Recent Developments Affecting Depository Institutions

by Benjamin B. Christopher*

Regulatory Agency Actions

Inter-Agency Actions

The federal bank and thrift regulatory agencies are engaging in joint or coordinated efforts in a number of regulatory areas that are mentioned specifically in this issue of the *Review*, among which are retail sales of non-deposit investment products, savings bank mutual-to-stock conversions, depository institution management interlocks, Community Reinvestment Act enforcement, prevention of discrimination in lending, and accounting practices. For full information on the inter-agency actions included in this issue, reference is necessary to the pages devoted to each of the agencies and the Federal Financial Institutions Examination Council.

Federal Deposit Insurance Corporation

Deposit Insurance Assessments

The FDIC will seek comments on issues related to the way deposit insurance premiums are calculated and collected. Currently, each insured institution determines its assessment premium amount semiannually and submits payment to the FDIC. Under the proposal, the FDIC would determine the assessment premium on a quarterly basis and send four quarterly invoices (two of which would become the semiannual Certified Statements) to the insured institution. The invoices for each quarterly period would be based on the quarterly Report of Condition provided by each financial institution for the immediately preceding quarter.

Each payment would be made *via* the Automated Clearing House (ACH) network in the form of a direct debit initiated by the FDIC. The first quarterly payment would be made approximately 32 days before the current semiannual payment date; the second quarterly payment would be made about 60 days after the current semiannual payment date.

The FDIC believes that the proposed amendments would result in a more efficient collection process, and would reduce regulatory burden on insured institutions. The amendments also would clarify the obligation of acquiring institutions to pay assessments on deposits assumed from institutions terminating their insured status; and would delete from the assessments regulation the existing references to experience factors, which are not available for use after 1994. *FIL-45-94, FDIC, 6/16/94; FR, 6/10, p. 29965.*

Retail Sales of Nondeposit Investment Products

The Office of the Comptroller of the Currency (OCC), FDIC, the Board of Governors of the Federal Reserve System (FRB) and the Office of Thrift Supervision (OTS) issued a joint statement on retail sales of mutual fund and other nondeposit investment products by federally insured financial institutions. The statement supersedes the guidance previously issued by each of the four agencies, and results in the agencies operating under the same inter-agency statement for the provision of mutual fund and other investment services. The statement applies to insured depository institutions selling at retail, either directly or indirectly, a mutual fund or other nondeposit investment product. Banks and thrifts recommending or selling such products should ensure that customers are fully informed that the products: (1) are not FDIC-insured, (2) are not deposits or other obligations of the institution and are not guaranteed by the institution, and (3) involve investment risks, including possible loss of principal. These disclosures should be conspicuous and presented in a clear and concise manner.

*Benjamin B. Christopher is a financial economist in the FDIC's Division of Research and Statistics.

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

The agencies said that tellers should not qualify customers, make specific recommendations about nondeposit investments, or accept orders. Among a number of other things that banks and thrifts should do to minimize the possibility of customer confusion are: when a customer opens an investment account, obtain a signed statement acknowledging that the disclosures have been received and understood; separate physically the investment sales areas from the deposit-taking areas; and ensure that investment sales personnel are properly qualified and trained. *FIL-9-94, FDIC, 2/17/94; "Inter-Agency Statement on Retail Sales of Nondeposit Investment Products," FRB, FDIC, OCC, OTS, 2/15/94.*

Savings Bank Mutual-to-Stock Conversions

The FDIC adopted an interim rule, effective February 15, 1994, that will enable the agency to formally review and, if necessary, prevent unfair or unsafe conversions of FDIC-supervised savings banks from mutual to stock form of ownership.

Among the FDIC's concerns are that, in some cases, insiders may set the stock offering price well below the true value of the institution, or they may obtain more than a fair share of the stock subscription. Excessive compensation packages also are of concern. Under the interim rule, an FDIC-supervised state-chartered savings bank must provide the appropriate FDIC regional office with advance notice of its plans to convert from mutual to stock form as well as copies of all application and disclosure materials. The FDIC has 60 days from the receipt of a complete notice to review the conversion plan before it can be consummated, although the agency can extend the review period for another 60 days. A proposed conversion could not be consummated if the FDIC objects within the allotted time. If the FDIC notifies the savings bank that it has no objection to the transaction or if the FDIC does not respond within the allotted time, the conversion may be completed. This interim rule departs from the FDIC's past practice of suggesting to other federal or state regulators that modifications be made in a conversion plan. *PR-7-94, FDIC, 2/8/94; PR-3-94, 1/28; FR, 2/15/94, p. 7194; 2/1/94, p. 4712.*

FDIC-insured mutual state-chartered savings banks that are not members of the Federal Reserve System would be required under a proposed rule to comply with new substantive provisions when proposing to convert to the stock form of ownership. The proposed requirements are similar to the OTS' regulations which were revised recently. Currently and during the pendency of this proposed rulemaking, the FDIC will continue to use the case-by-case procedure under the interim rule (see above) in reviewing notices of proposed conversions of state savings banks. The proposed rule would require (among other things): the submission of a full appraisal report, including a complete and detailed description of the elements that make up an appraisal report and justification for the methodology employed; a depositor vote on all mutual-to-stock conversions of state savings banks; that stock options (if any) be granted at no lower than the market price at which the stock is trading at the time of grant; that the subscription offering provide a reference to eligible depositors and others in the bank's "local community"; the submission of a business plan, including in part, a detailed discussion of how management intends to deploy the capital raised through the sale of stock in the conversion; and a prohibition on stock repurchases within one year following the conversion. *FR, 6/13/94, p. 30316; FIL-39-94, FDIC, 6/13.*

Financial Derivatives

FDIC-supervised commercial and savings banks were notified that the agency has updated and consolidated its guidance to examiners and regional offices regarding the analysis and treatment of financial derivatives, such as interest-rate swaps, futures and options contracts. The guidance is applicable principally to financial institutions that are "end-users" of derivatives. It focuses on the fundamental risks of financial derivatives and off-balance-sheet activities, with the expectation that it will assist examiners in determining institutions' potential exposure and in assessing their risk management practices. *FIL-34-94, FDIC, 5/18/94.*

BIF Reaches $15.2 Billion

The Bank Insurance Fund (BIF) totaled $15.2 billion (unaudited) on March 31, 1994, continuing its strong growth from $13.1 billion at year-end 1993, from a negative $101 million at the end of 1992, and a negative $6.8 billion in 1991. The BIF's recovery to date primarily has reflected improved underwriting income resulting from greatly reduced numbers of bank failures (no failures occurred in the first quarter) a drop in the estimated cost of banks expected to fail in future periods, and the Corporation's cost-control efforts. In 1993, gross revenue to the BIF totaled $6.4 billion (unaudited), including approximately $5.8 billion from assessments, $0.2 billion from interest on U.S. Treasury obligations, and $0.4 billion from other sources. Provision for loan losses was a negative $7.7 billion, and other expenses were $0.9 billion, resulting in net income of $13.2 billion to the BIF.

The ratio of the BIF to insured deposits stood at 0.80 percent at March 31, 1994, up from 0.70 percent at year-end 1993. The FDIC said in its quarterly statement that the BIF may reach the recapitalization goal of 1.25 percent as early as 1996.

The Savings Association Insurance Fund (SAIF) had net income of $262 million in the first quarter of 1994, and on March 31 the SAIF totaled $1.4 billion (unaudited), or 0.20 percent of insured deposits. Revenue to the SAIF in 1993 was $923 million, of which $898 million was assessments earned. Expenses and losses for the year amounted to $46 million. The net income of $877 million increased the balance of the SAIF to just under $1.2 billion at year-end. *Financial Reports, FDIC.*

Bank Failures Continue to Decline

Eight FDIC-insured banks, with assets totaling $844.7 million, have failed in 1994 through July 15, continuing the declining trend in bank failures. The banks were located in California (4), Connecticut (2), Massachusetts and Missouri. In 1993, there were 42 failures of insured institutions, twenty of which were located in California and ten in Texas.

The number of commercial banks on the FDIC's "Problem List" fell for the ninth consecutive quarter, to 383 as of March 31, 1994, and their assets declined for the eighth straight quarter, to $53 billion. A year earlier, there were 671 "problem" banks, with assets amounting to $377 billion. "Problem" savings institutions totaled 118 as of March 31, 1994, representing 5.3 percent of savings institutions in operation, and their assets were $89 billion, or 8.9 percent of savings institutions' assets. *FDIC Quarterly Banking Profile, FDIC, Recent Issues; and FDIC Office of Corporate Communications.*

Management Official Interlocks

The FDIC proposed to amend its regulations that implement the Depository Institution Management Interlocks Act as part of a joint initiative by the federal bank and thrift regulatory agencies. The Act generally prohibits certain management official interlocks between unaffiliated depository institutions, depository holding companies, and their affiliates. The proposal would create limited exemptions to the prohibition on management official interlocks between certain depository organizations located in the same community or "relevant metropolitan statistical area" (RMSA). Such interlocks would be permitted between institutions that together control only a small percentage of the total deposits in the community or RMSA. *FR, 4/20/94, p. 18764; 6/9, p. 29740.*

Activities of State-Chartered Banks and Subsidiaries

The FDIC approved final rules implementing statutory restrictions on the activities of insured state banks and their majority-owned subsidiaries. The new rules were to go into effect when published in the *Federal Register*.

With certain exceptions, the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) prohibits state banks and their majority-owned subsidiaries from conducting activities "as principal" that are not permitted for national banks. The bank may, however, engage in an otherwise prohibited activity if it meets its minimum capital requirements and the FDIC determines that the activity does not present a significant risk to the deposit insurance funds. Under the final rules:

(a) The term "as principal" is defined to exclude agency activities. Thus, a state bank can, without prior FDIC consent, operate insurance agencies, securities brokerage firms, real-estate agencies, travel agencies, financial planning services and certain other agencies if authorized by state law.

(b) Activities are listed that do not present a significant risk to the insurance funds and therefore are permissible. Among the activities are those defined by the FRB as "closely related to banking."

(c) Application procedures are described for an institution seeking FDIC consent to continue or begin an otherwise prohibited activity.

In a related action, state banks that are members of the SAIF are put under the same restrictions on corporate activities that apply to BIF-insured banks. *PR-133-93, FDIC, 11/30/93; FR, 12/8/93, pp. 64460, 64462.*

Activities and Investments of State Savings Associations

The FDIC is amending its regulations concerning applications and notices by savings associations. The amendments conform the definitions of "significant risk" and "equity security" to other definitions of those terms in the FDIC's regulations, and allow insured state savings associations to conduct activities and make investments without the FDIC's prior approval provided that the activities and/or investments were found to be permissible for federal savings associations under an order or a written interpretation issued by the OTS. This change also places insured state savings associations on a par with the treatment accorded insured state banks under the FDIC's regulations. The final amendment is effective December 8, 1993. *FR, 12/8/93, p. 64455.*

Receivership Rules: Least-Cost Resolution

The FDIC adopted a regulation required by FDICIA on the least-cost resolution of failed and failing depository institutions insured by the FDIC. The final rule adds a new Section to the FDIC's regulations stating the prohibition in Section 13(c) of the FDI Act on taking any action under that section that would have the effect of increasing losses to any insurance fund by protecting uninsured depositors or nondepositor creditors of a failed or failing depository institution. In addition, the final rule references the systemic-risk exception to the prohibition. The final rule also includes the provision of 13(c) which makes clear that the FDIC is not prohibited from engaging in purchase-and-assumption transactions under which uninsured deposits may be acquired so long as the loss to the insurance fund on those uninsured deposits is less than if the institution had been liquidated and the insured deposits were paid. The regulation is effective January 21, 1994. *FR, 12/22/93, p. 67662.*

CrossLand Sale Satisfied Least-Cost Mandate

A report by the U.S. General Accounting Office (GAO) concludes that the FDIC's resolution of the CrossLand Federal Savings Bank of Brooklyn, New York, in August 1993, was in compliance with the least-cost calculation and documentation requirements of Section 13(c) of the FDI Act, as amended by FDICIA, and criteria contained in an earlier report of GAO in July 1992.

CrossLand experienced substantial losses from 1989 through 1991, resulting from the weak New York real-estate market and the bank's concentration in real-estate development lending. CrossLand's efforts to replenish its capital as required by its primary regulator, the OTS, were unsuccessful. The bank, which had $8.7 billion in assets as of December 1991, was declared insolvent by the OTS on January 24, 1992.

The FDIC is required by statute to resolve a failed bank in a manner least costly to the BIF. Immediately upon CrossLand being declared insolvent, the FDIC placed the bank in conservatorship, and injected $1.2 billion in cash to restore capital to the required level and to strengthen the bank by reducing its high-cost debt. The FDIC also hired a chief executive officer to manage CrossLand in conservatorship and approved a business plan that was designed to return the bank to operating profitability by downsizing and stabilizing it. After considering various alternatives for resolving the conservatorship, in August 1993 the FDIC sold the conservatorship — by then the assets were down to $5.2 billion — through a public offering.

The report said the process the FDIC used for the 1993 decision was well-documented and adequately supported with cost estimates for each alternative, and that there was much improvement over the 1992 process in establishing a conservatorship. In addition, the GAO found no evidence of significant problems with the management and control of CrossLand during its operation under FDIC conservatorship. *FDIC Sale of CrossLand Conservatorship Satisfied Least-Cost Test, U.S. General Accounting Office, April 1994.*

The FDIC estimated the losses to the BIF from the CrossLand resolution, as of December 31, 1993, to be $784.8 million. *PR-20-94, FDIC, 3/30/94.*

Assistance for Areas Affected by Earthquake

The FDIC announced a series of steps to assist the rebuilding in the area damaged by the earthquake in Southern California. Guidelines that the FDIC will send to the banks it supervises suggest that extending repayment terms, restructuring existing loans or easing terms for new loans, if done in a manner consistent with sound banking practices, can both contribute to the health of the community and serve the long-term interests of the lending institution. Other regulatory relief actions include a temporary waiver of certain real-estate appraisal regulations for the affected areas, and temporary relief from certain capital requirements if an already adequately capitalized bank finds its asset levels increasing due solely to deposits of insurance proceeds or government assistance funds. *PR-4-94, FDIC, 1/25/94; FDIC Statement, 1/25/94.*

See also "Real Estate Appraisal Exceptions in Major Disaster Areas," *FR*, 2/11/94, p. 6531; OCC, FRB, FDIC, OTS, and NCUA, reporting actions pursuant to Section 2 of the Depository Institutions Disaster Relief Act of 1992 (DIDRA), which authorizes the federal financial institution regulatory agencies to make exceptions to statutory and regulatory requirements relating to appraisals for certain transactions.

Treasury Study of Depository Institutions Disaster Relief

The Department of the Treasury, in consultation with the federal bank regulatory agencies, is conducting, and requesting comments on, a study of the effectiveness of the federal banking agencies' response to recent disasters. Pursuant to Section 5 of DIDRA, the study group intends to complete the study by February 12, 1995, and will submit to Congress a final report including recommendations for administrative or legislative action. *FR, 6/29/94, p. 33574.*

Alternative Dispute Resolution

The FDIC adopted a Statement of Policy to further its commitment to the use of Alternative Dispute Resolution (ADR) for resolving appropriate disputes in a more timely, less-costly manner than litigation or administrative adjudication. The Statement reiterates the agency's support of the cost-effective use of ADR, including negotiation, mediation, early neutral evaluation, neutral expert fact-finding, mini-trials and other hybrid forms of ADR in appropriate instances; it does not favor the use of binding arbitration other than as set forth in the Administration Dispute Resolution Act of 1990. An ADR Task Force has been created to design, implement and coordinate ADR efforts across the Corporation, and to develop strategies for educating employees and disputants about ADR options. *FR, 3/30/94, p. 14860.*

Establishment and Relocation of Remote Service Facilities

The FDIC proposed revising its application and publication requirements for the establishment and relocation of remote service facilities (RSF), in order to lessen the regulatory burden on state nonmember banks and state-licensed branches of foreign banks. Currently, banks desiring to establish an initial RSF must comply with the requirements in these respects that are applicable to the establishment of a "brick and mortar" branch office, while successive RSFs may be established or relocated without a formal application. There is no differentiation based upon the condition of the applying institution.

The proposal provides that an institution whose most recent Community Reinvestment Act (CRA) rating is Satisfactory or better may establish and operate or relocate an RSF by filing a letter with the appropriate FDIC regional director containing certain specified information. Unless the institution is notified otherwise by the FDIC within seven days of receipt of the letter, the institution may establish or relocate the RSF. Existing public notice requirements would be dispensed with in this case. Other requirements would apply to an institution not having a CRA rating of Satisfactory or better, including that they comply with existing notice requirements. Unless the institution is notified otherwise within 15 days after processing of its information letter, the institution could establish or relocate the RSF. Should a protest be filed or other objection taken, the institution could not proceed until the FDIC provides a written notice of approval. *FR, 4/26/94, p. 21676.*

Disclosure Regarding Deposit Insurance Coverage

The FDIC proposed that plan administrators of certain retirement and other employee benefit accounts be provided timely disclosures about whether their funds qualify for "pass-through" deposit insurance coverage. In general, "pass-through" insurance means that each participant in the account rather than the total account balance, is individually insured up to $100,000. Under a 1991 law and the FDIC's implementing regulations, depositors in certain retirement and other employee benefit plan accounts are entitled to "pass-through" deposit insurance coverage based, in part, on whether the insured institution satisfies certain capital standards.

Among the types of accounts affected by the proposed rule are 401(k) retirement accounts, Keogh plan accounts, and corporate pension plan and profit-sharing plan accounts. Situations in which an employee benefit plan administrator would receive a notice indicating an institution's "prompt corrective action" (PCA) category, and whether employee benefit plan deposits at the institution would qualify for "pass-through" insurance coverage, include: (1) when an existing or prospective employee benefit plan depositor requests the information; (2) when someone opens an employee benefit plan account; (3) when the institution has been informed that its capital category has been reduced to "adequately capitalized" from "well-capitalized"; and (4) when the institution's capital category has been reduced to a PCA capital category below "adequately capitalized," thus eliminating "pass-through" insurance coverage on additional deposits.

Also, upon request, existing and prospective employee benefit plan depositors would receive more-detailed information about the institution's actual capital ratios. With the exception of immediate disclosures to depositors of new accounts, the notices would be provided within two business days. *PR-132-93, FDIC, 11/30/93; FR, 12/8/93, p. 64521.*

Allowance for Loan and Lease Losses

The FDIC adopted a Statement of Policy on allowance for loan and lease losses (ALLL) as recommended to the four federal regulators of banks and saving associations by the FFIEC. The statement provides comprehensive guidance on the maintenance of an adequate ALLL and an effective loan review system. It is another step by the agencies to promote consistency in supervisory policies among banks and thrifts.

The guidance, which is effective immediately, explains that the ALLL is designed to absorb estimated credit losses associated with the loan and lease portfolio, including binding commitments to lend. To the extent not provided for in a separate liability account, the ALLL should also be sufficient to absorb estimated credit losses associated with off-balance-sheet credit instruments such as standby letters of credit. The statement covers the responsibilities of the board of directors, the institution's management, and the examiners. *FIL-89-93, FDIC, 12/21/93; "Inter-Agency Policy Statement on the Allowance for Loan and Lease Losses (ALLL)," OCC, FDIC, FRB, OTS, 12/21.*

Proposal to Recognize Holding Gains and Losses in Tier 1 Capital

The FDIC issued for comment a proposal to conform its capital definitions for Part 325 leverage and risk-based capital purposes with the recently issued FASB Statement of Financial Accounting Standards No. 115. This new accounting standard requires banks to recognize, as a separate component of stockholders' equity, the amount of net unrealized holding gains and losses on securities held as "available for sale."

The FFIEC notified all banks in September that they must adopt the new FASB 115 accounting standard as of January 1, 1994, or the beginning of their first fiscal year thereafter, if later. Early adoption of this standard is also permitted for Call Report purposes to the extent allowable under FASB 115. The proposed changes would require institutions to include the FASB 115 capital component for "available for sale" securities when calculating Tier 1 capital for leverage and risk-based capital purposes. The FDIC invited comments on several specific questions. The proposed capital rule is similar to rules being developed by the OCC, FRB, and OTS. *FIL-1-94, FDIC, 1/4/94; FR, 12/29/93, p. 68781; PR-137-93, FDIC, 12/14/93; FR, 4/18/94, p. 18328.*

Affordable Housing Pilot Program

The FDIC announced a pilot effort with the Federal National Mortgage Association that will allow mortgage lenders to offer favorable financing to buyers of FDIC Affordable Housing properties. This pilot program, focusing on properties in Massachusetts, furthers the FDIC's goal to make residential properties retained from failed financial institutions available to low- and moderate-income purchasers. The FDIC, Fannie Mae and the Massachusetts Bankers Association have initiated programs to encourage lending institutions to participate in this joint effort. Eligible purchasers can receive a ten percent credit or grant toward the purchase of FDIC properties. The FDIC properties may be purchased under various arrangements in respect to the down payment and the payment of closing costs, with loan-to-value ratios ranging from 85 percent to 95 percent. *PR-6-94, FDIC, 2/8/94.*

Policy on Risk-Based Capital: Multifamily Housing Loans

Section 618 of the Resolution Trust Corporation Refinancing, Restructuring, and Improvement Act of 1991 (RTCRRIA) requires the FRB, FDIC, OCC and OTS to accord a 50 percent risk-weight to multifamily mortgage loans and related mortgage-backed securities meeting certain specified criteria and gives the agencies discretion to add other prudential safeguards.

The FDIC amended its risk-based capital guidelines, effective January 27, 1994, to assign a 50 percent risk-weight to loans secured by multifamily residential properties that meet certain conditions and to any securities collateralized by such loans. At present, these loans are assigned to the 100 percent risk-weight category. The rule should facilitate prudent lending for multifamily housing purposes. *FR, 1/27/94, p. 3779; 3/18, p. 12806.*

Securities Disclosure

Section 12 of the Securities Exchange Act of 1934 requires that the FDIC issue regulations substantially similar to those of the Securities and Exchange Commission or publish its reasons for not doing so. The FDIC proposed to make its securities disclosure requirements for banks with a class of securities registered under Section 12 substantially similar to those of the SEC in regard to: (1) disclosures of executive compensation; (2) disclosure requirements for small banks; and (3) proxies and related communications among shareholders. Comment is sought also on whether the agency should incorporate in its regulations by cross-reference the comparable SEC rules, or continue to maintain the separate but substantially similar body of rules. *FIL-36-94, FDIC, 5/20/94; FR, 5/2, p. 22555.*

Proposal to Eliminate Planned Growth Reports

The FDIC proposed to rescind its regulations that require all insured banks, except insured bankers' banks, to give prior notice of planned rapid growth that involves the solicitation and acceptance of fully insured deposits obtained from or through brokers or affiliates, the solicitation of fully insured deposits outside a bank's normal trade area, or secured borrowings, including repurchase agreements. The proposed rescission would lessen the regulatory burden on banks that are currently required also to comply with the FDIC's brokered deposit regulation and the prompt corrective action rule, both of which were designed in part to address the same risks resulting from rapid growth. *FR, 4/5/94, p. 15869.*

Fines for Violations of Mortgage Disclosure Law

The FDIC has started to impose fines against lending institutions for late or inaccurate submissions of data used by federal regulators to check for possible mortgage loan discrimination. The agency has fined six lenders, in amounts ranging from $2,000 to $4,000, for late submissions of 1992 and 1993 data required by the Home Mortgage Disclosure Act (HMDA). Data are required by March 1 each year from most lenders on their loans for home purchases, home improvement and refinancing, including the race, gender, income and property location of the loans and loan applications. Data for each institution and nationwide aggregate reports are made publicly available by the agencies. HMDA data for 1992 have been publicly available since October 1993, and the 1993 data reports are being processed for public release later this year. The FDIC supervises more than 3,200 of the 9,649 lenders reporting 1993 data. *PR-39-94, FDIC, 6/17/94.*

Court Rules Against FDIC on Suit Against Bank Officials

The U.S. Supreme Court ruled unanimously that state law and not federal law governed the conduct of lawyers representing a failed California thrift. In a Texas case, the Court declined to review a decision that held that federal law does not take precedence over state statutes of limitation for suing bank directors or officers for wrongdoing. The two decisions may place at risk an estimated $3 billion in FDIC and RTC claims.

In a recent article authored by FDIC Acting Chairman Andrew C. Hove, Jr., he expressed strong support for pending federal legislation that would allow federal regulators to sue for wrongdoing committed up to five years before the date of a banking institution's failure. *The Washington Post, 6/14/94; The New York Times, 7/15/94.*

Report on the Savings Association Insurance Fund (SAIF)

The Savings Association Insurance Fund Industry Advisory Committee, which was established by Congress in 1989, has recommended that the SAIF and the BIF be merged "as soon as possible." The FDIC administers SAIF, which was created by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) to insure savings institutions, replacing the former Federal Savings and Loan Insurance Corporation (FSLIC).

The Committee's report states that if $8 billion in funds authorized for SAIF by the RTC Completion Act of 1993 are actually appropriated when needed, it will at best avoid a short-term crisis if loss funds are needed by SAIF. Funds "authorized and arguably mandated" by FIRREA have never been provided by the Treasury.

Among the report's conclusions are that an assessment rate disparity between the BIF and SAIF of 13 to 20 basis points likely will occur approximately in 1996, rising to 18 to 20 basis points in 1997. This rate disparity will adversely impact the ability of SAIF-insured institutions to raise capital, and will result in a pronounced shrinkage in the SAIF-insured deposits base. A shrinking deposit base, combined with SAIF's fixed obligation to pay approximately $770 million per year in interest on Financing Corporation (FICO) bonds, will reduce available funds to cover future losses and expenses. FICO was created by the Competitive Equality Banking Act of 1987 to issue bonds to recapitalize the FSLIC. Unless the SAIF is fundamentally restructured, the report said, it cannot survive, and the only solution that realistically can avoid further costs to the taxpayers is a merger of the two funds. The resulting fund would achieve the statutorily mandated 1.25 percent reserve ratio in 1997, only one year later than currently projected for the BIF. By 1998, the assessment rate for all insured institutions would be reduced to a range of six to nine basis points, on the assumption of a continuation of the FICO interest obligation. *Report of the Savings Association Insurance Fund Industry Advisory Committee, March 1994.*

Real-Estate Recovery Is Broadening

A substantial improvement in real-estate markets across the nation occurred for the second quarter in a row, according to a survey of real-estate trends conducted by the FDIC in late April. The composite index that measures change in all types of real-estate markets rose to 78, up from 73 in the quarter ending in January and 67 in October 1993.

Values of the index above 50 indicate that more respondents believed conditions were improving than declining, compared to the previous quarter, while values below 50 indicate the opposite. The surveys, which began in April 1991, are based on interviews across the country with more than 450 senior examiners and asset managers at federal bank and thrift regulatory agencies.

Improvement was reported nationwide in both local housing markets and in local commercial real estate. Almost 70 percent of the respondents saw a strengthening of local housing markets in the three months ending in April, while only three percent reported weaker conditions. The improvement in commercial real estate — almost one half of the respondents reported improvement and only two percent saw worsening markets — was particularly encouraging.

Recovery in regional real-estate markets was most widespread in the South, and was strong also in the Midwest, continuing the relatively favorable assessments received from these regions in previous surveys. In California, stable market conditions were reported by two-thirds of the respondents for commercial real estate in the quarter, though it should be noted that the 23 percent seeing better conditions in the state was more than double the ten percent reporting weaker markets. In January, only one respondent saw improvement. In housing markets, 43 percent of California respondents in April believed markets were better, up from 29 percent in the preceding quarter. In the West outside of California, stronger conditions in commercial real-estate markets were reported by two-thirds of the respondents, and in housing markets by three-fourths of respondents. The broadening recovery extended also to the Northeast, where 74 percent of those interviewed saw improvement in housing markets, up from 54 percent in January, and 42 percent reported better commercial real-estate markets, rising from 33 percent in January.

Another positive development was that for the third consecutive quarter there was distinct progress nationwide in reducing excess inventories of commercial real estate. During the first two years of the survey, not much reduction was reported. While 65 percent of the respondents in April still reported an excess supply in commercial real estate, the figure was down from 72 percent in January and 82 percent in July 1993. California lagged here also with 94 percent reporting excess inventories in April. In residential real estate nationally, excess supply conditions were reported by 29 percent of the respondents, declining from 33 percent in January. Further evidence of improvement in housing markets was that 18 percent of those reporting nationally, and 33 percent in the Midwest, saw "tight" supply conditions. *Survey of Real Estate Trends, FDIC, April 1994.*

Newsletter on Consumer Issues

The FDIC introduced *FDIC Consumer News*, a quarterly, free newsletter that presents information of interest to bank customers. The first issue features a report to help consumers avoid costly mistakes under the insurance rules, noting the FDIC's concerns about the large number of depositors with funds over the $100,000 insurance limit, and the increased number of depositors' complaints that bank personnel gave them wrong information about their coverage. The report discusses the new deposit insurance rules that took effect December 19, 1993. Other topics in the first issue include federal efforts to increase lending to low- and moderate-income neighborhoods, new disclosures for deposit accounts and mutual funds sold by banks, and a new consumer protection law on unclaimed funds.

Each issue of the newsletter also will include the addresses and phone numbers of the various government agencies where consumers can get information or other help regarding their rights under the banking laws. *PR-131-93, FDIC, 11/22/93.*

Resolution Trust Corporation

Operations Update

The RTC resolved eight institutions in June, bringing the total number of resolutions to 726 since the inception of the agency in 1989. As of June 30, 1994, the RTC had 18 institutions remaining in its conservatorship program, all of which are expected to be resolved by the end of the third quarter of the year.

Assets under RTC management, including both conservatorships and receiverships, amounted to $48 billion at the end of May. The 25 conservatorships held about $16 billion in gross assets on May 31, 1994. Cash and securities were 31 percent of these assets; performing 1-4 family mortgages, 22 percent; other performing loans, 17 percent; delinquent loans, seven percent; real estate, three percent; investments in subsidiaries, ten percent; and other assets, ten percent. Assets in receivership remaining from the 718 institutions closed by the RTC amounted to $32 billion on May 31 (excluding approximately $11 billion in cash, liquid investments, and accounts receivable accumulated from receivership collections). Because many of the relatively marketable assets have been sold before an institution enters a receivership, most of the assets retained by the RTC in receivership consisted of lower-quality, less-marketable assets. Thus, real estate and delinquent loans represented 40 percent of receivership assets. Cash, securities, and performing 1-4 family mortgages represented only 18 percent of receivership assets.

From inception through May, the RTC collected $150 billion from securities, $101 billion from 1-4 family mortgages, $52 billion from other mortgages, $29 billion from non-mortgage loans, $16 billion from real estate, and $20 billion from other assets. Book value asset reductions were $413 billion, and the RTC recovered 89 percent ($367 billion) on these collections. The RTC has recovered 98 percent from securities, 97 percent from 1-4 family mortgages, 78 percent from other mortgages, 90 percent from non-mortgage loans, 56 percent from real estate, and 69 percent from other assets. The RTC also has collected $18.1 billion in receivership income.

As of the end of June 1994, RTC resolutions had protected 24.1 million deposit accounts from financial loss. These accounts had an average account balance of $9,000. The thrifts closed from the RTC's inception through May 31 held $228 billion in assets at the time of closure. Of this total, $49 billion, or 21 percent, were sold to acquirers (after taking into account assets returned to the RTC under put-back provisions of resolution transactions). Estimated resolution costs for the 718 closed thrifts totaled $84.5 billion. This amount represented 32 percent of their total liabilities at the time of resolution. If the insured deposits of all 718 institutions had been paid out to depositors, the estimated resolution costs would have been $88.4 billion. The $3.9 billion difference represented the estimated savings, or premiums, over insured-deposit payout costs. These savings were equal to two percent of core deposits, represented by deposits with balances below $80,000.

Since its inception through May 31, 1994, the RTC has obtained $118 billion in funding from external sources as follows: $50 billion in appropriations under FIRREA, $41 billion in loss funds authorized by 1991 Acts of Congress, and $27 billion in Federal Financing Bank (FFB) borrowings. The RTC also has obtained $105 billion in recoveries from receiverships. The RTC Completion Act, enacted into law on December 17, 1993, authorized the Treasury to provide the RTC with up to $18.3 billion in loss funds. *RTC Review, July 1994.*

Improved Returns in Nonperforming Loan Auction

The RTC's fourth National Nonperforming Loan Auction, held in Kansas City, Missouri, in April 1994, provided the highest return the RTC has received in these auctions, an average of 60 cents per dollar of book value, compared to 50 cents in the August 1993 auction. The improvement in recovery is credited to offering smaller-sized, geographically localized loan packages. An official said higher returns were obtained by stratifying loan pools by state, city and zip code. *RTC Investor, June 1994.*

Defining a Minority Neighborhood

The RTC adopted, and requested comments on an interim rule that defines "predominantly minority neighborhood" under Section 21 of the Federal Home Loan Bank Act, as amended. The interim rule is effective February 24, 1994. Section 21 requires, among other things, that in considering offers to acquire any insured depository institution, or any branch of an insured depository institution, located in a predominantly minority neighborhood, the RTC will give preference to an offer from any minority individual or minority-owned business, including depository institutions, over any other offer that results in the same cost to the Corporation. Section 21 permits the RTC to lease to a minority acquiror, on a rent-free basis, subject to certain conditions, any branch of a failed institution which is located in a "predominantly minority neighborhood," and authorizes the RTC to provide additional preferences in the form of capital assistance and performing assets. The interim rule generally defines "predominantly minority neighborhood" as any U.S. Postal Zip Code geographical area in which 50 percent or more of the persons residing there are minorities based upon the most recent Census data. *FR, 2/24/94, p. 8842.*

"Gross Negligence" Ruled Necessary to Convict Directors of Federal Thrifts

The U.S. Court of Appeals in Chicago ruled that the RTC must prove "gross negligence," rather than "simple negligence," to convict 13 former directors and officers of Concordia Federal Savings and Loan Association, which failed in 1990. The Court said that FIRREA established a national gross negligence standard for directors and officers at nationally chartered institutions. The Court did not rule on whether this national standard preempts state laws. This is the first such "negligence" case at the circuit court level to involve a federally chartered institution. Directors of state-chartered institutions have lost two cases in two other circuits. *AB, 11/15/93, p. 2.*

Court Rules on RTC's Power to Subpoena Information

In a case involving officials of two failed savings institutions, Trustbank Savings, McLean, VA, and American Pioneer Savings Bank, Orlando, FL, a federal appeals court limited the RTC's power to issue subpoenas for personal financial information to persons that the RTC may reasonably suspect may be liable for the institution's failure. Personal financial information to determine a potential defendant's liability in a savings and loan failure can be subpoenaed, as can information necessary to identify attachable assets, or to establish evidence of illegal asset transfers to avoid restitution payments to the RTC. The agency cannot subpoena personal financial information from officials of failed thrifts for the purpose of deciding whether to sue them. *WSJ, 3/23/94, p. B8; AB, 3/23, p. 3.*

Affordable Housing Accomplishments

A report on the RTC's Affordable Housing Disposition Program shows that through November 30, 1993, 78,000 dwelling units had been sold for $1.2 billion. These units consisted of about 23,900 single-family units, and 54,100 multifamily units of which 22,500 were solely for low- and very low-income tenants. Purchasers of the single-family homes had incomes averaging approximately $21,900, or 61 percent of the national median income, and they paid an average price of about $27,400. According to a recent survey of buyers at nationwide auctions, 40 percent were minorities, 74 percent were first-time buyers, and 13 percent were veterans.

The RTC realized 74 percent of appraised value for both single-family and multifamily properties, with an overall return of 65 percent of book value. *The Silver Lining, RTC, Fall/Winter 1993, p. 10.*

Federal Reserve Board

Extensions of Credit by Federal Reserve Banks

The FRB adopted amendments, effective January 30, 1994, to its Regulation A to implement Section 142 of FDICIA regarding limits on Federal Reserve Bank credit. Under Section 142, after December 19, 1993, the FRB may be financially liable to the FDIC for certain losses incurred by the insurance funds administered by the FDIC. The amendment was intended to discourage advances to undercapitalized and critically undercapitalized insured depository institutions, due to a concern that such advances could lead to increased losses to the insurance funds.

Among the principal substantive changes were: placing limitations on Federal Reserve Bank credit to undercapitalized and critically undercapitalized insured depository institutions; clarifying the term viable, as it applies to an undercapitalized insured depository institution; and providing for assessments on the Federal Reserve Banks for amounts that the FRB may be required to pay the FDIC under Section 142. The final rule provides that a Federal Reserve Bank may make or have outstanding advances to or discounts for a depository institution that it knows to be an undercapitalized insured depository institution only: (1) if, in any 120-day period, the advances or discounts are not outstanding for more than 60 days during which the institution is undercapitalized; (2) during the 60 days after the receipt of a written certification of viability from the Chairman of the FRB or the head of the appropriate federal banking agency; or (3) after consultation with the FRB. A Federal Reserve Bank may make or have outstanding advances to or discounts for an institution that it knows to be a critically undercapitalized insured depository institution only during the five-day period beginning on the date the institution became critically undercapitalized or after consultation with the FRB. *Press Release, FRB, 12/16/93; FR, 12/28, p. 68509.*

Capital Requirements for Recourse Arrangements

The FRB, OCC, FDIC and OTS proposed revisions to their risk-based capital standards regarding regulatory capital treatment of recourse arrangements and direct credit substitutes that expose banks, bank holding companies, and thrifts to credit risk. The joint proposal was developed under the auspices of the FFIEC. The proposal would allow banks and bank holding companies to maintain lower amounts of capital against low-level recourse transactions. Higher amounts of risk-based capital would be required against certain direct credit substitutes including, for banking organizations, purchased servicing rights that provide loss protection to the owners of the loans serviced, and purchased subordinated interests that absorb the first dollars of losses from the underlying assets, and, for both banking organizations and thrifts, certain guarantee-type arrangements (such as standby letters of credit) provided for third-party assets that absorb the first dollars of losses from those assets. The OTS is proposing to change its existing capital regulations only in respect to the capital requirements for the treatment of guarantee-type arrangements that absorb first-dollar losses.

In addition, the agencies are publishing a preliminary proposal to use credit ratings to match the risk-based capital assessment more closely to an institution's relative risk of loss in certain asset securitizations. *Press Release, FRB, 5/25/94; FIL-37-94, FDIC, 5/31; FR, 5/25, p. 27116.*

Community Reinvestment Act

The FRB, OCC, FDIC, and OTS proposed revising their regulations concerning the Community Reinvestment Act (CRA). The proposed procedures are designed to emphasize performance rather than process, to promote consistency in assessments, to permit effective enforcement against institutions with poor performance, and to reduce unnecessary compliance burden while stimulating improved performance.

The inter-agency proposal would replace 12 subjective factors now being used to assess an institution's CRA performance with three "tests" using objective, performance-based standards in the following areas: (1) lending test: the bank or thrift would be evaluated on loans made to low- and moderate-income areas as well as other areas; (2) service test: the institution's branch locations, their accessibility to low- and moderate-income areas, and the availability of credit and other services would be reviewed; (3) investment test: this analysis would cover investment in community development programs that benefit low- and moderate-income areas. The three tests would apply differently to different types of institutions; for example, relatively large institutions (generally those with assets of $250 million or more) would be evaluated on additional information not now reported regarding the geographic distribution of their consumer, small-business and small-farm loan applications, denials and originations. Smaller institutions would be evaluated under a streamlined method that would not include additional data on the geographic distribution of loans.

As an alternative to the three tests, each institution could submit a strategic plan that includes measurable goals for meeting its CRA obligations. The strategic plan would be open to public comment and would be subject to regulatory approval. If the institution failed to meet the goals set forth in its approved plan, its performance would be evaluated under the applicable tests or standards described above. *FR, 12/21/93, p. 67466; 2/3/94, p. 5138; PR-135-93, FDIC, 12/9/93.*

Truth in Savings

The FRB is publishing for comment a proposed official staff commentary to its Regulation DD. The commentary applies and interprets the requirements of the regulation, which became effective on June 21, 1993. The proposed commentary incorporates much of the guidance provided when the regulation was adopted, and addresses also additional questions.

The purpose of the Truth in Savings Act is to assist consumers in comparing deposit accounts offered by depository institutions. The Act requires institutions to disclose fees, the interest rate, the annual percentage yield, and other account terms whenever a consumer requests the information and before an account is opened. Fees and other information also must be provided on any periodic statement the institution sends to the consumer. Rules are set forth for deposit account advertisements and advance notices to account holders of adverse changes in terms. The Act restricts how institutions must determine the account balance on which interest is calculated. *Press Release, FRB, 1/31/94; FR, 2/7/94, p. 5536.*

The FRB decided not to preempt Wisconsin's truth-in-savings law, because the state law is not inconsistent with the federal statute. *FR, 5/10/94, p. 24032; AB, 5/12/94, p. 9.*

The FRB proposed new rules, which among other things, would have the effect of producing an annual percentage yield (APY) that reflects the time value of money.

The FRB withdrew other proposed amendments to the regulation that would have required an internal rate of return formula to calculate the APY. The withdrawal was based on considerations of cost and regulatory burden. *Press Release, FRB, 5/4/94; FR, 5/11, p. 24376.*

Truth in Lending: Depository Institutions Disaster Relief

The FRB granted temporary relief from certain provisions of Regulation Z governing waivers by consumers of the right to rescind certain home-secured loans, so that borrowers in disaster-affected communities in California can gain easier access to loan funds for emergency purposes. Consumers' use of preprinted forms to waive the right of rescission is permitted, if the home securing the extension of credit is located in the disaster area. A consumer must still provide the creditor with a signed, dated waiver statement that a personal financial emergency exists. The FRB's order is effective 2/11/94 and expires on 10/31/94. The FRB acted under provisions of DIDRA, which temporarily authorizes the FRB to make exceptions to the Truth in Lending Act and Regulation Z for transactions in an area the President has declared to be a major disaster area. *FR, 2/11/94, p. 6532.*

Equal Credit Opportunity: Appraisals

The FRB revised its Regulation B to implement amendments to the Equal Credit Opportunity Act contained in FDICIA. The law provides credit applicants with a right to receive copies of appraisal reports. The regulation is amended to provide alternative methods of compliance with the law. For creditors that do not automatically provide copies of appraisal reports, the regulation includes limits on when an applicant may request (and a creditor must provide) a copy of an appraisal report, and a requirement that applicants be notified of the right to receive a copy. The final rule applies to applications for credit to be secured by a lien on a residential structure containing 1-4 family units. The effective date is 12/14/93, and compliance is optional until 6/14/94. *FR, 12/16/93, p. 65657; FIL-12-94, FDIC, 2/28/94.*

Loans to Officers and Directors

The FRB approved a final rule, to be effective February 18, 1994, amending several provisions of its Regulation O. An interim rule is made permanent that increases the aggregate lending limit for small, adequately capitalized banks from 100 percent of a bank's unimpaired capital and surplus to 200 percent. Other amendments are designed to reduce the burden and complexity of the regulation. *Press Release, FRB, 2/18/94; FR, 11/23/93, p. 61803; 2/24/94, p. 8831.*

Public Welfare Investments

The FRB proposed amending its Regulation H, implementing Section 6 of DIDRA, to permit state member banks to make certain public welfare investments without specific FRB approval, and other public welfare investments with specific approval. The aggregate of the bank's public welfare investments must not exceed the sum of five percent of the bank's capital stock paid in and unimpaired and five percent of its unimpaired surplus. The FRB may waive this limit on a case-by-case basis, and permit such investments up to ten percent of capital stock and surplus as described above. Also, the FRB must limit a bank's investments in any one project.

The proposed rule identifies classes of public welfare investments that do not require FRB approval, leaving less-common investments and investments of more than five percent of a bank's capital subject to case-by-case review. Other requirements regarding public welfare investments without FRB approval include that the bank must be at least adequately capitalized and rated a composite CAMEL "1" or "2," and the bank must not be subject to any written agreement, cease and desist order, capital directive, or prompt corrective action directive. *FR, 5/26/94, p. 27247.*

Bank Investments in Premises

Effective July 5, 1994, the FRB is amending its Regulation H to allow a state member bank that meets certain conditions to invest in its premises an amount up to 50 percent of its Tier 1 capital without obtaining specific approval. Such an investment in premises generally should not cause significant risk to a bank which is well-capitalized, is rated CAMEL "1" or "2," and is not subject to any written agreement, cease and desist order, or capital directive. This action will significantly reduce the number of applications to invest in bank premises that are filed with the FRB and will thereby reduce regulatory burden. The amendment does not affect state member banks' ability to invest in bank premises, without conditions, up to the amount of their capital stock account. *FR, 6/3/94, p. 28761.*

Approval to Underwrite Equities

The FRB granted approval for Chase Manhattan Corp., through a wholly owned subsidiary, to underwrite and deal in all types of equity securities, including common stock, on a limited basis worldwide. Commercial banks are prohibited in general by the Glass-Steagall Act from engaging in investment banking activities, however Section 20 of the Act permits limited securities underwriting and dealing by banks. The FRB's rules do not allow a bank holding company's Section 20 subsidiary to derive more than ten percent of it gross revenue from underwriting and dealing in bank-ineligible securities over any two-year period. The Chase subsidiary also is subject to the recordkeeping, reporting, fiduciary standards, and other requirements of the Securities Exchange Act, the Securities and Exchange Commission, and the National Association of Securities Dealers. *BBR, 6/13/94, p. 1022.*

Alternative Test Proposed for Section 20 Compliance

The FRB proposed an alternative to the current test used to measure whether a Section 20 subsidiary is in compliance with the "engaged principally" criterion of Section 20 of the Glass-Steagall Act. Section 20 prohibits a member bank from being affiliated with a company that is "engaged principally" in underwriting and dealing in ineligible securities. The current test is based on the revenue earned from ineligible securities activities relative to the total revenue of the Section 20 subsidiary. Comments are requested on whether asset values or sales volume data, or a combination of both measures, should be used as a new alternative test. *Press Release, FRB, 7/6/94; FR, 7/12, p. 35516.*

Anti-Tying Rules Are Eased

The FRB granted approval for a brokerage subsidiary of First Union Corp., Charlotte, NC, to give price discounts on stock and bond commissions to retail customers who maintain required minimum balances in deposit accounts.

The Glass-Steagall Act requires holding companies to maintain stringent barriers between their securities and commercial banking activities. Anti-tying rules of the Bank Holding Company Act prohibit banks from requiring customers to purchase one service in order to receive another. The FRB used its authority under the BHC Act to grant exceptions if they serve the public interest. The FRB allowed a tie-in in 1990 when it permitted banks to offer price reductions on credit cards issued to their established customers. The agency said it could cancel the approval if anticompetitive practices should develop. *AB, 12/28/93, p. 1.*

The FRB proposed that the exception granted to First Union Corporation (see above) be made available to bank holding companies generally, thus avoiding the need for action on individual requests. The proposed amendments to Regulation Y would also permit discounts on any traditional bank product if the customer obtains another traditional bank product from an affiliate of the bank. *Press Release, FRB, 3/11/94; FR, 3/16, p. 12202.*

Home Mortgage Disclosure

The FRB is proposing several changes to its Regulation C to provide for earlier availability to the public of disclosure statements required by the Home Mortgage Disclosure Act of 1975, and to improve the quality of the data. Amendments to the Act in 1992 provided that starting with the HMDA reports for calendar year 1994, disclosure statements for individual lenders should be available to the public by July 1 of the following year, and that aggregate tables should be available at the central depositories by September 1. Among the proposed changes, lenders would be required to submit their data by February 1 instead of March 1. Another proposal is for reporting in machine-readable format, which should also improve data quality. Institutions also would be required to keep their loan application registers current during the year as data are being collected. *FR, 6/13/94, p. 30310.*

BHC Subsidiary Can Offer Career Counseling Services

The FRB approved an application from Comerica, Inc. under which Comerica of Detroit, MI would provide career counseling services through a Detroit subsidiary to banks, thrifts, bank and thrift holding companies, and their subsidiaries. The approval covers persons currently employed in, recently displaced from, or seeking employment in these organizations, and to employed persons in financially related positions in other kinds of organizations, and those seeking such positions. *BBR, 11/15/93, p. 754.*

Investments in Community Corporations Approved

The FRB gave approval for several state member banks to invest in the West Virginia Bankers Association

Community Development Corp., a for-profit corporation which will promote small-business development. Other banks may participate if they are adequately capitalized and not subject to any formal enforcement actions. Investments will be limited to two percent of a bank's capital and surplus. The OCC gave similar permission last December to national banks. It was not until DIDRA that individual banks were explicitly authorized to make investments in community development corporations, although bank holding companies already had this authority. About 75 banking companies are involved in these projects, increasingly through multibank consortia. *AB, 5/6/94, p. 3.*

Charging for Examinations of U.S. Offices of Foreign Banks

The FRB proposed to amend its regulations relating to the activities of foreign banking organizations in the U.S. to implement provisions of the Foreign Bank Supervision Enhancement Act of 1991 requiring the FRB to charge foreign banks for the cost of examinations of their branches, agencies, and representative offices in the U.S. The amount charged would be the number of examiner hours, times an hourly rate. For branches and agencies, examiner hours would be determined by applying a formula based on the branch's or agency's characteristics. For representative offices, the actual recorded examiner hours would be used. *FR, 12/15/93, p. 65560.*

Revisions to Payments System Risk-Reduction Program

The FRB adopted changes to its Policy Statement on Payments System Risk, involving the procedures that depository institutions must use if they choose to complete a self-assessment to establish a daylight overdraft net debit cap. First, effective for self-assessments performed on or after January 1, 1995, depository institutions must evaluate their operating controls and contingency procedures in addition to the three existing components of the self-assessment (creditworthiness, intraday funds management and control, and customer credit policies and controls). Second, depository institutions will use a "Creditworthiness Matrix" to determine their overall creditworthiness rating, except in certain limited circumstances.

The FRB is eliminating the requirement that branches and agencies of foreign banks provide information on U.S. funding capability and discount window eligible collateral for use in determining their daylight overdraft net debit caps. *FR, 1/20/94, p. 3104.*

Payments System Risk Policy

The FRB will assess a penalty fee, effective April 14, 1994, on the average daily daylight overdrafts in Federal Reserve accounts incurred by bankers' banks that do not maintain reserves, Edge and agreement corporations, and limited-purpose trust companies. The rate for the daylight overdraft penalty fee is equal to the regular daylight overdraft rate applicable to other institutions plus 100 basis points, quoted on a 24-hour basis, for a 360-day year, and adjusted for the length of the Fedwire operating day. The penalty fee should create an incentive for institutions that do not have regular discount window access to avoid incurring daylight overdrafts in Federal Reserve accounts. *FR, 2/24/94, p. 8977.*

Risk-Based Capital: Netting Arrangements

The FRB and OCC issued a joint proposal that would amend the agencies' risk-based capital guidelines to recognize the risk-reducing benefits of netting arrangements. A proposed revision to the Basle Accord would allow the recognition of such netting arrangements.

Under the proposal, institutions would be permitted to net, for risk-based capital purposes, the current exposures of interest- and exchange-rate contracts subject to qualifying bilateral netting contracts. Institutions would be allowed to net positive and negative mark-to-market values of rate contracts in determining the current exposure portion of credit-equivalent amounts of such contracts to be included in risk-weighted assets. *Press Release, FRB, 5/18/94; FR, 5/20, p. 26456.*

Netting Eligibility for Financial Institutions

The FRB approved a final rule, effective March 7, 1994, concerning the definition of "financial institution" in Section 402 of FDICIA. The Act validates netting contracts among financial institutions. Parties to a netting contract agree that they will pay or receive the net, rather than the gross, payment due under the netting contract. The Act provides certainty that netting contracts will be enforced, even in the event of the insolvency of one of the parties. *Press Release, FRB, 2/1/94; FR, 2/2, p. 4780.*

Protections Under Electronic Payments of Benefits

The FRB adopted amendments to its Regulation E in order to accord recipients of benefits, such as food stamps and Supplemental Security Income, much the same protections that are available to other users of electronic payment mechanisms. Electronic benefit transfer (EBT) programs involve the issuance of plastic access cards and personal identification numbers to benefit recipients. Benefits can be accessed through automated teller machine (ATMs) and point of sale terminals. The EBT amendments call for general application of the rules on liability for unauthorized transfers, error resolution, and most other provisions. Mandatory compliance was set for March 1, 1997, as requested by a federal EBT task force that represents all the major federal agencies with benefit programs. *Press Release, FRB, 2/24/94.*

Proposal to Expand Fedwire Funds Transfer Format

The FRB proposed expanding, by late 1996, the Fedwire funds transfer format and the adoption of a more comprehensive set of data elements. An expanded format would improve efficiency in the payments mechanism by reducing the need for manual intervention when processing and posting transfers. Also, truncation of payment-related information would be minimized when forwarding payment orders through Fedwire that were received *via* other large-value transfer systems, such as the Clearing House Interbank Financial Telecommunications (SWIFT). Comments are requested on the benefits and costs to depository institutions, to their customers, and to the overall payments mechanism, from the proposal. *FR, 12/1/93, p. 63366.*

Office of the Comptroller of the Currency

Bank Capital: Risks From Credit Concentration and Nontraditional Activities

The OCC, FRB, FDIC and OTS proposed a rule, to implement Section 305 of FDICIA, amending their risk-based capital standards by explicitly identifying concentration of credit risk and certain risks arising from nontraditional activities, as well as an institution's ability to manage these risks, as important factors in assessing an institution's overall capital adequacy.

While it is not feasible at this time to quantify the risk related to concentrations of credit for use in a formula-based capital calculation, techniques do exist to identify broad classes of concentrations and to recognize significant exposures. Institutions with significant levels of concentrations of credit risk should hold capital above the regulatory minimums. Risks posed by nontraditional activities will be taken into account by ensuring that, as members of the industry begin to engage in, or significantly expand their participation in, a nontraditional activity, the risks of that activity are promptly analyzed and the activity is given appropriate capital treatment. Section 305 requires the agencies to review their capital standards biennially to determine whether those standards are sufficient to facilitate prompt corrective action under Section 38 of FDICIA. Should, however, a nontraditional activity evolve rapidly in the industry, it promptly will be reviewed for proper treatment under risk-based capital. *FR, 2/22/94, p. 8420; FIL-15-94, FDIC, 2/25.*

Deferred Tax Assets

The OCC proposed to amend its capital adequacy rules to limit the amount of certain deferred tax assets that may be included in a national bank's Tier 1 capital for risk-based and leverage capital purposes. The proposal was developed jointly by the OCC, FRB, FDIC, and OTS to respond to the Financial Accounting Standards Board's Statement of Standards No. 109, which was issued in February 1992. The proposed amendment is expected to increase the amount of net deferred tax assets that a national bank may include when computing its regulatory capital. *FR, 12/23/93, p. 68065.*

Guidance on Derivatives

The OCC issued a guidance covering a wide range of issues that were addressed in a policy statement on derivatives adopted by the agency in the Fall of 1993. Among the provisions, the statement requires banks selling derivatives as agents to ensure that their products are appropriate for buyers. The earlier statement had dealt only with banks as principals. The new statement emphasizes that senior management must approve derivative products that present new risks to banks. It relaxes an earlier requirement that a bank credit officer must approve each derivatives transaction, to state that after a broad policy is established, other officials can approve derivatives transactions.

The statement says that "factors that are considered in determining a bank's overall capital adequacy include the quality of the bank's risk-management systems, and exposure to credit concentrations, as well as liquidity, interest-rate, market, legal and operational risks . . . banks with deficient risk-management practices or significant individual or aggregate risk exposures will be expected to hold capital above the regulatory minimums." *Bulletin 94-31, OCC, 5/10/94; WSJ, 5/10.*

Disclosures in Mutual Fund Sales

The OCC announced that in response to an interest expressed by a number of national banks in having the agency review disclosure materials they use in sales of mutual fund and annuity products, the agency is offering the opportunity for a one-time review of these disclosure materials. After an initial contact by an OCC examiner, banks will send in brochures, advertising copy or other promotional materials they wish to have reviewed, following the completion of which the bank will be contacted regarding the materials. *Letter to National Banks, OCC, 5/4/94.*

Real-Estate Appraisals

Effective June 7, 1994, the four federal regulators of banks and thrifts adopted rules, pursuant to Title XI of FIRREA, on real-estate appraisals that are intended to reduce costs and encourage lending without diminishing safe-and-sound banking practices. The revised rules: (a) increase the threshold level to $250,000, from $100,000, for loans that require a real-estate appraisal by a certified or licensed appraiser; (b) exempt from the appraisal requirements business loans of $1 million or less where the sale or rental of real estate is not the primary source of repayment; (c) expand and clarify other exemptions from appraisal requirements, such as those for renewals of existing loans, and loans that qualify for sale or are guaranteed by a U.S. government agency or government-sponsored agency; and (d) reduce and simplify the standards for conducting required appraisals, relying more on industry standards. *FIL-41-94, FDIC, 6/8/94; FR, 6/7, p. 29482.*

Inter-Agency Statement on Discrimination in Lending

Federal agencies that are responsible for enforcing fair lending laws adopted a uniform policy statement on discrimination in lending. The guidance addresses what constitutes lending discrimination under the Fair Housing Act (FHA) and the Equal Credit Opportunity Act (ECOA), including specifically such areas as what the agencies consider in determining if lending discrimination exists; what steps lenders might take to prevent discriminatory lending practices; and what lending patterns will be referred to the Department of Justice for investigation. The ECOA prohibits discrimination in credit transactions generally, while the FHA prohibits discrimination in residential real-estate-related transactions.

The statement notes that the courts have recognized three methods of proof of lending discrimination under the ECOA and the FHA: (a) "Overt evidence of discrimination," when a lender blatantly discriminates on a prohibited basis; (b) evidence of "disparate treatment," when a lender treats applicants differently based on one of the prohibited factors (such as race, national origin, sex, *etc.*); and (c) evidence of "disparate impact," when a lender applies a practice uniformly to all applicants but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity.

Questions and answers, and specific examples, are provided to assist lenders in respect to what constitutes discriminatory lending in the agencies' statement. *"Inter-Agency Policy Statement on Discrimination in Lending," OCC, FRB, FDIC, OTS (and other agencies), 3/8/94; FR, 4/15/94, p. 18266; FIL-29-94, FDIC, 4/29.*

"Retirement CD" Is Permitted

The OCC issued a "no-objection" letter that permits a Montana bank to offer a "Retirement CD" which combines features of a traditional certificate of deposit with certain payment terms and tax advantages of an annuity contract. Customers may open a Retirement CD account with a minimum initial deposit of $5,000, and may make subsequent deposits once a year, each of not less than $1,000. When opening an account the customer chooses a maturity date, with a minimum term of one year. They can elect to receive up to two-thirds of the account balance in a lump sum at maturity, and any amount which is not so received will be used as the basis for equal monthly lifetime payments to the customer. In respect to the Retirement CD as an annuity for income tax purposes, income taxes reportedly are deferred until the time of withdrawal. The certificate pays a fixed rate of interest up to the first five years, after which the interest rate is adjusted at the bank's sole discretion without reference to any independent index. However, the issuing bank guarantees that the interest rate will never fall below three percent per year. One condition that the OCC specified in its approval was that the bank should hedge its payment obligations; another was that the bank make full and accurate disclosures to its customers.

The FDIC has said the CD is a deposit for deposit insurance purposes, but emphasized that under no circumstances would FDIC insurance extend to the bank's commitment to make lifetime payments, and that this fact should be clearly and conspicuously stated by the bank. *AB, 5/13/94, p. 3; Public Letter, FDIC, 5/12.*

Small-Bank Examination Program to Reduce Paperwork

Under a program of the OCC now set to apply only to community banks, but which might be extended in part to larger banks, qualifying institutions that meet certain criteria will be subject to examination procedures requiring less documentation than is currently needed. Their paperwork requirements, especially in preparing for an examination, would be reduced. An official said the program generally would cover banks having assets of less than $100 million, though banks with assets up to $1 billion also might qualify. A qualifying institution would have a rating of "1" or "2" in the 5-point CAMEL scale, and generally would not be heavily involved in nontraditional products, such as mutual funds, annuities, or complex commercial real-estate loans. However, banks involved with mutual funds or annuities could qualify if they meet other criteria. *AB, 7/8/94, p. 1; Bulletin 94-40, OCC, 6/20*.

Banks' Acquisitions of Mutual Fund Companies Approved

The OCC gave approval for Mellon Bank Corp. to acquire Dreyfus Corp., the nation's sixth-largest mutual fund company. Among the conditions imposed on the approval, Dreyfus is required to obtain OCC approval before beginning any new business activities, and Mellon Bank is prohibited in most circumstances from lending to Dreyfus. Other conditions described by observers as "unusually detailed" require Mellon to submit plans to the agency detailing the post-acquisition management reporting structure, and explaining how the holding company will oversee Dreyfus' audit and compliance activities. When the transaction is completed, Mellon's mutual fund assets will increase from $3.7 billion to $71 billion, raising it to fifth place among mutual fund management companies. *AB, 5/5/94, p. 1.*

The OCC approved an application for First Union National Bank, Charlotte, NC, to acquire Lieber & Co., Purchase, NY, which advises and services 15 mutual funds in the Evergreen group with assets of about $3.2 billion. In an unusual move, the OCC had asked for public comment on both of the above acquisitions. *WSJ, 2/24/94, p. A4; 4/18.*

The FRB approved the Mellon-Dreyfus acquisition, effective June 22, 1994. In regard to the Truepenny Corp., a Dreyfus non-bank subsidiary which through another subsidiary partially owns a waterfront redevelopment project in New York City, the approval requires that Mellon's involvement in the project be terminated at the end of its first phase, estimated at about seven years, in order to comply with Regulation Y. Technically the project does not meet the community development investment criteria of the regulation, because it does not provide direct benefits primarily to low- and moderate-income persons. *Press Release, FRB, 6/22/94; BBR, 6/27, p. 1108.*

Lending Limits

The OCC proposed to revise its rules governing national bank lending limits, this being the first of a series of proposals intended to simplify the agency's regulations and reduce compliance costs. The revisions would clarify the scope and application of the lending limits, and update the rules to address frequently-asked questions and incorporate significant OCC interpretations of the lending limits. In addition, the revisions would simplify calculation of the lending limits by relying primarily on quarterly Call Report information, and revise the definition of capital and surplus upon which lending limits are based to rely on capital components that a bank must already calculate for Call Report purposes. A new exception would be added to the lending limits to allow a bank to advance funds to renew and complete funding a loan commitment under circumstances where the additional advance will protect the position of the bank. *FR, 2/11/94, p. 6593.*

Interstate Branching

A ruling by the OCC will enable NationsBank Corp. to merge two branching systems in Maryland and the District of Columbia. Federal law generally prohibits operating a single branch system across state lines, however, the approval was granted under a federal statute that allows banks to move their headquarters anywhere within 30 miles from the town or city where the bank was originally chartered. The headquarters of American Security Bank NA would be moved from DC to a suburb, Silver Spring, MD, and American, retaining its branches in DC, would be merged with Baltimore-based Maryland National Bank. Both of the branching organizations were acquired by NationsBank last year.

In a similar case that would result in interstate branching between New Jersey and Pennsylvania, the OCC in January granted approval for First Fidelity Bank, NA in Pennsylvania, to move its main office to Salem, New Jersey, and then merge with First Fidelity Bank, NA, New Jersey.

Legislation that would allow interstate branching is pending in Congress and in state legislatures including Georgia, Virginia and Florida. *WSJ, 2/7/94, p. B3C; BBR, 1/17, p. 116; 2/14, p. 306.*

Fair Housing Home Loan Data System

The OCC issued a final rule, effective June 20, 1994, amending its Fair Housing Home Loan Data System (FHHLDS). The rule enhances the OCC's ability to use data collected under HMDA in fair lending examinations and reduces recordkeeping requirements on national banks that are currently required to maintain duplicative information under both the FHHLDS and HMDA. The final rule replaces the current FHHLDS monthly recordkeeping requirement with the HMDA Loan/Application Registers already maintained by national banks, which will be required to be updated quarterly. All national banks subject to the HMDA, including those banks not subject to the FHHLDS, will be required to maintain information on the HMDA Loan/Application Registers on a quarterly basis. National banks that are not subject to the HMDA requirements will continue to be subject to the original FHHLDS recordkeeping requirement, which will be updated quarterly under this final rule. *FR, 5/20/94, p. 26411.*

National Bank in Delaware May Charge Late Fees to Out-of-State Customers

The Colorado Court of Appeals ruled that national banks are allowed under the National Bank Act to charge late fees based on the law of the state where the bank is located, even if the fees are not permitted in the customer's state (Copeland v. MBNA America, N.A., 5/26/94). MBNA, a national bank located in Delaware, issues Visa and MasterCard credit cards to customers nationwide. The Court found that under the Act as interpreted by the courts, interest includes late fees, and it supported MBNA's argument that it may export the interest rate which is permitted in Delaware, including the late fees the state allows, to customers in other states. *BBR, 6/13/94, p. 1033.*

National Bank Consolidations with Federal Savings Associations

The OCC is adopting final procedures for national banks to follow in merging or consolidating with federal savings associations. These transactions were authorized in Title V of FDICIA. To the extent appropriate, the procedures parallel the longstanding statutory and regulatory procedures governing mergers and consolidations between national banks and state-chartered financial institutions. Effective: May 2, 1994. *FR, 5/2/94, p. 22497.*

Restrictions on Banks' Insurance Activities Upheld

A U.S. District Court in Florida upheld a ruling by the State Banking Commissioner that bars Barnett Banks of Marion County, NA from selling insurance through a newly acquired agency. A state statute prohibits bank subsidiaries or affiliates of bank holding companies from insurance agency activities. Barnett argued that Section 92 of the National Bank Act as interpreted by the OCC permits banks to sell insurance in towns with a population up to 5,000. The Court found an express intent to preempt state insurance laws not to be present in Section 92, and thus the matter is determined by the provisions of the McCarran-Ferguson Act which leave insurance regulation and taxation to the states. Barnett has appealed the ruling to the U.S. Circuit Court of Appeals for the Eleventh Circuit. *BBR, 12/13/93, p. 934.*

Business Contracting Outreach Program

The OCC proposed a rule for the adoption of a Minority-, Women- and Individuals with Disabilities-Owned Business Contracting Outreach Program. The intention is to ensure that business concerns owned and controlled by those groups are provided the opportunity to participate in the agency's contracting process. This action, with respect to the minority- and women-owned businesses, is required by FIRREA, and inclusion of individuals with disabilities is consistent with the intent of the Rehabilitation Act of 1973 as amended. The OCC's activities include (a) targeting appropriate firms for participation in the program; (b) participating in business promotion events comprised of or attended by MWOB and IDOB firms to explain OCC contracting opportunities; (c) ensuring that the OCC contracting staff understands and actively promotes this program; and (d) registering MWOB and IDOB firms in the OCC's database to facilitate their participation in the competitive procurement process for OCC contracts. Ownership and control requirements are specified in the proposal that each prospective MWOB or IDOB must demonstrate that it meets in order to participate in the program. *FR, 11/10/93, p. 59686.*

Bank Investments in Community Development Corporations

The OCC amended its regulations concerning national bank investments in community development corporations (CDCs) and community development projects, effective December 31, 1993, to implement Section 6 of DIDRA. Among the amendments, adequately capitalized national banks with assets of $250 million or less would be exempt from required prior OCC approval for CDC and CD project investments, and can self-certify single investments up to five percent of their unimpaired capital and surplus. For national banks with assets of more than $250 million, self-certification of individual investments would be permitted up to the lesser of two percent of unimpaired capital and surplus, or $10 million. Investments that exceed either of those limits would require OCC approval. The ceiling on bank investments in CDCs and CD projects is raised from five percent of unimpaired capital and surplus to ten percent on a case-by-case basis, subject to a determination by the OCC that there is no significant risk to the deposit insurance fund.

The OCC said its action will reduce regulatory burdens associated with CDC and CD project investments, in a manner that will not endanger banks' safety and soundness, and is intended to promote economic growth and investments in low- and moderate-income areas and underserved rural communities. *FR, 12/27/93, p. 68464; BBR, 1/3/94, p. 8.*

Publication of CRA Ratings

A new monthly publication, The CRA Report, will include a listing of Community Reinvestment Act ratings, and for banks rated less than "satisfactory" the full text of their evaluations. CRA ratings of national banks will continue to be released monthly in the OCC's *Weekly Bulletin* and *Interpretations and Actions*. *BBR, 1/10/94, p. 54.*

Office of Thrift Supervision

Conversions From Mutual to Stock Form

The OTS is amending its regulations governing mutual-to-stock conversions of insured savings associations. Among the changes, the amendments revise and clarify the appraisal standards; prohibit the use of "running" proxies by managements of converting associations; provide stock purchase priority to long-term depositors, and require a stock purchase preference for eligible depositors residing in the association's local community. Also, the amendments prohibit management stock benefit plans in a conversion; prohibit merger conversions except in supervisory situations; lengthen the conversion public comment period; require associations to submit business plans for all conversions; prohibit the repurchase of a converted association's stock within one year of conversion; and make publicly available preliminary conversion proxy materials.

The interim final rule is effective May 3, 1994, and public comments were requested. *FR, 5/3/94, p. 22725.*

The OTS announced on January 31, 1994, that it was suspending the acceptance of applications involving merger conversions of mutual savings associations under its supervision, the moratorium to remain in effect while OTS reviews its regulations governing these conversions. Merger conversions are transactions in which a mutual savings association is merged into another entity, and the value of the mutual is converted into the stock of the acquirer. Standard conversions, in contrast, are those by which mutual thrifts convert to stock ownership without a merger or acquisition being part of the transaction. *NEWS, OTS, 1/31/94.*

Charter Conversions Denied on "Convenience and Needs" Criteria

The OTS denied applications of four savings associations to convert to state-chartered savings banks because they have failed to serve the convenience and needs of their respective communities or to satisfactorily carry out their responsibilities under CRA. These are the first denials by OTS of applications for such conversions. Three New Jersey thrifts — Pulaski Savings Bank, SLA, Springfield; Gibraltar Savings Bank, SLA, Mendham; and United Roosevelt Savings and Loan Association, Carteret — received "needs to improve" ratings on their last two CRA compliance examinations conducted by OTS, including the most recent in 1993. An Ohio institution — The Mayflower Savings & Loan Company, Groesbeck — received the same rating on its last compliance exam, in late 1992. The institutions range in size from the $60 million-asset Mayflower to the $160 million-asset (approximate) Pulaski. *NEWS, OTS, 2/18/94.*

Acquisition of Control of Savings Associations

The OTS proposed to incorporate into its rules the provisions of Section

211 of FDICIA, which amended the Home Owners' Loan Act to require that the OTS, in reviewing a holding company application to acquire a savings association, consider the competence, experience, and integrity of the officers, directors, and principal shareholders of the proposed acquirors and the savings association to be acquired. Under Section 211, OTS must deny an application if the company fails to provide adequate assurances that the company will make available such information on the operations or activities of the company, or any affiliate, as OTS requires. In addition, the OTS must deny an application by any foreign bank that is not subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the home country of the foreign bank. *FR, 11/23/93, p. 61850; 6/2/94, p. 28468.*

Capital Standards

The OTS issued a final regulation making its capital treatment of intangible assets consistent with rules previously adopted by the other federal banking agencies. The new rule also implements a statutory requirement on the valuation of purchased mortgage servicing rights (PMSRs) mandated by FDICIA. Among the changes under the new rule, PMSRs and purchased credit-card relationships (PCCRs) may be included in thrifts' core capital up to 50 percent of core capital. Previously, thrifts could not include PCCRs in their capital. These two types of intangible assets must be valued at the lower of 90 percent of fair market value calculated at least quarterly or 100 percent of remaining unamortized book value. A grandfather provision permits savings associations to continue to include the same amount of PMSRs that they have for the past several years. The new OTS rule disallows any new core deposit intangibles (CDIs) from counting as capital. However, the OTS will grandfather CDIs resulting from prior transactions or those under firm contract when the rule goes into effect on March 4, 1994. *NEWS, OTS, 2/2/94; FR, 2/2, p. 4785.*

The OTS proposed amending its minimum regulatory capital regulations by revising the definition of "common stockholders' equity," in order to incorporate a recent change in generally accepted accounting principles (GAAP), made by Statement of Financial Accounting Standards No. 115. The agency solicited comments particularly on certain questions with reference to SFAS 115, among which are: If unrealized gains and losses are included in regulatory capital, whether these gains and losses should be included in core capital for purposes of the leverage ratio requirement or the risk-based capital requirement; or included in supplementary capital for purposes of the risk-based capital requirement. Section 4 of the Home Owners' Loan Act of 1933 requires the OTS to prescribe accounting standards that incorporate GAAP to the same extent as used for regulatory purposes by the federal banking agencies. The proposal is similar to amendments the other federal banking agencies have proposed. *FR, 6/22/94, p. 32143.*

The OTS proposed amending its risk-based capital standards to recognize the risk-reducing benefits of netting arrangements. Savings associations would be permitted to net, for risk-based capital purposes, interest- and exchange-rate contracts subject to legally enforceable bilateral netting contracts that meet certain criteria. The amendments parallel recent amendments proposed by the FRB and OCC. The proposed amendments would allow thrift institutions to net positive and negative mark-to-market values of rate contracts in determining the current exposure portion of the credit-equivalent amount of such contracts to be included in risk-weighted assets. *FR, 6/14/94, p. 30538.*

Annual Independent Audits

The OTS proposed amending its annual independent audit rules for savings associations to conform to those applicable to other federally insured depository institutions. Under Section 112 of FDICIA, the FDIC requires annual audits of insured depository institutions with total assets of $500 million or more. The OTS proposes to eliminate its annual independent audit requirement, and to adopt the requirements in the FDIC's final rule for savings associations. The OTS proposes also to retain the authority to require independent audits of small savings associations if advisable for purposes of safety and soundness. *FR, 3/22/94, p. 13461.*

Authority to Provide Postal Services

The OTS said in a legal memorandum that federal savings associations may provide the same postal services that are authorized for national banks. These services appear to be limited to: selling stamps and other postal supplies; accepting matter for mailing; selling parcel insurance as agent for the U.S. Postal Service; accepting registered mail; and issuing money orders. A federal savings association offering these services must observe the appropriate rules of the U.S. Postal Service. The books and records of the postal operation must be kept separate from the records of other operations of the savings association and will be subject to inspection both by the OTS and the U.S. Postal Service. *Legal Division Memorandum, OTS, 3/24/94.*

CAMEL Rating System

The OTS is amending its regulations, effective April 19, 1994, to reflect the conversion from the MACRO to the CAMEL (capital adequacy, asset quality, management, earnings and liquidity) rating system. The change will reduce regulatory burden by using the same rating system employed by the other federal banking regulatory agencies, and will improve consistency with regard to risk-related assessments and joint examinations. The OTS expects that virtually no practical effect on savings associations will result from this change. *FR, 4/19/94, p. 18474.*

Release of Unpublished Information

The OTS proposed to amend its regulations pertaining to release of unpublished agency information that would include, in certain circumstances, records that are exempt from disclosure under the Freedom of Information Act (FOIA). The proposed regulation does not apply to requests for records that are required to be disclosed under FOIA. The proposal describes in detail the procedures that requesters must follow in seeking the release of unpublished information, and the criteria on which OTS will evaluate requests for this information. *FR, 12/9/93, p. 64695.*

Federal Financial Institutions Examination Council

Accounting for Securities Activities

The FFIEC issued an interim revision to its existing guidance on the accounting and reporting for securities and the holding of mortgage derivatives that addresses the relationship between a policy statement adopted by the federal banking and thrift supervisory agencies, effective February 10, 1992, and the Financial Accounting Standards Board's Statement No. 115, issued in May 1993. Banks must adopt the FASB Statement for their Reports of Condition and Income for fiscal years beginning after December 15, 1993. The interim revision to the policy statement: (a) removes the regulatory reporting requirement that "nonhigh-risk mortgage securities" that later become "high-risk" must be redesignated as held-for-sale or trading; (b) instructs examiners to consider any unrecognized net depreciation in held-to-maturity high-risk mortgage securities when they evaluate the adequacy of an institution's capital; (c) reiterates that mortgage derivative products that are high-risk when acquired shall not be reported in regulatory reports as held-to-maturity securities at amortized cost; and (d) explains that, for banks and thrifts, examiners may seek divestiture of high-risk mortgage securities that do not reduce interest-rate risk when the examiners determine that continued ownership of these securities represents an undue safety-and-soundness risk to the institution. The revision also identifies certain factors that provide evidence of this risk. *FIL-25-94, FDIC, 4/21/94; "Interim Revision to the Supervisory Policy Statement on Securities Activities," FFIEC, 4/15.*

Accounting for Loan Impairment

The FFIEC is seeking public comment on certain implementation issues arising from the Financial Accounting Standards Board (FASB) Statement No. 114, which will be effective for fiscal years beginning after December 15, 1994. Under the federal banking and thrift agencies' capital rules, general allowances for loan and lease losses are included in Tier 2 capital, subject to certain limits, but specific allowances are not eligible for inclusion in regulatory capital. Comments are asked to address whether the portion of an institution's allowance established under the Statement should be reported and considered as a specific allowance or a general allowance. Statement No. 114 contains provisions that describe how a creditor should recognize income on impaired loans. However, the FASB recently proposed to replace these provisions with one allowing creditors to use existing methods of income recognition. Among the issues on which the FFIEC is requesting comment are whether the regulatory nonaccrual standards should be retained, and the expected effect of FASB 114 on the level of institutions' allowances for loan losses. *Press Release, FFIEC, 5/13/94; FIL-35-94, 5/23; FR, 5/17, 25656.*

Electronic Imaging System Risks

The FFIEC issued a statement to alert the senior management of each FFIEC member agency and all examining personnel to the risks associated with electronic imaging systems in financial institutions. Electronic imaging systems are defined as the technology used to capture, index, store and retrieve electronic images of paper documents. Many of the traditional audit and security controls for paper-based systems may be reduced or absent in electronic document workflow. New controls must be developed and designed into the automated process to ensure that information in image files cannot be altered, erased or lost. Risk areas that management should address when installing imaging systems, and that examiners should be aware of when examining an institution's controls over imaging systems, are discussed. *Press Release, FFIEC, 12/20/93; FIL-13-94, FDIC, 2/25/94.*

Risk Management Seminars

The FFIEC will conduct two Risk Management Planning Seminars in 1994, in response to FIRREA which specifies that the Council "develop and administer training seminars in risk management for its employees and the employees of financial institutions." The seminars for top bank officials and directors will emphasize the development of policies and procedures to control risk. A seminar to be held in Houston, Texas, will be aimed at insured financial institutions of all sizes, while a seminar in New York City will focus on financial institutions that are larger than $500 million. *Press Release, FFIEC, 12/13/93.*

Fair Lending Seminars

The FFIEC will conduct three fair lending seminars in 1994 for chief executive officers of financial institutions. The goal of the seminars is to assist top management of the institutions in better understanding fair lending issues and instituting policies that ensure nondiscriminatory lending practices. Among the topics to be discussed at each seminar are the fair lending priorities of the agency principals and the initiatives underway to carry them out, the role of the Justice Department and the Department of Housing and Urban Development in enforcing the fair lending laws, and ways by which institutions have improved their fair lending. The agencies encourage attendance at these one-day seminars by a member of an institution's executive management team. *PR-23-94, FFIEC, 4/5/94.*

Federal Housing Finance Board

Advances to Capital-Deficient Members

The FHFB is amending its regulations, effective February 22, 1994, to incorporate requirements governing secured loans (called advances) made by the Federal Home Loan Banks to capital-deficient members. The final rule prohibits Bank lending to tangibly insolvent members, except at the request of the appropriate federal regulator or insurer, and restricts the Banks from lending to other capital-deficient members whose use of Bank advances has been prohibited by the appropriate federal regulator or insurer. In addition, the final rule provides that a Bank may allow a member to assume advances held by a non-member if the advances had previously been extended by the Bank to another of its members. *FR, 1/20/94, p. 2945.*

National Credit Union Administration

Organization and Operation of Federal Credit Unions

The NCUA adopted a final interpretive ruling and policy statement (IRPS), effective July 5, 1994, following a proposal issued in July 1993. The proposed IRPS was designed to: (a) update policies on low-income credit unions; (b) streamline the charter application process; (c) address credit unions undergoing corporate and military unit restructuring; (d) clarify NCUA policy on the "operational area" requirement for select group expansions; and (e) make certain other minor or technical changes.

To provide expanded credit union service to low-income persons the IRPS: (a) permits chartering associational low-income federal credit unions, where the association is organized solely for the purpose of providing credit union service to low-income persons; (b) permits a low-income federal credit union, whether associational or community based, to include in its charter, occupational, associational, and community common bond groups, without regard to location; and (c) permits a federal credit union of any type to include low-income groups in its field of membership, without regard to the group's location, either by forming an association which is organized solely for the purpose of providing such service or by including a community group which could be the basis for chartering a low-income credit union. The Board will institute special reporting requirements and special examination procedures for any credit union including a low-income group in its field of membership to ensure that adequate credit union services are provided to *all* persons in the community.

The NCUA determined also that federal credit unions of all types need additional flexibility when faced with distress situations such as significant corporate or military restructurings. Thus, the final IRPS: (a) permits federal credit unions of all types to apply for designation as a "distressed federal credit union" and to do so regardless of whether they are converting to community charter; (b) permits federal credit unions with such designations to add occupational and associational groups to their fields of membership regardless of location. Controls over the process include a comprehensive review by the NCUA Board prior to initial designation; groups must request service in order to be added to a distressed credit union's field of membership; the regional director must approve all expansion requests; and normal overlap procedures will apply. *FR, 6/3/94, p. 29066.*

Approval Greatly Enlarges CU's Potential Membership

In what appears to be the largest single potential membership expansion, the NCUA granted approval for Communicators Federal Credit Union, Houston, TX, whose members are mostly local telephone and supermarket workers, to expand its field of membership to include all retirees and senior citizens living within a 25-mile radius of Houston. The $97 million-asset credit union would have its potential membership enlarged to over 20 times its current 28,035 members. The three largest expansion approvals last year also primarily involved adding senior citizens groups. *AB, 4/15/94, p. 9.*

Mergers and Insurance Conversions

The NCUA proposed amendments to clarify that its regulations on mergers, voluntary termination and insurance conversion apply not only to federally insured credit unions converting to non-federally insured credit unions, but those converting to any institution that is not insured by the National Credit Union Share Insurance Fund (NCUSIF). The amendments will provide NCUA with clear authority to prevent abuses in connection with conversions, involving the agency's authority to require membership votes, to monitor the fairness of those votes, and to ensure that the transaction is handled in the best interests of the members of the NCUSIF. *FR, 6/30/94, p. 33702.*

Mutual Fund Investments

An NCUA letter to federal credit unions notes that the proliferation of mutual funds, the increasing complexity of mutual fund investments, and often rapid changes in fund portfolios have made it more difficult for credit unions to determine if an individual mutual fund is permissible, and to monitor funds' investments and investment transactions. For these reasons, and to eliminate examiner inconsistency, the NCUA is taking the position that an FCU may invest in a mutual fund only when the prospectus indicates that the fund's authority is *strictly* limited to investments and investment transactions that are legal for FCUs. Thus, a fund authorized to purchase Collateralized Mortgage Obligations (CMOs) and Real-Estate Mortgage Investment Conduits (REMICs) without restriction is an impermissible investment for FCUs, even though the FCU has evidence that the fund purchases only securities passing the high-risk securities test. The policy issuance is effective January 1, 1995. *Letter to Credit Unions, No. 150, NCUA, 12/93.*

Nonmember and Public Unit Accounts

The NCUA amended its regulations, effective June 20, 1994, to change the amount of nonmember and public unit accounts that a credit union may maintain, without a waiver, to 20 percent of total shares or $1.5 million, whichever is greater. Credit unions accepting nonmember and public unit accounts in excess of 20 percent of total shares are still required to develop a written plan and send it to the Regional Director. *FR, 5/19/94, p. 26101.*

Corporate Credit Unions

Noting that many corporate credit unions are closely tied to credit union leagues or trade associations through interlocking boards of directors or common management, the NCUA requested comment on whether to require that a corporate credit union's board of directors be independently elected by its members, that the board represent primarily the interests of those members that are credit unions, and that management report only to the corporate credit union's board of directors.

The corporate credit union system consists of 44 corporate credit unions serving the nation's 13,000 natural person credit unions, with the U.S. Central Credit Union in turn serving the corporate credit unions. The corporate credit union system provides liquidity, investment, and payment services to credit unions. As of December 31, 1993, the 44 corporate credit unions held about $41 billion in assets, half of which was reinvested in shares in U.S. Central. *FR, 4/19/94, p. 18503.*

Credit Unions Examined for Loan Bias

The NCUA said that data reported under HMDA for 1992 indicated that some credit unions are rejecting minority mortgage applicants at higher rates than non-minorities, and that those with the highest denial rates in the HMDA data would be given special examinations. The NCUA advised credit unions to review their lending policies and procedures to "ensure that the service and credit needs of all members are provided by their credit unions in a completely fair and nondiscriminatory way." The denial rate, according to the HMDA data, for all mortgage applicants is much lower than at other institutions: in 1992, the overall denial rate at CUs was 9.8 percent, compared to 15.7 percent for all other mortgage lenders. But the denial rate was 19.7 percent for black applicants, 16.6 percent for Hispanics, and 13.6 percent for Native Americans, compared to 7.7 percent for whites. *AB, 1/14/94, p. 8.*

Truth in Savings

The NCUA extended the date for compliance with its Truth in Savings regulation, to March 31, 1995 for credit unions of an asset size between $500,000 and $1 million as of December 31, 1993, that are not automated, and to June 30, 1995 for credit unions of less than $500,000 that are not automated. The compliance date for all other credit unions remains January 1, 1995.

The Truth in Savings Act (Title II of FDICIA) required the NCUA to issue implementing regulations for credit unions. The agency published a regulation on September 27, 1993. The regulation is effective January 1, 1995, except for some requirements not effective until approved by the Office of Management and Budget. The Act and regulation require credit unions to disclose fees, dividend and interest rates and other terms concerning share and deposit accounts, and limit the methods by which credit unions determine the balance on which dividends are calculated. *FR, 3/22/94, p. 13435.*

Legal Opinion on Interstate Export of Interest Rates

The NCUA, in an interpretive letter, addressed the authority of federally insured, state-chartered credit unions to export to other states the late charges allowed under the laws of the state where the credit union is located. It concludes that the credit unions have this authority regardless of any prohibition or limitation by the state where members reside. Late charges, the statement said, are included within the meaning of the term "interest" in Section 523 of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), and this statutory provision preempts all state law limitations in the member's state of residence on the interest which may be charged by a state-chartered, federally insured credit union. *Interpretive Letter, NCUA, 4/11/94.*

Incentive Pay Plans

The NCUA requested comments on whether to change its rule that prohibits federally insured credit unions from providing incentive pay plans to certain employees related to the credit union's lending activities. Under Section 701 of the agency's rules, federal credit unions are barred from making any loan or extending any line of credit if, either directly or indirectly, any commission, fee, or other compensation is to be received by the credit union's directors, senior management, loan officers, or any immediate family members of such individuals, in connection with underwriting, insuring, servicing, or collecting the loan or line of credit. The regulation does not restrict the payment of non-commission salary to employees. While an official in charge of lending may not receive compensation tied to the performance of the loan department, the agency has taken the position that a chief executive officer's compensation may be tied to the overall performance of the credit union, part of which is based on its loan activities. *FR, 3/15/94, p. 11937.*

State Legislation and Regulation

Disclosures to Bank Customers

California: More than 90 percent of banks in the state are obtaining signed disclosure acknowledgements from customers who purchase mutual funds, according to a survey by the California Bankers Association. The survey covered about ten percent of the membership of the Association. Such matters as mutual funds' lack of federal deposit insurance, and investment risks, are covered in the customer statements. *AB, 1/18/94, p. 8.*

Customers Given Trial Period on Annuities

California: Legislation that became effective on January 1, 1994, provides for a "trial" period of 30 days on the purchase of annuities and life insurance by persons over age 60 during which they can cancel the contracts and have all premiums returned. Previously, the institutions that sell these products had been granting a ten-day "free-look" period. The new legislation poses problems to sellers of variable annuities because of the market fluctuations in the underlying investment securities for the annuities contracts. *AB, 1/24/94, p. 13.*

Selling Annuities Permitted for Banks

Colorado: New legislation allows banks, bank holding companies, and their subsidiaries and affiliates to sell fixed- and variable-rate annuities. The statute requires that the seller receive written acknowledgment from the purchaser that the annuity involves investment risk that is not FDIC-insured. *BBR, 6/6/94, p. 991.*

Restraints on Credit Cards Eased

Colorado: The Governor signed a bill that eliminates prohibitions on credit-card fees and allows returned-check fees of up to $20, sets a minimum interest charge of up to 50 cents, and lets state-chartered institutions export fees and rates. Existing regulations limit the annual percentage rate (APR) on credit cards to 21 percent with, and 18 percent without, a grace period. The new law reflects federal regulations in requiring that a credit card's APR be conspicuously displayed. *AB, 5/25/94, p. 12.*

Maine: The Governor signed legislation containing several provisions aimed toward reversing losses of credit-card jobs to other states. Among the changes, it eliminates the 18 percent ceiling on annual rates and also a $12 maximum on annual fees, replaces a prohibition on late fees with a maximum fee, and for the 25-day grace period allows immediate calculation of interest for customers with an unpaid balance. Existing restrictions that were unchanged include prohibitions on: fee charged to cardholders who exceed their credit limit, returned-check charges, and charges by companies for attorney's fees during disputes. *BBR, 4/18/94, p. 705; 6/6, p. 991.*

Interstate Banking

Florida: The Governor is expected to sign legislation that allows, on a reciprocal basis, banking organizations in other states to acquire Florida-based banks, and permits Florida banks to make similar out-of-state acquisitions. The legislation would be effective May 1, 1995, and would take the state out of the Southeast regional banking compact. Virginia, and the Georgia legislature, passed similar bills earlier this year, and North Carolina enacted a law in 1993, to be effective July 1, 1996.

Interstate banking and branching legislation now being considered by the Congress would largely supersede the various regional banking networks. *AB, 4/4/94, p. 7; BBR, 4/4, p. 622.*

Housing Agency to Establish Bank

Florida: The State Comptroller approved an application by Dade County's Housing Finance Authority to establish a bank to provide home mortgages to low-income County residents. An official of the Authority noted that of 46 local banks asked recently to participate in a lending program, only one agreed to commit any funds. The Authority's mortgages are small, typically ranging from $25,000 to $50,000. The bank will not offer checking accounts, but will provide savings accounts, and expects to package quantities of low-interest loans into securities that could be sold to pension funds, university endowments and other investors seeking socially conscious investments. *The Miami Herald and Knight-Ridder/Tribune Business News, 12/8/93.*

Mutual Fund Sales Guidelines

Illinois: The Commissioners of Banks and Trust Companies adopted specific guidelines for state-chartered banks' sales of mutual funds. The guidelines, which closely follow guidelines issued by federal regulators, require that institutions disclose that a mutual fund investment is not a deposit, is not insured by the FDIC, and that the investment involves risks. Among other provisions are that personnel involved in soliciting or selling mutual funds should be trained for these activities, that the sales areas for mutual funds should be separate from deposit-taking areas, and that banks should not market mutual funds under names identical to the bank's name. *BBR, 3/28/94, p. 586.*

All Credit Unions in State Are Insured

Massachusetts: All state-chartered credit unions in the state are now covered by federal deposit insurance, the National Credit Union Administration said. Since the private share insurance crisis in Rhode Island, and the conversion process beginning in early 1991, a total of 124 credit unions, with assets of more than $3.6 billion, have applied for federal coverage, and of these the NCUA approved 106 for insurance. The remaining institutions have merged or closed. *BBR, 4/25/94, p. 750.*

Limit on Cleanup Liability Overturned

Michigan: The U.S. Court of Appeals for the District of Columbia ruled that the Environmental Protection Agency lacked statutory authority to issue its regulation under which a lender is not liable for cleanup costs when it does not participate in the management of the property. The decision came in a suit brought by the State of Michigan and the

Chemical Manufacturers Association to overturn the EPA rule. Shortly before the decision, the Clinton Administration introduced a Superfund reauthorization bill that would provide environmental liability protection to lenders and also authorize the EPA to issue such rules. *AB, 2/10/94, p. 1.*

Court Approves Bank's Purchase of Insurance Agency

Michigan: A decision of the Michigan Supreme Court permits a bank service company to purchase an insurance agency (Ludington Service Corp. v. Michigan, 1/25/94). The Court upheld a ruling by an appeals court that overturned the disapproval of the transaction by state insurance regulators. Legislation now being considered in the state legislature would give financial institutions broad authority to sell various kinds of insurance. *BBR, 2/7/94, p. 253.*

Unannounced Bank Examinations

Nebraska: The Department of Banking will begin conducting a limited number of unannounced examinations of randomly selected state banks. Currently, the Department provides advanced notice of several days to banks scheduled for examination. *Northwestern Financial Review, 4/23/94, p. 31.*

Interest-Rate Deregulation, Consumer Protections Enacted

New York: A new law eliminates the sunset provisions in a 1980 statute that removed interest-rate ceilings, and deregulates fees on credit cards and consumer installment loans. Other key provisions of the legislation that apply to banking institutions include: requiring them to provide basic banking services, including low-cost checking and savings accounts; prohibiting them from engaging in "geographic" discrimination; and requiring them to report their loan activity regarding small businesses and farms. In addition, a toll-free number is established at the New York Banking Department to provide consumers with interest-rate and other information; and two quasi-public companies are created to make loans to small businesses, especially those in economically depressed areas. *BBR, 2/7/94, p. 245; AB, 2/4, p. 14.*

Power to Sell Annuities

New York: The state's highest court, the Court of Appeals, affirmed that state-chartered banks can sell annuities. The court agreed with the Banking Department that annuities are similar to other investment products sold by banks, such as certificates of deposit. In some states, banks are not allowed to sell annuities which are regarded as insurance products. The OCC has authorized national banks to sell annuities, but the power remains unclear because of legal challenges at both the state and federal levels. *WSJ, 3/31/94, p. A2; AB, 3/31, p. 12.*

Reverse Mortgage Loans

New York: The Banking Board adopted regulations applicable to reverse mortgage loans. The loans enable persons aged over 60 to access the equity in their homes. Among the provisions, loans are limited to 80 percent of the anticipated value of the real property at maturity. Investment in reverse mortgage loans is limited to ten percent of the lender's capital, undivided profits and surplus. *AB, 4/11/94, p. 9; BBR, 4/11, p. 658.*

Stock Payment Disallowed in Mutual Conversion

New York: Officials of Greenpoint Savings Bank and others were required by state regulators, because of failure to obtain a fair appraisal of the thrift, to forego $40 million in stock benefits from a planned initial public offering in a conversion of Greenpoint from a mutual to stock form of organization.

Last Fall the state issued a proposal to tighten conversion regulations by requiring outside review of executive compensation and two appraisals of the converting institution's net worth. *AB, 1/26/94, p. 1.*

Fiduciary Powers for Foreign Banks

New York: The Banking Department adopted rules, effective May 18, 1994, providing authority for foreign banking corporations to engage in fiduciary activities, and setting up application procedures for the institutions to obtain permission to change their name, and for a license to establish a representative office, branch or agency. *BBR, 5/30/94, p. 959.*

State Bank Powers

Oklahoma: Revisions of the Banking Code give state banks automatic parity with national banks in respect to bank powers. The Banking Board is no longer required to adopt a regulation before a state bank may exercise a power conferred upon national banks. *Oklahoma Banker, 5/13/94, p. 9.*

Protection of Compliance Review Documents

Oklahoma: Amendments to the Banking Code provide a framework within which banks may establish compliance review committees, the findings of which are protected from discovery in civil suits brought against the bank. While the underlying data used by the compliance committee may still be discoverable and admissible, the data compilations and conclusions will be protected and kept confidential. Without this protection, many banks were hesitant to conduct rigorous internal reviews of compliance practices for fear the findings could be used against them. This legislation will not provide confidentiality for compliance review documents which relate to fraud committed by an insider of the institution. *Oklahoma Banker, 5/13/94, p. 9.*

Branching Restrictions

Oklahoma: New legislation has reinstated restrictions on branching by state-chartered savings and loan associations which terminated on July 1, 1993, equalizing the branching powers of state-chartered banks and savings and loans, until July 1, 1996. It closes the "Mississippi loophole" that has enabled national banks in other states to establish *de novo* branches despite statutory restrictions on such branching by state banks. *Oklahoma Banker, 4/15/94, p. 1.*

Thrift Drops Deposit Insurance

Oklahoma: Home Savings and Loan Association, Oklahoma City, a $15 million-asset state-chartered institution, has dropped its deposit insurance, and plans to pass on to customers its savings on premiums, offering higher interest rates on deposit accounts. Home Savings is the second small thrift in the state to have recently dropped its deposit insurance. Oklahoma is one of the few states that do not require state-chartered depository institutions to have FDIC insurance. *AB, 5/11/94, p. 3.*

Law Barring Home-Equity Loans Overturned

Texas: A panel of the Fifth U.S. Court of Appeals, reversing a lower court, ruled that federal laws and regulations preempt a state law that prohibits most home-equity loans. Under the homestead provisions of the state's constitution, liens on homes are unenforceable, except for loans to cover home purchases, taxes or improvements. *WSJ, 5/6/94, p. A4.*

Banking Department Receives Accreditation

Texas: The Department of Banking became the 29th state banking department to be accredited by the Conference of State Bank Supervisors. The Department supervises 514 state-chartered banks with more than $43 billion in assets. *Texas Banking, 5/94, p. 13.*

Bank and Thrift Performance

Insured Banks Earned $12.4 Billion in First Quarter

The FDIC reported that insured commercial banks earned $11.1 billion in the first quarter of 1994 (preliminary), an amount little changed from the last quarter of 1993, and about $400 million below the record level set in the third quarter of last year. For the year 1993, the banks earned $43.4 billion. Net operating income reached a new quarterly record of $10.7 billion. Lower loan-loss provisions and overhead expense, as well as increased noninterest income, were the principal factors contributing to the record operating earnings in the quarter. Net interest margins narrowed for the fifth consecutive quarter, as asset yields declined more rapidly than average funding costs. The average net interest margin in the first quarter was 4.26 percent, down from 4.40 percent in the last quarter of 1993, and from 4.67 percent in the last quarter of 1992.

Commercial banks' total assets grew by $137 billion in the first quarter, to $3,843.2 billion. This included a $99-billion increase in the quarter in banks' trading account assets which resulted from changes in accounting for on-balance-sheet amounts associated with certain off-balance-sheet derivatives contracts. The only loan categories having strong growth in the quarter were commercial and industrial loans, which increased by $10.6 billion, and consumer installment loans, up by $5.7 billion. Commercial and industrial loans now have had two consecutive quarters of strong growth. Noncurrent loans at commercial banks declined for the twelfth consecutive quarter, to $40.3 billion, down from $42.7 billion at year-end 1993, and from the peak level of $83.3 billion in the first quarter of 1991. Commercial banks' loan-loss provisions and loan charge-offs were the lowest quarterly amounts since the mid-1980s. The ratio of equity capital to total assets was 7.83 percent, down from 8.01 percent at year-end 1993.

Insured private-sector savings institutions earned $1.3 billion in the first quarter of 1994 (preliminary), representing a decline of $365 million from the previous quarter. Earnings for the year 1993 were slightly under $6.9 billion. Over 94 percent of all savings institutions reported positive net income in the first quarter. In the quarter the effects on earnings from lower loan-loss provisions, reduced overhead expense and higher net interest income were offset by large losses related to balance-sheet restructurings by a few large institutions. Average profitability was virtually unchanged from the previous quarter at institutions with less than $5 billion in assets. The average net interest margin was 3.41 percent, almost unchanged from the 3.39 percent in the fourth quarter, but down from 3.51 percent a year ago.

Assets of savings institutions decreased in the quarter by $4.1 billion, to $996.7 billion. Total real-estate loans fell by $12 billion in the first quarter, due largely to a drop in home mortgages. Mortgage-backed securities increased by $7 billion, and now represent 21 percent of all thrift assets.

Savings institutions' troubled assets fell from 2.10 percent of total industry assets to 1.96 percent during the quarter. A year ago, troubled assets represented 3.02 percent of all industry assets. Net charge-offs of nearly $800 million contributed to a $571-million decline in noncurrent loans during the quarter. Noncurrent real-estate loans fell to 2.05 percent of total real-estate loans from 2.09 percent a year ago. Institutions in the Northeast and West regions continue to have the highest noncurrent real-estate loan rates, at 2.75 and 2.47 percent, respectively. For the rest of the U.S., the average noncurrent rate is 0.89 percent. Equity capital grew by $971 million during the quarter, raising the average core capital "leverage" ratio to 7.55 percent at the end of March, and marking the fourteenth straight quarterly rise in this ratio.

Seventeen savings institutions with $7 billion in assets either were acquired by commercial banks or switched to commercial bank charters in the first quarter. During the same time, 28 mutual savings institutions with $18 billion in assets converted to stock organizations. Mutuals now account for 48 percent of all savings institutions and hold 20 percent of the industry's assets. *FDIC Quarterly Banking Profile, Fourth Quarter 1993; First Quarter 1994.*

Fair Lending Rated Highly Burdensome Rule

The compliance rules rated most often by respondents in a recent survey to be among the most burdensome were the Fair Lending statutes, followed by the Community Reinvestment Act and the Real Estate Settlement Procedures Act. Fair lending examinations encompass the Home Mortgage Disclosure Act, the Equal Credit Opportunity Act, and the Fair Housing Act. Compliance examinations are perceived as becoming longer, more detailed, and more reliant on statistical analysis. The *American Banker* surveyed 80 compliance officers, and of the institutions represented, 59 percent had more than $1 billion in assets, 12 percent were between $300 million and $1 billion, and 29 percent were under $300 million.

Compliance areas in which the responses suggested some progress included more involvement by senior managements in compliance, an improvement in respect to positive attitudes on the part of compliance officers about their jobs, more participation by men in areas of compliance responsibilities where women are still dominant, and expanding compliance sensitivity more widely throughout the bank. *AB, 6/30/94, p. 16.*

Electronic Delivery Systems Replace Branches

A study sponsored by the Bank Administration Institute concludes that 20 percent of existing bank branches will likely be closed by the end of the decade, as cash machines, home banking, and various electronic delivery systems continue to gain popularity with consumers. Fifty-seven percent of banking transactions already are taking place outside traditional branches, according to the study. Information from more than 35,000 accounts at ten major banks also indicate wide regional variations in the extent of branching. The Midwest, for example, is said to be relatively underserved by bank offices. In general, the older, rural, and small-town residents tend to favor branches, while the younger, urban bank customers prefer cash machines, telephones and computers for financial transactions.

The rapid increase in branches in supermarkets has resulted in another estimate that 5,000 such branches will be operating in the U.S. by the year 2000. This would be more than double the 2,100 in-store branches currently in operation and seven times the 1989 total of 675. Supermarket branches are seen as having advantages over conventional branches in usually being far less expensive to build and maintain, and also they enable banks to better penetrate retail markets in many cases. *AB, 11/22/93, p. 1; 1/27/94, p. 18; 2/16, p. 15.*

Usage of Direct Deposit Increasing

The number of employees being paid by direct deposit has tripled in the past five years to 35 percent of all employees in the U.S. at year-end 1993, according to the National Automated Clearing House Association. Over 56 percent of recipients of Social Security benefits receive their payments by direct deposit. *AB, 3/29/94, p. 14.*

Bounced-Check Fees Excessive, Deposit Interest Rates Too Low, CFA Says

The Consumer Federation of America charged that banks are "gouging" customers on bounced-check fees, receiving $4.35 billion in fees on bounced checks in 1992, over six times more than the direct cost of $685 million. The costs consisted of $581 million in processing expenses and $104 million in losses on uncollected checks. The $3.67 billion difference between the fees received and costs for bounced checks represented 11 percent of the industry's earnings of $32.2 billion in the year. An American Bankers Association spokesman said the amount of fees on bounced checks reflects cost recoupment and also the industry's effort to deter the activity. In addition, quantification of all of the costs related to bounced checks is difficult.

Large banks, those with assets exceeding $1 billion, had the highest bounced-check fee markup, 971 percent of costs, according to the CFA's study. Banks in the $300 million to $1 billion range showed a 469 percent markup, and smaller banks, 315 percent. *AB, 12/10/93, p. 1.*

Banks have not increased their rates paid on money-market accounts and NOW accounts, and have started to raise CD rates only since February, according to a CFA report, although money-market fund rates and Treasury-bill rates have been rising for the past year. The report says that if commercial banks had paid money-market fund rates on their money-market accounts, and paid 6-month Treasury-bill rates on their CDs, consumers would have received an additional $500 million in interest in April 1994, and $3 billion more in the twelve months ending in April. *BBR, 5/9/94, p. 824.*

State's Banks Will Cut Fees, Reduce Account Restrictions

Through the efforts of the Massachusetts Community and Banking Council, formed in 1990 and funded by the state Bankers Association, more than 140 banks have agreed to charge no more than $3 per month for checking and $1 a month for savings accounts. Deposit accounts can be opened with only a $10 deposit, and checking accounts will offer eight free withdrawals a month. The banks also have agreed on identification requirements that are easier for customers. Those who cannot present a credit card or a driver's license will be able to use utility bills, for example, as identification. The account changes take effect immediately. *AB, 6/29/94, p. 5.*

Banks May Require More Information to Help Reduce Bad Loans

By mid-1994 many bankers may be asking their prospective business borrowers to supply more information, using a 20-page form developed by the American Institute of Certified Public Accountants. The new form would seek much more extensive and detailed information than businesses usually have supplied in the past. This would include, for example, the company's five largest customers and suppliers and credit terms and limits for each, the company's plans for ownership succession, and much more information on accounting policies. Businesses would be likely to strongly object to some of the disclosures and small businesses in particular would not be able to meet some of the requirements without the additional expense of hiring an outside accountant. *WSJ, 12/16/93*.

Environmental Trade Group Formed

The Environmental Bankers Association has been formed by 25 banks with a mission of helping to protect banks from environmental risk and liability. An official said the Association is not a lobbying organization, and will focus on assisting banks internally in managing their environmental policies. Immediate goals include developing model environmental policies, preparing a member roster listing areas of specialization, establishing a member information clearinghouse, proposing bank examination protocol, and creating standards for evaluating consultants. Membership in the trade association is open to all banks. *AB, 3/31/94, p. 9*.

Credit Unions' Assets Now Over $300 Billion

Membership in U.S. credit unions reached 67.6 million at the end of May 1994, according to estimates released by the Credit Union National Association, representing a gain of about 5.8 percent since year-end 1992. Membership in credit unions in the U.S. has more than doubled since 1975. Credit unions' assets grew to an estimated $300.6 billion in May, up by 4.8 percent from year-end 1993, and 11.4 percent from 1992. The 1993 total was about 36 percent of total savings and loan assets and eight percent of commercial bank assets.

The estimated number of credit unions at the end of May was 12,789, down from 12,960 at year-end 1993. Of the latter total, 6,031 had assets of more than $5 million, and 574 had over $100 million in assets. CUNA notes that once a credit union reaches the $5 million size, their customers require and can support more extensive services such as share drafts, IRAs, larger consumer loans, automated teller access and credit cards. At year-end 1993, for example, the percentages of credit unions having assets of $5 million to $10 million, and those over $100 million (in brackets) offering these services were as follows: share drafts, 66.1 (97.5); IRAs, 68.9 (98.4); ATM cards, 27.7 (97.3); and credit cards, 42.8 (94.9). It may be noted that almost 80 percent of the employees of the $5-10 million group of credit unions were part-time workers or volunteers. *Credit Union Reports, CUNA*.

Recent Articles and Studies

Large Banks' Role in Banking Crisis

This article, by John H. Boyd and Mark Gertler, concludes that in the banking crisis in the 1980s, banks with the largest assets contributed disproportionately to the losses. This resulted from a combination of circumstances involving deregulation and financial innovations that led to increased competition in the industry and regulatory actions that tended to subsidize risk-taking by large banks more than small banks. Large banks benefitted from a "too big to fail" policy in ways that ranged from favored treatment at the Federal Reserve's discount window to direct subsidies. One of the undesirable results of this policy on the part of the federal bank regulators was to create a nontechnical incentive for banks to become large.

In support of their thesis, the authors examine first the potential sources of loan losses. The losses in the 1980s were caused to a substantial extent by regional factors, for example, in the Southwest the collapse of oil prices, and real-estate prices on the East and West Coasts. But after allowing for regional conditions, it is shown that the large banks still performed below the industry mean. One measure is the larger banks' relatively low capital-to-asset ratios in the period. Up to a certain asset size, a negative relationship between this ratio and a bank's size might be explained by diversification gains and increased access to purchased money markets as a bank grows larger. However, the ratio is found here to decline markedly with size well beyond the point that might be explained by economies of scale, and in particular a significant decline above the $10 billion level is noted. Other measures of portfolio risk are presented to indicate that large banks followed higher-risk practices than could be explained by scale economies.

The authors are against any "sweeping withdrawal" of the safety net. They are skeptical about the benefits of mergers of large banks that would create even larger institutions. Newly adopted regulatory capital standards are viewed as having a beneficial effect of forcing banks to internalize the costs of their portfolio decisions. Under FDICIA, not allowing a large bank to fail requires the concurrence of bank regulators and the Secretary of the Treasury. Other provisions of the Act restrict discount window lending as a means of keeping troubled banks in operation, and impose restrictions on interbank lending to undercapitalized banks. *Quarterly Review, Federal Reserve Bank of Minneapolis, Winter 1994, pp. 2-21*.

Competition in the Credit-Card Industry

Until about two years ago, credit-card interest rates in the U.S. had remained stable at about 18 percent for a number of years, although during this period there were large fluctuations in the costs of funds to lenders. Wide interest margins in the industry gave rise to Congressional concern about the adequacy of price competition among credit-card issuers. The U.S. General Accounting Office conducted a study of the credit-card industry between May 1992 and October 1993 focusing on the competitiveness aspects of the industry, and discussing various policy options.

It can be argued that the structure of the credit-card industry provides for adequate competition among card issuers. The industry has about 6,000 issuers, who set their own interest rates and other pricing terms, and there are another 14,000 "participating institutions." VISA and MasterCard permit virtually any federally insured depository institution to join and issue their credit cards. The industry's concentration level, as measured by the Herfindahl-Hirshman Index (HHI) estimated to be less than 565 (values of less than 1,000 are considered to be unconcentrated), suggests that the industry should be quite competitive.

Another viewpoint is that the largest card issuers have dominated the credit-card industry and have conformed to each other's interest-rate and pricing decisions. The evidence, the report says, does not appear to suggest that any one card issuer has acted as a dominant price leader. There is some evidence that these issuers have not engaged in tacit coordination wherein firms will not necessarily match a price increase by other firms in the market but will match a price decrease — a situation that generally results in stable pricing. Examples given are reductions in interest rates by some large card issuers in the past that were not matched by rival firms.

The reasons why credit-card interest rates were stable and industry earnings were high during the 1980s can be explained by differences between credit-card and other types of lending. Credit-card lending is riskier than most other lending activities. Average annual charge-off rates for VISA and MasterCard members from 1981 through 1993 consistently exceeded the average charge-off rates for commercial bank lending in the same period; in 1993, the charge-off rate for credit-card lending was more than five times the charge-off rate for all bank lending. Operating costs as a percentage of total lending costs are relatively high for credit-card lending, while funding costs are relatively low, thus changes in funding costs will tend to be less influential in shaping credit-card interest rates.

When an industry is experiencing strong growth, as the credit-card industry was in the 1980s, firms in that industry are not forced to compete as much on price to maintain their market shares and have satisfactory earnings. Moreover, the credit-card industry was not under competitive pressures caused by cardholder behavior in the 1980s. Traditionally, shopping by cardholders for lower interest rates has not been a strong characteristic of the industry. Consumers often do not respond to offers of cards with lower interest rates because of the search and switching costs that would be entailed. Cardholders with high credit-card balances and low incomes may find it particularly difficult to switch issuers.

Evidence from the early 1990s indicates that consumers have become increasingly concerned about credit-card debt and interest rates. In the past few years, improved information about interest rates and other credit-card pricing terms has been made available to consumers willing to shop for credit cards. The better information is attributable in large measure to the Fair Credit and Charge Card Disclosure Act of 1988, which, among other provisions, requires card issuers to provide readily-understandable information in all card solicitations about their interest rates, annual fees, and grace periods. The Act also requires the Federal Reserve to collect data on credit-card price and availability from a broad sample of financial institutions offering credit-card services, this information to be made publicly available, and reported to Congress semiannually.

The report concludes that the U.S. credit-card industry should continue to be closely monitored to determine whether the evidences of increased competition will be sustained. The report recommends that the Federal Reserve collect additional information, in particular data on the range of interest rates that issuers offer to cardholders. More information is needed for assessing the extent to which cardholders are benefitting from lower card interest rates, how these rates affect industry earnings, and the short- and long-term impacts of competitive developments within the industry. *U.S. Credit-Card Industry, U.S. General Accounting Office, April 1994.*

Preserving Minority Ownership of Financial Institutions

This U.S. Government Accounting Office report examines actions taken by the Department of the Treasury, FDIC, RTC, and OTS to satisfy the requirements of Section 308 of FIRREA, and Section 403 of RTCRRIA, which were designed to preserve minority ownership of financial institutions and provide assistance for minority-owned institutions and minority investors with acquiring failed institutions.

The FDIC's approach to preserving minority-owned banks is described in terms of maintaining the condition of existing minority-owned banks (MOBs) through the regular supervisory process. Actions include making available training, education, and technical assistance in Call Report preparation, consumer affairs and civil rights, and accounting. In July 1993, the agency reiterated that, as required by statute, when resolving failed MOBs, bids from qualified minority-owned financial institutions (MOFIs) nationwide are to be generally sought before bids from nonminority-owned financial institutions (NMOFIs). While the FDIC generally solicits bids from qualified MOFIs nationwide during its marketing efforts, the actual selection of the winning bidder is determined by the least-cost approach. In some cases state law restrictions on interstate acquisitions of failed or failing MOFIs may be overridden for the benefit of minority acquirers but not for the benefit of nonminority acquirers. The FDIC has established a national list of potential minority bidders for use in identifying and contacting minority investors and MOFIs that are interested in acquiring failed institutions. The agency has provided assistance in several cases to individual MOBs. In September 1992, agency officials stated they would not ordinarily approve a transaction that allows a troubled institution to acquire a failed institution because of the risk involved. One case was approved because the MOB's financial condition had improved. The agency also has supported several MOBs by using informal enforcement actions to communicate bank problems identified during the examination.

FDIC-supervised MOBs increased from 42 in December 1989 to 52 as of March 31, 1993. From August 1989 to July 2, 1993, 11 MOBs failed, and in their resolution the FDIC preserved the minority ownership of two, sold six to nonminorities, and closed three with payoffs to depositors. MOBs also acquired five failed NMOBs. Total assets of MOBs increased from approximately $5 billion at the end of 1989 to about $8 billion in March 1993.

The decline in minority-owned thrifts (MOTs) was not as dramatic as the decline in nonminority-owned thrifts (NMOTs): between December 1989 and March 31, 1993, MOTs were reduced by 27 percent from 56 to 41, while the number of NMOTs fell by 31 percent from 2,541 to 1,761. The decrease in assets held by MOTs was not as dramatic as the decrease in assets of NMOTs. MOTs' assets fell from $7 billion at the end of 1991 to $6 billion at the end of 1992, but by the end of the first quarter of 1993 had returned to the level of nearly $7 billion. Assets of NMOTs in the same period declined from $870 billion to $729 billion.

The RTC's approach to preserving the minority ownership of financial institutions includes extending preferences to bidders of the same ethnicity as the previous owners of the failed MOT. The RTC had registered, as of September 14, 1993, 297 minority investors or MOFIs for its list of potential bidders. RTC also offers interim capital assistance, in the form of loans, to successful minority bidders to facilitate the acquisition of institutions. The amount of such assistance is limited to two-thirds of the minimum capital required by the chartering and regulatory agencies, and is subject to repayment within two years. In April 1992, the RTC amended its minority preference resolution guidelines to comply with Section 403 of RTCRRIA which provides for assisting minority investors or institutions with acquiring failed NMOTs. When no acceptable bids are received for failed NMOIs, the agency may accept bids from minority investors or institutions and may provide interim capital assistance.

As of May 18, 1993, the RTC had provided over $7 million in interim capital assistance to six minority investors or institutions. Since its inception in August 1989 through May 18, 1993, the RTC had resolved 26 of the 29 failed MOTs. Minority ownership was preserved in 12 of the 26 resolutions. Nine of the remaining 14 failed MOTs were acquired by NMOIs because no acceptable proposals were received from minorities. However, the thrifts remained in their previous locations and continue to serve the community. Finally, the RTC closed five MOTs because no qualified minority or nonminority group expressed an interest in acquiring them.

Minority trade associations and executives of MOFIs expressed mixed evaluations of the effectiveness of the regulatory agencies' programs. Some said the FDIC and OTS should provide their examiners with more training on the unique circumstances of the minority-owned banking community and its practices; also, the agencies should not use the same procedures to examine smaller institutions' loan portfolios that are used for larger banks. One suggestion was that an FDIC-managed fund should be established to allocate capital to MOFIs that are attempting to acquire an institution that is about to fail. Assistance would be in the form of a loan to the acquirer. Another suggestion was that the RTC extend preference to minority groups when considering offers to acquire nonminority-owned institutions or branches located in minority communities. An OTS policy requiring $2 million in capital for new owners to acquire a failed thrift was said to be too restrictive.

The report said that neither the FDIC nor OTS had evaluated their minority-ownership program's effectiveness, and officials at the agencies say their focus has been on implementation rather than evaluation of their programs. Periodically surveying MOFIs to assess the effectiveness of current approaches is essential given the goals of the legislation and mixed views of the minority institution community regarding the agencies' efforts, the GAO stated.

March 31, 1993
Supervised Minority-Owned Institutions

	FDIC	**OTS**
African-American	22	17
Asian-American	17	13
Hispanic-American	11	11
Native-American	2	—
Total	**52**	**41**
Total Assets ($ billions)	8.32	6.51
Assets of Largest Institution ($ billions)	1.54	1.79
Assets of Largest Five Institutions ($ billions)	4.98	3.57

"Minority-Owned Financial Institutions — Status of Federal Efforts to Preserve Minority Ownership," U.S. Government Accounting Office, November 1993.

Interstate Banking: Effects of Deregulation

This report by the U.S. General Accounting Office analyzes the potential impact of further deregulation of interstate banking and branching, focusing on the effects on the structure of the banking industry, the risks to the safety and soundness of the industry, and other implications. Among the specific topics included are the legal and regulatory factors that will affect the response to a federal nationwide banking and branching law, and antitrust considerations.

Under the McFadden Act of 1927, national banks are allowed to branch anywhere in a state if such branching is allowed under the state law for banks chartered in that state. The Act generally prohibits interstate branching by member banks of the Federal Reserve System. State law governs interstate branching by state-chartered nonmember banks. New York, Oregon, Alaska, and North Carolina permit reciprocal interstate branching, but except for a few minor cases, no interstate branching has been allowed to date. The Douglas Amendment to the Bank Holding Company Act of 1956 permits bank holding companies to establish and acquire a bank in another state, provided such action is specifically permitted by the state the bank holding company wants to enter. Almost every state now has some statutory provision for such interstate banking, subject to varying restrictions and conditions.

Over time, revisions of state laws have contributed to a substantial increase in interstate banking. By early 1993, all but two states, Montana and Hawaii, permitted some form of interstate banking. Thirty-four states and the District of Columbia permit bank holding companies to enter from any state, either on a reciprocal or nonreciprocal basis. The remaining 14 states (as of 11/93) restricted interstate entry to bank holding companies from their own geographic region. Before states relaxed their interstate banking laws, bank holding companies were free to expand interstate through their nonbank subsidiaries, and banks also could cross state borders by establishing insured nonbank banks, Edge Act Corporations, and loan production offices. The Garn-St Germain Act of 1982 and the Competitive Equality Banking Act of 1987 authorized the interstate acquisition of failed banks and thrifts.

At year-end 1992, a majority of U.S. banking assets were owned by 190 banking companies that operate bank subsidiaries in more than one state. Approximately two-thirds of these assets were held in the banking companies' headquarters states, and one-third were held out-of-state. The nonbank activities of bank holding companies gave some larger banking companies a physical presence in virtually every state. In 16 states and DC, more than 40 percent of each of the states' bank assets are owned by banking companies headquartered out-of-state. In all except 13 states, more than ten percent of each of the states' bank assets are owned by out-of-state banking organizations.

Increased interstate banking is found to have contributed to a substantial consolidation of the U.S. banking industry and led to an increase in overall industry concentration. From December 1986 to December 1992, the number of independent banking companies in the U.S. declined almost 20 percent, from 10,620 to 8,794, while the percentage of banking assets controlled by the three largest banking companies — a measure of overall industry concentration — increased from 12.8 percent to 14.4 percent. This increase understates the relative importance of the larger banking companies, because they are the main holders of off-balance-sheet accounts excluded from the calculations. However, the study finds no direct relationship between increased interstate banking and changes in the state and local concentration levels of the three largest banking companies. The average concentration levels of the three largest banking companies in local banking markets did not change between 1980 and 1991. Increased interstate banking does not necessarily mean a reduced role for smaller banks. Between 1986 and 1992, banks with assets of less than $1 billion, measured in 1992 dollars, maintained a national market share of about 20 percent and increased their market share in nine of the 16 states with a relatively large amount of interstate banking.

The study concludes that removing federal interstate banking and branching restrictions would further encourage the growth of larger, more geographically diversified banking companies. The effects on interstate banking would depend on the extent to which state banking laws are overridden, actions of the state and federal regulators, and business decisions. While increased interstate banking is leading to increased national and regional concentrations of assets, concentration at the state and local levels increases only as a result of mergers and acquisitions among banks that are in the same states or local markets.

Removing interstate banking and branching restrictions could benefit the safety and soundness of the industry, the regulatory process, and many bank customers. However, the removal of such restrictions poses risks as well. The risks can be minimized if interstate expansion is restricted to well-managed and well-capitalized banks, and if the early closure and safety-and-soundness provisions of FDICIA are properly implemented. Risks to the quality and availability of banking services can best be minimized by ensuring that markets remain competitive through vigilant antitrust enforcement, and that laws and regulations governing credit availability are adequately enforced. While interstate banking offers potential benefits to banks and the banking system from reduced costs, expanded market opportunities, and greater diversification of risks, the extent that these benefits are realized depends largely on how well banks are managed. *Interstate Banking — Benefits and Risks of Removing Regulatory Restrictions, U.S. General Accounting Office, November 1993.*

Banking Concentration Stable in Most Western States in 1980s

This study by Elizabeth Laderman examines the effect that banking consolidation, including such mergers as those between Bank of America and Security Pacific National Bank, and Wells Fargo Bank and Crocker National Bank, had on concentration of banking markets in the West from 1982 through 1992.

Antitrust analysis of bank mergers by the regulatory agencies and Department of Justice focuses mainly on the effects on the structure of local banking markets, using as a measure the Herfindahl-Hirschman Index (HHI). This index is computed as the sum of the squares of the percent market shares of bank deposits of the competitors in the local market. Under DOJ guidelines, a bank merger that increases the HHI in a local market by 200 points and results in an index of at least 1800 would raise competitive concerns. Deposits of savings institutions are included with a weight of 50 percent in calculating the HHI of local banking markets. The guidelines have resulted in merged banks being required to divest banking offices to reduce the effects on market concentration, and even to denials of merger applications.

Within the Twelfth Federal Reserve District, consisting of Alaska, Arizona, California, Hawaii, Idaho, Nevada, Oregon, Utah, and Washington, this study delineates 243 local banking markets. Statewide average HHIs were calculated by multiplying the HHI in each market by a market-specific weighting factor, which is the deposits in that market divided by the sum of all deposits in all local markets in the state, and adding up all the weighted HHIs for the state. The study finds that, for the most part, bank consolidation has occurred along with stable or decreasing local market concentration, and this holds true in both metropolitan and rural markets. Even California, with two of the largest bank mergers, showed a net decline in weighted average HHIs. In Arizona and Nevada, the HHIs declined by 370 points and 989 points, respectively. The two states with increases in the HHI were Alaska and Hawaii. In Alaska the HHI rose by 183, mostly because of the largest bank's acquisitions as approved by regulators of several of the mid-sized banks in the state that were in weak financial condition. Hawaii had an increase of 709, in part because the largest bank in the state acquired a fairly large savings and loan association.

One factor in the stable or declining HHI in most of the western states is the increase in the number of banks in some local banking markets, through entry of new banks and branches of existing banks. From 1982 to 1992, 67 local banking markets saw increases in the number of banks. For example, new entry played an important role in the decline in the HHI in both Arizona and Nevada. Another factor is the "dynamics" of competition in local markets, where an "evening out" of market shares suggests that small banks have provided a competitive check on larger banks. Competitors may be able to attract customers from merged institutions because they close branches or otherwise change bank practices, which has happened in some interstate as well as intrastate acquisitions. Following some of the larger mergers in particular, competitors have undertaken aggressive promotional campaigns aimed at attracting the customers of merged or acquired institutions. *Weekly Letter, Federal Reserve Bank of San Francisco, 1/28/94.*