



Statement

of

Ellen Seidman, Director

Office of Thrift Supervision

concerning

Year 2000 Computer Compliance

before the

Committee on Banking and Financial Services

United States House of Representatives

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Office of Thrift Supervision
Department of the Treasury

1700 G Street N.W.
Washington, D.C. 20552
202-906-6288

**OFFICE OF THRIFT SUPERVISION
YEAR 2000 COMPUTER COMPLIANCE
SUBMISSION FOR THE RECORD
TO THE COMMITTEE ON BANKING
AND FINANCIAL SERVICES**

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Mr. Chairman and Members of the Committee, thank you for the opportunity to submit a statement for the record on the Office of Thrift Supervision's (OTS) Year 2000 computer compliance efforts. The Year 2000 computer problem has received much attention, not only nationally but globally. The problem has the potential for disrupting the business of both the public and private sectors. The OTS is aggressively and affirmatively responding to the challenge of ensuring that the computer operations of thrift institutions and their service providers work as smoothly as possible when the calendar rollover occurs less than 26 months from now. This involves educating the industry about the Year 2000 problem and its solution, and requires the dedication of examination resources. In fact, we have been fostering awareness about Year 2000 problems during our information systems examinations of thrift institutions for some time.

The OTS' supervisory strategy for addressing Year 2000 compliance involves:

1. Enhancing industry awareness of the Year 2000 problem;
2. Expanding the examination process to include Year 2000 review procedures;
3. Providing active supervision to ensure that our regulated institutions make the necessary system changes by year-end 1998; and,
4. Monitoring and testing our overall efforts toward following our plan and fulfilling our responsibilities to protect our insured institutions.

This strategy operates in tandem with initiatives of the Federal Financial Institutions Examination Council ("FFIEC") on Year 2000 compliance.

We are, in general, heartened by the response of most thrift institutions to the problem and to our program. However, since many of our institutions are reliant upon independent service providers, we must ensure we have clear and direct statutory authority to examine and supervise their activities as well. Unlike the other Federal banking regulators, we have authority to examine those service providers only as a required condition of their contracts with institutions we supervise. We believe the risks inherent in this limited authority are unacceptable and have submitted to Chairman Leach proposed legislation that would grant OTS the same authority as other Federal banking regulators. We urge swift passage of this legislation.

Industry Awareness

Our first formal effort to enhance industry awareness about Year 2000 issues began in the summer of 1996 when the OTS, along with the other financial institution regulators represented on the FFIEC, sent the industry a statement alerting it to computer system risks that may arise from the forthcoming calendar rollover to the next century. In addition to explaining the issues and concerns, the statement provides an action plan and guidelines for financial institutions to follow to ensure that computer systems will function properly and without disruption when the Year 2000 arrives. The statement stresses the need for early, careful planning to alleviate what could become significant problems in the future.

In May 1997, the OTS and the other FFIEC agencies sent a follow-up industry advisory highlighting the need for institutions to make all information processing systems Year 2000 compliant and identifying specific concerns institutions should consider in managing any necessary system conversion process. The statement:

- Outlines the Year 2000 project management process;
- Identifies external risk issues that should be considered as part of a Year 2000 project management plan;
- Discusses operations issues that may be relevant to a Year 2000 planning process;
- Describes the general supervisory approach that will be followed by the FFIEC agencies; and,
- Encloses, for industry awareness and internal use, the FFIEC Year 2000 examination procedures.

The FFIEC also developed and made public on its Internet Web Site a Year 2000 page that contains relevant policy releases and examination procedures, as well as "hot links" to other sites of interest that offer useful Year 2000 materials.

As part of further FFIEC efforts to promote awareness of the Year 2000 issue, the agencies will be releasing several additional advisories in coming months. These advisories will cover topics such as business stability risks posed by the Year 2000 rollover, managing business relationships with vendors, monitoring credit risk exposure of borrowers in light of potential Year 2000 problems, and expectations for testing computer renovations and conversions. Additionally, the FFIEC is sponsoring a conference with vendors on November 10, 1997, and will be pursuing other vendor conference possibilities, including a Bank Administration Institute Year 2000 Summit in December 1997.

We are working closely with industry trade groups to ensure that they are aware of this issue. The FFIEC agencies have met with several trade groups to exchange information, and to let the trade groups know that agency staff are available to speak at industry gatherings and provide assistance as needed on Year 2000 issues. We are planning further follow-up with these groups in the coming months.

In addition to interagency activities, the OTS raises Year 2000 issues with thrift institutions at various industry forums. As recently as this past weekend, an OTS official discussed Year 2000 compliance with members of the American League of Financial Institutions, the trade association of minority-owned thrifts, at that trade group's annual convention. I personally emphasized the importance of Year 2000 compliance in my first meeting with members of this group. In September of this year, an OTS official highlighted the Year 2000 problem at a compliance conference sponsored by America's Community Bankers (ACB). Again, I took the opportunity of my first talk to ACB's members at their annual conference to stress the need to deal with this problem quickly and thoroughly. Our Northeast Regional office arranged a well-attended symposium on Year 2000 compliance this past May which attracted over 100 thrift institution representatives and 29 service bureaus.

Moreover, for the past several years, the OTS has included the Year 2000 issue within the scope of routine information systems examinations of thrift institutions and the companies that provide data services to them. We have made Year 2000 compliance an integral part of these examinations.

OTS also recently added to its Internet Web Site a computer application that helps institution management monitor progress toward completing a Year 2000 conversion and renovation project. This spreadsheet-based checklist guides management through the assessment, planning and implementation phases of a computer modification project so that systems will continue to operate correctly into the new millennium.

These activities enhance awareness of the issues, as well as promote a better understanding of steps needed to ensure proper identification and correction of potential computer problems.

Year 2000 Examination and Supervisory Process

A significant component of our plan involves expanding our examination process to include procedures pertaining to Year 2000 issues. To obtain an overall initial assessment of the industry's preparedness, OTS decided to conduct off-site supplemental examinations of all thrift institutions, using specially-designed procedures. As of May 30, 1997, our regional offices sent Year 2000 supplemental examination procedures and guidelines to each thrift institution, asking for a response by September 30, 1997. This first round of examinations assesses each thrift institution's awareness of, and planning for, the impact the Year 2000 calendar rollover may have on information processing systems, and identifies the risks that the rollover may pose for individual institutions and the industry as a whole. Key data from these examinations is maintained in a special database established to help us monitor institutions' progress toward completing necessary system changes, and to set future examination priorities.

By mid-1998, we will examine each thrift's actual Year 2000 renovation and conversion efforts. Appropriate follow-up attention will be given to those that have not completed their Year 2000 conversion by that time. Consistent with the phases identified in the FFIEC advisory, we will then turn our examination attention to testing efforts. We have encouraged our regional offices to use the full range of examination approaches available to them to ensure the completion of these examinations, based on the circumstances at each thrift institution. Clearly, some institutions will need more attention than others. For example, we are particularly aware of the potential burden of Year 2000 compliance on smaller institutions. This strategy will assure that we use our resources in an efficient manner while continuing to devote proper attention to our other statutory and regulatory mandates.

In conducting examinations, we have marshaled our resources to ensure that needed attention is given to the Year 2000. Generally, we are using our safety and soundness examination force to conduct the examinations of thrift institutions. We are using our Information Systems (IS) examiners to focus on service bureaus and shared application software providers. Regional management is coordinating the efforts of these examination disciplines to avoid duplication of work in cases involving examination of in-house computer systems. Regional management is also involving IS examiners directly in Year 2000 examinations of institutions with large or complex data processing environments.

Although the ultimate responsibility for Year 2000 compliance rests with the thrift institutions themselves, many of them rely on the services of outside companies and vendors for their data processing operations. Consequently, it is incumbent on us to conduct detailed reviews of the progress of servicers to ensure the systems will function properly. Our IS examiners, as well as those from the other banking agencies, are also conducting Year 2000 examinations of these entities. We completed initial examinations of both national and regional entities by September 30, 1997. These entities provide services to a large number of thrifts and other financial institutions. We will also complete examinations of other key data servicers by mid-1998, if not sooner. As mentioned at the beginning of this statement, we have submitted proposed language to the Committee that would ensure that institutions that use service providers can meet the Year 2000 challenge with confidence.

The proposed statutory language is intended to address an existing statutory anomaly that arises from the fact that, unlike the other Federal banking agencies, the OTS does not have explicit statutory authority to examine the operations of third party contractors that perform various data processing functions and provide electronic network services for savings associations. Although the Bank Service Company Act grants the other Federal banking agencies this examination authority, the Home Owners' Loan Act does not include the same statutory authorization for the OTS. The OTS, so far, has generally been able to overcome this statutory shortcoming by requiring savings associations to authorize such examinations when contracting with a service provider, such as an ATM network or a data processing service. However, some service providers have been resistant to such contractual provisions and, as a result, thrifts are hindered in their ability to contract for services.

Not only are we looking at thrifts and their service providers, but we are also looking at each institution's entire environment. OTS examiners review whether thrifts are properly evaluating Year 2000 renovation and conversion efforts among their service corporations, operating subsidiaries, holding companies and other affiliates. Further, our examiners have been instructed to determine if institutions are monitoring counter party risk and credit risk as they relate to Year 2000 preparedness.

Consistent with this element of our efforts, we are also looking at Year 2000 issues as part of the corporate applications we process to ensure that any corporate acquisition will not have adverse effects on an applicant. For example, applicants are asked to provide specific information on the strategies they have developed to address Year 2000 problems. If necessary, application approval will be conditioned upon favorable results from the OTS Year 2000 examination program.

Monitoring

We have taken several steps to ensure our efforts are coordinated and we stay on schedule. First, we appointed one of our highest level examiners as our National Year 2000 Coordinator. This individual is charged with ensuring that regional staff direct appropriate attention to all OTS-regulated thrift institutions and their servicers, including adequate monitoring of progress and follow-up to address identified problems. She generally works with quality assurance staff and management in our regional offices to review agency efforts to ensure industry-wide compliance. Second, we have instructed our regional management to involve our quality assurance staff on monitoring at the local level. Third, we developed an internal survey system—which utilizes examination results to compile reports—that pinpoints progress at each thrift institution on implementing individual Year 2000 plans.

Preliminary Observations from Year 2000 Examinations

Your invitation letter also asked us to assess the progress the industry has made to date in meeting the Year 2000 challenge. The OTS will prepare a general assessment of the thrift industry's preparedness for the Year 2000 rollover by year-end 1997. In the interim, however, we do have some preliminary results from the off-site examinations that have been completed to date.

- In general, thrift management has a good sense of awareness of the Year 2000 problem. Management is actively involved in addressing the scope of the potential issues and developing strategies and remedial plans. This holds true for smaller as well as larger institutions. Most thrifts have appointed an officer or committee to spearhead their Year 2000 efforts.
- Although awareness levels are typically high, some of the responses suggest that thrift management may not be fully attuned to the critical time sensitivities associated with this issue, particularly where processing is performed by service bureaus. This indicates the need for further follow-up with the industry in the form of additional guidance and enhanced supervision, and we will respond accordingly. As noted, the papers that the FFIEC agencies are preparing on vendor management and business stability risk will be released in the coming months. These papers will note our concerns in these areas.
- Thrift institutions that rely on outside servicers have been contacting the servicers to discuss plans for addressing Year 2000 problems that could occur. Some thrifts report that servicers are demonstrating a commitment to work with the industry toward the timely resolution of issues.

- For nearly 90 percent of the thrift industry, renovation efforts by the thrifts or their servicers are underway.

The OTS's Internal Year 2000 Progress

In addition to monitoring industry efforts to address Year 2000 problems, the OTS is actively addressing conversion of its internal systems. In 1996, we completed an assessment of our national systems and developed a conversion plan. To date, we have completed approximately 61 percent of the computer code modifications necessary for Year 2000 compliance. Another 30 percent of computer code revisions are currently underway, with modifications to the remaining 9 percent to begin shortly. All modifications are expected to be completed during 1998. Validation testing of converted systems commenced in September 1997, and further intensive testing will be conducted during 1998 and 1999. In addition, beginning in 1998, the electronic filing software provided by OTS to the industry to facilitate data entry, editing, and data transmission of regulatory reports will be Year 2000 compliant.

Washington and regional OTS staff are also actively reviewing infrastructure and building support software and hardware. Approximately 95 percent of our Washington building systems, including elevators, heating and air conditioning controls, emergency systems, and electrical distribution systems have been determined to be Year 2000 compliant. Programs and software obtained from external vendors and contractors are being inventoried for compliance purposes, and all new procurement contracts contain Year 2000 compliance requirements. The OTS complies with Treasury Year 2000 requirements for status reporting and cost modeling.

Conclusion

The OTS takes this issue very seriously and looks forward to working with you as our efforts proceed. The combination of enhancing industry awareness, conducting examinations, actively supervising the industry and monitoring our own compliance efforts should ensure that effective and timely actions are taken to avoid problems when the calendar rolls over to the Year 2000. We know that no matter how well we are prepared, there will be glitches and there will be problems. But, we are committed to making those problems as small and as manageable as possible.