent of consumers

preferred ATMs and only 4 percent preferred banking over the Internet. *BBR*, 9/10/01, p. 361.

BANK AND THRIFT PERFORMANCE

First-Quarter 2002 Results for Commercial Banks and Savings Institutions

FDIC-insured commercial banks earned \$21.7 billion during the first quarter of 2002, up from \$19.8 billion in the first quarter of 2001. Key factors in the higher earnings were wider net interest margins at large banks and slow growth in noninterest expenses. Banks' annualized return on assets (ROA) was 1.33 percent in the first quarter, up from 1.26 percent one year earlier. The number of commercial banks on the FDIC's "Problem List" increased from 95 to 102 in the quarter, and assets of "problem" banks rose from \$36 billion to \$37 billion. Six insured commercial banks failed in the first quarter of 2002.

FDIC BIF-insured mutual savings institutions reported earnings of \$3.6 billion in the first quarter of 2002, an increase of \$715 million from the first quarter of 2001. The industry's ROA for the quarter was 1.12 percent, down from 1.18 percent in the fourth quarter of 2001 but up from 0.95 percent one year earlier. There were 22 "problem" thrifts, up slightly from 19 at year-end 2001; however, assets of "problem" thrifts increased dramatically during the first quarter, rising to \$15.0 billion from \$3.7 billion in the previous quarter. No thrifts failed during the first quarter of 2002.

FDIC Quarterly Banking Profile, First Quarter 2002.

Second-Quarter 2002 Results for Commercial Banks and Savings Institutions

Continued strength in consumer loan demand, plus a favorable interest-rate environment, outweighed the negative effects of weakness in commercial loans for banks in the second quarter of 2002. Commercial banks' earnings rose to \$23.4 billion in the second quarter, which is \$1.7 billion higher than in the previous quarter. Commercial banks' average ROA was 1.41 percent in the sec-

ond quarter of 2002, up from 1.33 percent in the first quarter of 2002 and from 1.21 percent in the second quarter of 2001. The number of commercial banks on the FDIC's "Problem List" increased from 102 to 115 during the quarter, but assets of "problem" banks declined from \$37 billion to \$36 billion. One bank failed during the second quarter.

FDIC BIF-insured mutual savings institutions, benefiting from a favorable interest-rate environment and gains on sales of securities, earned \$3.9 billion in the three months from April through June 2002, which is \$236 million higher than in the previous quarter and \$519 million higher than one year earlier. The industry's ROA for the second quarter rose to 1.19 percent, up from 1.12 percent in the first quarter of 2002 and from 1.06 percent in the second quarter of 2001. The number of "problem" thrifts fell slightly from 22 to 21 during the quarter, and "problem" assets dropped sharply from \$15.0 billion to \$3.8 billion. One thrift failed and, with assistance, merged into a commercial bank. *FDIC Quarterly Banking Profile, Second Quarter 2002.*

Third-Quarter 2002 Results for Commercial Banks and Savings Institutions

FDIC-insured commercial banks earned \$23.3 billion during the third quarter of 2002, falling slightly from \$23.4 billion in the second quarter of 2002. Banks' average ROA was 1.37 percent in the third quarter, down from 1.41 percent in the second quarter but up from 1.17 percent in the third quarter of 2001. The number of commercial banks on the FDIC's "Problem List" increased from 115 to 126 in the quarter, and assets of "problem" banks rose from \$36 billion to \$38 billion. One commercial bank failed in the third quarter of 2002.

A favorable interest-rate environment helped FDIC BIF-insured mutual savings institutions realize \$1.9 billion in gains from sales of securities, increasing industry earnings to just under \$4.0 billion in the third quarter of 2002, up from \$3.9 billion in the second quarter of 2002 and from \$3.5 billion in the third quarter of 2001. The industry's ROA for the quarter was 1.20 percent, up from

1.19 percent in the second quarter of 2002 and from 1.08 percent one year earlier. The number of "problem" thrifts declined from 21 to 20 during the quarter, but assets of these institutions rose slightly from \$3.8 billion to \$3.9 billion. No thrifts failed during the quarter. *FDIC Quarterly Banking Profile, Third Quarter 2002.*

INTERNATIONAL DEVELOPMENTS

Canada

On June 14, 2001, the Canadian Parliament approved new framework legislation for Canada's financial services sector, clearing the way for increased competition in the industry. Bill C-8, An Act to Establish the Financial Consumer Agency of Canada and to Amend Certain Acts in Relation to Financial Institutions, was published by the Department of Finance on October 24, 2001. The legislation, which consists of 75 regulations, is expected to promote efficiency and growth in the financial services sector, foster international competitiveness and domestic competition, empower and protect consumers of financial services, and improve the regulatory environment. Key elements of the legislation include permission for financial institutions to engage in a broader range of investments in specific areas of electronic commerce, either through holding companies or through traditional parent-subsidiary structures; permission for financial institutions operating in Canada to establish regulated, nonoperating holding companies that are subject to less regulatory burden than chartered banks; creation of the Financial Consumer Agency of Canada to enforce consumer-oriented provisions of federal financial institution statutes; and provisions to ensure that the government's new entry regime for foreign banks (permitting foreign banks to directly operate branches in Canada) is consistent with the regulatory framework for domestic banks. Of the 75 regulations, 37 relate to the new framework's

restructuring of the permitted investment regime, 18 relate to the new holding company regime for financial institutions, 6 relate to the creation of the new Financial Consumer Agency of Canada, 6 relate to changes to the foreign bank regime, and the remaining 8 are aimed at various other policy objectives. *BBR: 6/25/01, pp. 1081-83; 10/29/01, pp. 704-6; 11/12/01, pp. 792-93; 12/3/01, pp. 911-13.*

China

China's securities regulators issued new regulations allowing commercial banks to directly trade stocks for clients beginning May 1, 2002. Additionally, beginning August 1, 2002, all banks, both Chinese and foreign, became eligible to buy and sell foreign exchange to individuals, ending the People's Bank of China's monopoly in the foreign exchange market. *BBR: 4/29/02, pp. 758-59; 8/5/02, p. 252.*

Japan

Prime Minister Junichiro Koizumi's cabinet on November 12, 2002, established an office for speeding up the disposal of nonperforming loans. The Industry Reconstruction and Employment Strategy Headquarters, which is directed by Mr. Koizumi, was formed as an equity-issuing organization that is fully owned by the governmental Deposit Insurance Corporation (DIC). Its funds will be drawn from the DIC's financial rehabilitation fund or on a new account to be formed. *BBR, 11/18/02, pp. 824-25.*

On November 29, 2002, the Japanese government introduced a nonperforming loan workout schedule that features stricter bank asset inspections, launches a bank inspection team, and injects emergency central bank loans and public funds into nonviable banks. The workout schedule also highlights stricter implementation of prompt cor-

rective measures on banks whose capital has been exhausted; the measures would require such banks to restore stable bank management within one year. In addition, such banks would be put under control of the government and the Bank of Japan as institutions that require “special assistance.” *BBR*, 12/2/02, p. 900.