Recent Developments Affecting Depository Institutions

by Lynne Montgomery*

REGULATORY AGENCY ACTIONS

Inter-Agency Actions

Bank Examiners Adopt New Risk-Based Procedures

On October 1, 1997, the Federal Reserve Board, the FDIC, and state banking departments began implementing a common risk-focused examination procedure for state-chartered community banks. The new process channels examiners' attention toward those activities posing the highest level of risk at each bank and aims to improve bank examiners' ability to diagnose emerging problems. The Federal Reserve Board (FRB) and the FDIC developed exam procedure modules to help examiners analyze community banks' most important activities, including loan portfolio management, securities, management and internal controls, earnings, and capital.

In order to simplify examinations further, federal and state examiners are using a new software program called "ELVIS" (Examiner Laptop Visual Information System). Examiners may use the program to organize notes and store agency rules, which reduces the burden of documentation and paperwork and gives examiners more time to analyze a bank's operations. *AB, 10/2/97; BBR, 10/6/97, pp. 527–528.*

Simplified Market Risk Rules

On December 9, 1997, the FDIC approved an interim final rule allowing banks under its supervision to calculate specific market risks with internal valuation models, eliminating the requirement to compare the model-generated results with those of the standardized measure developed by the international Basle Committee on Banking Supervision. The rule reduces regulatory burden by no longer requiring institutions to develop and maintain two separate methods for measuring market risk exposure to specific stock and bond positions in their trading portfolios. The rule applies only to those institutions whose trading portfolio represents 10 percent or more of their assets, or whose trading activities amount to $1 billion or more.

The rule was approved on an inter-agency basis, with the FRB issuing an interim rule on December 19, and the OCC on December 23, 1997. The three agencies together supervise fewer than 20 institutions that would be affected by the market risk rule. *PR–92–97, FDIC, 12/9/97; BBR, 12/15/97, p. 868.; NR 97–115, OCC, 12/23/97.*

Less-Frequent Exams for Healthy Banks and Thrifts

The four federal banking and thrift regulatory agencies issued a final interim rule on April 2, 1998, that permits less-frequent examinations for small, well-run thrifts and banks. The rule shifts the exam cycle for eligible institutions from every 12 months to

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every 18 months. Eligible institutions must have no more than $250 million in assets, be rated CAMELS 1 or 2, be well-capitalized and well-managed. A longer exam cycle permits the agencies to focus their resources on institutions that present the most immediate supervisory concerns and reduces regulatory burden on smaller, well-run institutions. *OTS 98–25, 4/2/98.*

Common Merger Application

The four federal regulatory agencies for banks and thrifts proposed a uniform application for institutions to use for mergers, consolidations, and combinations. Financial institutions would no longer be required to submit different forms to each agency. The action is part of the agencies' continuing review of corporate forms to simplify procedures, eliminate duplicative or outdated policies, and otherwise reduce burdens for financial institutions. *NR 98–7, OCC, 1/21/98.*

HMDA Data Collection Rules

Beginning January 1, 1998, depository institutions with assets totaling $29 million or less will be exempted from collecting data on mortgage loan originations. The Home Mortgage Disclosure Act (HMDA) requires lenders above a certain size to collect data on the loans they originate and file reports of that data with federal regulators. The Economic Growth and Regulatory Paperwork Reduction Act of 1996 provided that the asset exemption level be tied to increases in the Consumer Price Index. In January 1997, the FRB issued an interim rule raising the asset exemption level from $10 million to $28 million in order to bring the requirement up to date with the 1996 index. During the twelve-month period ending in November 1997, the price index rose 2.4 percent, resulting in a new exemption threshold of $29 million in assets. The new level will be in effect throughout 1998. *BBR, 12/22/97, p. 906.*

No Banking Holiday for Year 2000

The FRB announced that banks would remain open for normal operations on December 31, 1999. Various financial and trade groups have suggested that a banking holiday on December 31, 1999 would give the banks more time to deal with potential computer-related disruptions caused by the century date change. However, the FRB believes that bank resources will be better spent "preparing for the year 2000 change-over rather than addressing the operating, financial, legal and other consequences that would flow from a date-change holiday." *BBR, 2/2/98, p. 165.*

Expanded Year 2000 Authority

On March 20, 1998, President Clinton signed legislation giving the Office of Thrift Supervision and the National Credit Union Administration additional authority to address Year 2000 computer-related problems. The "Examination Parity and Year 2000 Readiness for Financial Institutions Act" would give the thrift and credit union regulatory agencies the same supervisory authority over third-party software vendors that banking regulators already have. The new law further requires that financial regulatory agencies offer seminars to the institutions they regulate on the safety-and-soundness implications of the Year 2000 problem and offer model approaches for solving common Year 2000 problems. The law puts the regulatory authority of credit unions and thrifts on par with that of other financial regulators. *BBR, 3/30/98.*

Federal Deposit Insurance Corporation

Tanoue Nominated to Head FDIC

On November 7, 1997, President Clinton nominated Honolulu banking attorney Donna Tanoue to head the FDIC. Ms. Tanoue will replace Acting FDIC Chairman Andrew C. Hove Jr., who took the post in June 1997, after the resignation of former Chairman, Ricki Helfer. Ms. Tanoue is currently a partner with the law firm of Goodsill, Anderson, Quinn & Stifel. Her practice has focused on banking and real-estate finance, with emphasis on bank regulatory matters. Formerly, she served as Commissioner of Financial Institutions for the state of Hawaii, and she is credited with restoring financial stability to Hawaii's thrift and industrial loan company industry. *BBR, 11/17/97, p. 738.*

Semiannual Agenda of Regulations

The FDIC published its semiannual regulatory agenda in the *Federal Register* on October 29, 1997. The agenda provides information about the FDIC's projected new rule makings, as well as existing regulations under review and completed rule makings. Many of the actions are the result of the FDIC Board's ongoing efforts to reduce the regulatory burden on banks, simplify rules, improve efficiency and comply with the Riegle Community Development and Regulatory Improvement Act of 1994. The agenda contains 31 regulatory actions. Seven actions have been completed and the remaining actions are in various stages of the rule-making process. *PR–79–97, FDIC, 10/30/97.*

Assessment Rates

On November 12, 1997, the FDIC Board of Directors voted to leave deposit insurance premium rates unchanged through the first half of 1998. The current risk-related assessment rates range from zero basis points to 27 basis points for both BIF-insured and SAIF-insured institutions. The FDIC reported that more than 95 percent of BIF-insured institutions and more than 90 percent of SAIF-insured institutions are rated well-capitalized and will continue to pay nothing for their deposit insurance coverage. The rate schedule is expected to maintain both the BIF and SAIF reserve ratios above the Congressionally mandated 1.25 percent (reserves as a percent of insured deposits). As of June 30, 1997, the BIF ratio was 1.35 percent and the SAIF ratio was 1.32 percent. *PR–82–97, FDIC, 11/12/97.*

Bank Failure

The FDIC announced the first bank failure in more than a year. On November 21, 1997, the Louisiana Commissioner of Financial Institutions closed Southwest Bank, Jennings, La., and named the FDIC as receiver. The FDIC approved the assumption of Southwest Bank's deposits by newly chartered First Southwest Bank, also of Jennings. First Southwest Bank opened its doors on November 24, 1997. The FDIC estimated the cost to the Bank Insurance Fund to be approximately $3.5 million. The Southwest Bank failure is the first BIF-insured institution to fail since August 1996 and the first bank in Louisiana to fail since November 1992. *PR–84–97, FDIC, 11/21/97.*

External Auditing Procedures

Effective December 31, 1997, the FDIC rescinded an obsolete policy statement that provides guidance on external auditing programs for state-chartered banks that are not members of the Federal Reserve System. The policy statement recommended that all FDIC-supervised banks have their financial statements reviewed by a certified public accountant as part of their external auditing programs. The policy also provided two alternatives for an institution whose board of directors or audit committee determined that a financial statement audit was inappropriate for their external auditing program. However, the FDIC has determined that the two alternatives are no longer acceptable substitutes for an audit and has offered two new alternatives. The new alternatives consist of a report on the institution's balance sheet, or documentation of adequate internal controls on certain parts of its regulatory reports, both of which should be performed by an independent accountant. *BBR, 1/12/98, pp. 46–47.*

1997 Financial Results

The Bank Insurance Fund (BIF) earned $1.4 billion in 1997, ending the year with a record fund balance of $28.3 billion. The Savings Association Insurance Fund (SAIF) earned net income of $0.5 billion for the year and ended the year with a record balance of $9.4 billion. The continuing low numbers of bank and thrift failures contributed to the strong results. Only one BIF-insured institution failed during the year. No SAIF-insured institution failed in 1997. Revenue for the BIF totaled $1.6 billion for the year. The fund earned $1.5 billion in interest on investments in U.S. Treasury securities and received another $25 million in deposit insurance assessments. The SAIF received $550 million in revenue, consisting of $535 million in interest on investments in U.S. Treasury securities and $14 million in deposit insurance assessments.

The FSLIC Resolution Fund (FRF) assets in liquidation were reduced by 51 percent over the year to a balance of $2.4 billion at year-end. Federal Financing Bank borrowings for the FRF were reduced by $3.7 billion to $0.8 billion. *PR–20–98, FDIC, 3/24/98.*

Real-Estate Survey – October 1997

The October 1997 issue of the *Survey of Real Estate Trends* reported continuing positive views of local commercial and residential real-estate markets. The survey polled 311 senior examiners and asset managers at the federal bank and thrift regulatory agencies. More than half of those responding to the survey (54 percent) reported improved commercial market conditions for the three months ending in October, compared to only 46 percent of those participating in October 1996. Forty-two percent of the participants reported that residential real-estate market conditions were better than three months earlier, compared to 35 percent in October 1996.

The national composite index used by the FDIC to summarize results for both residential and commercial real-estate markets was 71 in October, which is down from 74 in July but up from 67 in October

1996. The national index for commercial markets of 77 in October was essentially unchanged from July. The commercial index increased for all regions except the South. In contrast, the residential composite index fell in all four regions. The national residential index was 67 in October, down from 73 in July. Index values above 50 reflect improving conditions, while values below 50 indicate declining conditions. *Survey of Real Estate Trends, FDIC, October 1997.*

Real-Estate Survey – January 1998

The January 1998 issue of the *Survey of Real Estate* Trends reported that conditions in residential and commercial real-estate markets continued to be favorable. Forty-nine percent of those surveyed described local housing market conditions as improving, compared with 42 percent in October. Strong home sales and a tight housing supply contributed to the favorable observations of housing market conditions. The percentage of participants noting better conditions in local commercial markets dropped to 49 from a record high of 54 in October.

The national composite index increased from 71 in October to 72 in January. Regionally, the respondents reported an increasingly tight housing market in the West, rising sale prices for existing homes in the Northeast, above-average volume of apartment construction in the Midwest, and increasing sales of commercial properties in the South. The survey polled 298 examiners and assets managers from the federal bank and thrift regulatory agencies. *Survey of Real Estate Trends, FDIC, January 1998.*

Report on Underwriting Practices

The October 1997 issue of the *Report on Underwriting Practices* reported that banks' underwriting standards showed no widespread problems, but indicated that lending for both commercial real estate and construction should be monitored more carefully in the future. Compared to the previous report issued in May 1997, more institutions active in commercial real-estate and construction lending made higher-risk loans. Implemented in early 1995, the survey of underwriting practices is aimed at providing early warnings of potential problems in underwriting practices at FDIC-supervised, state-chartered nonmember banks. The focus of the survey is threefold: material changes in underwriting standards for new loans, degree of risk in current practices, and specific aspects of the underwriting standards for new loans. Slightly more than 90 percent of the banks examined in the six-month period ending September 30, 1997 showed no material change in overall underwriting practices since their last examination. *Report on Underwriting Practices, FDIC, October 1997.*

Foreign Banking Activities

On March 24, 1998, the FDIC Board of Directors announced a new regulation that dramatically reduces filing requirements for most banks when they want to open a foreign branch or make a foreign investment. In addition, the regulation permits well-run, well-capitalized institutions with no pending enforcement actions to initiate new activities abroad without prior Board approval. The institutions are required to notify the FDIC after new operations begin. The new regulation also streamlines the FDIC's internal application processing procedures, which will expedite decisions on application requests. *PR–19–98, FDIC, 3/24/98.*

Deposit Interest Payments

The FDIC Board of Directors approved a final rule on February 10, 1998, making its exceptions to the statutory ban on demand deposit interest payments track those issued by the FRB. Under the final rule, the FRB's exceptions to the statutory ban on paying interest on certain demand deposits would automatically apply to all FDIC-supervised institutions. Before the rule, federal law required the FDIC to issue similar exceptions to the general prohibition on demand deposit interest payments that the FRB authorized for the institutions it supervises. However, occasionally the FRB issued a specific exception to the ban before the FDIC could implement a similar action, which put the FDIC-supervised institutions at a temporary competitive disadvantage relative to FRB-supervised institutions. *BBR, 2/16/98.*

Federal Reserve Board

Risk-Based Approach to Consumer Compliance Reviews

On September 25, 1997, the Federal Reserve Board announced a new risk-based consumer compliance supervision program and extended the consumer compliance exam cycle for state member banks and foreign banking companies. The program, which will be phased-in throughout 1998, focuses on the relationship between "regulation risk" and "product risk" to determine the likelihood of an institution complying with consumer protection rules. The relationship between the two risk elements will be correlated to determine the appropriate level of oversight for an institution.

The program also extends the frequency of consumer exams for well-managed state member banks with excellent compliance histories. State member banks with less than $250 million in assets and two "satisfactory" or better ratings for compliance with consumer protection rules and the Community Reinvestment Act would be examined every 36 months, instead of every 18–24 months. Banks with more than $250 million in assets and excellent compliance records will be evaluated every 24 months, and banks with consumer compliance problems will be examined annually. *BBR, 10/6/97, p 528.*

Regulation Z

The Federal Reserve Board announced final revisions to its Regulation Z, the Truth in Lending Act Regulation. The revisions would allow lenders to provide borrowers with simplified disclosures for variable-rate loan payments. The final rule applies to any adjustable-rate loan with maturity greater than one year that is secured by the borrower's principal residence. The rule became effective on November 21, 1997, with compliance optional until December 22, 1997. *BBR, 12/1/97, p. 806.*

Regulation U

Beginning April 1, 1998, the FRB will permit banks to lend up to 100 percent of the purchase price of "small cap" stocks listed by NASDAQ. Under Regulation U, the banks were not permitted to lend more than 50 percent of the purchase price of these securities. The FRB also gave banks permission to lend up to half the purchase price of exchange-traded options. Before this decision, banks were not permitted to lend any portion of the purchase price of these securities. A federal law continues to prevent banks from financing more than half the purchase prices of issues traded on major exchanges, such as the New York Stock Exchange or the other securities listed by NASDAQ. *AB, 12/19/97.*

New Policy on Cash Processing

Under a revised Federal Reserve Board policy statement published in the *Federal Register* on March 10, 1998, depository institutions will have more flexibility to obtain cash services from district Federal Reserve Bank offices. The statement allows banks to designate ten "end-points" to receive cash from a Federal Reserve Bank office. An "end-point" is defined as a branch, head office, money room, or armored car used by the depository institution to handle cash orders and deposits. Previously, the FRB required banks to access the cash processing system from sites within their home Federal Reserve Bank district. The revised policy provides flexibility to depository institutions to make the most cost-effective arrangements for obtaining cash services from Reserve Bank offices. *AB, 3/10/98; BBR, 3/16/98, p. 429.*

Office of the Comptroller of the Currency

Ludwig Resigns

After five years as Comptroller of the Currency, Eugene A. Ludwig resigned at the end of his term on April 4, 1998. He plans to return to the private sector and to spend more time with his family. *BBR, 1/26/98, p. 121.*

Acting Comptroller

Effective April 5, 1998, Julie L. Williams became acting Comptroller of the Currency. Ms. Williams had been Chief Counsel since 1994 and was also designated First Deputy Comptroller. Under the National Bank Act, she automatically became acting Comptroller following Mr. Ludwig's departure. *NR 98–37, OCC, 4/6/98.*

Asset Securitization Handbook Issued

The OCC released its first handbook on asset securitization on November 12, 1997, entitled *Comptroller's Handbook: Asset Securitization*. The OCC acknowledged that the loans most often consolidated for securitization are consumer loans but anticipates that non-consumer assets will be next. The handbook is aimed at giving bank officials a better understanding of the benefits and risks associated with securitization and outlines procedures for effective risk management. The booklet also focuses on a bank's use of asset securitization to manage its balance sheet and generate fee income. *NR 97–101, OCC, 11/12/97; BBR, 11/17/97, p. 758.*

New Assessment Schedule

On December 3, 1997, the OCC released a new schedule of fees and assessments that means extra costs for national banks and other OCC-regulated institutions that receive lower supervisory ratings. For each national bank or OCC-regulated foreign firm, the OCC imposes a semiannual assessment based on a formula set out in 12 CFR 8.2; however, the formula did not reflect the extra costs involved in supervising banks that need special attention. The new rule imposes a surcharge equal to 25 percent of their assessment on banks scoring 3, 4, or 5 under the CAMELS rating system. Foreign branches or agencies of foreign banks that receive ROCA ratings of 3, 4, or 5 will also pay a 25 percent surcharge. The ROCA rating ranks risk management, operational controls, compliance, and asset quality. In addition, the assessments for nonlead national banks in multibank holding companies were lowered by 12 percent. The OCC also dropped the annual franchise fee that had been imposed on national banks that are registered as municipal or government securities dealers. The final rule took effect on December 31, 1997. *NR 97–106, OCC, 12/3/97; BBR, 12/8/97, p. 836.*

Survey of Credit Underwriting Practices

The 1997 *Survey of Credit Underwriting Practices* found that strong competition among financial institutions is driving national banks to continue easing credit standards for most types of commercial loans. The survey evaluated the lending practices at 80 of the largest national banks and compared the results to the 1996 survey. Almost 60 percent of the banks participating in the survey eased lending standards for one or more types of commercial loans. The survey reported weaker underwriting standards for home-equity and residential real-estate loans; however, loan requirements were tighter for small-business and agricultural loans. The survey also noted that credit requirements were stricter for credit cards, consumer loans, and affordable housing lending. The aggregate loan portfolio of the banks surveyed was approximately $1.5 trillion, which represents approximately 84 percent of all outstanding loans in national banks as of June 30, 1997. *NR 97–112, OCC, 12/16/97; BBR, 12/22/97, p. 901.*

National Banks to Sell Crop Insurance

The OCC's General Counsel stated that the National Bank Act permits national banks to offer crop insurance in connection with loans they make to farm customers. Crop insurance is intended to protect farmers' loss of income because of crop failure or low yields, and to reduce lenders' exposure to agricultural credit risk. The 1996 farm bill repealed federal farm price guarantees on many crops, which has increased banks' risk of farmers defaulting on agricultural loans. As a result, many farmers have become interested in national banks providing crop insurance coverage. State-chartered banks in Iowa have been selling crop insurance to farm customers for years through licensed agents employed by the banks. The General Counsel wrote that crop insurance enhances or facilitates a bank's lending activity by protecting the bank's loans, and is therefore part of a bank's lending operations. *BBR, 1/5/98, p. 14.*

Year 2000 Preparations Factor in Applications

In an advisory letter released on January 23, 1998, the OCC said that national banks' preparations for the Year 2000 computer problem would be a factor when reviewing certain applications. The applications addressed in the letter include new charters, mergers, conversions, and new federal branches of foreign banks. Applications for certain operating subsidiaries are also affected, and applicants will have to make sure that their vendors are Year 2000-compliant. *NR 98–8, OCC, 1/23/98; BBR, 2/2/98, p. 165.*

Bank Underwrites Municipal Bonds

A barrier between commercial and investment banking was broken on December 11, 1997, when the OCC gave permission to a national bank to underwrite municipal revenue bonds. Zions First National Bank of Salt Lake City, Utah, is permitted to form an operating subsidiary to issue the bonds. The Glass-Steagall Act prohibits banks from underwriting securities or owning stock in corporations that are "principally engaged" in securities underwriting; however, the Act makes no mention of firms that earn only a portion of their revenue by underwriting securities. The OCC claims that this omission enables banks to own firms involved in underwriting. *AB, 12/12/97, 1/7/98.*

Bank Offers Digital Signature Products

The OCC has conditionally approved an application for Zions First National Bank to be the first financial institution to offer digital signature products to its customers. Digital signatures are used for electronic authentication of the sender of an electronic message and can provide an important way for consumers and businesses to decide which electronic communications they can trust. The approval permits Zions to establish an operating subsidiary to act as a certification authority to enable subscribers to generate digital signatures that verify the identity of a sender of an electronic message. The certification process will also enable subscribers to be certain that communications received have not been altered during transmission. The bank plans to focus on certification services primarily involving corporate and government contracts. *NR 98–4, OCC, 1/13/98.*

Office of Thrift Supervision

Seidman Named Director

On October 29, 1997, Ellen S. Seidman was sworn into office to a five-year term as Director of the OTS. She takes over the agency from Nicolas Retsinas, who became Director in October 1996 while remaining Assistant Secretary and Federal Housing Commissioner at the Department of Housing and Urban Development.

Ms. Seidman spent the past four and one-half years as special assistant to President Clinton for economic policy at the White House National Economic Council. During her time at the Economic Council, she was chairwoman of the interagency working group on pensions and has been responsible for issues such as financial institutions, natural disaster insurance, bankruptcy, and home ownership. Before joining the Administration, she was Senior Vice President for Regulation, Research, and Economics at Fannie Mae. *OTS 97–78, 10/28/97; BBR, 11/3/97, p. 688.*

Court Rules for Thrift Acquirers

On December 22, 1997, the U.S. Court of Federal Claims ruled in favor of the acquirers of several troubled thrifts on contract claims against the federal government. The acquirers claimed that the government breached existing contracts when it changed the accounting and regulatory treatment of supervisory goodwill through the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) in 1989. The acquirers claimed that the favorable accounting and regulatory treatment promised by the government was key to their acquisitions when they acquired the thrifts earlier in the 1980s. There are more than 120 pending cases brought by acquirers of troubled thrifts. *BBR, 1/5/98, p. 29.*

Electronic Guidelines Urge Internal Controls

On October 15, 1997, the OTS issued examination guidelines that focus heavily on an institution's internal policies and controls for Internet banking and other electronic services. The guidelines emphasize that thrifts should adopt risk-management programs to monitor threats posed by electronic banking. OTS examiners are instructed to conduct a brief initial test that primarily determines whether a thrift has proper auditing procedures to monitor its technologies. If the initial review raises concerns, examiners will use more-detailed checks in up to seven areas, including strategic planning, operating controls, business insurance coverage, and information security. *AB, 10/17/97.*

Intermediate Holding Companies

Effective April 1, 1998, the OTS will allow mutual holding companies to set up a stock holding company as an intermediate subsidiary. The stock holding company will be sandwiched between the mutual holding company and its savings association in a three-level corporate structure. The controlling interest in the subsidiary holding company resides with the parent mutual holding company. The OTS said the rule provides mutual holding companies with increased flexibility to establish corporate structures that can take advantage of market opportunities while protecting the rights of mutual depositors. *TR–192, OTS, 3/9/98; BBR, 3/16/98, p. 446.*

Lower Liquidity Requirement

On November 24, 1997, the OTS lowered the liquidity requirement for savings associations from 5 to 4 percent of the institution's liquidity base. The new final rule also requires that each savings association maintain sufficient liquidity to ensure its safe-and-sound operation. The final liquidity rule increases regulatory flexibility and is part of the OTS's ongoing effort to simplify its regulations and reduce regulatory burden. *OTS 97–82, 11/24/97.*

Capital Distributions

The OTS proposed a rule on January 7, 1998, that would allow well-run, healthy savings associations to pay cash dividends without notifying their federal regulator. The institutions would have to satisfy specified criteria in order to qualify. The proposed rule change would bring the OTS's capital distribution regulations into greater conformity with those of the other federal banking regulators and reflects the improved capital position of the thrift industry. *OTS 98–1, 1/7/98.*

National Credit Union Administration

Supreme Court Rejects NCUA Policy but House Brings Relief

On February 25, 1998, the U.S. Supreme Court ruled against the National Credit Union Administration, stating that it misread the Federal Credit Union Act when it eased membership standards for a class of federal credit unions. The case centered on Section 109 of the Federal Credit Union Act, which requires members of each credit union to share a "common bond." Since 1982 the NCUA has argued that federal occupation-based credit unions meet the "common bond" requirements even if multiple occupations are represented, and the NCUA allowed credit unions to expand their membership dramatically. The American Bankers Association and several banks sued the NCUA, charging that the statute limits each credit union to one employee group, all of whose members share a single common occupational bond. The Court agreed with the bankers in an opinion by Justice Clarence Thomas. However, on March 26, 1998, the House Banking Committee approved a bill that gives credit unions relief from the Supreme Court ruling. The bill, called the Credit Union Membership Access Act, was also approved by the House of Representatives on April 1, 1998. *BBR, 3/2/98, p. 333; BBR 3/30/98; AB, 4/2/98.*

NCUA Approves Chartering Change

The National Credit Union Administration's Board of Directors voted on January 22, 1998, to adopt an amendment to its rules to make it easier for a credit union to convert to a community-based charter. The Board agreed to remove the current requirement that credit unions wishing to convert to community charters must provide evidence of community support. *BBR, 1/26/98, p. 141.*

New Risk Rating System for Corporates

The National Credit Union Administration is testing a new risk rating system for corporate credit unions. The new system, the Corporate Credit Union Risk Rating System (CCURRS), is expected to replace the current system, CAMELS, by May 1, 1998. Corporate credit unions provide investment, payment, liquidity, and support services to natural-person credit unions. The NCUA said the new system was designed to recognize that corporate credit unions are unique and "the combination of financial and operational risks managed by corporates differ significantly from the risks incurred by commercial banks, thrifts, and natural-person credit unions." *BBR, 2/2/98, p. 188.*

Securities and Exchange Commission

Year 2000 Costs Disclosed

The Securities and Exchange Commission issued guidelines on January 12, 1998, requiring that publicly traded banks disclose what they expect to spend rectifying possible Year-2000 computer problems. The institutions are also required to outline their general plans for addressing the computer problems in their financial statements and provide a timetable for carrying them out. *AB, 1/13/98.*

Federal Housing Finance Board

FHLBanks to Meet SEC Disclosure Standards

The Federal Housing Finance Board proposed a rule that would require Federal Home Loan Banks to comply with SEC quarterly and annual reporting rules. Certain securities issued by the Finance Board and the FHLBanks are exempt from registration and reporting requirements of the Securities Exchange Act of 1934 and are treated as government securities. Under the Finance Board's proposed rule, FHLBanks would be required to submit unaudited quarterly financial statements, as well as audited annual financial reports, to the Board and FHLBank members. The reports would be prepared in accordance with the SEC's financial disclosure and accounting requirements. Currently, all of the FHLBanks submit annual financial statements, but not all of them issue quarterly financial reports. *BBR, 1/26/98, p. 141.*

FHLBanks Continue to Borrow

The Federal Housing Finance Board voted unanimously to allow the Federal Home Loan Bank System's Office of Finance to continue to borrow without limit through the rest of 1998. In late 1997, the Finance Board decreed that the Office of Finance's debt-issuance authority would expire at the end of March. The Board lifted the constraint as it prepares to address underlying policy issues relating to the System's finances. The FHLB System has come under criticism for pursuing aggressive borrow-and-invest practices at the expense of its traditional mission of making low-cost loans, called advances, to mortgage-lending institutions. *The Wall Street Journal, 3/16/98.*

OTHER ENTITIES

Financial Accounting Standards Board

Derivatives Rule Delayed

The Financial Accounting Standards Board voted to delay by six months the effective date of its new derivatives rule. The new derivatives rule, which will become effective June 15, 1999, will require companies to report derivatives at fair market value on quarterly income statements. Bankers and regulators have argued that the cost of compliance, coupled with the Year 2000 expenses, would be extremely burdensome. *AB, 12/18/97.*

Federal Financial Institutions Examination Council

Year 2000 Guidance

The FFIEC issued additional guidance for financial institutions on risks they face because of the Year 2000 date change. The inter-agency statements, "Guidance Concerning Institution Due Diligence in Connection with Service Provider and Software Vendor Year 2000 Readiness" and "Guidance Concerning the Year 2000 Impact on Customers" supplement the statement issued on May 5, 1997. The guidance clarifies the importance of developing and executing a due-diligence process for each mission-critical service and product supplied by service providers or software vendors. This process should enable an institution's management to identify the obligations of the institution and its service providers and software vendors. The institution should also establish an effective monitoring program of the renovation phase, establish a process for testing the renovated products and services, and adopt contingency plans in the event of information systems disruptions. The statements also provide guidance that should enable a financial institution's management to effectively assess the Year 2000 readiness of the institution's borrowers, fund providers, and asset management. *FIL–29–98, FDIC, 3/18/98.*

STATE LEGISLATION AND REGULATION

Texas

On January 1, 1998, a constitutional amendment was passed that permits home-equity lending in Texas. This amendment ends a 123-year-old prohibition on home-equity lending in Texas. The amendment permits homeowners to borrow up to 80 percent of the market value of a home. *BBR, 11/10/97, p. 712.*

Florida

On February 27, 1998, Florida regulators imposed a 90-day moratorium on conversions of credit unions from federal to state charters in order to prevent a flood of applications resulting from the February 25, 1998, U.S. Supreme Court ruling that credit unions must be composed of only one employer group. *BBR, 3/9/98, p. 400.*

Iowa

With Congress threatening to abolish the thrift charter, savings and loans in Iowa are urging lawmakers to create a new state savings bank charter. If the plan were enacted, Iowa's 30 thrifts could convert to the new charter and retain liberal branching rights. Iowa forbids commercial banks from branching into communities where another bank already operates. Commercial banks could also use the new charter to better compete with brokerage firms, credit unions, and other financial-services companies. *AB, 2/10/98.*

BANK AND THRIFT PERFORMANCE

Third-Quarter 1997 Results for Commercial Banks and Savings Institutions

Commercial banks continued to produce record earnings, reporting net income of $14.8 billion for the third quarter of 1997. Third-quarter earnings were $131 million more than the previous earnings record set in the second quarter. This also marks the third consecutive quarter that earnings reached an all-time high. The increase in earnings this quarter was supported by stronger financial performance of credit-card specialty banks, and by higher trading profits at a few large banks. In the second quarter, restructuring charges and the expense of boosting reserves at some large credit-card banks caused profits for that group of institutions to dip sharply. Profits of this group more than doubled in the third quarter to $1.3 billion. The third-quarter annualized return on assets was 1.22 percent, down slightly from the second quarter ROA of 1.24 percent, but above the 1.19 percent of a year ago. For the fourth consecutive quarter, no insured commercial banks failed. The number of problem banks decreased from 74 in the second quarter to 71 at the end of the third quarter. The problem banks have total assets of approximately $5 billion.

FDIC-insured savings institutions reported earnings of $2 billion in the third quarter of 1997, for an annualized ROA of 0.79 percent. Earnings declined from the second quarter by $398 million, primarily because of charges related to acquisitions. The savings industry earned $6.6 billion in the first three quarters of 1997, up by $1.7 billion over the same period in 1996, and within $1 billion of the annual record set in 1995. Ninety percent of all savings institutions showed improved quarterly earnings from a year ago. The number of problem institutions declined to 27, compared to 29 in the second quarter. Assets of problem institutions declined to $2 billion at the end of the third quarter from $2.8 billion in the second quarter. *FDIC Quarterly Banking Profile, Third Quarter 1997.*

Fourth-Quarter 1997 Results for Commercial Banks and Savings Institutions

Insured commercial banks had record earnings in the fourth quarter of 1997, as well as for the full year. Fourth-quarter net income totaled $15.3 billion, an increase of $511 million from the third quarter. For all of 1997, banks posted record net income of $59.2 billion, up $6.9 billion from 1996 annual results. The FDIC attributes the higher bank earnings in 1997 to increased net interest income and higher noninterest income. The fourth-quarter annualized return on assets rose to 1.24 percent, up from 1.22 percent in the third quarter of 1997 and 1.21 percent in the fourth quarter of 1996. For the full year, commercial banks' ROA was 1.23 percent, the highest annual rate recorded by the industry since the FDIC was established. One insured commercial bank failed during the fourth quarter, which was the first bank failure in 15 months.

FDIC-insured savings institutions reported net income of $2.4 billion in the fourth quarter, an increase of $197 million from the fourth quarter of 1996. Total earnings for the year were a record $8.8 billion, which is $1.8 billion higher than in 1996. The main reasons for the record earnings were lower noninterest expenses, a decline in provisions for future loan losses, and increased profits from sales of securities. Savings institutions had an annualized ROA of .95 percent in the fourth quarter and posted an ROA of .93 percent for the year. There were no federally insured savings institution failures in 1997, which is the first year of no failures since 1959. *PR–14–98, 3/12/98.*

RECENT ARTICLES AND STUDIES

The Treasury Department released a study on November 17, 1997, entitled *American Finance for the 21st Century*. The study finds that financial marketplace failures, even very large ones, are inevitable; and therefore, federal regulators should adopt a policy of containment that isolates individual upsets while protecting the financial system as a whole. Congress directed the Treasury to perform the study in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994. The report was written by Robert E. Litan, director of the Economic Studies Program at the Brookings Institution, and Jonathan Rauch, a contributing editor of the *National Journal*. *BBR, 11/24/97, pp. 778–79.*

On December 11, 1997, the House Banking Committee released a report entitled *U.S. Financial Services Sector Vulnerable to Computer Attack*, which claims that the U.S. financial-services sector is not addressing security problems fast enough to keep up with the rapid growth of the Internet. The report addresses the vulnerability of the financial-services sector to foreign and domestic computer crime and estimates that financial firms may be losing $2.4 billion a year because of theft by computer. The reasons stated for the vulnerability are that computer software is outdated, telecommunications systems are easy to access globally, and computer hackers can decipher encryption codes. *BBR, 12/15/97, p. 881.*

A similar study released on December 18, 1997, by the FDIC reported that financial institutions must recognize the security risks associated with the Internet and implement appropriate measures to protect their systems and data from unauthorized access. The paper, entitled *Security Risks Associated with the Internet*, identifies risks posed by using the Internet as an information resource or service delivery tool. The paper is intended to supplement the FDIC Division of Supervision's existing supervisory procedures for electronic banking activities, and to provide bank managers with information to help identify potential risk factors and security solutions. *FIL–131–97, 12/18/98; BBR, 1/5/98, p. 9.*

The Treasury Department released a study on December 11, 1997, entitled *Credit Unions*, which was mandated by the Economic Growth and Regulatory Paperwork Reduction Act of 1996. The report concludes that credit unions are safe-and-sound institutions. The study also concludes that the credit union insurance fund is well-capitalized, has had few losses over recent years, and appears to be able to handle financial crises in the credit union industry. The study did recommend that credit union regulators adopt supervisory policies for market risk similar to those employed by bank regulators, including capital requirements, market-risk measurements, and prompt corrective action provisions for troubled credit unions. *BBR, 12/15/97, pp. 885–86.*

The FDIC has published a study entitled *History of the Eighties—Lessons for the Future*, which presents a comprehensive analysis of the banking crises of the 1980s and early 1990s. The two-volume study also evaluates the lessons learned from the crises. In the first volume, the FDIC presents its assessment of the economic, structural, supervisory and legislative conditions present as the era of failures began. The FDIC also reviews how these factors changed over time, as well as the policy implications for future banking problems. The second volume contains the proceedings of the History of the Eighties symposium held by the FDIC in 1997. *PR–1–98, FDIC, 1/8/98.*

The Consumer Bankers Association's annual *Consumer Credit Collections Study* reported that bankruptcies account for 40 percent of all credit-card losses at large banks. The study, released on January 16, 1998, also reported that the credit-card bankruptcy charge-off rate at smaller institutions was 27 percent. *BBR, 1/26/98, p. 130.*

A Georgetown University study entitled *Credit Union Insurance and Regulation* concludes that the government should maintain a separate insurance fund for credit union deposits. The study finds that credit unions are better capitalized than banks, and the credit union fund performed much better than the other funds during the economic crises of the late 1980s and early 1990s. The study also examines corporate credit unions and recommends increased oversight and new rules to prevent these institutions from investing in risky financial instruments. *AB, 10/31/97.*

INTERNATIONAL DEVELOPMENTS

Japan

On November 17, 1997, Hokkaido Takushoku Bank Ltd. collapsed. It is Japan's tenth-largest bank and the first of Japan's ten major commercial banks to require a bailout. Japan extended emergency central bank loans and arranged for North Pacific Bank to take over the failed bank's deposits and outstanding loans. *The New York Times, 11/17/97.*

One week later, on November 24, 1997, Japan's fourth-largest securities company collapsed. Yamaichi Securities Co. was unable to borrow sufficient operating funds after two U.S. ratings companies rated its credit as "junk." The company also disclosed that it had nearly $1.6 billion in previously undisclosed losses that were hidden off its balance sheet. *The Wall Street Journal, 11/24/97.*

On January 12, 1998, The Ministry of Finance reported that Japanese commercial banks' bad loans, nonperforming loans, and loans with potential risks totaled 76.7 trillion yen (approximately $590 billion), which is 14 percent of their total loans of 624.9 trillion yen. Prime Minister Ryutaro Hashimoto announced that his government was drafting amendments to the Deposit Insurance Law and Financial System Stabilization legislation in order to help stabilize the Japanese financial system. The amendments would allow the governmental Deposit Insurance Corporation (DIC) to conduct on-site and other types of investigations of failed banks and allow public prosecutors to indict parties who block the investigations. *BBR, 1/19/98, p. 101.*

Japan's Ministry of Finance has agreed to allow banks to have banking subsidiaries without establishing a bank holding company. A ban on holding companies was lifted last year, which enabled a bank to establish a bank holding company under which it can own securities and other financial subsidiaries. However, not a single bank has expressed intentions to establish a holding company because of complexity related to the transfer of assets between the holding company and subsidiaries, and other details. The Ministry thus came up with the amendment in an apparent move to encourage bank mergers and improve their efficiency and productivity. *BBR, 1/26/98, p. 153.*

On February 16, 1998, the Japanese Diet passed two bills that will provide 30 trillion yen ($260 billion) in taxpayer money to assist in the disposal of commercial bank nonperforming loans and to reinforce the protection of depositors. The Law for Emergency Measures for Financial Function Stabilization gives the Deposit Insurance Corporation the authority to issue government bonds and borrow 10 trillion yen. The government would use the borrowings to purchase commercial banks' preferred shares and subordinated debt securities in the event of bank failures. The other measure approved by Japanese legislators includes amendments to the Deposit Insurance Law that allow the Deposit Insurance Corporation to issue seven trillion yen worth of government bonds to compensate for commercial bank losses. It also sets up the government-backed Liquidation and Collection Bank as the recipient bank of bad loans held by healthy banks. *BBR, 2/23/98.*

Indonesia

Indonesia plans to merge four big state-owned banks into one institution in an effort to clean up the poorly managed and inefficient government financial institutions. The plan will also allow foreign banks to buy into any state-owned bank. *The Wall Street Journal, 1/2/98.*

On January 27, 1998, the Finance Ministry announced a package of measures that is intended to restart the flow of money into the economy. The package included guarantees on bank deposits, an end to all curbs on the foreign ownership of banks, and the creation of a special agency that would rehabilitate ailing banks. *The New York Times, 1/27/98.*

South Korea

In December 1997, the South Korean government received a $55 billion bailout package from the International Monetary Fund in exchange for an agreement to dismantle the country's interlocked financial and industrial system, known as Korea Inc. In accordance with the IMF agreement, the government closed ten of the country's 30 merchant banks in February 1998. A government-backed bridge bank was created to assume the failed institutions' assets and liabilities. *The Wall Street Journal, 12/4/97, 2/2/98.*

United Kingdom

On October 28, 1997, the U.K. Securities and Investments Board changed its name to the Financial Services Authority (FSA). The name change is part of a broad revision of the regulation of U.K. financial markets aimed at consolidating banking supervision and investment services regulation into one regulatory body.

One of the first actions taken by the FSA was the signing of an information-sharing memorandum of understanding with the Bank of England and two U.S. regulators, the SEC and the Commodity Futures Trading Commission. The MOU is expected to enhance the ability of the regulators to obtain information about the activities of U.S. and U.K. internationally active firms. It also sets forth procedures for co-operation when addressing potentially significant market events experienced by U.S. or U.K. securities or banking firms. *BBR, 11/3/97, pp. 696–97.*

China

On February 28, 1998, China's top legislative body, the Standing Committee of the National People's Congress, gave approval to the Ministry of Finance to issue $33 billion of domestic bonds to bail out the country's state bank monopoly. Ninety percent of the country's bank assets are controlled by four state-owned institutions. Authorities have also proposed that China introduce a deposit insurance plan and appoint a federal agency to audit all bank assets for the first time since 1949. *BBR, 3/9/98, p. 410.*

Russia

Russia's central bank withdrew 316 banking licenses in 1997, which is more than 15 percent of the country's banks. The central bank is continuing to weed out the country's weakest financial institutions and will be quicker to withdraw licenses in the future. Analysts predict the number of banks will continue to decline sharply this year, as smaller banks struggle to survive in the low inflation environment and bigger banks seek to expand by merger or acquisition. *Financial Times, 1/7/98.*

102 Nations Sign Financial-Services Pact

On December 13, 1997, a deal was reached between 102 nations, which will open up foreign markets to banks, insurance companies, and other financial institutions. The deal, which was coordinated by the World Trade Organization (WTO) and is the result of seven years of work, is expected to boost world growth and restore confidence in the Asian financial markets. The range of services covered under the agreement is broad and includes: traditional banking services, such as depositing and lending; securities services, including trading in equities and derivatives; and insurance services, including the sale of insurance, brokerage, and reinsurance.

The agreement's main achievement is that it locks market access offers into a legally binding framework. Any signatory country that does not adhere to the agreement must answer to the WTO's Dispute Settlement Body and face the possibility of trade sanctions. The agreement will be open to participating governments for signature in January 1999 and will take effect in March 1999. Developing countries will have phase-in schedules that will allow some governments to wait until 2020 to completely implement their financial-services offers. *BBR, 12/22/97, pp. 922–23.*

Guidelines on Internal Bank Controls

On January 19, 1998, the Basle Committee on Banking Supervision issued a series of guidelines designed to improve the evaluation of internal bank controls. The guidelines call on national banking supervisors to ensure the establishment of improved management oversight and control structures in banks under their authority. The guidelines also require banking supervisors to ensure that banks are carrying out adequate risk assessments and to address other issues such as improving internal communication, and monitoring and evaluation of internal control systems in banks. The guidelines reflect a growing concern about the adequacy of existing internal controls. *BBR, 1/26/98, p. 149.*