Recent Developments Affecting Depository Institutions

by Jane Coburn*

REGULATORY AGENCY ACTIONS

Federal Deposit Insurance Corporation

Chairman Helfer Announces Resignation

On March 14, 1997, Ricki R. Helfer announced her resignation as Chairman of the FDIC, effective June 1. Chairman Helfer's resignation letter to President Clinton stated she achieved the goals she set when taking office on October 7, 1994. Several of these goals included the formation of the Division of Insurance to identify emerging areas of risk and to provide economic data to field examiners; a systematic analysis into the causes of the banking crisis of the 1980s and early 1990s; and the use of a diagnostic approach to bank examinations that focuses on risk. The direction of the agency changed under Chairman Helfer to an agency that stresses the need to help banks stay healthy and serve their communities. The passage of the Deposit Insurance Funds Act of 1996 on October 1, 1996, which resulted in the full capitalization of the Savings Association Insurance Fund, was a notable achievement. Chairman Helfer was the first woman to head a federal bank regulatory agency. *PR-19-97, FDIC, 3/14/97.*

Vice Chairman Hove Named Acting Chairman

Vice Chairman Andrew C. Hove, Jr. became FDIC's Acting Chairman on June 1, 1997. This is Mr. Hove's third term as Acting Chairman, including a two-year period following the death of Chairman William Taylor. Prior to serving as an FDIC Board member, Mr. Hove was Chairman and CEO of Minden Exchange Bank and Trust of Nebraska. *PR-39-97, FDIC, 6/2/97.*

FDIC Adopts ADR Policy

The FDIC on January 10, 1997, adopted a policy statement to further its commitment to the use of alternative dispute resolution (ADR) as an attempt to limit litigation or to provide a means of settling disputes. The policy statement was modified because of the re-enactment of the Administrative Dispute Resolution Act.

Real-Estate Survey—January 1997

The outlook for the nation's residential and commercial real-estate markets continued to be favorable during the fourth quarter of 1996, according to the FDIC's January 1997 issue of *Survey of Real Estate Trends*. This is a survey of senior examiners and other experts at the federal bank and thrift regulatory agencies about developments in their real-estate markets. The national composite index that summarizes responses reached 68 in January, up from 67 in October. The commercial index equaled 71 and the residential index was 65. Residential real-estate markets continue to show strength. Commercial markets are improving, with additional reports of rising sale prices and a larger volume of sales of commercial properties. *Survey of Real Estate Trends, January 1997.*

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

Real-Estate Survey—April 1997

The April 1997 issue of the *Survey of Real Estate Trends* reported improvements in real-estate markets across the country. The survey of senior examiners and asset managers at the federal bank and thrift regulatory agencies indicated that during the previous three months overall results were positive, with widespread gains occurring in residential and commercial markets. Residential real-estate markets improved in the Northeast and Midwest regions.

The composite index used by the FDIC to summarize results for both residential and commercial real-estate markets nationwide reached 71 in April, up from 68 in January. The commercial index reached 74, up from 71 in January; the residential index rose to 69 from 65 in January. Values above 50 reflect improving conditions, values below 50 indicate declining conditions. Reports of excess supply in commercial real-estate markets continued to decline because of reports of higher demand for new office space. The housing markets outlook continued to improve in April, with reports of tight supply in every region. *Survey of Real Estate Trends, April 1997.*

Real-Estate Survey—July 1997

The July 1997 issue of the *Survey of Real Estate Trends* reported that conditions in residential and commercial markets improved during the prior three months. The composite index that summarizes the residential and commercial markets moved to 74 in July, up from 71 in April. The regional composite indexes moved upward in July except for the Midwest region, which was unchanged. The West region's composite index and component index had the strongest showing of the four regions. Three hundred federal banking and thrift agency examiners and asset managers responded to the survey. *Survey of Real Estate Trends, July 1997.*

Electronic Banking Safety-and-Soundness Exam Procedures

On January 29, 1997, the FDIC issued safety-and-soundness examination procedures to its examiners that pertain to electronic banking. The procedures focus on planning, administration, internal controls, and policies. These procedures are just one component of a four-part approach to evaluating the risks inherent in emerging electronic banking activities. *FIL-14-97, FDIC, 2/26/97.*

Part 344 Regulations Revised

The FDIC has approved a rule that updates the regulations on securities record keeping and confirmation requirements for insured branches of foreign banks and nonmember banks. The rule revised Regulation 344 with an effective date of April 1, 1997. *BBR, 3/3/97, pp. 400-401.*

1996 Financial Results

The Bank Insurance Fund (BIF) earned $1.4 billion in 1996, ending the year with a balance of $26.9 billion. Assessment revenue equaled $73 million, with interest earned on investments in U.S. Treasury obligations reaching $1.3 billion. The BIF reserve ratio reached 1.34 percent at year-end 1996. Five banks failed during the year with $182 million in total assets and $43 million in estimated losses to the BIF. The Savings Association Insurance Fund (SAIF) grew to a balance of $8.9 billion at year-end 1996. The SAIF reserve ratio at year-end 1996 equaled 1.30 percent. Net income equaled $5.5 billion, which included a $4.5 billion one-time special assessment that capitalized the fund. One SAIF-insured institution failed in 1996 with total assets of $35 million and at an estimated cost to the SAIF of $14 million. *PR-21-97, FDIC, 3/25/97.*

1997 Midyear Financial Results

The Bank Insurance Fund earned $535 million in the first half of 1997, ending the second quarter with a balance of $27.4 billion. The Savings Association Insurance Fund reached $9.1 billion with earnings of $246 million. *PR-58-97, FDIC, 8/26/97.*

Assessment Rates

The FDIC Board voted on May 6, 1997, to leave deposit insurance premium rates unchanged for the remainder of 1997. The assessment rate schedule for the remainder of 1997 ranges from zero basis points to 27 basis points for BIF-insured and SAIF-insured institutions. The FDIC reported that 95 percent of BIF-member institutions and 90 percent of SAIF-member institutions are rated well-capitalized and will continue to pay nothing for their deposit insurance coverage. The FICO rate on BIF-assessable deposits was set at 1.26 basis points; the rate for SAIF-assessable deposits was set at 6.30 basis points. *FIL-59-97, FDIC, 6/6/97; PR-30-97, FDIC, 5/6/97.*

Semiannual Agenda of Regulations

The FDIC published its most recent semiannual regulatory agenda in the *Federal Register* on April 25, 1997. The agenda provides information about the FDIC's current and projected rule makings, as well as information on existing regulations under review, and completed rule makings. Many of the pending regulations have resulted from the FDIC Board's continued efforts to reduce the regulatory burden on banks, simplify rules, improve efficiency, and to comply with the Riegle Community Development and Regulatory Improvement Act of 1994. Of the 30 final or proposed rule changes, 8 were completed, 6 were published as proposals, 14 were expected to be proposed for public comment, and 2 may be issued for public comment. *PR-33-97, FDIC, 5/14/97.*

Proposed Changes to Simplify Deposit Insurance Rules

On April 29, 1997, the FDIC Board proposed changes to clarify and simplify the deposit insurance rules. The changes will make insurance rules less burdensome, more efficient, and easier to understand. The rules will include commonplace illustrations explaining how particular provisions affect basic types of consumer accounts. Also revisions to the following insurance rules are proposed: added flexibility for third-party deposits made by businesses on behalf of their customers, an extended grace period for beneficiaries, and clarification of insurance coverage of living trust accounts. *PR-27-97, FDIC, 4/29/97.*

Foreign Banking Activities

The FDIC Board proposed a rule that would allow well-managed state nonmember banks with international operations to engage in new activities without filing a formal application. The proposed rule consolidates and updates existing regulations with the goal of allowing state nonmember banks to compete effectively internationally. The FDIC's international rules have not been revised since 1979 and will be consolidated into one regulation and reflect interagency standards. *PR-45-97, FDIC, 6-24-97.*

Report on Underwriting Practices

The semiannual *Report on Underwriting Practices* found that bank underwriting standards are sound but that some institutions engage in potentially dangerous lending practices. The purpose of the survey is to provide an early-warning mechanism for identifying potential lending problems and to report on the riskiness of current underwriting practices at FDIC-supervised, state-chartered nonmember banks. The focus of the survey is threefold: material changes in underwriting standards for new loans, degree of risk in current practices, and specific aspects of the underwriting standards for new loans. The April issue of the *Report on Underwriting Practices* indicated that 91 percent of the examined banks showed no material change in underwriting practices since their last examination. *Report on Underwriting Practices, FDIC, April 1997.*

Federal Reserve Board

Regulatory Relief

The Federal Reserve Board on February 19, 1997, eliminated numerous rules and application requirements, with the intent to improve the competitive environment for banks. Tying restrictions have been eliminated and several activities (securities, data processing, consulting, and investment advisory) have been added to the list of activities permissible for bank holding companies. The changes in the rules should also shorten the application processing time related to the Community Reinvestment Act. *AB, 2/20/97.*

Federal Funds Rate Increase

The Federal Reserve Board raised the federal funds rate 0.25 percent on March 25, 1997, to 5.5 percent. The federal funds rate, the rate that banks charge each other for the use of overnight funds, had remained unchanged since January 1996. *WSJ, 3/26/97.*

Regulation CC

The Federal Reserve Board on March 18, 1997, issued a final rule clarifying Regulation CC which governs the availability of funds and the collection of checks. The effective date for the rule is April 28, 1997. The clarification related to the Federal Reserve's check collection and return process. *BBR, 3/24/97, pp. 548-49.*

Regulation M

The Federal Reserve Board has finalized its consumer leasing rules relating to Regulation M. The rules are effective immediately, with compliance optional until October 1, 1997. Regulation M applies to leases of personal property valued at less than $25,000 and when the lease term exceeds four months. *BBR, 4/7/97, p. 638.*

Regulation Z

The Federal Reserve Board has revised Regulation Z, the Truth in Lending Regulation. The revised ruling provides guidance on the treatment of fees associated with mortgage loans and error tolerances because of the disclosure of finance charges and other costs. The rule became effective February 28, 1997, with compliance optional until October 1, 1997. *BBR, 3/10/97, pp. 444-45.*

Examination Frequency

On January 24, 1997, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision issued an interim rule and request for comment on a proposal to expand the examination frequency cycle for particular institutions. Examination frequency will be expanded to an 18-month cycle for 2-rated, well-managed banks from the current asset size limit of $100 million to a new limit of $250 million. *Federal Reserve Bulletin, March 1997.*

Office of the Comptroller of the Currency

Derivatives Handbook Published

The OCC issued guidelines to national bank examiners relating to derivatives trading. The lengthy handbook includes guidelines on bank employee compensation, validation of national banks' risk measurement models, and early termination agreements. *AB, 1/27/97.*

National Access Committee Formed

The Comptroller has formed a National Access Committee to support research, policy development, and outreach efforts to meet the OCC objective of improving access to financial services for the public and to support national banks' new product and geographic markets. The committee, which plans to meet quarterly, includes 12 OCC employees and is chaired by the Assistant Deputy Comptroller for Compliance Management. *NR-97-28, OCC, 3/14/97.*

Revenue Report

The Comptroller issued a working paper titled, "Profit Persistence in Large U.S. Banking Companies." The working paper concluded that banks earn higher profits by focusing on revenue-enhancing businesses rather than by focusing on cost-cutting measures. The study reviewed 237 large bank holding companies during 1986-92. *AB, 2/28/97.*

Rules Changed for Bank Fiduciaries

On December 27, 1996, the OCC released final changes to the regulations that govern the fiduciary activities of national banks. These rules, which have not been reviewed since the mid-1960s, became effective January 29, 1997. The rules include standards for how national banks hold and invest assets for their beneficiaries. *BBR, 1/6/97, p. 6.*

Director's Handbook

The Comptroller has published a handbook describing the responsibilities of national bank directors. The handbook, "The Director's Book: The Role of a National Bank Director," was last revised in 1987. The handbook explains bank directors' responsibilities in overseeing the operations of a bank. *AB, 4/9/97.*

International Comparison

The Comptroller released a study titled, "Commercial Banking Structure, Regulation, and Performance: An International Comparison," on March 24, 1997. The research found no adverse effects for banks that are allowed to conduct a range of securities, insurance, and real-estate activities directly or through subsidiaries. The OCC reviewed the banking environments of 19 countries. *BBR, 3/31/97, p. 594.*

Housing Video

The OCC has produced a videotape and workbook that demonstrates to national banks how to participate in the federal low-income housing tax-credit program. The discussion includes how national banks can participate in providing affordable rental housing using the federal program under the investment authority provided national banks by the OCC's community development and other public welfare investment regulations. *BBR, 6/2/97, p. 1,045.*

Virtual National Bank

The OCC has chartered the first virtual national bank, although the bank will not operate on the Internet. The bank intends to operate using telephone connections or customers' personal computers and offer deposit products and electronic bill payment. The Houston-based Compubank was chartered late this summer and will begin operations on February 1, 1998. *AB, 8/29/97.*

Federal Financial Institutions Examination Council

Call Report Changes

Beginning with the June 30th Call Report, filers will report residential mortgage assets separately from other assets and mortgage derivatives separately from other securities. Additional details on the maturities of residential loans and mortgage derivatives will also be required. *AB, 3/4/97.*

CAMELS Guide

The FFIEC has published a question-and-answer guide explaining the new S-component in the CAMELS supervisory rating system. The guide clarifies the revised CAMELS rating system that the financial institution regulatory agencies adopted in December 1996. The guide addresses questions such as how the S-component, which is a measure of sensitivity to market risk, will be determined and its importance relative to the composite rating. The sixth component of the CAMELS rating system reflects the degree to which changes in interest rates, foreign-exchange rates, commodity prices, or equity prices can influence an institution's earnings or capital. The S-component represents the institution's management ability to identify, measure, monitor, and control market risk. Also considered as part of the grading of the S-component is the institution's total asset size, complexity of activities, and the level of capital and earnings with respect to the level of market risk exposure. *FIL-17-97, FDIC, 3/7/97; FIL-105-96, FDIC, 12/26/96; Regional Directors Memorandum, 97-004, FDIC, 1/8/97.*

Year 2000 Conversion

The FFIEC issued a statement to financial institutions addressing the Year 2000 date change. The statement provides guidance on the activities needed to make computer systems capable of recognizing dates after 1999. The statement encourages financial institutions to reprogram their computer systems to adapt for the date change. The FFIEC included a five-point plan—awareness, assessment, planning, validation, and implementation. The statement indicated that bank regulators will review financial institutions' efforts by mid-1998. *FIL-50-97, FDIC, 5/9/97.*

Office of Thrift Supervision

Lending Rule

The Office of Thrift Supervision (OTS) finalized a new rule that allows federal thrifts to lend twice as much to commercial borrowers. The rule will allow thrifts to lend up to 20 percent of assets, with stipulations for small-business loans. The rule became effective April 3, 1997. *AB, 4/9/97.*

Holding Company Report

According to an OTS report titled "Holding Companies in the Thrift Industry," one-third of all thrift assets are held by savings-and-loan companies with some non-banking-related activities. The OTS reports that ownership of a thrift by a commercial firm includes the following advantages: enhanced access to capital markets, lower borrowing costs, and customer service advantages. *BBR, 4/21/97, pp. 758-59.*

Liquidity Level

The OTS has proposed a rule change to lower its minimum liquidity requirements for SAIF-insured institutions. The OTS would lower the liquid asset requirement to 4 percent. *BBR, 5/19/97, p. 958.*

New Federal Thrifts

The OTS has initiated new rules to simplify the paperwork requirements and reduce administrative costs for forming a new federal savings institution. The new rules are effective July 1, 1997. *BBR, 5/26/97, p. 1,007.*

Thrift Depositor Protection Oversight Board

The House Banking Committee unanimously agreed to abolish the Thrift Depositor Protection Oversight Board. The Board was created in 1989 during the savings-and-loan debacle with the purpose of overseeing the Resolution Trust Corporation (RTC). The RTC was abolished in 1995. *BBR, 9/15/97, p. 400.*

National Credit Union Administration

The Supreme Court on February 24, 1997, agreed to rule on whether credit unions may serve employees at more than one company. The Court will be making a decision whether to overrule the federal appeals court decision requiring all members of a credit union to share a single, common bond. This case originally began in North Carolina in 1990. *AB, 2/25/97.*

Federal Housing Finance Board

New Ruling

The FHFB approved a rule that allows Federal Home Loan Banks to lend to borrowers that are not members of the System. Previously, FHFB approval was required. Nonmember institutions must meet several criteria to be eligible to receive advances. *AB, 2/20/97.*

Mortgage Partnership Finance Program

The FHFB approved a pilot program to find new ways of funding and managing home mortgages. The Mortgage Partnership Finance Program is being tested at the Chicago FHLBank. The potential benefits of the pilot include greater credit availability for housing finance and increased profitability for member banks. *BBR, 1/13/97, p. 79-80.*

Qualified Thrift Lender

The FHFB approved an interim final rule on February 6, 1997, to aid the FHLBank System in determining whether commercial bank and credit union members satisfy the qualified thrift lender (QTL) requirements. The new rule allows FHLBanks to accept supplemental financial information not available in quarterly Call Reports. The rule allows for more assets that savings associations are permitted to use to qualify for the QTL standards. Savings associations may now include the full amount of educational, small-business, and credit-card loans. *BBR, 2/10/97, p. 270.*

Eligibility and Pricing Rule

The FHFB on February 19, 1997, approved a rule that establishes uniform eligibility and pricing requirements for FHLBank System advances to nonmember state housing finance agencies. *BBR, 2/24/97, p. 368.*

Community Support Program

The FHFB adopted new rules governing its Community Support Program. The new rules streamline the program's documentation review process and reduce compliance requirements to a one-page community support statement. The ruling also addresses uniform performance standards for all members of the FHLB System and a commitment to promote housing finance and support local communities. *BBR, 5/12/97, p. 903-904.*

Securities and Exchange Commission

The SEC approved a rule requiring extensive disclosure about the financial risks posed by derivatives. The rule should enable investors to understand better how a company uses derivatives. The rule becomes effective in 1998. *WSJ, 1/29/97.*

STATE LEGISLATION AND REGULATION

Alaska

Alaska enacted a new trust fund law on April 1, 1997. The state has removed all limits on the life of a trust established in the state. And there will not be any limits on how long individuals can remain beneficiaries of their own trust. *AB, 4/21/97.*

Arkansas and Nebraska

Arkansas and Nebraska have enacted interstate branching legislation, effective May 31, 1997. *BBR, 3/31/97, p. 611.*

Colorado

Colorado's Governor approved legislation allowing banks and other financial institutions to sell insurance. Banks, thrifts, and credit unions will be allowed to sell insurance and annuities. The new rule supersedes the limitation of selling insurance in communities of less than 5,000 people. Both banking and insurance professional associations favored the legislation. *BBR, 5/19/97, p. 951.*

Connecticut

Connecticut's state legislature has developed a new state charter to encourage the formation of new banks. The purpose of the new community bank charter is to increase the availability of banking services to small businesses and other customers not served by large banks. The new charter is expected to be approved by the Connecticut General Assembly. *AB, 1/24/97.*

Connecticut's state legislature passed legislation that would allow state-chartered banks to sell insurance. The Governor of Connecticut approved this legislation on July 8. *AB, 6/10/97.*

Delaware

Delaware's state legislature passed legislation this summer that protects trust assets from creditors. The new trust legislation also waives public filing of trust agreements and assigns trust rulings to the state chancery court instead of local courts. This law was passed to enable Delaware to remain competitive with the recently enacted Alaskan trust law. *AB, 7/24/97.*

Illinois

Both houses of the Illinois General Assembly approved legislation that would allow state-chartered banks to sell insurance products. *BBR, 6/2/97, pp. 1,038-39.*

Maine

The Maine state legislature approved a small-business bank charter, with the institutions termed merchant banks. These merchant banks, considered nonbanks, will not accept deposits nor be regulated by federal bank regulatory agencies. *AB, 4/21/97.*

On June 5, Maine's legislature created a new charter for financial institutions in the state. All new charters issued in Maine will be universal banks, with all institutions granted the same powers. Prior restrictions applicable to savings banks and thrifts have been eliminated. State-chartered banks, savings banks, and thrifts became universal banks and will share powers that were previously unique to each charter. *AB, 6/11/97 and BBR, 6/16/97, p. 1,147.*

Mississippi

On March 10, 1997, the Governor of Mississippi signed legislation that clarifies that state-chartered banks have insurance powers equal to those of national banks. *BBR, 3/31/97, p. 611.*

Montana

The Montana legislature has voted to opt out of the Riegle-Neal interstate branching law. The newly signed state law will forbid interstate branching until September 30, 2001. The state will allow statewide branching for the first time; previously, banks could only branch within their home county and adjoining counties. Montana and Texas are the only two states to opt out of interstate branching. *AB, 4/8/97.*

New Hampshire

New Hampshire state banks will be able to sell insurance in communities with 5,000 or fewer residents beginning in 1998. The state insurance commissioner will regulate the sale of insurance by financial institutions. The law requires that banks keep banking and insurance activities separate. *BBR, 7/7/97, p. 26.*

Pennsylvania

Pennsylvania's Governor signed legislation allowing state banks to sell insurance. The new law was passed without any restrictions on where state-chartered banks may sell insurance. The law does prohibit the receiving of a loan based on the borrower purchasing insurance from the same bank. *AB, 6/30/97.*

Utah

Utah's Governor signed legislation ending a ten-year freeze on the issuance of industrial loan company charters. Industrial loan companies will be permitted to make loans and are FDIC-insured. The new law allows companies to enter the banking business without the Federal Reserve Board supervision required for bank holding companies. The industrial loan charter will allow similar powers to those of a national bank except for checking services. *AB, 4/3/97.*

Wyoming

The Wyoming legislature has voted to opt in to the Riegle-Neal interstate branching law. The interstate banking bill will allow interstate branch banking and bank mergers in the state. The Governor is expected to sign the legislation later this year. *BBR, 2/24/97, p. 365.*

BANK AND THRIFT PERFORMANCE

1996 Results

Commercial banks' full-year earnings were $52.4 billion in 1996, setting a new record. This was an increase of $3.6 billion (7.5 percent) over 1995. Commercial banks' full-year return on average assets (ROA) rose to 1.19 percent, up from 1.17 percent in 1995. This is the second-highest annual ROA reported by the industry, after the 1.2 percent registered in 1993.

Approximately $13.7 billion in net earnings was reported for the fourth quarter of 1996. This represented the third-highest quarterly net income ever reported. Approximately 60 percent of insured banks reported earnings gains for 1996, and more than two-thirds of all banks reported full-year ROAs of 1 percent or higher. Noninterest income contributed heavily to the record level of earnings in the fourth quarter, which was 13.3 percent higher than in the fourth quarter of 1995. The number of problem banks dropped to 82 in 1996, down from 144 for 1995. The total assets of problem banks declined 71 percent during 1996, falling to $5 billion.

Profits earned by FDIC-insured savings institutions reached $2.2 billion in the fourth quarter, for an average annualized ROA of 0.85 percent. Net interest margins held relatively steady in the fourth quarter, rising to 3.24 percent from 3.22 percent in the third quarter. The number of problem savings institutions fell to 35 in 1996, down from 49 in 1995. The assets of problem savings institutions fell 50 percent, to $7 billion in 1996. *FDIC Quarterly Banking Profile, Fourth Quarter 1996; PR-16-97, FDIC, 3/13/97.*

First-Quarter Results for 1997

Commercial banks' average return on assets—the industry's performance barometer—was 1.26 percent in the first quarter. It was the 17th consecutive quarter that the industry's ROA exceeded one percent and the fourth-highest ever reported. Insured commercial banks earned a record $14.5 billion in the first quarter. Earnings were fueled by strong growth in interest-earning assets and continued increases in noninterest income. The number of problem banks dropped to 77, down from 82 in 1996. There were no bank failures in the first quarter of 1997.

Profits earned at FDIC-insured savings institutions were $2.4 billion in the first quarter, for an average annualized ROA of 0.96 percent. This represents a decline in earnings of $136 million from the same period last year. The number of problem savings institutions remained unchanged from year-end, at 35. The total assets of problem savings institutions declined to $5.3 billion from $7.0 billion. *FDIC Quarterly Banking Profile, First Quarter, 1997; PR-42-97, FDIC, 6/17/97.*

Second-Quarter Results for 1997

Commercial banks' average return on assets (ROA) was 1.25 percent in the second quarter, up from 1.18 percent in the first half of 1996. This is the 18th consecutive quarter that the industry's ROA exceeded 1 percent. Insured commercial banks earned a record $14.6 billion in the second quarter—a $154 million improvement over the record the industry set in the first quarter. Earnings were fueled by a surge in commercial and industrial lending. The profitability of credit-card lenders—74 institutions where credit-card loans are more than half of their total loans—has significantly eroded over the past three years. Almost half of these institutions reported declining income in the second quarter, with 14 credit-card banks losing money in the quarter. This drop in profitability is because of a rise in charge-offs, with credit-card charge-offs accounting for two-thirds of all loan charge-offs reported by commercial banks during the second quarter. The number of problem banks dropped to 74, down from 82 in 1966. There were no bank failures in the first half of 1997.

Profits earned at FDIC-insured savings institutions reached $2.4 billion in the second quarter, for an average annualized ROA of 0.95 percent. The number of problem savings institutions fell to 29 at midyear from 35 institutions at the end of the first quarter. Assets of problem savings institutions declined to $2.8 billion. *FDIC Quarterly Banking Profile, Second Quarter, 1997.*

RECENT ARTICLES AND STUDIES

The U.S. General Accounting Office (GAO) released a study on January 6, 1997, titled, "Japanese Bank Regulatory Structure." *AB, 1/8/97.*

A Federal Reserve Board study finds that nonbanks are making gains against traditional consumer lending institutions. The study found that finance and other loan companies are growing faster than traditional sources of consumer lending. The study was published in the January 1997 issue of the *Federal Reserve Bulletin*. *AB, 1/16/97.*

On March 26, 1997, the GAO released a report titled, "Material Loss of Oversight Information From Interstate Banking Is Unlikely." The report concludes that interstate branching is unlikely to result in a material loss of information needed for regulatory oversight and modification of regulatory reporting requirements is not necessary. *GAO/GGD-97-49, March 1997.*

The Federal Reserve Bank of Boston published a study on bank consolidation with regard to borrower concentration limits. The study, "Have Borrower Concentration Limits Encouraged Bank Consolidation?", reviews motivations for bank mergers and their regional patterns. *FRB of Boston, New England Economic Review, January/February 1997.*

The GAO issued a report on March 27, 1997, warning of the risks associated with mergers between banks and nonfinancial firms. The GAO report predicted few benefits from combining banking and commerce. *AB, 3/31/97, p. 459.*

The Federal Reserve Bank of New York released a report detailing information that increased household debt tends to signal increased consumer spending. The more common thought is that spending will drop as debt increases. *BBR, 3/10/97, p. 459.*

The Federal Reserve Bank of St. Louis released a study finding that the new policy of immediately disclosing Federal Open Market Committee decisions has been beneficial. The study found that the concerns about an announcement effect and increased financial market volatility were unwarranted. *WSJ, 5/2/97.*

The Federal Reserve Bank of St. Louis and the University of Missouri produced a report titled, "Do Markets and Regulators View Bank Risk Similarly?". The conclusion of the research was that market forces are not a substitute for government regulation of banks, because regulators and investors view risk differently and regulators require adequate capital to guard against bank failure. *AB, 5/9/97.*

The Federal Reserve Bank of Cleveland has concluded that the central bank can increase consumer spending in the short term but is unable to increase real economic growth. The report is titled, "Monetary Policy and Real Economic Growth." *AB, 6/31/97.*

The Congressional Budget Office released a study claiming that a separate thrift industry is no longer needed because of the fact that home mortgage loans are readily available to the public. The large secondary market for mortgage debt is a significant reason for the CBO's finding. *BRR, 6/23/97, p. 1,181.*

The Office of the Comptroller of the Currency published a study stating that deposit insurance does not give banks a significant subsidy. The study claims that the net insurance-related subsidy enjoyed by a bank is minimal and may be negative. The study entitled, "The Competitive Implications of Safety Net-Related Subsidies," is available from the OCC. *AB, 7/11/97.*

Support Group for Modern Banking

A new banking group entitled the Support Group for Modern Banking was formed in March. The managing trustee, Carter Golembe, stated the purpose of the group is dedicated to preserving recent gains and expanding the national bank franchise. Eighteen industry leaders are the founding members with the goal of participating in litigation, filing comment letters, and writing policy papers; lobbying is not planned. *AB, 3/31/97.*

INTERNATIONAL DEVELOPMENTS

Basle Committee

The Basle Committee on Banking Supervision has issued a 12-point list of principles to improve bank management of interest-rate risk. The list, which was issued on January 21, 1997, also eliminated the effort to incorporate a capital charge for interest-rate risk into its bank risk-based capital rules. Overall, the principles state that banks need a risk management process that identifies and monitors interest-rate risk. *BBR, 1/27/97, pp. 177-78.*

Canada

The Canadian government announced on February 14, 1997, that foreign banks will be allowed to operate in Canada directly through branches. Presently, foreign banks operate through subsidiaries, meeting costly capital and regulatory requirements. The United States has long favored this change. Canada expects this decision will encourage new banks to enter the Canadian market and to improve the competitive environment for foreign banks. Legislation to enact this change in bank policy will occur later in 1997. *WSJ, 2/18/97.*

China

China is preparing to permit more foreign investment in the country's insurance and banking sector. China has indicated a readiness to allow more foreign investment but has not established a time-line for relaxing the current limitations. *BBR, 3/1/7/97, pp. 527-28.*

England

The British government announced in May that the Bank of England will exercise its monetary policy responsibilities independent of the Treasury and that the Bank's supervisory powers will be transferred to the Securities and Investments Board. The Securities and Investments Board is an umbrella organization that oversees a variety of other regulators. British authorities based the removal of bank supervision on the fact that the distinctions between banking, securities firms, and insurance companies are no longer clear. *The Financial Times, 5/21/97, p. 1.*

Japan

Japan has agreed to lift its ban on the formation of holding companies, beginning January 1998. However, the formation of holding companies will not be allowed if it leads to an excessive concentration of business power. A holding company exceeding $125 billion in assets will be subject to close government examination. The Japan Fair Trade Commission is expected to issue effective cease-and-desist measures for violations. *BBR, 3/3/97, p. 426.*

Japanese consumers are placing substantial funds in foreign-currency deposits and other products sold by foreign banks in Japan. Low interest rates and bad-debt troubles are two contributing factors. Two years ago, foreign banks' share of foreign-currency deposits equaled 5 percent; today, it is 15 percent. *BBR, 9/8/97, p. 382.*

Bank of International Settlements Quarterly Report

The 1997 first-quarter report of the Bank of International Settlements (BIS) stated that the international banking market remained healthy but there is cause for concern. The area of concern is the large cross-border investment flows because of interest-rate differentials. The BIS recommended tighter rules for credit risks and the need to strengthen international risk-control systems. Also of concern is the establishment of the European Monetary Union. *BBR, 6/2/97, p. 1,056.*

Romania

Romania has legalized the privatization of state banks. The measure was signed on May 19, 1997. The government of Romania is scheduled to sell five state banks this year. The state-owned banks will be marketed to local or foreign investors through capital increases, share auctions, or both. *BRR, 6/2/97, p. 1,060.*

Russia

The Russian Central Bank has developed new restrictions for foreign banks operating in Russia. The restrictions include the doubling of capital and the adding of more Russian citizens as employees. The rules became effective May 15, 1997. *BBR, 5/19/97, p. 973.*