

Recent Developments Affecting Depository Institutions

by Lynne Montgomery*

REGULATORY AGENCY ACTIONS

Interagency Actions

Gramm-Leach-Bliley Financial Services Modernization Act

On November 12, 1999, President Clinton signed into law a bill allowing banking, insurance, and securities firms to affiliate, and creating rules aimed at protecting consumers and low-income communities. The Gramm-Leach-Bliley Act is the result of approximately two decades of effort to repeal the anti-affiliation provisions of the 1933 Glass-Steagall Act and the 1956 Bank Holding Company Act. In general, the Gramm-Leach-Bliley Act: lifts restrictions on affiliations among banks, securities firms, and insurance companies; expands the financial activities permissible for financial holding companies and insured depository institutions; and provides for a greater degree of functional regulation of securities and insurance activities conducted by banking organizations. The Act will also expand the reach of the Community Reinvestment Act (CRA) by requiring banks to have at least "satisfactory" CRA ratings to take advantage of the new law's expanded powers. In addition, the Act takes significant steps to protect consumers' financial privacy, such as requiring financial institutions to disclose their privacy policies and allowing consumers to block their financial institutions from sharing personal financial information with third parties. The Act also directs the Treasury Department to study the financial-services industry's privacy practices and recommend further legislative

steps. The Act becomes effective on March 11, 2000. *BBR*, 11/15/99, p. 765-766.

Independent Audits for Small Banks and Thrifts

On September 28, 1999, the Federal Financial Institutions Examination Council (FFIEC) issued an interagency policy statement on external auditing programs of banks and savings associations. The policy statement recommends, but does not require, that banks and thrifts with assets under \$500 million undergo external audits annually. The FFIEC noted that approximately 65 percent of smaller institutions already undergo external audits. The policy statement is aimed at smaller institutions because larger institutions are already required to undergo annual audits by independent certified public accountants. The policy statement is effective for fiscal years beginning on or after January 1, 2000.

The FFIEC is made up of representatives of the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Reserve Board, and the Federal Deposit Insurance Corporation (FDIC). The National Credit Union Administration is also a member of the group, but does not plan to adopt the policy at this time. *BBR*, 10/4/99, p. 518-519.

*Lynne Montgomery is a senior financial analyst in the FDIC's Division of Research and Statistics.

Reference sources: *American Banker* (AB) and *BNA's Banking Report* (BBR).

Extended Exam Cycle for Foreign Banks

On October 22, 1999, the Federal Reserve Board, the OCC, and the FDIC adopted a final rule to expand the examination frequency cycle for certain U.S. branches and agencies of foreign banks. The rule finalizes an interim rule, which was effective August 28, 1998, that made healthy, smaller U.S. branches and agencies of foreign banks eligible for exams every 18 months, instead of every 12 months. U.S. banks were given the opportunity to have exams every 18 months in a 1991 law, but foreign banks were not afforded the same treatment at that time. The extended exam cycle applies to U.S. branches or agencies of a foreign bank that have total assets of \$250 million or less and have received a supervisory ROCA rating of 1 or 2. (ROCA stands for risk management, operational controls, compliance, and asset quality.) In addition, the foreign bank branch or agency must meet certain specified capital requirements and must not be subject to any formal enforcement action by U.S. regulators. *PR-FRB, 10/21/99; BBR, 10/25/99, p. 649.*

Web Site Privacy Survey

On November 9, 1999, the Federal Reserve Board, the OCC, the FDIC, and the OTS released a report on the results of a survey of Internet privacy policies of banking and thrift institutions. The survey examined 314 randomly selected Web sites of financial institutions, plus the Web sites of the 50 largest banks and thrifts. The agencies conducted the survey between May and July 1999, examining the Web sites' collection of consumer information, interactive capabilities, and privacy disclosures. The purpose of the survey was to provide an indication of the state of the industry with respect to data collection and on-line privacy disclosures. The survey results were published in the *Interagency Financial Institution Web Site Privacy Survey Report*.

Overall, 48 percent of the 364 Web sites surveyed posted a privacy disclosure, in the form of either a privacy policy or an information practice statement. Sites that collected personal information were three times as likely to post a privacy policy than sites that did not collect personal information. The survey also found that 96 percent of the nation's 50 largest banks and thrifts that are on-line provided a privacy policy or information practice statement. The agencies

define a privacy policy as "a comprehensive statement regarding the collection and use of consumer information," and an information practice statement is "a statement describing a particular information handling practice, such as data security." *PR-66-99, FDIC, 11/9/99; BBR, 11/15/99, p. 774.*

Guidance on Asset Securitization Activities

The four federal banking agencies released guidance on December 13, 1999, reminding financial institutions of basic risk-management practices that should be in place at institutions engaging in securitization activities. The agencies said that recent examinations have shown "significant weaknesses" in the asset securitization activities at certain financial institutions, and they noted that such weaknesses raise concerns about the basic level of understanding and controls at financial institutions that engage in securitization activities. The guidance highlights the risks associated with retained interests in securitizations, and points out that reported values for retained interests should be reasonable, conservative and supported by objective and verifiable documentation. The guidance states that institutions should ensure that sufficient capital is held to support the risks associated with securitization activities, and the institutions are expected to place concentration limits on retained interests relative to equity capital. In addition, the guidance states that institutions should establish and implement an adequate and independent audit function to oversee securitization activities effectively. The guidance, which was issued by the FDIC, the Federal Reserve Board, the OCC, and the OTS, is part of the agencies' ongoing review of securitization activities at insured depository institutions. *PR-80-99, FDIC, 12/13/99; BBR, 12/20/99, p. 983.*

Federal Deposit Insurance Corporation

Chairman Tanoue Renominated

On January 31, 2000, President Clinton renominated FDIC Chairman Donna Tanoue to a new six-year term. Ms. Tanoue, who joined the FDIC as Chairman on May 26, 1998, is currently finishing the term of former FDIC Chairman Ricki Helfer. Her term was set to expire on October 3, 2000. *BBR, 2/7/00, p. 243.*

Houseworth Nominated to Board of Directors

President Clinton nominated Richard H. Houseworth to the FDIC Board of Directors on January 31, 2000. Mr. Houseworth is the Superintendent of Banks for the State of Arizona. He has served as the U.S. Alternate Executive Director of the Inter-American Development Bank and as both a consultant to the Assistant Secretary of the Treasury for International Affairs and as the Director of the Export-Import Bank of the United States. *Bloomberg News, 1/31/00.*

Assessment Rates Maintained

The FDIC Board of Directors voted on November 8, 1999, to maintain the existing insurance assessment rate schedules for both the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF) through June 2000. Since the FDIC applies a risk-based assessment system for insurance coverage, the healthiest institutions currently pay nothing for insurance and the weakest institutions pay up to 27 cents per \$100 of insured deposits. Federal law requires the FDIC to maintain a minimum reserve ratio of 1.25 percent, or \$1.25 for every \$100 of insured deposits, in the BIF and the SAIF to cover the costs of bank and thrift failures. As of June 30, 1999, the BIF reserve ratio was 1.40 percent and the SAIF ratio was 1.29 percent. *BBR, 11/15/99, p. 771-772.*

Municipal Securities Rule Rescinded

Effective December 19, 1999, the FDIC rescinded an agency regulation that requires insured state nonmember banks that are municipal securities dealers to file with the FDIC certain information about potential municipal securities principals. The FDIC says the regulation is unnecessary and duplicative, and the number of entities covered by the regulation is declining. The OCC and the Federal Reserve Board have already rescinded their regulations on this subject; thus, the FDIC's rescission maintains uniformity among the banking agencies. *BBR, 11/22/99, p. 822-823.*

Report on Underwriting Practices

The October 1999 issue of the *Report on Underwriting Practices* reported no significant change in overall loan underwriting practices at FDIC-supervised banks during the six months ending September 30, 1999, compared to the previous six-month period

ending March 31, 1999. However, the FDIC examiners reported increased concerns about the level of "carryover debt" at FDIC-supervised banks actively making agricultural loans. Carryover debt refers to loans that are not paid off at the end of the growing season and are subsequently carried over into the next growing season. The survey of loan 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. The October report includes surveys from 1,227 FDIC-supervised banks that were examined during the six months ending September 30, 1999. *Report on Underwriting Practices, FDIC, October 1999.*

Real-Estate Survey—October 1999

The October 1999 issue of the *Survey of Real Estate Trends* reported that the nation's commercial and residential real-estate markets continued to show improvement in the late summer and early fall, but at a slower pace than before. The quarterly survey polled 297 senior examiners and asset managers from the FDIC, the Federal Reserve System, the OCC, and the OTS. Reports about residential real-estate-market activity were notably less positive than in recent surveys; however, assessments of improvements in residential markets continued to outweigh reports of worsening market activity. Specifically, 31 percent of the survey respondents described the general direction of their local housing market as better in October than three months earlier, compared to 45 percent in July. Reports of weaker housing markets increased from 3 percent in July to 10 percent in October. As for commercial market trends, 33 percent of the respondents in October noted better conditions in local markets, down slightly from 35 percent in July.

The national composite index used by the FDIC to summarize results for both residential and commercial real-estate markets was 62, down from 69 in July. Index scores above 50 indicate improving conditions, while index scores below 50 indicate declining conditions. Beginning in 2000, the FDIC will conduct a substantially revised and expanded semi-annual survey, covering the periods January to June and July to December. As a result, the next FDIC

published real-estate report is expected to be available in August 2000. *Survey of Real Estate Trends, FDIC, October 1999.*

Financial Results for Third-Quarter 1999

The FDIC reported that the Savings Association Insurance Fund (SAIF) earned income of approximately \$365 million for the first nine months of 1999; however, the Bank Insurance Fund (BIF) experienced a comprehensive loss (net loss plus unrealized loss on available-for-sale securities) of \$113 million for the first nine months of 1999. At September 30, 1999, the BIF balance was approximately \$29.5 billion, down from \$29.6 billion at year-end 1998. The decrease in the fund balance was primarily attributable to recognizing estimated losses of \$917 million for the resolution of bank failures in 1999 and the prior year. The BIF revenues totaled \$1.4 billion for the first nine months of 1999, including \$1.3 billion in interest on investments in U.S. Treasury obligations and \$25 million in deposit insurance assessments. The SAIF closed the quarter with an unrestricted fund balance of \$9.2 billion and \$978 million in the restricted SAIF Special Reserve. The Special Reserve was established on January 1, 1999, and contains the amount by which the SAIF exceeds the Designated Reserve Ratio of 1.25 percent. However, the Gramm-Leach-Bliley Act of 1999 eliminated the SAIF Special Reserve upon enactment on November 12, 1999, so the SAIF's total fund balance is now unrestricted. The SAIF earned \$442 million in revenue during the first nine months of 1999, consisting of \$432 million in interest on investments in U.S. Treasury obligations and \$10 million in deposit insurance assessments.

The FSLIC Resolution Fund (FRF) returned \$3.7 billion in appropriated funds to the U.S. Treasury in the third quarter, pursuant to the RTC Completion Act. The Act required the FDIC to return any funds that were transferred to the Resolution Trust Corporation (RTC) pursuant to the Act but not needed to satisfy obligations of the RTC. FRF assets in liquidation were reduced to \$592 million on September 30, 1999. The FRF was established in 1989 to assume the remaining assets and obligations of the former Federal Savings and Loan Insurance Corporation (FSLIC). On January 1, 1996, the former Resolution Trust Corporation's financial operations were merged into the FRF. *PR-81-99, FDIC, 12/14/99.*

Bank Failures

On November 19, 1999, the California Superintendent of Banks closed Pacific Thrift and Loan Company, Woodland Hills, California, and the FDIC was named receiver. Pacific Thrift and Loan had total assets of approximately \$118 million and total deposits of \$108 million in roughly 2,600 accounts. Affinity Bank, Ventura, California, paid a premium of \$350,000 to assume the failed institution's \$106 million of insured deposits and to purchase approximately \$13 million of the assets. The FDIC will retain the remaining assets for later disposition. The FDIC estimates that this transaction will cost the Bank Insurance Fund (BIF) approximately \$50 million. Pacific Thrift and Loan was the sixth failure of a BIF-insured institution in 1999.

On December 10, 1999, the New York Superintendent of Banks closed Golden City Commercial Bank, New York, New York, and the FDIC was named receiver. Golden City was a state-chartered bank with total assets of approximately \$89 million and total deposits of \$82 million. Cathay Bank, Los Angeles, California, paid the FDIC a premium of \$2.7 million to assume all the deposits and purchase approximately \$85 million of the failed bank's assets. This was the seventh failure of a BIF-insured institution in 1999; however, the FDIC anticipates that this will be a no-cost transaction for the BIF.

The Iowa Superintendent of Banking closed Hartford-Carlisle Savings Bank, Carlisle, Iowa, on January 14, 2000, and the FDIC was named receiver. Hartford-Carlisle had approximately \$114 million in assets and total deposits of \$69 million in approximately 7,700 accounts. The FDIC approved the assumption of the insured deposits of Hartford-Carlisle by Citizens Bank, Carlisle, Iowa. Citizens Bank, a newly chartered subsidiary of Spectrum Bancorp, Omaha, Nebraska, paid a premium of \$5.5 million to assume the insured deposits and to purchase approximately \$4 million of the failed institution's assets. The FDIC will retain the remaining assets for later disposition. The FDIC has identified apparent fraud at the failed bank and estimates that the losses at the bank will range between \$18 million and \$25 million. Hartford-Carlisle is the first failure of a BIF-insured bank in 2000. *PR-71-99, FDIC, 11/22/99; PR-79-99, FDIC, 12/10/99; PR-4-2000, FDIC, 1/14/00.*

Federal Reserve Board

Greenspan Confirmed for Fourth Term

On February 3, 2000, the U.S. Senate voted to confirm Alan Greenspan to serve a fourth, four-year term as chairman of the Federal Reserve Board. Mr. Greenspan's current term was due to expire on June 20, 2000. He was first appointed by President Reagan and took office as chairman on August 11, 1987. President Bush named Mr. Greenspan to a second term in 1991, and President Clinton tapped him for his third term in February 1996. *BBR*, 1/13/00, p. 59; *BBR*, 2/7/00, p. 243–244.

Senate Confirms Vice Chairman

On September 30, 1999, the Senate confirmed the nomination of Roger W. Ferguson as vice chairman of the Board of Governors of the Federal Reserve System. Mr. Ferguson has been a member of the Board of Governors since November 1997. In August 1999, President Clinton nominated Mr. Ferguson to fill the vice-chairman seat, which is a four-year appointment. Mr. Ferguson replaces Alice Rivlin, who left the Federal Reserve Board in mid-summer 1999. *BBR*, 10/4/99, p. 517.

Interest Rates

On November 16, 1999, the Federal Open Market Committee (FOMC) voted to raise the targeted federal funds rate by 25 basis points, increasing the rate from 5.25 percent to 5.50 percent. In a related action, the Board of Governors approved a 25-basis-point increase in the discount rate, raising the rate from 4.75 percent to 5.0 percent. The FOMC raised the federal funds rate an additional 25 basis points on February 2, 2000, increasing the rate to 5.75 percent. The Board of Governors also approved a 25-basis-point increase in the discount rate, raising the rate to 5.25 percent. The federal funds rate is the fee that banks charge each other for overnight loans, and the discount rate is the fee charged to financial institutions for borrowing from their district Federal Reserve Banks. *PR-FRB*, 11/16/99; *PR-FRB*, 2/2/00.

New Communications Procedures for Federal Open Market Committee

The Federal Open Market Committee announced on January 19, 2000, that it approved modifications to its disclosure procedures in an effort to enhance communication to the public. The FOMC determined

that a statement would be issued to the public immediately after every FOMC meeting. The previous procedure was to release a statement only in the event of a policy action or a major shift in the Committee's view about prospective developments. The FOMC also changed its language describing its assessment of future developments. The prior procedure was to describe the FOMC's view about the period ahead in terms of the relative chances of an increase or decrease in the intended federal funds rate. Under the new procedures, an announcement will indicate how the Committee assesses the risks of heightened inflation pressures or economic weakness in the foreseeable future. The modifications take effect as of the February 2000 FOMC meeting. *PR-FRB*, 1/19/00.

Regulation CC

The Federal Reserve Board adopted a final rule amending Regulation CC, Availability of Funds and Collection of Checks, in order to give banks the option to experiment with nontraditional ways to return unpaid checks, such as by electronic means. However, using an electronic image for check presentation will be optional and by agreement for those institutions that want to participate. Institutions will not be required to enter into such an agreement involving electronic check processing. The final rule was effective December 15, 1999. *PR-FRB*, 10/28/99; *BBR*, 11/8/99, p. 727.

HMDA Reporting Exemption Threshold Increased

The Federal Reserve Board announced on December 15, 1999, that the exemption threshold for depository institutions that are required to report data under the Home Mortgage Disclosure Act (HMDA) was increased from \$29 million to \$30 million. Beginning December 31, 1999, depository institutions with assets of \$30 million or less will be exempt from reporting data on their housing-related lending activities in 2000. The final rule amends Regulation C, which implements the Home Mortgage Disclosure Act. The asset level that releases institutions from reporting data under HMDA is adjusted each year on the basis of changes in inflation as measured by the Consumer Price Index for Urban Wage Earners and Clerical Workers. *PR-FRB*, 12/15/99; *BBR*, 1/3/00, p. 10.

Interim Rule for Bank Holding Companies and Foreign Banks with U.S. Offices

On January 19, 2000, the Federal Reserve Board approved an interim rule setting forth procedures for bank holding companies and foreign banks with U.S. offices to elect to be treated as financial holding companies. Financial holding companies may engage in a broad range of securities, insurance, and other financial activities under Title I of the Gramm-Leach-Bliley Act. The rule becomes effective on March 11, 2000, which is also the effective date of the Gramm-Leach-Bliley Act. *PR-FRB, 1/19/00.*

Office of the Comptroller of the Currency

Hawke Confirmed by Senate

On October 7, 1999, the Senate confirmed John D. Hawke, Jr. for a five-year term as Comptroller of the Currency. Mr. Hawke has held this office since December 8, 1998, after being appointed by President Clinton during a Congressional recess. *NR 99-92, OCC, 10/8/99.*

1999 Survey of Credit Underwriting Practices

In its 1999 Survey of Credit Underwriting Practices, which was released in September 1999, the OCC reported that national banks tightened their underwriting standards for commercial loans in 1999 for the first time in the past five years. The survey covered the period between March 31, 1998, and March 31, 1999. The OCC looked at the 67 largest domestic banks with assets of over \$2 billion. The aggregate loan portfolio of the banks in the survey was \$1.8 trillion as of December 31, 1998, which represents 90 percent of all outstanding loans at U.S. banks. Examiners at 25 percent of the banks surveyed reported tightened underwriting standards for commercial loans in 1999, compared with 4 percent in 1998. At the same time, examiners at 13 percent of the surveyed banks reported an easing of underwriting standards in 1999, compared to 44 percent in 1998. Additionally, the survey found that international loans, syndicated and national loans, and agricultural loans experienced the most pronounced tightening in underwriting standards, while commercial real-estate and middle market credits experienced the most easing of underwriting standards. Despite the reported tightening of standards, exam-

iners reported that the level of inherent portfolio credit risk continued to increase for all of the surveyed commercial and retail products. This embedded risk is the result of banks taking on higher levels of risk in previous years, which will take time to work its way through the loan portfolios. *BBR, 10/4/99, p. 513-514.*

New Handbook on Internet Banking

The OCC issued a new handbook on October 14, 1999, outlining procedures for examining Internet banking activities at national banks. The handbook, which is part of the Comptroller's Handbook for National Bank Examiners, is the most comprehensive document on Internet banking issued by the OCC to date. The handbook outlines risks unique to Internet banking. For example, the handbook notes that Internet loan customers can be anywhere in the world which creates special challenges in authenticating identities, an important element in making sound credit decisions. In addition, Internet banking customers react quickly to changing market conditions and could create deposit volatility for banks. The handbook emphasizes that interest-rate and liquidity risk can exist with Internet customers, which might require increased monitoring of liquidity. Additional issues addressed in the handbook are: customer privacy, the anonymity of banking over the Internet, and the threat from intruders into bank systems. *NR 99-94, OCC, 10/14/99.*

Final Rules Reduce Regulatory Burden on Community Banks

On November 4, 1999, the OCC adopted final rules that will reduce the regulatory burden on community banks. One change to Part 7 of the OCC's regulations allows banks to buy back their own stock more easily and to pay cash for the acquired shares. This increased flexibility will make it easier for community banks to meet Subchapter S status, which permits smaller corporations (those with fewer than 75 shareholders) to avoid paying corporate taxes. Another Part 7 rule change increases the number of ways bank directors can hold required stock interests, called "qualifying shares," in the bank they serve. Directors may now acquire qualifying shares under an agreement that would give the seller the right to repurchase the shares if the director ceases to serve on the board or seeks to transfer ownership to another. This change is designed to improve the ability of

national banks to attract qualified directors. The final rules also state that, because automated teller machines and other remote service units are excluded from the definition of a branch under federal law, they are not subject to state geographic restrictions, operational restrictions, or licensing laws. Further, the rules clarify that a facility that combines non-branch functions of a loan production office, deposit production office, and remote service unit is not a branch. The final rules also clarify the scope of the OCC's "visitorial" powers over national banks. This authority applies in the case of an examination of a bank, inspections of a bank's books or records, regulation and supervision of activities permitted under federal banking law, and enforcement of compliance with any applicable federal or state laws on such activities. *NR 99-99, OCC, 11/3/99; BBR, 11/8/99, p. 726.*

Information-Sharing Accord

The OCC and insurance regulators in Illinois, Iowa, Mississippi, and Washington, D.C., have reached agreements to share information when consumers complain about bank insurance sales. The agreements are part of an ongoing effort to improve relations between the OCC and state insurance regulators. The agreements call for the OCC and the insurance departments to send copies of complaints to each other and also to communicate on other matters, including regulatory and policy initiatives. The OCC now has agreements with 23 state insurance regulators. The agreements enhance consumer protection and ensure compliance with appropriate insurance sales standards. *BBR, 1/3/00, p. 9.*

Office of Thrift Supervision

New Guidance on Directors' Responsibilities

On October 21, 1999, the OTS unveiled a new agency document that is aimed at providing more guidance to directors of thrifts. The new guide, "Directors' Responsibilities Guide," covers such topics as selecting and retaining competent management, establishing a thrift's objectives and strategies, establishing policies and procedures to achieve those objectives, identifying and understanding associated risks, monitoring and assessing the progress of operations, and ensuring the institution's compliance with laws and regulations. The new guide, which is more comprehensive than the first guide issued by the

OTS in 1989, was prompted by the high turnover among thrift directors because of mergers, new institutions, and retirements.

The OTS issued a second document, "Directors' Guide to Management Reports," which explains various management reports commonly used by thrifts. This guide is also intended to help directors in exercising their oversight duties and responsibilities. *OTS 99-71, 10/21/99; BBR, 10/25/99, p. 660.*

New Compliance Guide and Handbook

In December 1999, the OTS issued an updated guide that is designed to help institutions identify and understand the primary regulatory requirements and evaluate the effectiveness of their compliance programs. "Compliance: A Self-Assessment Guide" was first published in 1988 and revised once before this current revision. The guide emphasizes that a successful compliance operation requires the commitment of the institution's directors and active involvement of senior management. Accompanying that commitment must be effective and comprehensive policies and procedures, including suitable internal review mechanisms. The guide serves as an internal reference source for managers, compliance officers and others whose duties include compliance matters. *OTS 99-92, 12/20/99.*

In January 2000, the OTS also issued an updated compliance handbook that includes new interagency fair lending examination procedures which were developed by the Federal Financial Institutions Examination Council and implemented by the OTS. The fair lending procedures in the handbook provide extensive and detailed guidance for evaluating fair lending and compliance using a risk-focused approach. The handbook, entitled the *Compliance Activities Handbook*, also contains a section on electronic banking, providing additional guidance on agency guidelines and policies regarding the use of electronic technologies and innovative product delivery systems while maintaining compliance with consumer protection obligations. *BBR, 1/24/00, p. 156.*

Federal Housing Finance Board

Expanded Authority for Mortgage Asset Programs

On October 4, 1999, the Federal Housing Finance Board approved a resolution allowing the 12 Federal

Home Loan Banks to offer single-family Member Mortgage Asset programs, such as the Mortgage Partnership Finance program, which allow for risk-splitting between the FHLBank and the member bank originating the mortgage loan. The Mortgage Partnership Finance program (MPF), which started as a pilot program at the Chicago FHLBank in July 1997, allows FHLBank members to sell mortgage loans they originate to a FHLBank rather than to Fannie Mae or Freddie Mac, thus avoiding the guarantee fees paid to Fannie Mae and Freddie Mac. The FHLBank can then sell participation interests in the program to other FHLBanks. The new resolution allows for an additional risk-sharing structure for the existing MPF program. The resolution also allows for a new program, the Mortgage Partnership Purchase program (MPP), which was recently proposed by the FHLBanks of Cincinnati, Indianapolis, and Seattle. Under the MPP program, the FHLBanks can purchase fixed-rate, single-family mortgages from member financial institutions, subject to the establishment of a credit risk-sharing account to transfer some of the credit risk. Through the process, the member would provide further credit enhancements for the mortgage loans by providing supplemental mortgage insurance. Thrift industry groups have raised competition-related concerns over these mortgage asset programs. Several groups sued the Finance Board in 1997, claiming the Board had exceeded its authority in allowing the MPF program and that the Chicago FHLBank was going into direct mortgage lending by starting up the program. However, the U.S. Court of Appeals for the Fifth Circuit rejected the legal challenge on January 20, 2000. *BBR, 10/11/99, p. 576-577; BBR, 1/24/00, p. 159-160.*

New Rule Gives FHLBanks More Authority

On December 14, 1999, the Federal Housing Finance Board voted to adopt and issue for comment an interim final rule that implements provisions to

transfer corporate governance responsibilities from the Finance Board to the boards of the Federal Home Loan Banks. Under the new rule, banks will have final approval over: employee selection and compensation; budgets, bylaws, and dividend payments; and forms relating to advances, conditional advances, and transfers of advances and advance participations. Further, the rule sets limits that the law imposes on the compensation of FHLBank directors. Under the budget requirement in the rule, FHLBanks no longer have to submit to the Finance Board budget and financial reports. FHLBanks can also engage in construction transactions without the approval of the Finance Board. *BBR, 12/20/99, p. 1000.*

National Credit Union Administration

Operating Level on Insurance Fund

The Board of Directors of the National Credit Union Administration (NCUA) approved a final rule on October 6, 1999, setting the normal operating level for the National Credit Union Share Insurance Fund (NCUSIF) between 1.2 and 1.5 percent equity level. Credit unions are required to maintain a deposit in the NCUSIF equal to 1 percent of their insured shares at the close of the preceding reporting period. However, the NCUA has the authority to set a normal operating level for the fund, and the agency is required to declare a dividend to credit unions when the available asset ratio exceeds 1 percent and the NCUSIF exceeds the normal operating level. The NCUA Board determined that no insurance premium assessment was necessary for 2000, since projections indicate that the NCUSIF's investment earnings will continue to be adequate to cover all insurance and operating costs while maintaining at least a 1.3 percent equity level. The Board also agreed to return \$88.4 million in dividends to federally insured credit unions, which is the fifth consecutive cash dividend issued by the NCUSIF. *NCUA-PR, 10/6/99; BBR, 10/11/99, p. 578-579.*

STATE LEGISLATION AND REGULATION

California

On November 2, 1999, San Francisco and Santa Monica voters approved a local ordinance that prohibits banks from charging noncustomers extra fees for using automated teller machines. Proposition F prohibits financial institutions from imposing sur-

charges of any kind on a customer for accessing an ATM located within San Francisco. Supporters of the bill accuse banks of "double dipping" by charging noncustomers fees when their home bank already assesses those customers. However, the California Bankers Association filed suit on

November 3, 1999, to block the Proposition, arguing that the ordinance will only affect state-chartered banks. The bankers argued that the National Bank Act, which sets no cap on fees by national banks, overrides local restrictions so that the ordinance is ineffective with respect to national banks. On November 15, 1999, the U.S. District Court for the Northern District of California granted a preliminary injunction preventing San Francisco and Santa Monica from enforcing Proposition F. In addition, the District Court issued another ruling on November 24, 1999, which prevents individual consumers in Santa Monica from using the new ordinance as a basis for a lawsuit against banks that charge the extra fees. *BBR, 11/8/99, p. 752; BBR, 11/15/99, p. 800; BBR, 11/22/99, p. 842; BBR, 12/6/99, p. 926.*

Michigan

On January 5, 2000, Michigan Governor John Engler signed legislation that will overhaul and modernize the Michigan Banking Code. The new Banking Code of 1999 modernizes Michigan's existing banking statute by removing obsolete and conflicting provisions. In addition, the legislation eliminates barriers to the use of technology in bank operations and reduces bureaucracy for both the banks and the state regulator. The law also extends the period between examinations of healthy banks to 18 months, which will reduce the burden on banks and make it easier for the Michigan Financial Institutions Bureau to coordinate supervision with federal agencies. The new law becomes effective on March 1, 2000. *BBR, 1/17/00, p. 101.*

BANK AND THRIFT PERFORMANCE

Third-Quarter 1999 Results for Commercial Banks and Savings Institutions

FDIC-insured commercial banks earned \$19.4 billion during the three months from July through September 1999, which represents the highest quarterly earnings ever reported by the industry. The surge in commercial banks' earnings reflected continued strength in noninterest revenues, especially fee income, as well as a moderation in noninterest expenses. Noninterest income rose to \$36.9 billion, from \$34.5 billion in the second quarter of 1999, and \$29.6 billion one year earlier. Banks' annualized return on assets (ROA) was 1.42 percent in the third quarter, up from 1.25 percent in the second quarter and 1.15 percent a year earlier. The number of problem banks rose from 62 in the second quarter of 1999 to 69 in the third quarter, and there were three bank

failures during the quarter.

FDIC BIF-insured mutual savings institutions reported net income of \$2.8 billion in the third quarter of 1999, which is \$13 million less than in the second quarter. The slight decline in industry earnings was caused by lower gains on sales of securities, which fell to \$276 million in the third quarter from \$445 million in the second quarter. The industry's ROA for the third quarter was 1.00 percent, down from 1.03 percent in the second quarter and 1.14 percent in the third quarter of 1998. The number of problem thrifts declined to 11 thrifts with \$3.9 billion in assets, down from 14 thrifts in the second quarter with \$4.2 billion in assets. There was one thrift failure during the third quarter of 1999, which is the first failure of a thrift institution in almost three years. *The FDIC Quarterly Banking Profile, Third Quarter 1999.*

RECENT ARTICLES AND STUDIES

An article in the October-December 1999 issue of the Atlanta Federal Reserve Bank's Financial Update reports that insurance sales by banks should not have a major effect on the safety and soundness of well-run institutions. Senior economic analyst Michael Padhi argues that, as banks prepare to expand into the insurance market with the recent enactment of the financial modernization law, recent data suggest that insurance sales do not pose a big threat to well-managed bank holding companies.

The study focused on insurance agency subsidiaries of bank holding companies in the Atlanta Federal Reserve District. *BBR, 12/6/99, p. 916-917.*

Timothy J. Yeager, an economist with the Federal Reserve Bank of St. Louis, reports that community banks will continue to play an important role in the marketplace, despite the new challenges and pressures community banks are facing because of the changing U.S. financial marketplace. Community

banks—those banks with less than \$300 million in assets—will play a role in the future banking environment because they provide personal customer service and cater to small businesses. Mr. Yeager's article, "Down, But Not Out: The Future of

Community Banks," appears in the October 1999 issue of the St. Louis Federal Reserve Bank's quarterly publication *The Regional Economist*. *BBR*, 12/13/99, p. 955.

INTERNATIONAL DEVELOPMENTS

Information-Sharing Framework

The OCC, the Board of Governors of the Federal Reserve System, and the European Commission signed a statement of cooperation on September 17, 1999, and agreed upon a common framework to enhance information sharing among international bank supervisors. The framework provides a basis for bilateral cooperative arrangements between U.S. and European Union (EU) supervisors for overseeing banking organizations that have material operations in each other's jurisdiction. The framework addresses three specific areas: sharing of supervisory information and consultation on common supervisory issues; on-site inspections; and confidentiality of shared supervisory information. The framework provides sufficient discretion and flexibility to take into account any factors that are particular to the supervisory authorities and banking organizations involved. Although the statement of cooperation is not a legal document, it provides a basis for subsequent, more detailed bilateral arrangements between U.S. supervisors and the bank supervisors in the EU member states. The statement of cooperation and framework for information sharing do not affect existing bilateral arrangements between the United States and EU member states. *NR 99-88, OCC, 10/1/99.*

China

The United States and China entered into an agreement on November 15, 1999, which would provide foreign financial institutions wider access to China's markets. The deal constitutes a precondition for allowing China to apply for membership in the World Trade Organization (WTO). Foreign banks would be allowed to engage in local-currency transactions with Chinese companies within two years after China joins the WTO, and they would be permitted to handle retail-banking transactions with Chinese consumers within five years. U.S. and other foreign banks would also be allowed to engage in all transactions that Chinese banks currently handle. In addition, all restrictions or limitations on geographic expansion by U.S. and other foreign bank branches

in China would be lifted within five years. Foreign financial institutions would also be able to acquire 33 percent minority stakes in Chinese fund management companies, with an option to increase those positions to 49 percent. The pact also calls for the beginning of talks to allow foreign investment banks to acquire 33 percent stakes in ventures to underwrite domestic securities issues, including debt, equity, and foreign-currency-denominated securities. *AB, 11/17/99.*

Japan

On February 9, 2000, the Japanese government announced the sale of Long-Term Credit Bank of Japan Ltd. (LTCB) to a U.S. investor group led by Ripplewood Holdings. The transaction marks the first-ever sale of a Japanese bank to foreign ownership. To effect the transfer of LTCB to the investor group, the New LTCB Partners, the Japanese government will spend an estimated \$34 billion in taxpayer money for the cleanup of LTCB's delinquent assets. *BBR, 2/14/00, p. 330.*

Mexico

On September 22, 1999, Mexican officials published new rules that would gradually strengthen requirements for bank capitalization and credit classification. The new rules should help bring Mexico's banking regulations in line with international standards. Among the most important changes in the new reforms is the gradual reduction of deferred taxes as basic capital on banks' balance sheets to a maximum of 20 percent of the value of the tax credit. Currently, banks can treat 100 percent of deferred taxes as basic capital on their balance sheets. In addition, the new rules require banks to deduct from basic capital their investments in non-financial companies that are not publicly traded. Those investments in companies that are publicly traded must also be deducted from banks' basic capital, when the investments exceed 15 percent of the capital. The new rules for classification of credit risk would permit financial authorities to evaluate risk for mortgages,

credit cards, and business loans, with additional reserve requirements determined according to risk. Officials of the National Banking and Securities Commission (Comision Nacional Bancaria y de Valores) will later announce the new methodologies

for classifications of credit risk, as well as new accounting criteria, bases for fixed-asset valuation, and the evaluation of deferred tax levels in banks where deferred taxes form a significant part of their basic capital. *BBR, 9/27/99, p. 498-499.*