

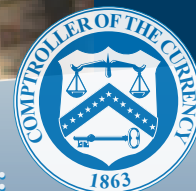


Comptroller of the Currency  
Administrator of National Banks



# ANNUAL REPORT

FISCAL YEAR 2004



The National Banking System:  
Backbone of a Strong U.S. Economy

# OCC Vision

The Office of the Comptroller of the Currency (OCC) seeks to assure a banking system in which national banks soundly manage their risks, comply with applicable laws, compete effectively with other providers of financial services, offer products and services that meet the needs of customers, and provide fair access to financial services and fair treatment of their customers.

# MISSION

The Office of the Comptroller of the Currency was created by Congress to charter national banks, to oversee a nationwide system of banking institutions, and to assure that national banks are safe and sound, competitive and profitable, and capable of serving in the best possible manner the banking needs of their customers.

# Annual Report

Fiscal Year 2004



OFFICE OF THE COMPTROLLER OF THE CURRENCY

**John D. Hawke, Jr.**

*Comptroller of the Currency*

The Administrator of National Banks

October 2004

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## Comptroller's Viewpoint

I am pleased to report that the fiscal year ending September 30, 2004 was another successful year for the national banking system. The system's earnings continued to be strong. Just as important, credit quality was good and improving – improving dramatically in some instances. Only in a few categories of consumer loans have we seen some slippage in asset quality, which the OCC continues to monitor carefully.

Most analysts believe that the economic expansion will continue. If this assumption proves accurate, given current trends, national banks should experience continued strength and profitability.

The national bank charter has never been stronger. It is a matter of great pride for the OCC that most of the country's largest banks, as well as nearly 2,000 mid-sized and community banks, operate under the national charter, reflecting not only its strength, but also the very high regard in which the OCC is held by the banking community.

FY 2004 was a year that saw a number of major OCC regulatory and supervisory initiatives come to fruition.

In January, the OCC issued two final rules on national bank preemption and visitorial powers. The first rule codified a series of court decisions and OCC interpretations regarding the types of state laws that apply to national banks. The second rule clarified the scope of the OCC's visitorial authority under federal law. These rules responded to numerous questions the OCC had received about the extent to which state



laws apply to national banks and the authority of state or other agencies to examine or take action against national banks.

The new rules also included a tough new standard designed to keep predatory lending out of national banks. Under our new rule, which applies to all consumer lending activities, lenders may not make loans that rely upon the foreclosure value

of the collateral for repayment. This restriction will prevent national bank lenders from extending credit with an eye toward seizing a borrower's home.

The OCC took other aggressive action in FY 2004 to protect national bank consumers. We issued guidance to national banks citing specific credit card practices that we view as unacceptable because they may constitute unfair or deceptive acts or practices, or could otherwise expose a bank to compliance and reputation risk. These included failure to disclose the circumstances under which the issuer might unilaterally increase the cost of credit to the cardholder; marketing programs that promote credit limits that are seldom granted; and the use of promotional rates in solicitations without clear disclosures about the restrictions on the applicability and

continuation of those rates. We also took action on behalf of consumers against specific banks that engaged in unfair or abusive practices, requiring some banks to set aside millions of dollars for restitution to consumers who were victimized.

Some of the OCC's most important achievements occurred in the international arena. In last year's "Comptroller's Viewpoint," I wrote – referring to the work of the Basel Committee on Banking Supervision – of my optimism "that the spirit of compromise, cooperation, and commitment will bring us even closer to the end of the long road to Basel II in the coming year." That hope was fulfilled in June with the release of the new capital framework. Although there is an enormous amount of work to be done in order to prepare for the scheduled year-end 2007 implementation date, I am confident that the spirit of cooperation that helped make Basel II possible will also enable us to achieve a new era in risk management – with its positive implications for financial stability – across the world's banking system.

The linkage between financial and political stability has never been closer than it is today, and this linkage is being tested in the ongoing war against terrorism. At a time of great national challenge, all Americans are being asked to do their part, and I'm proud to acknowledge the contribution of the team of OCC examiners who volunteered to spend the better part of last year on the ground in Iraq, assisting local officials to develop and establish an independent and professional bank supervision department. Their work will materially assist the Iraqi people in achieving the goal of a democratic and prosperous society.

A major focus of the war on terrorism has been to identify and choke off the sources of terrorist financing. The OCC has played a major role in that effort through its Bank Secrecy Act compliance program, which seeks to ensure that national banks have strong systems and controls in place to prevent and detect money laundering and terrorist financing. Overall, this program has been effective. In FY 2004, however, deficiencies in the OCC's BSA supervision of the Riggs National Bank came to light, prompting a number of remedial steps to improve our BSA and anti-money laundering supervision. We are also stepping up our cooperation with other federal bank supervisory and law enforcement agencies to ensure that our nation's financial institutions do not become vehicles for illicit activities.

The OCC's reputation rests on the superb quality of its people – the most talented and dedicated people I have known in my nearly 17 years of government service. It has been my goal to ensure that this agency continues to attract the best and the brightest, and continues to be viewed as one of the premier agencies of our entire government.

On October 13, my term of office as the 28<sup>th</sup> Comptroller of the Currency comes to an end. For more than 140 years, the OCC has been serving the American people and the national banking system with great distinction. I consider myself extremely fortunate to have had the opportunity to lead the agency during this important period in its distinguished history.



**John D. Hawke, Jr.**  
Comptroller of the Currency

October 13, 2004

# History of the Office of the Comptroller of the Currency



## 1863

President Abraham Lincoln signs the Currency Act of 1863, establishing the Office of the Comptroller of the Currency. The act sets chartering standards for national banks and permits these banks to issue currency.

Hugh McCulloch is appointed the first Comptroller. As head of the Indiana banking system, McCulloch had opposed creation of the national banking system. He later reconciles himself to the new system and accepts an offer from Secretary of the Treasury Salmon P. Chase to head it as Comptroller.

The first national bank charter is issued to the First National Bank of Philadelphia.

The first national bank examination is completed.

The first national bank note is issued.



## 1865

Freeman Clarke is named Comptroller after McCulloch accepts President Lincoln's offer to become Treasury Secretary. McCulloch continues as Secretary under Andrew Johnson, working to contract the paper money supply in the post-Civil War era.

Congress attempts to drive state banks out of existence by levying a 10 percent tax on state bank notes.

The first national bank failure (First National Bank of Attica, New York) occurs on April 14, the same day that President Lincoln is shot.



## 1867

Hiland R. Hulburt becomes Comptroller.



## 1872

President Ulysses S. Grant appoints John Jay Knox as Comptroller. Knox serves until 1884—the second-longest term in the history of the OCC. A low failure rate of 73 banks in 12 years testifies to the effectiveness of the Office.



## 1884

Henry W. Cannon begins his term as Comptroller, during which he stresses analysis of bank examination reports.



## 1886

William L. Trenholm is appointed Comptroller.





### 1889

Edward S. Lacey is named Comptroller.



### 1892

A. Barton Hepburn becomes Comptroller.



### 1893

James H. Eckels is 35 years old when he is appointed Comptroller. Secretary of the Treasury Lyman J. Gage comments that "there was not much to Eckels," referring to the Comptroller's small stature. "But what little there was three-quarters brains." Eckels endures the Panic of 1893, when more than 100 national banks close their doors.



### 1898

Charles G. Dawes is appointed the 10<sup>th</sup> Comptroller, urging during his term that examiners be paid a fixed salary rather than fees based on bank size. After World War I, Dawes is appointed to head a commission that devises a plan for the defeated German nation to pay its war debts and regain economic stability. For his work on what becomes known as the "Dawes Plan," he wins the 1925 Nobel Peace Prize jointly with Sir J. Austen Chamberlain. He also serves as Calvin Coolidge's vice presidential running mate in the 1923 election. In 1929, President Herbert Hoover appoints Dawes ambassador to Great Britain. Dawes is also a skillful composer of popular music. The Tommy Edwards oldie, "It's All in the Game," is set to music composed by Dawes.



### 1901

William Barret Ridgely is appointed Comptroller.



### 1908

Lawrence O. Murray is named Comptroller. He places new emphasis on stricter bank chartering standards and insists on onsite bank supervision.

### 1913

The Federal Reserve System is established.



### 1914

John Skelton Williams becomes Comptroller and contests the Federal Reserve Board role in supervising national banks.



### 1921

D.R. Crissinger is named Comptroller and promotes national bank branching.



### 1923

Henry M. Dawes, brother of former Comptroller Charles Dawes, is appointed Comptroller.



### 1924

Joseph W. McIntosh becomes Comptroller.



### 1928

John W. Pole is appointed Comptroller.



### 1933

J.F.T. O'Connor twice declines President Franklin D. Roosevelt's offer to nominate him as Comptroller before accepting the position.

Roosevelt declares a four-day "bank holiday," and more than 1,400 national banks, owing depositors more than \$2 billion, are declared insolvent and denied permission to reopen. O'Connor is responsible for reorganizing the national banks that can be saved and liquidating those that cannot. To sell off bank assets, O'Connor employs sound trucks advertising real estate owned by the banks; his tactics are so successful that 93 cents out of every dollar in assets in those banks are returned to depositors.

O'Connor also helps establish the Federal Deposit Insurance Corporation (FDIC) and serves as one of its three directors.

### 1935

Banking Act of 1935 retires national bank currency in favor of Federal Reserve notes.



### 1938

Preston Delano begins his term as Comptroller and leaves in 1953 after serving longer than any other Comptroller.

OCC, Federal Reserve Board, and FDIC agree to share responsibility for bank examinations.



### 1953

Ray M. Gidney is appointed Comptroller.

### 1956

Bank Holding Company Act of 1956 places restrictions on interstate banking.



### 1961

President John F. Kennedy nominates James J. Saxon to be Comptroller. Saxon's top priority is to expand the national banking industry and liberate national banks from regulation he deems burdensome. Saxon permits national banks to engage in businesses from which they had previously been barred, such as selling insurance and issuing credit cards.



### 1966

William B. Camp is appointed Comptroller.



### 1973

James E. Smith becomes Comptroller. Smith adopts a more risk-focused approach to bank supervision.

### 1974–75

A study by the accounting firm of Haskins and Sells recommends that the OCC focus its supervision on troubled banks, rather than on all banks equally – the precursor to "risk-based supervision."



### 1977

John G. Heimann is named Comptroller. He reorganizes the OCC to reflect the increasing need for specialization.

### 1978

Federal Financial Institutions Examination Council (FFIEC) is established to provide uniform bank supervision.



### 1981

C. Todd Conover is appointed Comptroller and promotes the deregulation of national banks.



### 1985

Robert L. Clarke becomes Comptroller. He strengthens risk-based examination practices to meet a nationwide banking crisis.

### 1989

In response to the 1980s banking crisis, Congress passes the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). The act replaces the Federal Home Loan Bank Board with the Office of Thrift Supervision and provides pay parity among federal financial regulatory agencies.

### 1991

The FDIC Improvement Act (FDICIA) imposes new regulatory requirements on banks and enhances regulatory safeguards.



### 1993

Eugene A. Ludwig is named Comptroller. Ludwig encourages access to credit and the growth of bank subsidiaries.



### 1998

John D. Hawke, Jr., is named Comptroller. He strengthens the competitiveness of the national bank charter, works to end disparities in the funding of state and national bank supervision, and tightens OCC budget controls.

## OCC at a Glance

**T**he Office of the Comptroller of the Currency continued its strong stewardship of the national banking system during a year of excellent industry health. The OCC also maintained a keen focus on its internal financial controls, while the value of the national bank charter gained increasing recognition. This annual report presents the OCC's most significant program accomplishments, performance results toward its long-term strategic goals, and financial status for Fiscal Year (FY) 2004.

### Profile

The OCC was established in 1863, as a bureau of the Department of the Treasury. The OCC is responsible for supervising, regulating, and licensing the nation's federally chartered banks.

As of September 30, 2004, the OCC was responsible for regulating and supervising 1,934 national banks and 52 federal branches of foreign banks in the U.S. Based on the most recent data (June 30, 2004 call reports), national banks held \$4.6 trillion in assets or 57 percent of the total assets of all U.S. commercial banks.

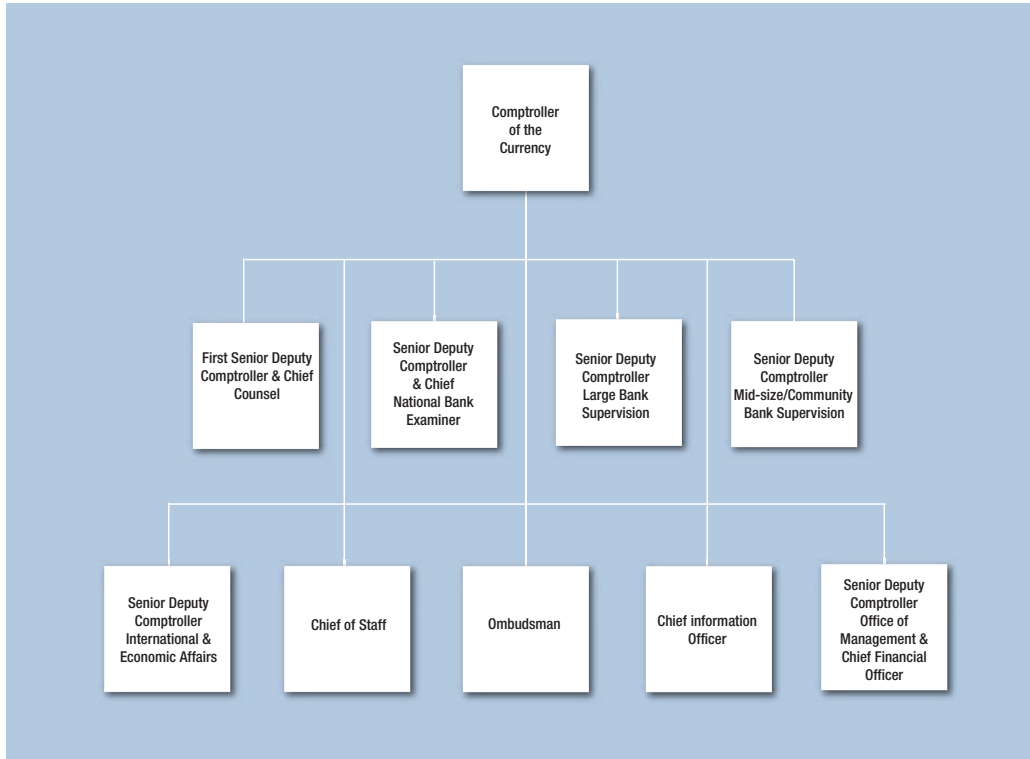
The OCC's operations are funded primarily by semiannual assessments levied on national banks (99 percent) and 1 percent from interest revenue from its investments in U.S. Treasury securities and licensing and other fees combined. The OCC does not receive congressional appropriations to fund any of its operations.

### Structure

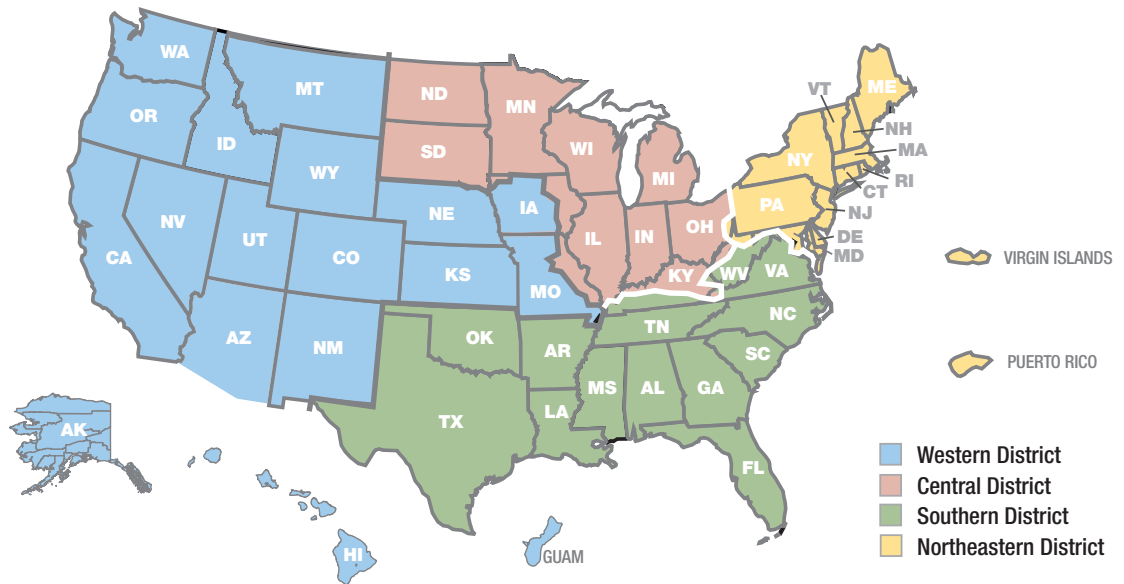
As of September 18, 2004, the OCC had 2,727 OCC employees, including 1,824 bank examiners. The OCC has its headquarters in Washington, D.C., a data center in Maryland, and four district offices in Chicago, Dallas, Denver, and New York. The OCC also has 48 field offices and 23 satellite locations in cities throughout the U.S., resident examiner teams in the 25 largest banking companies supervised, and an examining office in London, England.

The OCC is headed by the Comptroller of the Currency, who is appointed for a five-year term by the President, with the advice and consent of the Senate. An Executive Committee of senior executives of the major business units advises the Comptroller on policy and operational issues. To provide more focused attention on critical issues, senior executives also serve on smaller subcommittees (audit; bank supervision; budget and finance; human capital; regulatory policy, legal and external affairs; and technology and systems) that regularly report to the Comptroller and Executive Committee.

**Figure 1: OCC Organization**



**Chart: District Map**



## Strategic Goals

The OCC has four strategic goals to achieve its mission and contribute to the achievement of the Department of the Treasury's strategic goals (promoting prosperous U.S. and world economies and preserving the integrity of financial systems). The OCC's goals, as defined in its FY 2003-2008 Strategic Plan, are:

- A safe and sound national banking system.
- A flexible legal and regulatory framework that enables the national banking system to provide a full competitive array of financial services.
- Fair access to financial services and fair treatment of bank customers.
- An expert, highly motivated and diverse workforce that makes effective use of OCC resources.

## Performance Measures

Consistent with the Government Performance Results Act (GPRA) and its implementing guidance, the OCC issues an annual performance budget outlining the performance goals and measures for the year. The OCC's performance information presented in this report is reliable and complete, as ascertained through the FY 2004 management control assessment process described in the *Systems, Controls, and Legal Compliance* section of this report. The OCC's performance on the GPRA goals is incorporated in the program area discussions. Appendix A presents a complete list of the OCC's GPRA performance measures, workload indicators, customer service standards, and the results achieved during FY 2004. Performance results for the three previous years are also presented, as available.

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<sup>1</sup>Acronym for composite rating banks are given as a result of a bank examination. The letters stand for Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk.

## Program Results

The OCC accomplishes its mission through three major programs: supervise, regulate, and charter. Accomplishments from the OCC's programs and operations follow.

- 1,642 strategy certifications were completed for examination activities that concluded:
  - 99 percent of national banks were well-capitalized.
  - 94 percent of national banks earned strong composite CAMELS<sup>1</sup> ratings of 1 or 2.
  - 96 percent of national banks merited high consumer compliance ratings of 1 or 2.
- 486 Community Reinvestment Act (CRA) examinations completed.
  - 230 bank consultations on community development opportunities were conducted.
  - 100 percent of qualified banks that were within one year of their first large bank CRA examination were offered a consultation.
- 457 enforcement actions completed on banks and individuals.
  - 41 percent of problem national banks rehabilitated.
- Approximately 150 substantive inquiries, including formal and informal appeals, processed by the Office of the Ombudsman.
- 66,864 calls fielded by the OCC's customer assistance call center.
  - 74 percent of the 68,104 closed consumer complaints were completed within 60 calendar days of receipt.
- 119 responses issued to banks' requests for legal opinions.
  - 87 percent of legal opinions were issued within established time frames.
- 2,592 corporate applications received.
  - 96 percent of the 2,477 decisions issued

- were within established time frames.
- 34 percent of all corporate applications were received electronically.
- Examination and licensing activities performed in a quality and professional manner.
  - External ratings on the OCC’s examination and licensing functions exceeded goals for all service standards.

Other noteworthy program accomplishments in FY 2004 included:

- Issued the final rules on Preemption and Visitorial Powers in January 2004.
- Placed all national banks under continuous supervision using individually developed supervisory strategies based on the specific risk profile and the condition of the bank.
- Initiated a Quality Management (QM) review and evaluation of the approach to, and effectiveness of, its Bank Secrecy Act/Anti-Money Laundering (BSA/AML) supervision programs. The OCC also approved the development of an enhanced database of national bank-filed Suspicious Activity Reports (SARs) and a revised risk assessment process to better identify high-risk banks.
- Revised examination procedures for key sections of the USA PATRIOT Act, in coordination with other federal banking agencies.
- Completed the shared national credit (SNC) review that covered 7,490 credits with commitments totaling \$1.5 trillion, in coordination with the Federal Reserve and the FDIC. The quality of large syndicated bank loans showed marked improvement this year. Adversely rated loans continue to subside, although certain industries continue to have a high concentration of adversely rated loans.
- Trained and placed 74 new bank examiners into permanent field positions for community bank supervision. Another 40 examiners have begun on-the-job training and will be placed into permanent field

positions in the first half of FY 2005. This initiative is critical to the OCC in light of the number of examiners who are expected to retire over the next five years, as well as the need to deploy experienced examiners to supervise the new mid-size and large banks entering the national banking system.

- Added nine corporate applications and seven notices to the Electronic Corporate Application Process (e-Corp) for electronic filing.
- Provided a team of four examiners to help design and build Iraq’s bank supervision system. The team served as technical advisors on supervision issues, including the underlying concepts of risk-based supervision and CAMELS ratings, guidance documents, bank reporting and analysis, and training.
- Completed the security certification and accreditation for 73 percent of the OCC’s information technology systems, achieving the Department of Treasury’s FY 2004 target of 70 percent.

## Financial Management Results

- Received an unqualified audit opinion from its independent public accountant on the FY 2004 financial statements with no material weaknesses.
- Completed timely and accurate monthly and quarterly financial and performance reporting.
- Published the annual statement of reasonable assurance on the Federal Managers’ Financial Integrity Act (FMFIA) and substantial compliance on the Federal Financial Management Improvement Act (FFMIA).
- Paid invoices totaling \$68.8 million with 98.7 percent paid timely, achieving the Office of Management and Budget’s (OMB) goal for government entities.
- Collected assessments totaling \$490.3 million with 98.4 percent collected within five work days.

## Operations and Accomplishments

To achieve its strategic goals and accomplish its mission, the OCC separates its activities into three major program areas: supervise, regulate, and charter. The OCC formulates its budget and tracks costs and full-time equivalents<sup>2</sup> (FTE) by these programs. The OCC's most significant accomplishments and activities for FY 2004 are discussed by program.

### Supervise Program

This program encompasses the supervision of national banks and their subsidiaries, federal branches and agencies<sup>3</sup> of foreign banks, national trust companies, bank data software vendors, and data processing service providers. This program also consists of activities to identify, analyze, and respond to emerging systemic risks and trends that could affect an individual national bank or the entire national banking system. The Committee on Bank Supervision establishes and oversees areas of emphasis for the OCC's supervisory activities. The committee is comprised of the Chief National Bank Examiner and the senior deputy comptrollers for Large Bank Supervision and Mid-size/Community Bank Supervision. These activities support the OCC's strategic goals of a safe and sound national banking system and fair access to financial services and fair treatment of bank customers.

The supervise program, by far the largest program, is the core for accomplishing the OCC's mission. The OCC for FY 2004 devoted 2,212 FTEs or 82 percent of total FTEs to the supervise program, while the cost of the program was \$392.1 million.

Two business lines reside within the supervise program, large banks and mid-size/community banks. The mid-size/community bank business line consists of mid-size banks, credit card banks, community banks, and federal branches and agencies. The business line approach recognizes that institutions of varying sizes and complexity present different risks and require unique supervision philosophies.

The OCC's large bank program is responsible for supervising the 25 largest and most complex national banking companies, using teams of dedicated onsite examiners. During FY 2004, areas of supervisory emphasis for the large bank program included credit quality and credit risk management, corporate governance, assessing the impact of Basel II, the integrity of banks' financial statements, ensuring adherence to accepted accounting practices, allowance for loan and lease loss reserve procedures and adequacy, and operational related vulnerabilities.

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<sup>2</sup>Full-time equivalent is the number of paid hours accumulated during an entire fiscal year by a full-time position (40 hours per week). Generally, this is between 2,080 and 2,096 hours depending on the number of paid days that fall within a given year.

<sup>3</sup>Federal branches and agencies are branches and agencies licensed by the OCC and operated by foreign banking organizations. Federal agencies are offices that engage in the business of banking but do not accept deposits or exercise fiduciary powers.



There are 27 banking companies in the OCC's mid-size bank program and 21 companies in the OCC's credit card bank program. During FY 2004, areas of supervisory emphasis for the mid-size and credit card bank programs included commercial real estate, BSA/AML reviews, emerging credit risks, consumer compliance, and the effectiveness of risk management programs and controls.

The vast majority of banks in the OCC's community bank program have less than \$1 billion in total assets. Banks are assigned to an OCC portfolio manager who oversees the supervisory strategies for the banks. These strategies combine onsite examinations and off-site analysis to monitor bank performance. During FY 2004, areas of supervisory emphasis for the community bank program included credit quality, adequacy of the allowance for loan and lease losses, liquidity monitoring and contingency plans, interest rate risk monitoring and controls, and banks' increasing reliance on noninterest income.

The supervise program is further divided into three subprograms: examining, enforcing, and ensuring fair access and fair treatment. These are discussed in more detail as follows.

### ***Examining***

At the beginning of FY 2004, the OCC completed the transition to a continuous supervision process in the community bank program. This process had previously been adopted in the large bank, mid-size, and credit card bank programs. Under this process, a supervisory strategy is developed based on the risk profile and condition of each banking institution. The strategy includes a variety of supervisory activities, both examinations and off-site analyses, to be completed throughout a supervisory cycle. Examination activities include safety and soundness, consumer compliance, information technology, and asset management examinations. The supervisory cycle conforms to either a 12- or 18-month time frame, depending on the size, complexity, and condition of the bank. All large and mid-size banks, credit card banks, and federal branches are on a 12-month supervisory cycle. At the end of each bank's cycle, OCC examiners certify the completion of the supervisory strategy and onsite activities, assign CAMELS ratings, and communicate their findings to the bank.

The OCC completed and certified 1,642 supervisory strategies during FY 2004. Included in this number are strategy certifications for all large, mid-size, and credit card banks; all federal branches and agencies; and more than 82 percent of community banks. In addition to strategy certification activities, the OCC conducted 486 CRA examinations, which are on either an 18- or 36-month cycle.

The supervisory strategy certifications completed during FY 2004 show that national banks continued to operate in a safe and sound manner as shown by assigned CAMELS ratings and assessments of capital levels. For the past four years, 98 or 99 percent of all national banks have been well-capitalized. Similarly, 94 or 95 percent of all national banks received a CAMELS rating of 1 or 2 each year, since FY 2001. The OCC also exceeded all of its customer service standards for examination activities. The customer service results were based on 690 examination surveys completed by banks for the period, July 2003 through June 2004, a 40 percent response rate. The survey is based on a five-point scale, in which 1 indicates complete agreement and 5 indicates complete disagreement with the survey statements.

Table 1 shows the results of the examining performance measures.

**Table 1: Examining Performance Measures, FY 2001 – FY 2004**

Performance Measures	FY 2001	FY 2002	FY 2003	FY 2004 Target	FY 2004 Actual <sup>4</sup>
Percentage of national banks that are well-capitalized	98%	99%	99%	95%	<b>99%</b>
Percentage of national banks with composite CAMELS rating of 1 or 2	94%	95%	94%	90%	<b>94%</b>
Average survey response that the examiner-in-charge and the examination team were knowledgeable	N/A	N/A	1.26	≤ 1.5	1.34
Average survey response that the examiner's requests for information before and during the examination were reasonable and justified by the examination scope	1.36	1.36	1.31	≤ 1.75	1.36
Average survey response that the examination team conducted the examination in a professional manner	1.21	1.21	1.20	≤ 1.75	1.25
Average survey response that during exit and board meetings, the examiner-in-charge and examination team clearly and effectively communicated their findings and concerns	1.33	1.32	1.27	≤ 1.75	1.37
Average survey response that the report of examination clearly communicated examination findings, significant issues, and the corrective actions (including time frames) management needed to take	1.31	1.30	1.26	≤ 1.75	1.30
Average survey response that ongoing communication by the examiner-in-charge with senior management and the board was appropriate	1.29	1.29	1.25	≤ 1.75	1.30

### Commercial Real Estate Review

The OCC completed a review of commercial real estate lending across mid-size banks during FY 2004. The review identified some fundamental weaknesses related to systems and controls for commercial real estate lending as well as best practices related to commercial real estate lending and the management of concentrations of credit. As an outgrowth of this review, the OCC and other federal bank regulatory agencies issued guidance reminding banks about the existing standards for independence outlined in the real estate appraisal and lending regulations, and the Interagency Appraisal and Evaluation Guidelines.

### On-the-Job Bank Examination Training for Newly Hired Bank Examiners

In FY 2003 the OCC embarked on a recruitment program for entry-level bank examiners. This initiative is critical to the OCC in light of the number of examiners who are expected to retire over the next five years, as well as the need to deploy more experienced examiners to supervise the new mid-size and large banks entering the national banking system. Newly hired bank examiners join a training team led by experienced examiners and receive on-the-job experience examining banks for their first six to eight months with the OCC. During FY 2004, 19 training teams with 74 entry-level bank examiners hired in June 2003 and January 2004 completed their training team assignments and were placed in permanent field office locations in the community bank line of business. During June 2004, nine new training teams commenced their on-the-job examiner training. This group of 40 examiners is expected to join community bank field offices in the first half of FY 2005. Additional details on this initiative are included in the *Human Capital* section of this report.

<sup>4</sup>Performance numbers shown in bold italics are estimates. Some performance data is obtained from quarterly call reports from banks. The September 30, 2004 call reports are not due until 30 or 45 days after the end of the period. Additionally, examinations concluded late in the fiscal year are not finalized for 30 to 60 days. As a result, complete fiscal year data is not yet available and estimates are reported.

## **Enhancements to the Financial Institution Data Retrieval System**

The Financial Institution Data Retrieval System (FINDRS) provides bank supervision staff quick and easy access to a database of information about holding companies, banks, Electronic Data Processing (EDP) servicers, and federal branches. FINDRS information comes primarily from reports of condition by banks and holding companies. Users can create systemic and comparative analysis reports, as well as reports on specific institutions.

During FY 2004, FINDRS added reports on performance and peer averages for bank holding companies and federal branches. Standard reports for groups of banks were also added, such as Asset Mix Indicators, Asset Quality Indicators, Capital Indicators, Earnings Indicators, Interest Rate Risk Indicators, and Liquidity Indicators. The OCC continued to train its supervision staff in the use of FINDRS in FY 2004. During the 18-month period ending July 31, 2004, more than 1,100 persons used the FINDRS application to generate reports.

## **Large Bank Credit Tool**

The Large Bank Credit Tool (LBCT) helps Large Bank examiners assess industry segments in commercial and industrial loan portfolios that are likely to improve or deteriorate over the next 12 months under “consensus” and “pessimistic” economic scenarios. The commercial real estate portion of the LBCT compares a bank’s outlook for its commercial real estate lending products with consensus and pessimistic views from a third party. LBCT allows examiners to plan their supervision more efficiently and helps them identify vulnerable industries and markets for increased supervision. The OCC is currently piloting the use of LBCT and plans to explore further applications in FY 2005.

## **Risk Committees**

The OCC National Risk Committee (NRC) identifies primary and emerging risks to the national banking system, stays abreast of evolving business practices and financial market issues, advises the OCC’s Executive Committee of material risks facing the national banking system, and recommends OCC supervisory responses. The District Risk Committees (DRCs) operate in each district. The NRC is chaired by the deputy comptroller for Risk Evaluation. Its members include senior managers from key areas across the OCC as well as DRC chairpersons. The NRC identifies resource and training needs and provides specialized support, examiner guidance, and examiner training in areas such as bank technology, asset management, retail credit, compliance, mortgage banking, derivatives, and interest rate risk management. These efforts ensure consistent and efficient responses to emerging risks to preclude redundancies, encourage the sharing of ideas throughout the OCC, and serve as a resource to the DRCs.

## **National Bank Appeals**

The national bank appeals process resolves individual appeals and inquiries from national banks. The Ombudsman, with the consent of the Comptroller, has the discretion to stay any agency decision or action pending resolution of an appealable matter. The Ombudsman’s office processed approximately 150 substantive inquiries, including formal and informal appeals, during the year.

## ***Enforcing***

Enforcement activities ensure that corrective action is taken to address violations of laws, rules, regulations, and non-compliance with policies or procedures by national banks, their insiders, and other affiliated parties. Activities include the OCC’s formal enforcement actions, as well as informal actions to support prompt

detection and mitigation of problems before they affect a bank's viability. The OCC conducts investigations, takes administrative actions, and litigates those actions.

During FY 2004, the OCC took formal and informal enforcement actions against national banks and institution-affiliated parties who engaged in violations of laws and regulations or unsafe or unsound banking practices. The actions included temporary cease-and-desist orders, final cease-and-desist orders, removal or prohibition orders, civil monetary penalties (CMPs), and formal agreements. The OCC's Fast Track Enforcement Program helps ensure that bank insiders and employees who have committed criminal acts involving banks, but who are not being criminally prosecuted, are prohibited from working in the banking system. This program resulted in several prohibitions and personal cease-and-desist orders during FY 2004. Table 2 summarizes all enforcement actions completed in FY 2004.

**Table 2: Enforcement Actions, FY 2004**

Type of Enforcement Action	FY 2004	
	Against National Banks	Against Institution-Affiliated Parties
Cease-and-Desist Orders	19	24
Temporary Cease-and-Desist Orders	-	1
Civil Monetary Penalties	4	44
Civil Monetary Penalties Amount Assessed	\$25,061,950	\$553,500
Formal Agreements	40	-
Memoranda of Understanding	10	-
Commitment Letters	10	-
Suspension Orders	-	3
Letters of Reprimand	-	27
12 USC 1818 Removal/Prohibition Orders	-	37
12 USC 1829 Prohibitions	-	238
<b>Total Enforcement Actions</b>	<b>83</b>	<b>374</b>

### Bank Secrecy Act/Anti-Money Laundering

The OCC investigates and brings enforcement actions against national banks that fail to meet BSA/AML requirements to report suspicious transactions. The OCC coordinates with other regulatory and law enforcement authorities to ensure compliance with BSA/AML provisions and detect, track, and prevent domestic and foreign criminals and terrorists who would attempt to use the national banking system to facilitate the financing of their activities. A more comprehensive discussion of BSA/AML initiatives is in the *Partnership and Outreach* section of this report.

The OCC brought enforcement actions against several banks for inadequate BSA/AML compliance programs. Among other requirements, banks were ordered to provide internal controls, auditing, the designation of BSA compliance officers, and employee training programs. For example, the OCC assessed a \$25 million CMP against one bank for numerous BSA/AML violations upon discovering that the bank failed to implement an effective AML program.

## Unfair and Deceptive Acts or Practices

The OCC continues to respond vigorously to abusive, unfair, or deceptive business practices by national banks, thereby promoting fair treatment of bank customers and fair access to financial services for all Americans.

- The OCC brought a cease-and-desist and restitution action against a credit card bank that offered secured credit cards to people with impaired credit histories and encouraged them to charge a \$200 security deposit to the card. After paying various fees, customers who received the bank's minimum credit line of \$260 had only \$2.50 in available credit. Nearly half of the people who enrolled in the program defaulted, damaging their credit ratings. In bringing an enforcement action, the OCC prohibited the bank from charging customer security deposits to credit cards and from charging interest on security deposits, and prohibited the bank from accepting deposits to fund its operations. The bank was required to set aside \$10 million to pay restitution to affected customers.
- The OCC brought a cease-and-desist and restitution action against a bank for violating several consumer protection laws by charging duplicative fees and unearned service fees, failing to provide required consumer disclosures, and other violations. The OCC ordered the bank to make \$288,000 in restitution to affected customers and improve its consumer compliance program.

## Credit Card Bank and Trust Bank Supervision

The OCC addresses supervisory concerns related to Competitive Equality Bank Act (CEBA) credit card banks and trust banks through operating agreements, liquidity reserve deposit accounts (LRDAs), and capital assurance and liquidity maintenance agreements (CALMAs). The OCC uses operating agreements in pending corporate applications by banks to address specific areas of supervisory concern. For example, banks can be required to achieve capital levels that exceed regulatory minimums; maintain sufficient liquid assets, as defined by the operating agreement, to meet the bank's daily liquidity needs; submit and comply with business plans; or establish and maintain a LRDA at a third-party depository institution or Federal Reserve Bank. CALMAs are agreements between the bank and its parent requiring the parent to provide capital and liquidity support to the bank.

"Rent-a-charter" is a practice in which a nonbank company contracts with a national bank, thereby enabling the nonbank company to conduct an aspect of its business through the national charter and prompting the company to claim that its activities enjoy the benefits of a national charter. The OCC brought an enforcement action against an uninsured trust bank that engaged in rent-a-charter activities and failed to maintain proper internal controls, and conducted other unsafe and unsound practices. The OCC and the trust bank entered into a formal agreement, which required the trust bank to maintain appropriate capital and liquidity levels; establish and maintain appropriate management structures, risk controls, and audit processes; and remedy violations of law.

## Actions to Combat Insider Abuse

The OCC's Enforcement and Compliance Division initiated and litigated enforcement actions against bank insiders and other institution-affiliated parties who engaged in unsafe or unsound practices, unlawful conduct, or breaches of duty. The OCC acted when such practices, conduct, or breaches could have caused or did cause harm to a national bank, or other banks, or resulted in financial gain or other benefit for the insider. Several cases resulted in prohibitions, CMPs, restitution, or other personal cease-and-desist orders.

- The OCC initiated an enforcement action against a former bank chief executive officer (CEO) and president who originated highly questionable loans that collectively violated the bank's legal

lending limit. The loans involved nominee borrowers, use of proceeds for purposes other than those identified in loan documentation, and use of proceeds from newer loans to keep other loans current. Funds were disbursed to certain borrowers while record keeping entries concealed the true nature of the transactions. Without admitting or denying liability, this former insider agreed to a consent order prohibiting him from banking, and requiring him to divest himself of his stock in the bank and pay \$50,000 in restitution.

- The OCC brought an enforcement action against a former insider for engaging in unsafe and unsound practices and other misconduct, including preparing a loan application without verifying loan information and without performing a credit analysis, failing to disclose the true purpose of the loan, signing off on the loan under the above-described circumstances, and maintaining insufficient loan documentation. Without admitting or denying liability, this former insider consented to a personal cease-and-desist order and agreed to pay a \$20,000 CMP.
- The OCC initiated an enforcement action against a bank's attorney, who through erroneous legal advice caused the bank to pay an illegal golden parachute package to the spouse of the bank's chairman. Without admitting or denying liability, this attorney consented to the OCC's issuance of a personal cease-and-desist order prohibiting him from providing legal representation, directly or indirectly, to any insured depository institution, requiring him to pay a \$25,000 CMP and \$195,000 in restitution.
- The OCC initiated an enforcement action against a former chairman and CEO of a bank who engaged in unsafe and unsound practices, and breached his fiduciary duty to the bank. He facilitated the bank's purchase of discounted assets at par value in connection with adjusted price trades and enabled the restructuring of certain customers' exposure to avoid delinquency without recognizing Allocated Transfer Risk Reserves (ATRRs) on the exposure. This caused the bank to overstate its earnings and conceal losses, while exposing it to additional losses. Further, this insider negotiated unsafe and unsound terms for a loan and approved the loan based on grossly insufficient credit analysis and documentation. Without admitting or denying liability, this former insider consented to an OCC order prohibiting him from banking, requiring him to pay a \$40,000 CMP and \$960,000 in restitution.

## **Early Intervention**

The OCC continues to supervise problem banks aggressively, ensuring prompt corrective action, early intervention, and least-cost resolution. To minimize losses to the FDIC bank insurance fund, the OCC uses a program of structured early intervention and resolution strategies for banks that are being rehabilitated and returned to district supervision; going through voluntary liquidation; being sold or merged; or closed. In those circumstances, OCC orders can require the bank to submit a plan to sell, merge, or liquidate at no loss or cost to the bank insurance fund, should certain triggering events occur affecting the bank's condition.

The OCC took responsible action on all banks within 90 days of becoming critically undercapitalized. The OCC also worked diligently to rehabilitate problem banks identified at the end of FY 2003. Of the 121 institutions with a CAMELS rating of 3, 4, or 5 on September 30, 2003, 36 had improved CAMELS ratings by the end of FY 2004. Another 14 of the 121 banks were sold, merged or left the system without loss to the insurance fund during the year. The OCC achieved a 41 percent rehabilitation rate exceeding the performance target of 40 percent. This was an increase over the 32 percent achieved in FY 2003.

## Ensuring Fair Access and Fair Treatment

Activities in this subprogram include:

- Conducting risk-based fair lending examinations.
- Educating community and consumer organizations, and facilitating their interactions with the OCC.
- Researching new opportunities for community development financing and publishing best practices.
- Conducting outreach to national banks to assist them in meeting their obligations under the CRA rules.
- Meeting with people and groups protesting banks' corporate applications.
- Reviewing or approving individual bank community development activities.
- Reviewing issues related to fair access to financial services and fair treatment of bank customers.

The OCC completed the integration of compliance risk supervision into ongoing supervision activities for national banks. Overall, consumer compliance ratings for national banks remained at a high level during FY 2004. The OCC's performance in this subprogram is depicted in Table 3.

**Table 3: Ensuring Fair Access and Fair Treatment Performance Measures, FY 2001 – FY 2004**

Performance Measures	FY 2001	FY 2002	FY 2003	FY 2004 Target	FY 2004 Actual
Percentage of national banks with consumer compliance rating of 1 or 2	N/A	N/A	96%	94%	<b>96%</b>
Percentage of community banks that are within one year of their first large bank Community Reinvestment Act examinations in which the OCC offers to provide consultation on community development opportunities	N/A	N/A	100%	100%	100%
Percentage of consumer complaints closed within 60 calendar days of receipt	N/A	N/A	87%	80%	74%

### Consumer Complaints

The Customer Assistance Group (CAG) reviews and processes complaints from consumers of national banks and their operating subsidiaries. The CAG has highly trained compliance professionals equipped to deliver responsive customer service. The operation employs state-of-the art call center technology with bilingual call routing (English and Spanish), a Web-based complaint resolution process, and Internet and FAX access 365 days a year.

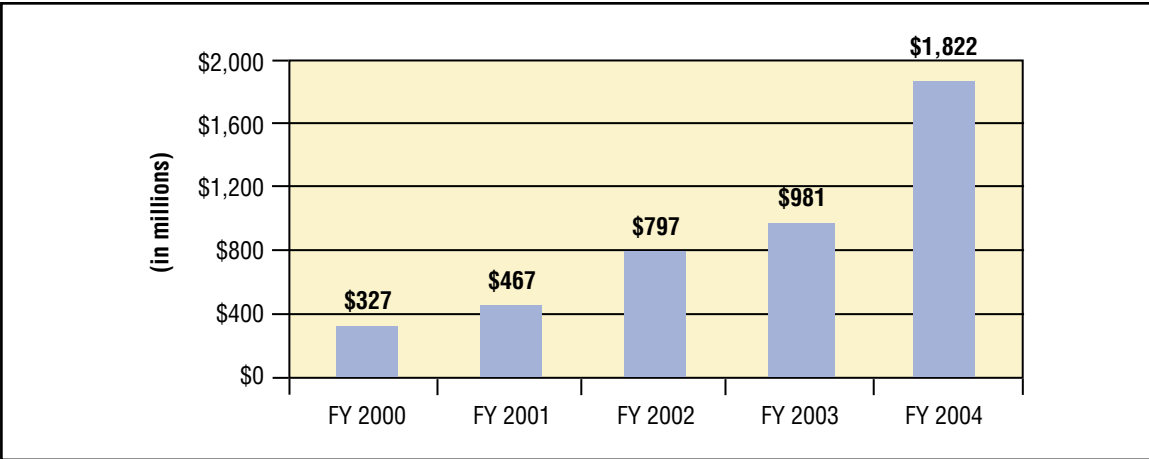
During FY 2004, the CAG received 66,864 calls, opened 68,026 cases, and closed 68,104 cases. Of the cases closed, 74 percent were completed within 60 calendar days of receipt. This was a decline from 87 percent in FY 2003. Although the number of consumer complaint cases declined by 9 percent from FY 2003, the increase in complexity of written cases and a decline in the number of cases that could be closed over the phone contributed to the CAG missing the performance goal this year. Management expects to meet this goal in FY 2005 by adding staff and increasing the efficient and effective use of technology.

In FY 2004, the CAG improved its procedures for processing consumer referrals from states attorneys general and state departments of banking. The CAG expanded its phone hours by more than 20 percent including inbound call service on Fridays, beginning October 1, 2004. These enhancements strengthen the OCC’s ability to provide high quality customer service and financial education to customers of national banks and their operating subsidiaries. Throughout its operation, the CAG has maintained a philosophy of resolving cases on first contact whenever possible.

**Community Affairs**

In January 2004, the OCC identified national banks that would receive their first large bank CRA examination in the next 12 months and offered to consult with each bank. The Community Affairs staff conducted 230 bank consultations to those and other national banks during FY 2004. Consultations covered strategies for national banks’ responsibilities under CRA, including local and regional investment opportunities; the OCC’s regulations for community development investments; federal low-income housing tax credits; and new markets tax credits. Over the past few years, as the number of these bank consultations have increased, there has been significant increases in the amount of investments national banks have made under the OCC’s community development investment regulation (12 CFR 24) as exhibited in Figure 2.

**Figure 2: National Bank “Part 24” Community Development Investments, FY 2000 – FY 2004**



In addition, the OCC met with community and consumer organizations, as well as a national civil rights organization about payroll stored value cards, refund anticipation loans, predatory lending, payday lending, financial literacy, and other consumer issues. These meetings provided the OCC with insights about challenges and opportunities for better access to financial services for consumers in disadvantaged communities. Additional activities are discussed in the *Industry and Community Outreach* section of this report.



## OCC Examiners Assist Iraqi Government to Establish Effective Bank Supervision

This year four OCC examiners stepped out of their routine into hazardous duty to help design and implement a bank supervision system in Iraq.



*From left to right; Steven Strasser, Cathryn Fitzgerald, Marty Wiseman, and Steve Lane*

Enduring dangerous conditions for six months, Steven Strasser and Marty Wiseman of Operational Risk Policy, and Cathryn FitzGerald and Steve Lane of Large Bank Supervision helped establish the foundation for a modern Iraqi banking system in vital areas:

- In consultation with the Iraqis, updated the Basel Core Assessment initiated by the Treasury's Iraqi task force and provided management training to convert assessment recommendations into a strategic planning process.
- Using OCC community bank examination procedures, created a risk-based training module designed to provide tools and techniques to the Iraqi Central Bank supervisors. All full time supervisors participated in two one-week seminars.
- Supplied guidance on appropriate methodology and approach in supervising insolvent banks, including appointing conservators.
- Furnished the Central Bank of Iraq Governor and the deputy governors with recommendations for an organizational restructure of the Supervision Department and qualifications for bank supervision management and staff.
- Consulted with Coalition counsel regarding a Commercial Bank Law, Central Bank of Iraq Law and the Anti-Money Laundering Anti-Terrorist Financing Act of 2004.
- Helped in the development of implementing regulations for the Commercial Bank Law and the Central Bank of Iraq Law and provided guidance to Central Bank senior management on implementation.
- Developed and conducted two one-week blocks of training for approximately 50 Iraq bank supervisors on risk-based supervision principles.
  - Introduced the concept of “CAMELS” ratings and a process to rate the banks.
  - Created a merit selection process for external training opportunities, including an IMF-sponsored event in Bahrain based on testing of knowledge gained from the bank supervision training.
- Provided recommendations to improve bank reporting and analysis. Prepared data analysis of banks' condition based on bank reported data to include trend and ratio analysis of key balance sheet and income data.
- Met with the Iraq Private Bankers Association to educate Iraqi bankers on new bank supervision techniques they could anticipate from the Central Bank of Iraq (CBI) and recommendations to forge closer working and training alliance with the CBI on basic risk-based bank supervision techniques and analysis.

## Regulate Program

The regulate program establishes regulations, policies, operating guidance, and interpretations of general applicability to national banks. These regulations, policies, and interpretations set systemwide standards, define acceptable banking practices, provide guidance on risks and responsibilities facing national banks, or prohibit (or restrict) banking practices deemed to be imprudent or unsafe. This program also includes establishing examination policies, handbooks, and interpretations for examiners, as well as representing and defending the OCC's regulatory authorities and interpretations in administrative, judicial, and congressional hearings. These activities support the strategic goal of a flexible legal and regulatory framework that enables the national banking system to provide a full competitive array of financial services.

The OCC devoted 368 FTEs or 14 percent of total FTEs to the regulate program, which cost \$63.6 million in FY 2004.

For the past two years, the OCC issued 87 percent of external legal opinions within the established time frames, exceeding the goal of 85 percent. In addition, the OCC issued nine final rules, four interim rules, eight notices of proposed rulemaking, and one advance notice of proposed rulemaking.

Among the most significant rulemakings completed this year were:

- *Bank Activities and Operations; Real Estate Lending and Appraisals (12 CFR 7 and 34), 69 Fed. Reg. 1904 (January 13, 2004) (the Preemption Rule)*. The final Preemption Rule adds provisions to OCC regulations that address the applicability of certain types of state laws to national banks' lending and deposit-taking activities. The rule also contains a general statement that state laws are preempted if they "obstruct, impair, or condition" national banks' ability to exercise fully the powers authorized to them under federal law. The rule preempts only the types and features of state laws that pertain to making loans and taking deposits specifically listed in the regulation. The rule does not apply to other types of state laws. The OCC may determine on a case-by-case basis whether state laws not listed in the regulation are preempted under the pre-existing, judicially established standards for federal preemption under the "obstruct, impair, or condition" phrasing of the rule.
- *Bank Activities and Operations (12 CFR 7), 69 Fed. Reg. 1895 (January 13, 2004) (the Visitorial Powers Rule)*. A federal statute, 12 USC 484, says the OCC has exclusive visitorial authority with respect to national banks unless federal law provides otherwise. Longstanding OCC regulations implement this visitorial powers statute by providing that state officials are not authorized to inspect, examine, or regulate national banks, except when another federal law authorizes them to do so. The final Visitorial Powers Rule clarifies that the scope of the OCC's exclusive visitorial authority applies to the content and conduct of national banks' banking activities. The rule also clarifies that the preservation of visitorial powers "vested in the courts of justice" does not grant state regulatory or law enforcement officials new authority, in addition to what they otherwise have, to exercise visitorial powers over national banks.
- *Lending Limits Pilot Program (12 CFR 32), 69 Fed. Reg. 51355 (August 19, 2004)*. This final rule extends and expands the lending limits pilot program that authorizes special lending limits for 1-4 family residential real estate loans and small business loans. Under the pilot program, eligible national banks with main offices in states that prescribe a higher lending limit for residential real estate loans or small business loans than the current federal limit may apply to take part in the program and use the higher limit. The pilot program originated in 2001 and was scheduled

to expire in June 2004. The final rule extends the program for three years, until June 2007, and expands it to include certain agricultural loans.

- *Rules, Policies, and Procedures for Corporate Activities; International Banking Activities (12 CFR 5 and 28) 68 Fed. Reg. 70691 (December 19, 2003)*. This final rule clarifies certain regulatory definitions and simplifies approval procedures for foreign banks seeking to establish federal branches and agencies in the U.S. These changes make the treatment of federal branches and agencies of foreign banks conform to that of their domestic national bank counterparts.

## **Legal Opinions**

Orders and legal opinions issued during FY 2004 included:

- *Letter to the National Conference of Commissioners on Uniform State Laws (NCCUSL) and the American Law Institute (ALI)*. This letter clarifies the scope of the final Preemption Rule by confirming that 1) the Uniform Commercial Code (UCC) does not “obstruct, impair, or condition” the ability of national banks to exercise fully the powers granted by federal law; and 2) those powers are implemented and supported by the UCC, which provides a uniform law of general applicability on which parties rely in their daily commercial transactions. (June 10, 2004).
- *Letter to Wachovia Bank, NA*. This letter confirms certain aspects of Wachovia Bank, NA’s fiduciary powers and concludes that the bank has the authority to implement a national fiduciary program. The letter also confirms that pursuant to the OCC’s regulations at 12 CFR 9.7(e)(2), any state law, other than a law made applicable by 12 USC 92a, that limits or establishes preconditions on the exercise of the fiduciary powers that are to be exercised as part of the bank’s program are not applicable to the bank. Finally, the letter notes that while a national bank may have the federal authority to act in various fiduciary capacities in a given state, that authority does not determine whether a state instrumentality has authority under its governing state statutes to contract with the national bank for fiduciary services. Interpretive Letter No. 995 (June 22, 2004).
- *Letter to National Association of State Treasurers (NAST) and the National Association of Unclaimed Property Administrators (NAUPA)*. This letter clarifies the scope of the final Preemption and Visitorial Powers Rules by confirming that the OCC’s preemption and visitorial powers rules do not change existing standards, established by U.S. Supreme Court precedent and federal statute, that govern the applicability and enforcement of state unclaimed property and escheat laws. (September 28, 2004).
- *Reinsuring Mortgage Insurance*. The OCC decided that national banks could collectively own with other financial institutions a mortgage reinsurance company that provides mortgage reinsurance on the loans of the participating financial institutions and their affiliates and subsidiaries. The national bank participants could make a non-controlling investment in the mortgage reinsurance company using the notice procedure under the OCC’s regulations at 12 CFR 5.36(e), if the bank otherwise qualifies under the criteria of that section. Interpretive Letter 985 (January 14, 2004).
- *Branch Names*. The OCC opined that a national bank’s proposal to operate branches in a retail store under a separate trade name that incorporated the names of the store and the bank would be consistent with the Interagency Statement on Branch Names. The opinion was based upon the bank’s representations that it would take certain steps to avoid customer confusion. Interpretive Letter 977 (October 24, 2003).

- *Lending Limits.* The OCC opined that, when a Native American tribe and its individual members dependent on the same business enterprises as sources of income but the individual members did not control the tribe, loans to tribe members generally would not be combined with loans made to other tribe members or to the tribe itself for purposes of the loan combination rules applicable to national banks. Interpretive Letter 979 (December 18, 2003).
- *Branching.* The OCC concluded that the installation of UPS drop boxes capable of receiving deposits at nonbranch offices of a national bank will not cause those offices to be considered branches because the drop boxes are owned by an independent third party and can be used by the general public for nonbanking transactions. Interpretive Letter 980 (December 24, 2003).
- *Stock Warrants.* The OCC opined that a national bank could convert stock warrants acquired in addition to, or in lieu of, loan interest into shares of stock and immediately sell them when there was no market for the warrants. Interpretive Letter 992 (May 10, 2004).
- *Interest on Loans.* The OCC concluded that 12 USC 85 permits national banks to charge loan prepayment fees when a state parity statute permits state banks to do so. Interpretive Letter 1004 (August 4, 2004).

### ***Supervisory Guidance, Policies, and Examination Handbooks***

The OCC issued supervisory guidance, policies, and examination handbooks on various issues and risks affecting national banks, including:

- *Secured Credit Cards.* The OCC advised national banks that, in light of consumer protection and other concerns, national banks should not offer secured credit card products (or similar unsecured products) that charge security deposits or fees to the credit card account if that practice would substantially reduce the available credit and card utility for consumers. The OCC also described the compliance, credit, and other risks presented by more traditional secured credit card products, and enumerated recommended practices for issuers of secured credit cards in areas, such as product marketing, product structure and terms, and credit risk management. (OCC Advisory Letter 2004-4).
- *Credit Card Marketing and Account Management Practices.* The OCC also alerted national banks to three specific credit card marketing and account management practices that the OCC regards as unacceptable because they may constitute unfair or deceptive acts or practices, or could otherwise expose a bank to compliance and reputation risk. These include failure to disclose the circumstances under which the issuer might unilaterally increase the cost of credit to the cardholder, marketing programs that promote credit limits that are seldom granted, and the use of promotional rates in solicitations without clearly disclosing the significant restrictions on the applicability of those rates. (OCC Advisory Letter 2004-10).
- *Risk Management of New, Expanded, or Modified Bank Products and Services.* This guidance outlines the risk management processes that banks should have in place to help ensure that potential new, expanded, or modified products or services provide appropriate risk-versus-return profiles and are consistent with a bank's strategic direction. Failure to conduct appropriate due diligence and risk management could result in credit losses, compliance issues, litigation exposure, unfavorable returns, and diminished reputation in the marketplace. (OCC Bulletin 2004-20).

- *Embedded Options and Long-Term Interest Rate Risk.* Banks that have invested a significant portion of their earning assets in products with embedded options (e.g., prepayment options on many residential mortgages) may be highly vulnerable to rising rates. This guidance alerts banks to the importance of measuring the cash flow and valuation risks for assets and liabilities with embedded options and discusses steps that banks can take to manage interest rate risk effectively. (OCC Bulletin 2004-29)
- *Tax Lien Certificates.* The OCC issued guidance on appropriate risk management practices for banks that purchase tax lien certificates. The guidance notes that purchase of tax lien certificates exposes banks to credit, operational, liquidity, and reputation risks. Because tax lien certificates arise through the nonpayment of taxes, the guidance instructs that such loans generally warrant a “substandard” rating and should be reported as “Other Assets” in a bank’s Report of Condition and Income. (OCC Bulletin 2004-39).
- *Electronic Record Keeping and Payroll Card Systems.* These advisory letters provide national banks with general background information on these emerging technologies, and discuss compliance and regulatory issues that banks should consider before implementing such systems or products. (OCC Advisory Letters 2004-9 and 2004-6).
- *Related Organizations Handbook.* This booklet in the *Comptroller’s Handbook* series has been revised to emphasize and clarify the OCC’s expectations for robust corporate practices and risk management systems governing related organizations. It also includes revisions to reflect provisions of the Gramm-Leach-Bliley Act of 1999 (GLBA) and the Federal Reserve’s Regulation W.
- *Revised Booklet on Detecting Red Flags in Board Reports.* The OCC updated this booklet, along with a “pocket guide” version to help bank directors meet their fiduciary responsibilities and comply with the corporate governance provisions of the Sarbanes-Oxley Act of 2002.

The OCC also issued supervisory guidance and examination procedures in partnership with other federal financial regulators. These initiatives are discussed in the *Partnership and Outreach* section of this report.

## **Litigation Activities**

The OCC was a party to, or prepared, “friend of the court” briefs in several cases related to bank powers, federal preemption of state law, enforcement actions, problem banks, and Title VII actions. Some examples follow.

- *Challenge to denial of golden parachute payments.* A U.S. District Court granted the OCC and FDIC summary judgment in a challenge to the agencies’ denial of a national bank’s request for permission to make a severance payment and annual split-dollar insurance premium payments to a terminated senior executive officer. The former executive officer challenged the interpretation of the golden parachute statute and regulations on which the agencies based their findings that the payments at issue were golden parachute payments and that reasonable grounds existed for the denial. The court found that the agencies’ interpretation and implementation of the law were reasonable. *Knyal v. OCC, FDIC*, No. C 02-2851 PJH (N.D. Cal., November 25, 2003).
- *Preemption of state law restrictions on activities of mortgage operating subsidiary.* A U.S. District Court, in granting the bank’s motion for summary judgment, held that 12 CFR 7.4006 preempts the

Connecticut Banking Commissioner from enforcing against a national bank operating subsidiary state laws that require businesses to obtain a state license to engage in making first and second mortgages. *Wachovia Bank, NA v. Burke*, No. 3:03CV0738 JCH (D. Conn. 2004, May 25, 2004).

- *Decisions that federal law authorizes a national bank to charge document preparation fees.* A state court in Michigan held that a national bank had a right to charge loan documentation fees without being subject to the restrictions on such fees imposed by Michigan law. *Brannam v. The Huntington Mortgage Co.*, Case No. 00-40439-CH (Cir. Ct., Muskegon City, Mich., February 2004).
- A state appellate court in Illinois upheld the dismissal of 37 cases, consolidated for appeal, in which the plaintiffs sought to recover restitution or damages for document preparation fees that they had paid in connection with obtaining real estate mortgages. The OCC had filed a “friend of the court” brief with a lower court in support of the bank’s position that federal law authorizes a national bank to charge document preparation fees. Although the appellate court dismissed the cases on a different ground, this did not vacate the decision of the trial court. *Jenkins v. Concorde Acceptance*, Consol. Appeal No. 02-2738 (App. Ct., Ill., December 31, 2003).
- *The Fair Credit Reporting Act (FCRA) preempts state laws that impose restrictions on information sharing with affiliates.* The defendant municipalities withdrew their appeal to the Ninth Circuit of a U.S. District Court decision holding that provisions of the FCRA preempt ordinances that impose restrictions on the sharing of confidential consumer information between financial institutions and their affiliates. The municipalities repealed the ordinances that were the subject of the litigation and asked the Ninth Circuit court to vacate the district court’s order. The Ninth Circuit granted the motion, and the district court vacated its decision. *Bank of America v. Daly City*, Nos. C 02-4343 and C 02-4943 (N.D. Cal. 2003).

## Charter Program

The charter program involves activities related to chartering national banks, as well as evaluating the permissibility of structures and activities of national banks and their subsidiaries. The program includes the review and approval of new national bank charters, federal branches and agencies, mergers, acquisitions, conversions, business combinations, corporate reorganizations, changes in control, operating subsidiaries, branches, relocations, and stock and debt issues. The charter process incorporates conditions and agreements needed to support the safe and sound operation of the resulting entities. These activities support the strategic goal of a flexible legal and regulatory framework that enables the national banking system to provide a full competitive array of financial services.

The OCC devoted 98 FTEs or 4 percent of total FTEs to the charter program, which cost \$16.4 million in FY 2004.

The OCC exceeded all FY 2004 performance targets and customer service standards for its licensing operations. The customer service results were based on 732 licensing surveys completed by banks during the year, which was a 35 percent response rate. The survey is based on a five-point scale, in which 1 indicates outstanding and 5 indicates significantly deficient. The OCC also followed up with every applicant that rated the overall licensing process 3 or worse. This follow-up helps the OCC understand the applicant’s concerns and make the appropriate modifications to its licensing process. The licensing and customer service performance measures and results are presented in Table 4.

**Table 4: Licensing and Customer Service Performance Measures, FY 2001 – FY 2004**

Performance Measures	FY 2001	FY 2002	FY 2003	FY 2004 Target	FY 2004 Actual
Percentage of licensing applications filed electronically	N/A	N/A	8%	15%	34%
Percentage of licensing applications completed within established time frames	96%	96%	97%	95%	96%
Average survey rating of OCC's timeliness on licensing applications	1.15	1.19	1.16	≤1.5	1.20
Average survey rating of the knowledge of OCC's licensing staff	1.17	1.19	1.14	≤1.5	1.20
Average survey rating of the professionalism of OCC's licensing staff	1.10	1.12	1.09	≤1.5	1.10
Average survey rating of the overall licensing services provided by OCC	1.16	1.17	1.14	≤1.5	1.20

### Licensing Decisions

A responsive and efficient licensing operation is essential to meet the needs of banks that are part of, or seek to become part of, the national banking system. The OCC received 2,592 applications and 70 After-the-Fact notices during FY 2004. Table 5 shows the corporate applications received in FYs 2003 and 2004. Corporate applications increased by more than 400 (20 percent) over FY 2003. Of the 2,477 decisions issued on applications during FY 2004, 96 percent were completed within the established time frames. The OCC has maintained this high level of responsiveness (96 or 97 percent) for the last four years. Table 6 shows the timeliness of the OCC's actions by type of application for FYs 2003 and 2004. The OCC exceeded its goal for timely decisions while providing a consistently high quality of services as rated by applicants.

**Table 5: Corporate Application Activity, FY 2003 and 2004**

	Applications Received		FY 2004 Decisions			
	FY 2003	FY 2004	Approved	Conditionally Approved [4]	Denied	Total
Branches	1,439	1,765	1,794	4	0	1,798
Capital /Sub Debt	119	136	45	3	0	48
Change in Bank Control	16	16	13	0	1	14
Charters	29	31	9	27	2	38
Conversions [1]	19	21	15	3	0	18
Federal Branches	4	4	1	1	0	2
Fiduciary Powers	37	22	11	2	0	13
Mergers [2]	61	90	90	6	0	96
Relocations	236	288	283	0	0	283
Reorganizations	115	137	114	8	1	123
Stock Appraisals	0	1	0	0	0	0
Subsidiaries [3]	85	81	41	3	0	44
Total	2,160	2,592	2,416	57	4	2,477

[1] Conversions are conversions to national bank charters.

[2] Mergers include failure transactions when the national bank is the resulting institution.

[3] This count does not include 109 After-the-Fact notices received in FY 2003 and 70 After-the-Fact notices received in FY 2004.

[4] On April 14, 2000, the Licensing Department issued guidance imposing special conditional approval for all bank charters requiring the OCC to be notified before a significant change in the operating plan during the first three years of operation.

**Table 6: OCC Licensing Actions and Timeliness, FY 2003 and 2004**

		FY 2003			FY 2004		
		Number of Decisions	Within Target		Number of Decisions	Within Target	
Application Type	Target Time Frames in Days [1]		Number	%		Number	Number
Branches	45 / 60	1,313	1,285	97.9%	1,798	1,769	98.4%
Capital /Sub Debt	30 / 45	93	89	95.7%	48	46	95.8%
Change in Bank Control	N/A / 60	10	10	100.0%	14	14	100.0%
Charters [2]		15	8	53.3%	38	22	57.9%
Conversions	30 / 90	18	13	72.2%	18	14	77.8%
Federal Branches	N/A / 120	5	5	100.0%	2	2	100.0%
Fiduciary Powers	30 / 45	12	12	100.0%	13	7	53.9%
Mergers	45 / 60	72	62	86.1%	96	86	89.6%
Relocations	45 / 60	230	227	98.7%	283	278	98.2%
Reorganizations	45 / 60	100	92	92.0%	123	100	81.3%
Stock Appraisals	N/A / 90	0	0	N/A	0	0	N/A
Subsidiaries	30 / 60	50	50	100.0%	44	44	100.0%
Total		1,918	1,853	96.6%	2,477	2,382	96.2%

Note: Most decisions (97 percent in FY 2003 and 99 percent in FY 2004) were made in the district offices, International Banking and Finance, and Large Bank Licensing under delegated authority. Decisions include approvals, conditional approvals, and denials.

- [1] Those filings that qualify for the “expedited review” process are subject to the shorter time frames listed. The longer time frame is the standard benchmark for more complex applications. New time frames commenced in 1997 with the adoption of the revised Part 5. The target time frame may be extended if the OCC needs additional information to reach a decision, permits additional time for public comment, or processes a group of related filings as one transaction.
- [2] For independent charter applications, the target time frame is 120 days. For holding-company-sponsored applications, the target time frame is 45 days for applications eligible for expedited review, and 90 days for all others.



## Electronic Filing of Applications

During FY 2004, the OCC continued to offer a wider array of applications and notices on e-Corp. In February 2004, the OCC added seven capital applications and one capital notice. In August 2004, Licensing added two investment in subsidiaries and equities applications, and six notices. e-Corp is available free to all national banks on the National BankNet (OCC's secure extranet site for national banks). The e-Corp application process uses simple, yet innovative, interactive features to make the submission of licensing applications easier. This includes the ability to sign electronically, and submit, e-Corp applications and notices on-line.

e-Corp went live on March 3, 2003, when branch and relocation applications were made available. At the end of FY 2004, 15 types of applications and 12 types of notices were available on e-Corp, making the vast majority of common filings available electronically. Filing electronically is optional. Thirty-four percent of all applications were filed electronically, more than twice the target number for FY 2004, and a four-fold increase from the 8 percent in FY 2003.

## Other Licensing Accomplishments

The OCC publishes the 23-booklet *Comptroller's Licensing Manual* electronically. The OCC updates the electronic manual regularly as changes occur, an option not available with the printed format. During FY 2004, seven Manual booklets were revised, posted to the OCC's Web site, and made available on compact disc (CD) for examiners and the public. The most extensive project was to merge the "Corporate Organization" booklet with the "Charters" booklet.

The OCC continued to improve its licensing procedures through the Field Guidance Project, including a comprehensive review and update of field investigations and guidance on reopening examinations. Comprehensive new guidance for conducting examination activities for conversion proposals was made available in FY 2004 on the OCC's Intranet and to bank examiners on CD-ROM, as well as incorporated into the OCC's automated examination application, Examiner View (EV). In addition, EV added new templates for field investigation and reopening reports.

## Change in Bank Control

The OCC's objective in administering the Change in Bank Control Act (CBCA) is to maintain and enhance public confidence in the national banking system by preventing anti-competitive activity, inadequate financial support, or unsuitable management in national banks. The OCC reviews each CBCA notice and disapproves transactions that could have serious harmful effects.

The OCC's CBCA activity is reflected in Table 7. The OCC received 16 CBCA notices and acted on 14 notices in FY 2004.

**Table 7: Change in Bank Control Act [1], 2001–9/30/2004**

Year	Received	Acted On	Not Disapproved	Disapproved	Withdrawn
2004*	16	14 [2]	13	0	0
2003*	16	10	9	1	0
2002	10	10	9	1	0
2001	18	17	17	0	0

[1] Notices processed with disposition.

[2] Includes one Notice with no activity and considered abandoned by the OCC.

\*Fiscal Year

## ***Community Reinvestment Act***

Consistent with 12 CFR 5, the “Public Notice and Comments” booklet (February 2003) details the OCC’s procedures for handling CRA issues in applications, including the treatment of adverse comments from the public. During FY 2004, the OCC received adverse comments from the public on four CRA-covered applications. The OCC also reviewed and publicly addressed CRA issues raised in another application. On the OCC’s Web site, the OCC’s monthly Interpretations and Actions listed the decisions on applications presenting CRA issues, as shown in Table 8.

**Table 8: List of Applications Presenting Community Reinvestment Act Issues Decided, FY 2004**

<b>Bank, City, State</b>	<b>Interpretations and Actions</b>	<b>Document Number</b>
Citibank USA, NA, Sioux Falls, SC	November 2003	CRA Decision No. 117
Wells Fargo Bank, NA, San Francisco, CA	December 2003	CRA Decision No. 118
J.P. Morgan Trust Company, NA, Los Angeles, CA	January 2004	CRA Decision No. 119
Sun National Bank, Vineland, NJ	January 2004	CRA Decision No. 120
PNC Bank, NA, Pittsburgh, PA	January 2004	CRA Decision No. 121
Bank of America Corporation, Charlotte, NC	March 2004	Conditional Approval No. 577
HSBS Bank and Trust Company (Delaware), NA, Wilmington, DE	July 2004	CRA Decision No. 122

## **Partnership and Outreach**

In addition to the activities discussed under each program area, the OCC works with other regulators, the industry, community groups, and consumer organizations to promote the OCC’s mission and accomplish its strategic goals and objectives in an effective and efficient manner.

### ***Financial Regulators***

Primarily through the FFIEC, the OCC works closely with the other federal banking agencies (Board of Governors of the Federal Reserve System [FRB], Federal Deposit Insurance Corporation [FDIC], Office of Thrift Supervision [OTS], and National Credit Union Administration [NCUA]) to coordinate supervisory policies, regulations, regulatory reporting requirements, and examiner training on issues that cut across the banking system. These efforts reduce regulatory burden by promoting greater uniformity, consistency, and efficiency in the supervision of insured depository institutions.

The OCC also works with other state, federal, and international regulators and supervisors on matters of mutual interest.

The OCC has entered into information-sharing agreements with insurance departments in 48 states and the District of Columbia and meets regularly with the National Association of Insurance Commissioners.

The OCC works closely with the Securities and Exchange Commission (SEC) on securities, brokerage, and accounting and disclosure issues, and with the Federal Trade Commission (FTC) on consumer protection and privacy issues. In FY 2004, the OCC continued to consult with the SEC on revisions to SEC rules implementing the bank broker-dealer provisions of the GLBA, and to work with the SEC and state regulators on other matters of mutual interest. For example, the OCC worked closely with the SEC and the New York attorney general in taking enforcement action against an uninsured trust bank engaged in illegal late trading

and market timing. The OCC, FDIC, FRB, OTS, and SEC also issued for public comment a proposed statement on complex structured finance activities. The statement describes the types of internal controls and risk management procedures that can assist financial institutions to identify and address the reputation, legal, and other risks associated with complex structured transactions.

The OCC is a member of the administration's Financial and Banking Infrastructure Information Committee (FBIIC) and, as discussed later, has joined other federal regulators to combat money laundering and terrorist financing activities. Throughout FY 2004, OCC staff assisted FBIIC's efforts to identify and address the financial sector's vulnerabilities to terrorism.

On the international front, the OCC is participating in efforts by the Basel Committee on Banking Supervision to update and revise the Basel Capital Accord to make the capital standards required of internationally active banks more comprehensive, risk sensitive, and reflective of advances in banks' risk measurement and management practices (Basel II).

The OCC worked closely with other regulators to address emerging risks and issues facing the industry, reduce regulatory burden, and enhance regulatory efficiency. These efforts included:

- *Basel II Implementation and Revisions to Risk-Based Capital Standards.* In June 2004, the Basel Committee issued its "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Framework). This Framework forms the basis upon which the U.S. banking agencies and representatives of the other Basel Committee member countries will develop proposed revisions to existing capital adequacy regulations and standards. The OCC continues to work closely with the other federal banking agencies (FDIC, FRB, and OTS) on implementation issues associated with the proposed Basel II Framework. These efforts have included outreach meetings with industry participants to discuss and receive feedback on the Framework; continued work on supervisory guidance for portfolios and risk exposures that outlines the key components of the measurement and management structures that banks subject to the revised Framework will need to meet; benchmarking exercises to assess banks' progress in developing and implementing operational risk measurement techniques that would be consistent with the Framework's requirements; and impact studies to assess the potential effect of the Framework.

In addition to these efforts, the banking agencies issued final rules in FY 2004 to amend their risk-based capital standards for certain asset-backed commercial paper programs.

- *Initiatives to Enhance Consumer Safeguards.* Throughout FY 2004, the OCC partnered with other federal regulators to enhance consumer protection safeguards. The agencies issued proposed rules under the Fair and Accurate Credit Transactions Act regarding affiliate marketing and protection of consumer information and sought public comment on, and continued the development of, simplified privacy notices. To help consumers combat identity theft, the FFIEC agencies prepared and made available a deposit statement stuffer that explains Internet "phishing" and steps that consumers can take to protect themselves. To combat predatory and abusive lending practices, the FFIEC-member agencies partnered with the FTC, Office of Federal Housing Enterprise Oversight, Department of Housing and Urban Development, and Department of Justice, to publish a brochure on predatory lending. The brochure, "Putting Your Home on the Loan Line is Risky Business," cautions consumers about predatory lending and tells them how they can guard against such practices. The brochure was in English and Spanish. The FFIEC-member agencies also issued for comment proposed supervisory guidance on overdraft protection programs.

- *Expanded Guidance on Technology-Related Risks.* During FY 2004, the federal banking agencies completed their revisions of the 1996 *FFIEC Handbook on Information Systems*. The 1996 handbook was replaced by a series of 12 booklets addressing topics such as business continuity planning, information security, electronic banking, outsourcing, retail and wholesale payment systems, audit, and management.
- *Initiatives to Reduce Unnecessary Regulatory Burden and Enhance Efficiency.* The OCC continues to work with the other FFIEC-member agencies on a multi-year project to review their regulations to identify outdated, unnecessary, or burdensome regulatory requirements imposed on insured depository institutions by the Economic Growth and Regulatory Paperwork Reduction Act. During FY 2004, the agencies requested public comment about possible relief in consumer protection rules related to lending and account/deposit relationships. The agencies also hosted outreach meetings with bankers and community groups in New York, Nashville, Seattle, Chicago, Washington, D.C., and San Francisco to solicit input on burden reduction. In June 2004, the agencies testified about regulatory reform before the Senate Committee on Banking, Housing and Urban Affairs.

The OCC, the FDIC, and the FRB also continued work on their project to create a shared central depository for collecting, validating, storing, and distributing call report information. When completed, this project will provide enhanced data quality and expedited data sharing.

- *Joint Examination Programs.* The banking agencies continued their joint supervisory programs, including the SNC Program, the Interagency Country Exposure Review Committee, and the interagency examination program for multi-regional data processing servicers. The SNC program is governed by an interagency agreement between the FRB, FDIC, and the OCC, to provide uniformity and efficiency in analyzing and rating large, complex credits. A SNC is defined as any loan or formal loan commitment extended to a borrower by a supervised institution, or any of its subsidiaries and affiliates, that aggregates \$20 million or more and is shared by three or more institutions under a formal lending agreement. The program benefits the regulatory agencies and the banks by: 1) eliminating the redundancy of reviewing the same credit in multiple institutions; 2) ensuring that credits are reviewed in a uniform and consistent manner; 3) maximizing resources; and 4) limiting disruptions to banks' operations. The FY 2004 SNC review covered 7,490 credits with commitments totaling \$1.5 trillion.
- *Updated Supervisory Guidance.* The federal banking agencies issued supervisory guidance throughout the year to bankers on risks posed by bank activities and methods banks can use to manage those risks. In addition to the items previously discussed, interagency guidance was issued on:
  - Safety and soundness and legal issues involved in providing financial support to investment funds advised by the institution or its subsidiaries or affiliates.
  - Appropriate accounting treatment for deferred compensation agreements.
  - Revisions to the agencies' uniform agreement on the classification of securities to reflect changes in accounting standards and bank risk management practices.

## **Bank Secrecy Act and Anti-Terrorist Financing Activities**

The OCC works closely with other federal financial regulators and criminal law enforcement agencies to combat money laundering and terrorist financing. Some of these interagency groups are mentioned below. At the request of law enforcement authorities, the OCC also provides expertise and assistance in criminal investigations involving bank fraud and other white-collar crime. OCC examiners and staff are frequent instructors and speakers at BSA/AML schools and industry conferences.

The OCC also continues to play an important role in improving the AML and terrorist financing controls in banking throughout the world. For the past several years, the OCC has provided examiners to assist with U.S. government-sponsored international AML and terrorist financing assessments. The OCC maintains a cadre of specially trained examiners that has provided assistance to the Treasury Department and the State Department on these assessments around the world, including South and Central America, the Caribbean, the Pacific-rim nations, the Middle East, Russia, and the former Eastern Bloc nations.

### **Interagency Groups to Combat Money Laundering and Terrorist Financing**

#### **Suspicious Activity Reports Owners Group**

- Administers the bank SAR database and SAR form, which is jointly owned by the banking agencies and the Financial Crimes Enforcement Network (FinCEN).
- Coordinated by FinCEN and/or the federal banking agencies.

#### **Bank Secrecy Act Advisory Group**

- Created by statute to coordinate BSA/AML-related matters among federal and state regulatory agencies, law enforcement, and the private sector.
- Headed by Treasury and meets twice a year.
- Includes various subcommittees (one addressing examination procedures and consistency) that meet more frequently; the OCC chairs the subcommittee on SAR confidentiality.

#### **Bank Fraud Working Group**

- Addresses criminal matters of mutual interest to bank regulators and law enforcement.
- Meets monthly under the direction of the U.S. Department of Justice's Fraud Section.
- Includes more than 13 agencies – bank regulators, SEC, Federal Bureau of Investigation, Internal Revenue Service–Criminal Investigations, U.S. Secret Service, and other law enforcement authorities.

#### **Financial Action Task Force (FATF)**

- Sponsored by the Organization for Economic Cooperation and Development (OECD) for international AML policy and coordinating body.
- Headed by Treasury with outreach to the bank regulators for input and participation as necessary.
- Issues position papers and recommendations for governments' efforts to fight money laundering and terrorist financing.

#### **FFIEC BSA Working Group**

- Formed recently at the request of FFIEC-member agency principals.
- Addresses the coordination of updated interagency BSA/AML examination procedures and training and ancillary matters.

The OCC and other federal banking agencies revised the examination procedures for key sections of the USA PATRIOT Act (Act). These procedures will be incorporated into the OCC's revised "Bank Secrecy Act" booklet in the *Comptroller's Handbook*. The OCC is coordinating its handbook revisions with the other federal regulators. The OCC took the lead in drafting the January 2004 interagency "Frequently Asked Questions" (FAQs) regarding the application of section 326 of the Act that requires banks to have a customer identification program. A second set of interagency FAQs is scheduled to be issued by the end of Calendar Year (CY) 2004. In June 2004, the OCC and other federal banking agencies issued an interagency advisory providing guidance to the banking industry about accepting accounts from foreign governments, embassies, and political figures. Interagency guidance was also issued on recent rulings affirming the statutory safe harbor provision for financial institutions and their employees in reporting known or suspected criminal offenses or suspicious activities pursuant to the 1992 Annunzio-Wylie Anti-Money Laundering Act.

The OCC's QM Division initiated a review and evaluation of the approach to, and effectiveness of, its BSA/AML supervision programs. The OCC also approved the development of an enhanced database of national bank-filed SARs and a revised risk assessment process to better identify high-risk banks.

Throughout FY 2004, the OCC also continued its efforts with FinCEN and the other agencies to explore better ways to use BSA information in the OCC's examination process and to enhance information sharing among the agencies in this critical area. In September 2004, the OCC and other federal banking agencies entered into a Memorandum of Understanding (MOU) with FinCEN to establish information sharing procedures for certain BSA-related activities. Through this MOU, the agencies intend to improve interagency coordination on BSA examination and compliance.

### ***Industry and Community Outreach***

The OCC maintains open communications with key constituents that are affected by, and interested in, the OCC's mission. The Comptroller and senior managers seek input and feedback on issues facing the banking industry through outreach meetings with industry groups and trade associations. "Meet the Comptroller" roundtables are creative responses to the need for continuing dialogue between bankers and senior OCC officials.

The OCC's outreach efforts during FY 2004 included four telephone seminars for bankers in which bankers listen to agency experts discuss experiences and policy imperatives, and interact with them during question-and-answer sessions. Seminar topics were Rural Economic Development Lending Opportunities for Community Banks, Condition of the Banking Industry, Outsourcing Technology Services, and Financing Minority Businesses. More than 3,000 listeners participated in these telephone seminars during the year.

The OCC also conducted workshops on Understanding OCC's Risk Assessment Process for about 275 community bank directors. The goal was to enhance understanding of risk-based supervision; increase familiarity with major risks in commercial banking; learn the types of questions to ask managers, auditors, and examiners; and review common ways to identify, measure, monitor, and control risk. Additionally, the OCC developed a new program, Credit Risk: A Directors Focus, attended by about 175 community bank directors. The program aimed to increase directors' knowledge of effective credit risk management processes, help them assess and control their bank's risk profile, and improve their ability to evaluate the quality of their management information systems. Other outreach activities were discussed under the *Community Affairs* section of this report.

## Management

The OCC's strategic goal of an expert, highly motivated and diverse workforce that makes effective use of OCC resources is closely aligned with the objectives of the President's Management Agenda (PMA). The OCC continued its efforts during FY 2004 to achieve the goals established by the OMB for each PMA initiative. A brief discussion of each initiative follows.

### Initiatives

#### ***Budget and Performance Integration***

The OCC further refined its planning, budgeting, and evaluation process for the FY 2005 budget cycle. For a second year, business units developed their budget requests based on staffing models to support their FTE needs and program plans to identify the activities to be accomplished with the expected objectives and performance measures. The budget and finance subcommittee played a key role in the budget reviews, bringing greater credibility and sustainability to the process. A new activity-based labor allocation structure was implemented for time reporting at the beginning of FY 2004. During FY 2005, business units will use the activity data to validate the labor estimates in their staffing models, which will enhance the FY 2006 budget formulation process. Beginning in January 2004, performance reporting was incorporated into the quarterly financial reports to senior management. To meet the standards for this initiative, the OCC evaluated several efficiency measures for external reporting. Although these measures were not adopted for FY 2005, the OCC will continue to evaluate methods to measure efficiency that will be meaningful internally and externally.

#### ***Competitive Sourcing***

To date, the OCC has completed streamlined A-76 studies for 30 percent of its commercial activity FTEs. During FY 2003, two competitions representing 65 FTEs were conducted within the Information Technology Services (ITS) function. One of these satisfied the OCC's FY 2004 PMA goal. These competitions resulted in retaining the activities in-house. The OCC has met all of its competitive sourcing goals and has no additional studies planned. The OCC will continue to evaluate the potential for further studies.

#### ***Expanded e-Government***

The OCC re-engineered its Capital Planning and Investment Control (CPIC) process to ensure that requests for information technology (IT) align with the OCC's mission, goals, and objectives, and support the delivery of OCC programs and services. In FY 2004, the OCC introduced portfolio management oversight disciplines in line with the Clinger-Cohen Act,

which requires federal agencies to treat IT as an investment, and developed disciplined repeatable processes to select, control, and evaluate IT in support of OCC goals and objectives.

The OCC's Investment Review Board established two scoring teams to review proposed investments for 1) mission alignment, 2) performance improvement, 3) risk management, 4) project management, and 5) enterprise architecture to ensure the selection of the best IT investments. Technology projects with business cases that totaled more than \$4.2 million were not pursued as a result of the vigorous review process this year. Approval of the FY 2005 IT portfolio by the technology and systems subcommittee and the Executive Committee demonstrated senior management's direct involvement in the selection of IT projects.

The OCC's capital planning process aligns with the Department of the Treasury's CPIC process and requirements. The OCC is recognized as a best practice leader in capital planning across the department. The re-engineered process has placed the OCC in a position to plan IT initiatives strategically and to monitor return on investments and other benefits derived from IT investments effectively.

At the end of FY 2004, the OCC had completed the security certification and accreditation for 73 percent of its information technology systems. The OCC is scheduled to complete the remaining certifications and accreditations by April 1, 2005.

The OCC is participating to varying degrees in government-wide technology initiatives including Integrated Acquisition, eAuthentication, eTraining, and Online Rulemaking. As part of the plan to retire existing mainframe platform technology, the OCC is considering implementing an e-Travel system during FY 2006.

### ***Improving Financial Performance***

The OCC meets all of the objectives for this PMA initiative. The OCC successfully issued its FY 2003 Annual Report before November 15 for the third consecutive year. The agency received an unqualified opinion with no material weaknesses on both the FY 2003 and FY 2004 financial statements. No material weaknesses have been identified since FY 1999 with the final corrective action completed in FY 2002. The OCC consistently closed its accounting records for month-end financial reporting on a timely and accurate basis. Financial reports are provided to the budget and finance subcommittee monthly and to the Executive Committee quarterly for timely operational decisions. In January 2004, performance reporting was incorporated into these quarterly reports to senior management.

### ***Human Capital***

Over the past year, the OCC continued to address human resource issues that are critical to its long-term strategic priorities. Of primary concern is the growing number of retirements facing the OCC over the next five years, particularly among examiners in large banks and with specialty skills. The addition of mid-size and large institutions to the national banking system is creating an even greater need for experienced examiners.

The OCC is in the second year of its expanded recruitment program for entry-level bank examiners. The program has been highly successful in attracting a diverse pool of applicants with superior qualifications. To foster retention of new examiners, the OCC has returned to a pre-commission examiner training program that includes six to eight months on a training team and nearly 800 hours of classroom training and self-study. In addition, new hires are surveyed every six months to identify potential retention problems early and improve recruitment processes.

A second major recruitment initiative has been to encourage examiners to move between Mid-size/Community Bank and Large Bank Supervision. New incentive programs were created to encourage the best qualified



examiners to apply for rotational examiner-in-charge positions in Large Banks and other senior level Large Bank positions in New York City. An external recruitment strategy also has been implemented to target experienced prospects for Large Banks, particularly in New York City.

The OCC has identified critical bank supervision competencies as credit risk, risk management, capital markets, asset management, bank technology, mortgage banking, bank secrecy, and money laundering. Updated training programs for commissioned examiners and the Examiner Specialty Skills Program, which has 722 members, are contributing to the development of these competencies in the OCC's bank supervision staff. In addition, the OCC initiated a work team to strengthen its career management and leadership development programs. The OCC will create strategies and courses of action to identify and develop employees viewed as potential managers and further develop managers who are candidates to succeed senior management. The OCC also is developing a training curriculum for administrative professionals to ensure they get the training they need, particularly to keep pace with changes in technology.

A new affinity group was organized this year by a group of tenured women in the OCC who appreciate the opportunities that OCC has given to them and who want to give back to the organization by helping others. All four of the OCC's affinity groups have been involved in establishing mentoring programs for their constituents and in contributing to the OCC's internal and external recruitment efforts. The affinity groups also sponsor awareness and observance month programs. An annual forum of the affinity group leaders promotes an exchange of ideas on how affinity groups can contribute further to OCC's strategic goals and the needs of the OCC's workforce.

The OCC was named one of the best places to work in the federal government by the Partnership for Public Service and the Institute for the Study of Public Policy Implementation at American University, based on results of the Office of Personnel Management (OPM) survey of federal government employees. The OCC scored among the top 25 government organizations with its highest scores in teamwork, support for diversity, pay and benefits, training and development, strategic management, effective leadership, family-friendly culture, work-life balance, performance-based rewards, and career advancement. These scores reflect the OCC's strong commitment to cultivating an employee-focused and performance-based culture where employees are expected to develop their skills and knowledge continuously.

For more than two decades, the OCC's compensation program has awarded pay increases based solely on job performance and the increase in duties and responsibilities. Annual employee performance plans describe the objectives and how they relate to the accomplishment of the OCC's strategic priorities. Ongoing statistical analysis continues to show that these programs are working; high performers receive larger annual pay increases and are more likely to receive awards and promotions.

The OCC surveys other federal financial institution regulatory agencies annually to ensure that its compensation programs are comparable. The OCC also participates in interagency groups to exchange information on the comparability of benefit and work-life programs. The OCC's compensation and benefit programs are designed to support its mission and human capital goals and priorities.

Other management initiatives follow.

### ***Workplace Fairness and Alternative Solutions***

The OCC implemented an initiative to educate managers and employees on the prevention and early resolution of workplace conflicts and other EEO-related programs. As of September 30, 2004, about 50 percent of the OCC's workforce has received formal training led by the OCC's EEO counselors. The OCC has focused on reducing formal EEO complaints and promoting the OCC's Fair Alternative and Innovative Resolutions (FAIR) Program.

The number of formal EEO complaints filed in FY 2004 decreased by 50 percent from FY 2003. FAIR offers alternative dispute resolution (ADR) techniques to encourage open dialogue and the early resolution of issues. The OCC has provided non-EEO workplace conflict services to 18 managers and employees during FY 2004.

### ***Workforce Effectiveness***

Recommendations from the FY 2003 headquarters office study were implemented during FY 2004. The restructuring objectives combined closely related functions, reduced layers of managers where appropriate, improved communication and coordination of work, and better ensured that work performed in headquarters advances the OCC's mission. Affected employees received the same benefits offered to employees affected by the district restructuring that was completed in FY 2003, including a buyout program with outplacement assistance.

### ***Continuing Education and Resource Alternatives***

The OCC's learning management system became fully operational in May 2004 with FY 2005 training planned and scheduled through the Automated Learning Information System (ALICE). The system provides employees with access to their training transcripts and individual development plan capabilities.

During FY 2004, the OCC re-instituted the Resource Group as a means of providing resources to agency projects and initiatives. Currently staffed with 14 employees, Resource Group members serve as supplemental staff in performing ongoing activities, or as technical experts, bank examination support, and internal consultants performing special projects.

### ***Information Technology***

- *Information Security.* During FY 2004, the OCC improved compliance with the Federal Information Security Management Act (FISMA); implemented a new secure messaging system that allows OCC examiners to exchange sensitive information securely with national banks; deployed intrusion detection sensors to identify possible compromises of network defenses; deployed spam blocking on OCC e-mail; blocked access to insecure and inappropriate Web sites; scanned all OCC Internet traffic; scanned the entire OCC network to identify security vulnerabilities; and avoided attacks by worms and viruses that crippled other public and private organizations.
- *Systems Development Life Cycle (SDLC).* The OCC completed the SDLC Framework in May 2004 and the SDLC methodology in September 2004. Following an independent assessment and subsequent pilot, the SDLC will be implemented for all FY 2006 projects. The SDLC provides a series of best practice standards that application developers will use to mitigate risks associated with each phase of software acquisition or development.
- *Mainframe Retirement.* This project will eliminate obsolete technology and address the related problem of obtaining vendor support for maintaining OCC systems that are housed on the mainframe. The OCC developed a project plan to retire the mainframe by September 2007. A project team was formed and business unit representatives were identified.
- *Supervisory Information System (SIS).* SIS is a suite of bank supervision applications that support bank examiners. The first phase, SIS-Office, the Web-based application designed to replace Office View in EV, was implemented in June 2004. SIS-Office ensures that work papers identified for deletion are routinely evaluated and acted upon, collects and stores data on deleted work papers in a records management repository, and improves response time of EV by reducing the size of the database.

- *National Credit Tool (NCT)*. This Web-based tool enhances the efficiency and quality of the loan portfolio examination process in community banks by automatically producing valid statistical samples for examination, automatically preparing worksheets previously completed manually, and generating standardized reports. In FY 2004, NCT added a credit concentrations report, a commercial real estate stress-testing worksheet, and a usage report. NCT also gained the ability to create a trial balance file and quarterly updates of credit analytics information for comparative analyses.
- *Examiner View*. This bank supervision system obtained enhanced controls for compliance with the Community Bank Supervision Handbook Procedures, an enhanced Interest Rate Risk segment to reduce examiner administrative burden, added data elements to track compliance with the Sarbanes-Oxley Act, and improved availability of current information.
- *Wireless Network Access*. The OCC deployed about 250 wireless cellular modems to examination teams across the country. The modems supplement dial-in access to the OCC network. The modems have been especially useful in locations where phone lines are not readily available or cost-effective.

## ***Continuity of Operations***

The Contingency Planning Oversight Committee (CPOC) provides policy guidance and directs the preparation and implementation of the OCC's Continuity of Operations Plan (COOP). The CPOC has two mandates, to oversee the training, tabletop exercises, and other drills that are needed to perfect and implement the COOP continuously, and to ensure effective coordination with other components of the federal government in responding to emergencies that affect the operations of national banks and the national banking system.

During FY 2004, the OCC reorganized its security, critical infrastructure protection, and emergency management functions into a new business unit. A new position, national director for critical infrastructure protection & security, was established to direct COOP-related activities. The CPOC was also reorganized to create a new Continuity Planning Coordinating Committee to oversee eight functional working groups to focus on the following areas: 1) emergency processes and procedures, 2) communication processes, 3) orientation and annual training, 4) testing and exercises, 5) IT testing and exercises, 6) emergency facilities, 7) interagency coordination, and 8) administration and documentation.

Each of the OCC's COOP teams was reorganized to address changes in the OCC's recovery strategies and issues identified from the Testing, Training, and Exercise Program.

- *Testing, Training, and Exercises*. Testing of various elements of the OCC's COOP was completed during FY 2004, including a comprehensive Relocation/Tabletop Exercise involving staff throughout the country. The OCC also participated in the government-wide Forward Challenge 04 and other interagency exercises. Two evacuation drills and a shelter-in-place drill were conducted at OCC headquarters, and OCC field elements continued to test various aspects of their site-specific emergency plans. Alert and notification drills, interagency communications drills, and other interagency testing also took place during FY 2004. Testing of the OCC's IT recovery plan continues on a regular basis, focusing on recovering systems and applications needed to support the OCC's critical infrastructure. Training for the OCC's COOP and emergency teams will continue on a regularly scheduled basis.
- *Plan Maintenance*. The OCC recognizes that the COOP must remain a "living document" to be viable. The OCC COOP plan has been developed as an e-Redbook, which all COOP personnel and managers can access. The plan also resides on memory sticks that COOP personnel can carry

with them. Individuals have been assigned responsibility to update sections of the plan based on a maintenance schedule.

- *Emergency Preparedness.* Survival kits are issued to all OCC employees and contractors, and additional survival supplies have been stored at each office location. Emergency preparedness resources and information continue to be provided to all employees on a regular basis, with copies placed on the OCC's emergency preparedness Web site.

A new headquarters Emergency Operations Center (EOC) was built and was used for the shelter-in-place drill during FY 2004. The EOC ensures that the Executive Committee can continue to perform critical functions during shelter-in-place emergencies. During FY 2004, the OCC transitioned to a new COOP site that is shared with other federal agencies. The new site meets all federal regulations from the Department of Homeland Security, Federal Emergency Management Agency. An additional MOU has been signed with another federal agency for shared COOP relocation space within the District of Columbia, for emergencies that do not require an evacuation of the city.

The OCC participates in FBIIC activities to provide secure communications throughout the financial services regulatory community, coordinate emergency response efforts across agencies, and identify threats within the financial services industry. The OCC has established emergency communications protocols, purchased new secure communications equipment for its COOP sites, and participated in interagency communications tests.

- *Emergency Communication.* The OCC is working on new processes and procedures for communicating with and accounting for employees during and after an emergency. A new system, which utilizes an interactive automatic dialing system, an emergency information database, and the OCC's customer service call center in Houston, is under development. The OCC has also enhanced its ability to communicate with national banks during an emergency and continues testing, updating, and improving these procedures.

## Program Evaluations

At the direction of the Comptroller, the Program and Management Accountability Division evaluates the effectiveness and efficiency of programs and operations, and reviews resource requests and utilization to improve the management of the OCC. The Program Analysis Unit's (PAU) reviews in FY 2004 included FY 2005 staffing model development, capital planning process, grade and pay issues, real estate analysis, depot maintenance process, ITS data on potential for additional staff, ITS' mainframe exit strategy and cost estimates, Communications Division, human resource benchmarking, and outsourcing impact analysis. Other discussions of program reviews are dispersed throughout this report.

## Management Challenges and High-Risk Areas

The Treasury's Office of the Inspector General (OIG) has identified the following management challenges: linking resources to results, information security, duplicative or wasteful practices, and AML/BSA. The last, AML/BSA, has implications for the OCC in that the OIG plans to conduct follow-up work on previously identified supervisory weaknesses. Actions that the OCC has taken on this and the other challenges are discussed elsewhere in this report. The Government Accountability Office (GAO) has not identified high-risk areas specific to the OCC.

## Letter from the Chief Financial Officer

I am pleased to present the OCC's financial statements as an integral part of the FY 2004 Annual Report and am pleased to say that for FY 2004, our independent auditors rendered an unqualified opinion with no material weaknesses. In addition to our significant achievements during the fiscal year, we have laid the groundwork for operational excellence and a process of continued improvement.

Highlights of some of our significant accomplishments during the past year, include:

- The OCC has again received a “green” rating under the President’s Management Agenda from the Department of the Treasury for improving financial performance and has met all core criteria for each component of the measure.
- For the second year, business units developed program plans and staffing models to justify their budget requests for FY 2004, eliminating “maintain current level” budget formulation. This year the budget and finance subcommittee of the Executive Committee played a key role in the review of unit budgets adding greater credibility to the process.
- During FY 2004, the OCC re-engineered its Capital Planning and Investment Control process. The revised process helps ensure that requests for information technology are aligned with the agency’s mission, goals, and objectives and that the process is in line with the Clinger-Cohen Act. Technology projects with business cases that totaled more than \$4.2 million were not pursued as a result of the vigorous review process used this year.
- The OCC continues to progress toward full implementation of its reserve policy, whereby funds are earmarked for rare events that could potentially disrupt ongoing operations.
- The OCC has made great progress in updating its emergency preparedness plans and is playing an increasing role in the financial services sector critical infrastructure support.
- The auditors have determined that the corrective actions taken to address last year’s report effectively resolved the two reportable conditions.
- To provide better business management, the Office of Management is striving to become a strategic-based, metrics-driven, customer-focused organization. As a foundation, we are implementing a balanced scorecard to measure our progress toward the business goals of the Office of Management. This effort will help us ensure that we deliver the right services to our customers in the most efficient and effective manner. As we build on our considerable FY 2004 accomplishments, we are beginning to address the following challenges:
  - Reviewing our internal controls and making adjustments where necessary to better meet the OCC’s needs.
  - Enhancing our cost accounting capabilities to better serve management’s needs.
  - Managing the OCC as an evolving organization to respond better to structural changes in the national banking system.



Thomas R. Bloom

# Financial Management Discussion

## **Strategic Focus**

Financial management in today's environment presents challenges as we respond to increasing needs for strong financial reporting, responsible internal controls, and accountability for results. In FY 2004, the Office of Management's Financial Management department (FM) confirmed its dedication to these principles by updating its strategic business unit plan and identifying a strategic focus on operational excellence.

Consistent with the OCC's mission and vision, FM stresses the importance of and our commitment to:

- Fiscal responsibility and stewardship.
- Meeting the needs of our customers.
- Our dedicated staff.
- Efficient and effective financial management operations.

The near term goals of our strategic focus include:

- Improved understanding of customer needs and expectations.
- Re-engineered business processes that take advantage of our technological capabilities.
- Projects and programs that are managed effectively.

Additionally, as part of an Office of Management initiative, FM has adopted best business practices designed to accomplish those goals. The best practices include the Balanced Scorecard and Lean Six Sigma. The Balanced Scorecard is a framework that allows us to translate our strategy into measurable results. Lean Six Sigma incorporates the voice of the customer into our processes as we make them more effective and efficient.

## **Major Accomplishments**

Our FY 2004 performance demonstrates that our new strategy provided a solid foundation for improving OCC financial management this year and in the future. The OCC's FY 2004 financial management accomplishments and future challenges include:

### **Financial Accountability**

The OCC continues to place a high priority on providing accurate and reliable financial data to its customers. Toward that end, the OCC successfully resolved all prior year audit findings, identified improvements to internal control processes, consistently met the Department's deadline for a three-day close for producing financial statements, achieved "green ratings" for data quality, and implemented new and updated policies and procedures.

### **Customer Service Initiatives**

Using valuable input received from OCC customers, we have begun to improve the reporting capabilities of the OCC's financial management system. The OCC made a concerted effort to resolve outstanding system, reporting, and performance challenges resulting from the prior year upgrade. The OCC upgraded the integrated

financial management and acquisition system with the latest PeopleSoft service and maintenance packages and performed a hardware upgrade to improve performance and system response time. The OCC also implemented the Aperture Space Management software to better track asset management details.

In a continuing effort to modernize its financial systems, the OCC moved forward with the development of e-Time, a Web-based, self-service time and labor system. The e-Time system replaces the OCC's legacy time entry system and is scheduled for deployment in FY 2005. The OCC is considering the implementation of an e-Travel system, which would support the PMA. The proposed e-Travel system is an end-to-end solution that supports the entire travel process, which includes planning and authorizing travel, making reservations, delivering electronic tickets, calculating and approving reimbursements, and archiving data. This e-Travel system would replace the OCC's legacy travel reporting system and is tentatively scheduled for deployment in FY 2006.

### **Improvements to Processes**

We made a concerted effort to attain our goal of operational excellence by reviewing internal processes for efficiency and effectiveness, incorporating the voice of the customer as an integral part of our analysis.

The OCC enhanced and accelerated its reporting production cycle for disseminating financial information to its internal and external customers. This streamlined approach allowed the OCC to produce its Annual Report and respond to other financial information inquiries ahead of deadlines.

Significant improvements to the OCC-wide budget process for FY 2005 included direct oversight by the budget and finance subcommittee and the shortening of the appeals phase of its formulation process. These improvements resulted in a reduction of the time expended by executives to reach budget decisions.

Looking ahead, a Lean Six Sigma project on disbursements is expected to improve internal processes from requisition through payment.

### **Enhancements to Internal Controls**

Throughout the fiscal year, the OCC resolved prior year audit findings. Moreover, we identified improvements to our control processes. Additionally, through partnering with ITS to more effectively manage contractor support, we began to transfer systems knowledge to the FM staff. The OCC implemented stronger detection and prevention controls for duplicate payments. We also issued new or revised policies and procedures relating to general ledger maintenance, travel programs, and assessment and payment certification processes. We also built ongoing analysis and follow-up corrective actions into the new processes.

### ***Funding Sources and Uses***

#### **Funding Sources**

The OCC does not receive appropriations. The Comptroller, in accordance with 12 USC 482, establishes budget authority for a given fiscal year. The total budget authority available for use by the OCC in FY 2004 was \$476.9 million and \$436.0 million in FY 2003. The OCC's operations are primarily funded by assessments collected from national banks and other income, including interest on investments in U.S. Treasury securities.

Total revenue recognized for FY 2004 amounted to \$497.8 million compared to \$466.1 million in FY 2003. The increase of \$31.7 million in total revenue recognized is due mostly to increased assessments (\$30.1 million) as a result of the more than 10 percent growth in bank assets during the period. Table 9 depicts the components of total revenue recognized for FY 2004 and FY 2003.

**Table 9: Components of Total Revenue, FY 2004 and FY 2003 (in millions)**

	FY 2004	FY 2003	Change
Assessments	\$482.3	\$452.2	\$30.1
Investment Income	11.3	10.2	1.1
Other Sources [1]	4.2	3.7	0.5
Total Revenue	\$497.8	\$466.1	\$31.7

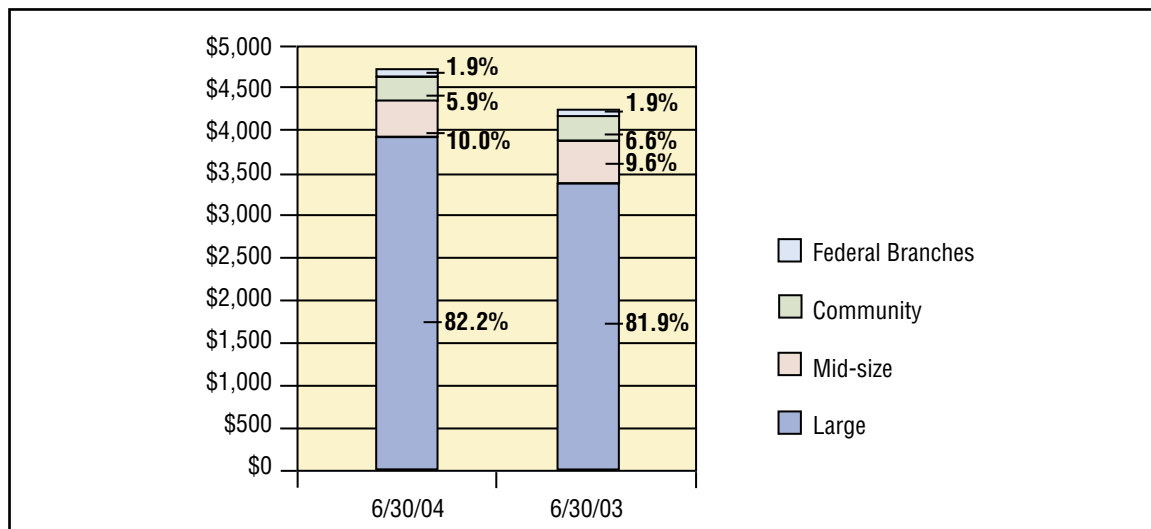
[1] Other sources of revenue include bank licensing fees, revenue received from the sale of publications, and other miscellaneous sources.

Investment income is earned on the investment of available funds in U.S. Treasury securities. The increase in investment income for FY 2004 is largely due to the \$54 million increase in the book value of OCC's portfolio during the fiscal year. The book value of the OCC's portfolio at September 30, 2004 was \$481.6 million compared to \$427.6 million at September 30, 2003. Budget authority for FY 2004 and FY 2003 included \$1.9 million and \$1.7 million, respectively, of investment income. The remaining investment income was designated to fund the Contingency Reserve that is discussed later under *Reserves*.

### Bank Assets and Assessment Revenue

In FY 2004, the composition of national bank assets remained mostly unchanged compared with FY 2003. For the same period, mid-size banks' share of the OCC's assessment revenue increased by 2 percentage points and community banks' share declined by 2 percentage points. National bank asset growth and the movement of assets into the national banking system were the impetus for higher assessments for FY 2004. Figure 3 shows the composition of national bank assets by large banks, mid-size banks, community banks, and federal branches for FY 2004 and FY 2003.

**Figure 3: Composition of National Bank Assets as of June 30, 2004 and 2003 (in billions)**

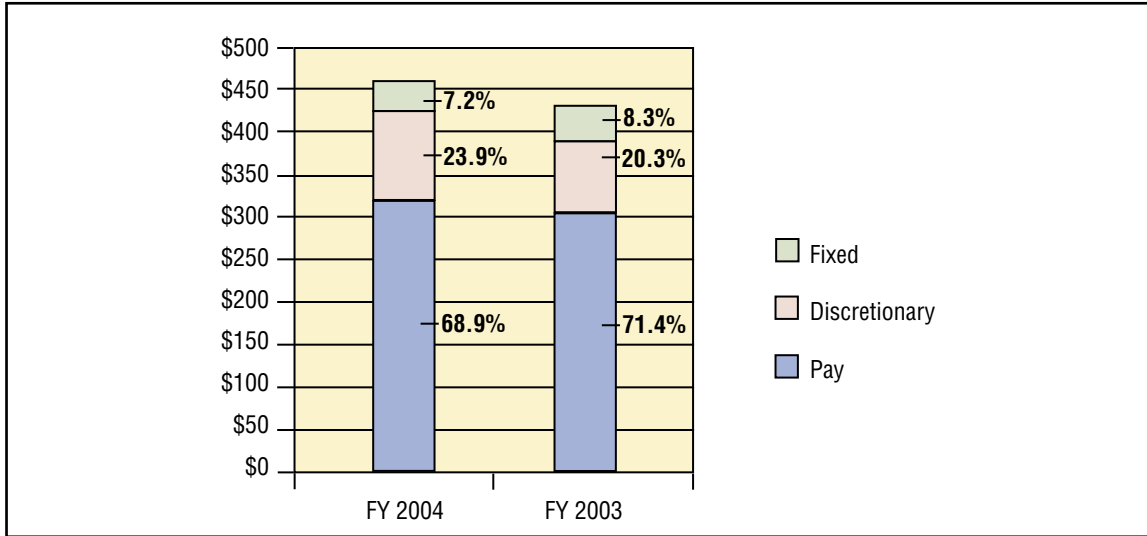




## Funding Uses

The OCC classifies its funding uses as pay, discretionary, and fixed. Pay encompasses payroll-related costs; discretionary reflects all other funding uses, such as contractual services, travel, training, and capital projects; and fixed primarily includes rent, utilities, and office maintenance. In FY 2004, the OCC's total funds used were \$463.0 million, an increase of 8 percent over the level in FY 2003. Of the total funds used in FY 2004, \$318.9 million was categorized as pay, \$110.9 million as discretionary, and \$33.2 million as fixed. The OCC's operations are service-intensive; therefore, the majority of funds are used for pay. The OCC experienced a \$21.8 million increase in non-pay funds used primarily for various office space improvements and IT investments. Figure 4 depicts the uses of the OCC's funding for FYs 2004 and 2003.

**Figure 4: FY 2004 and 2003 Funding Uses (in millions)**



## Financial Review

The OCC received an unqualified opinion on its FY 2004 and 2003 financial statements. The financial statements include a Balance Sheet and Statements of Net Cost, Changes in Net Position, Budgetary Resources, Financing, and Custodial Activities. The financial statements and notes are presented on a comparative basis, providing financial information for FYs 2004 and 2003. These financial statements summarize the OCC's financial activity and position. Highlights of information presented on the financial statements follow.

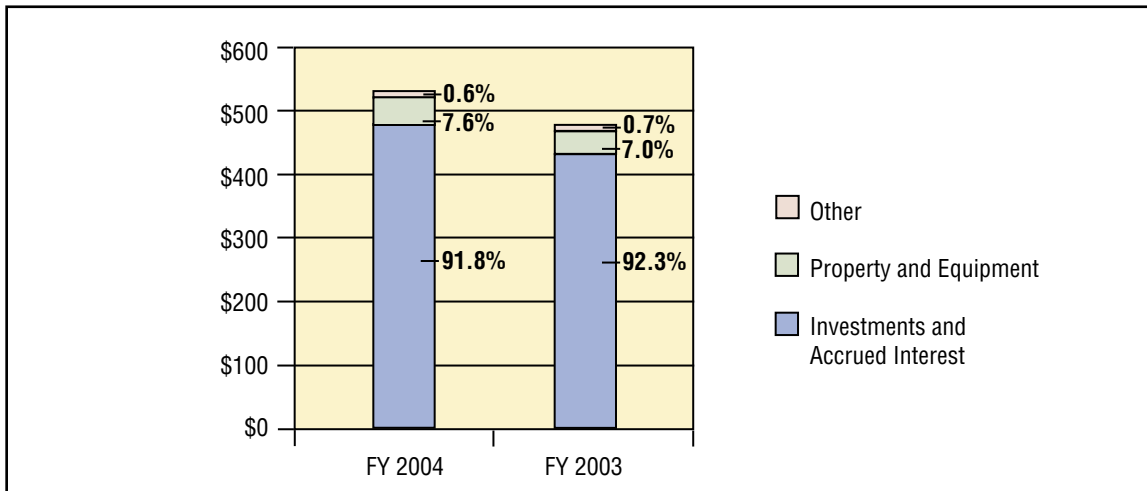
### Balance Sheet

The Balance Sheet, as of September 30, 2004 and 2003, presents the resources that are owned by the OCC and available for use (assets), the resources due to others or held for future recognition (liabilities), and the resources that comprise the residual (net position). For clarity in presentation, assets and liabilities are differentiated between those resulting from transactions between the OCC and other federal entities (intragovernmental) and transactions between the OCC and non-federal entities.

### Composition of and Trends in OCC Assets

The Balance Sheet shows that total assets as of September 30, 2004, increased by \$61.7 million from their level at September 30, 2003. The increase of \$54.4 million in Investments and Related Interest was attributed to a rise in assessment collections during FY 2004. The increase of \$7.2 million in Property and Equipment was due primarily to software purchases. Figure 5 shows the composition of the OCC's assets.

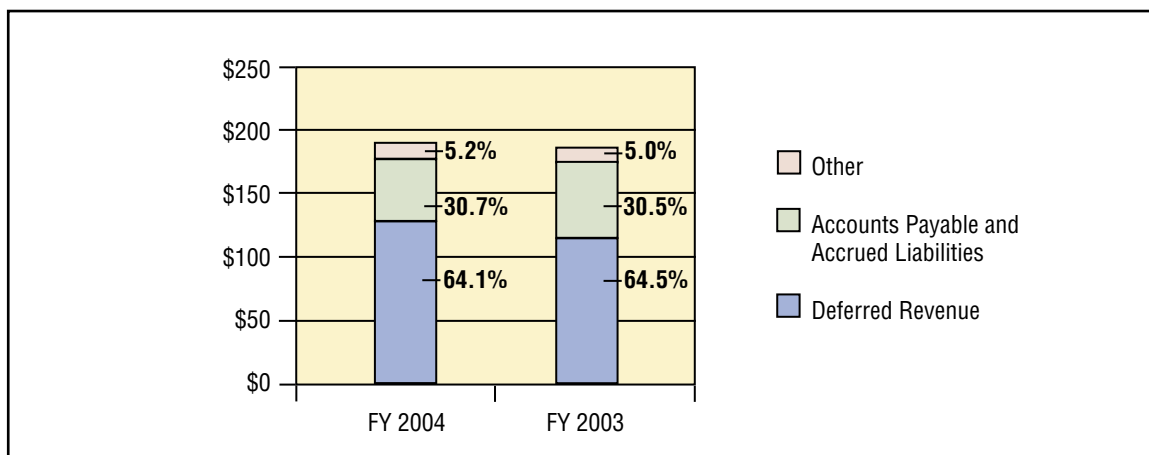
**Figure 5: Composition of FY 2004 and FY 2003 Assets (in millions)**



### Composition of and Trends in OCC Liabilities

Total liabilities as of September 30, 2004, increased by a net of \$13.6 million over their level at September 30, 2003. The OCC's liabilities are largely composed of deferred revenue, accounts payable, and accrued liabilities. Deferred revenue represents the unearned portion of semiannual assessments that have been collected but not yet earned. The increase of \$8.0 million in deferred revenue was due to a rise in assessment collections during FY 2004. The increase of \$5.3 million in accrued liabilities was largely due to an increase in pay and employee benefits. Figure 6 illustrates the composition of the OCC's liabilities.

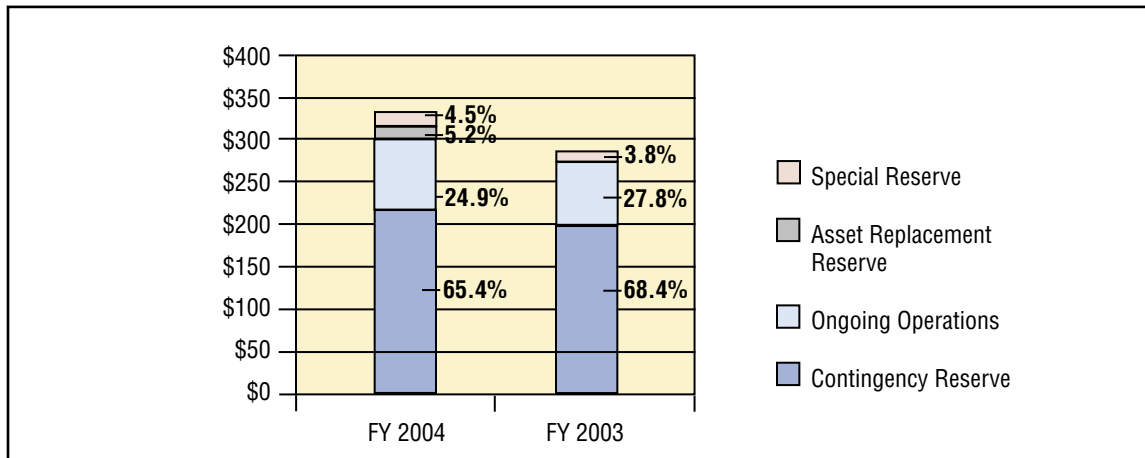
**Figure 6: Composition of FY 2004 and 2003 Liabilities (in millions)**



## Composition of and Trends in OCC Net Position

The OCC's net position of \$335.5 million as of September 30, 2004, and \$287.4 million as of September 30, 2003, represents the cumulative net excess of the OCC's revenues over its cost of operations since inception. As discussed in the next section, the OCC reserves a significant portion of its net position to supplement resources made available to fund the OCC's annual budget and to cover foreseeable but rare events. The OCC also earmarks funds for ongoing operations to cover undelivered orders, the consumption of assets, capital investments, and district office restructuring. Figure 7 shows the composition of the OCC's net position.

**Figure 7: Composition of FY 2004 and 2003 Net Position (in millions)**



## Reserves

The establishment of financial reserves is integral to the effective stewardship of the OCC's resources, particularly since the agency does not receive congressional appropriations. The Contingency Reserve funds foreseeable but rare events beyond the control of the OCC, such as a major change in the national banking system or a disaster, such as a fire, flood, or significant impairment to the OCC's information technology network that may interfere with the OCC's ability to accomplish its mission. The Asset Replacement Reserve funds the replacement of IT equipment, leasehold improvements, and furniture replacements for future years. The amount in the replacement reserve is determined based on the cost of replacement and the useful life of assets. The Special Reserve reduces the effect of unforecasted shortfalls or unbudgeted and unanticipated requirements.

## Statement of Net Cost

The Statement of Net Cost presents the full cost of operating the OCC's programs for the years ended September 30, 2004 and 2003. In FY 2004, the OCC eliminated analyze risk as a separate program area for managing its operations. The activities that comprised the analyze risk program were so closely aligned to the objectives and performance goals of the supervise program that maintaining a separate program was no longer meaningful. In addition, the OCC adopted in FY 2004 an activity-based time allocation process that allowed for a better allocation of costs between the programs. Costs are further differentiated between those resulting from transactions between the OCC and other federal entities (intragovernmental) and transactions between the OCC and non-federal entities (with the public). The full cost includes an imputed cost of \$22.5 million in FY 2004 and \$20.7 million in FY 2003, the cost of the OCC's Federal Employees Retirement System (FERS) and Civil Service Retirement System (CSRS) plans, paid by the OPM. The full program costs increased by

\$21.1 million primarily due to increases in pay and benefits, contractual services, imputed costs, and non-capitalized IT investments. The full costs are reduced by earned revenues to arrive at net cost. Earned revenues increased by \$31.7 million because of a rise in assessments collected during FY 2004.

### ***Statement of Changes in Net Position***

The Statement of Changes in Net Position presents the change in the OCC's net position resulting from the net cost of the OCC's operations and financing sources other than exchange revenues for the years ended September 30, 2004 and 2003. The line item, Imputed financing from costs absorbed by others, increased by \$1.8 million. The OCC's financing source resulted from a contribution of \$22.5 million in FY 2004 and \$20.7 million in FY 2003, by the OPM toward the OCC's FERS and CSRS retirement plans.

### ***Statement of Budgetary Resources***

The Statement of Budgetary Resources presents the budgetary resources available to the OCC for the year, the status of these resources at the end of the year, and the net outlay of budgetary resources at the end of the year. The OCC obligated 53.0 percent of its budgetary resources for the year. The remaining 47.0 percent was available primarily to cover the OCC's reserves.

### ***Statement of Financing***

The Statement of Financing demonstrates the relationship between the OCC's proprietary (net cost of operations) and budgetary accounting (net obligations) information. For FY 2004, the statement shows \$36.0 million in excess resources available to finance activities, a net increase of \$29.5 million over September 30, 2003. This net increase resulted from a \$36.5 million increase in resources available netted against the increase of \$5.2 million in resources used (obligations incurred). The increase in net resources available is primarily due to increased assessments and imputed financing, while the increase in resources used results primarily from various office space and IT investments.

### ***Statement of Custodial Activities***

The Statement of Custodial Activities identifies revenues collected by the OCC on behalf of others. These revenues result primarily from CMPs that are assessed through court enforced legal actions against a national bank and/or its officers. CMP collections are transferred to the Department of the Treasury's General Fund. The CMPs transferred to the Department of the Treasury increased by \$24.6 million over their level at September 30, 2003 due to a one-time \$25 million penalty assessment on a national bank.

### ***Prompt Payment***

The Prompt Payment Act and the OMB Circular A-125 require agencies to make payments on time, pay interest penalties when payments are late, and take discounts only when payments are made on or before the discount date. OMB's goal is a prompt payment rate of greater than 98 percent. The OCC's prompt pay rate was 98.7 percent in FY 2004, compared to 98.6 percent achieved in FY 2003. Table 10 summarizes the OCC's prompt payment performance for FYs 2004 and 2003.

**Table 10: Prompt Payment Performance, FY 2004 and FY 2003**

	FY 2004 Amount	FY 2003 Amount	FY 2004 Number	FY 2003 Number
Invoices paid	\$68,819,284	\$69,210,143	21,301	20,910
Invoices paid late	\$4,645,377	\$3,802,695	281	287
Interest penalties paid	\$6,642	\$3,960	196	127

***Electronic Funds Transfer***

The use of electronic funds transfer (EFT) rather than paper checks for payments provides greater control over their timing and reduces payment cost. During FY 2004, we continued our efforts to maximize the use of payment mechanisms as required by the Debt Collection Improvement Act of 1996. Table 11 summarizes EFT usage for FYs 2004 and 2003.

**Table 11: Electronic Funds Transfer Performance, FY 2004 and FY 2003**

	FY 2004	FY 2003
Vendor payments	99.4%	99.6%
Employee payments	99.9%	99.9%

***Erroneous Payments***

The erroneous payments program meets the criteria of the Improper Payments Information Act of 2002 (IPIA) to support the Department of Treasury’s strategic goal. The goal is to: Ensure Professionalism, Excellence, Integrity and Accountability in the Management and Conduct of the Department of the Treasury. The OCC analyzed payments (excluding payroll) made during FY 2004 and identified 11 erroneous payments totaling \$338,844. The OCC corrected or recovered all erroneous payments made during the year.

The OCC affected software enhancements and additional manual controls to reduce erroneous payments. The changes were documented in a Financial Policy & Procedure document (FPP) – Payments Certification Process, which governs the daily certification process.

**Methodology for Identifying Improper Payments**

The OCC conducts both pre-payment reviews and post-payment audits to identify improper or erroneous payments. As part of its sensitive payments program, the OCC conducts a 100 percent pre-payment review of executive travel vouchers and relocation payments, thereby helping to prevent erroneous payments. The OCC uses for post-audit activities a sampling approach to audit travel vouchers and data-mining techniques to detect potential erroneous payments. Immediately upon their identification, the OCC commences collection to assure recovery of funds. Also, the OCC is conducting a Lean Six Sigma review of the non-payroll process to bring about efficiencies and to determine the need for additional controls.

Based on the analyses, the OCC has concluded that erroneous payments will not exceed 2.5 percent of non-payroll payments and \$10 million. The OCC is compliant with the Erroneous Payments Recovery Act of 2001 and the IPIA.

## **Limitations to the Financial Statements**

The financial statements have been prepared to report the assets, liabilities, and net position of the OCC, its net costs, changes in net position, budgetary resources, and reconciliation of net costs to budgetary obligations, and its custodial activity pursuant to the requirements 31 USC 3515(b).

While the statements have been prepared from the books and records of the OCC in accordance with GAAP and the formats prescribed by the OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources that are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. government, a sovereign entity.

## **Systems, Controls, and Legal Compliance**

This section of the report provides information on the OCC's compliance with FMFIA, FFMIA, and other legal and regulatory requirements.

### **Federal Managers' Financial Integrity Act of 1982**

FMFIA requires federal agencies to establish management controls and financial systems to ensure that:

- Programs achieve their intended results.
- Resources are used in a manner consistent with the agencies' missions.
- Programs and resources are protected from waste, fraud, and mismanagement.
- Laws and regulations are followed.
- Reliable and timely information is used for decision-making.

FMFIA further requires the head of each agency, based on an evaluation, to provide an annual Statement of Assurance on whether the agency has met the above requirements. The Assurance Statement must also disclose material control weaknesses along with the specific actions management intends to take to remedy the weakness. To be considered a material weakness for inclusion in the Assurance Statement, the problem must be significant enough that it severely impairs the organization's ability to accomplish its mission or to prepare timely, accurate financial statements or reports. Such weaknesses are of sufficient magnitude that the agency is obliged to report them to external stakeholders.

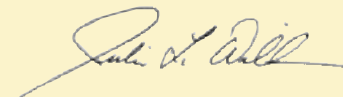
### **Fiscal Year 2004 Annual Assurance Statement**

#### **Federal Managers' Financial Integrity Act**

"On the basis of a comprehensive assessment of the Office of the Comptroller of the Currency's management controls, including assurances provided by each Executive Committee member, and having fully considered the comments and findings of our external auditors, Gardiner, Kamyra, and Associates, I am pleased to report that our management control systems and financial systems, as a whole, provide reasonable assurance that the objectives of FMFIA have been met for fiscal year 2004."

#### **Federal Financial Management Improvement Act**

"OCC financial systems substantially comply with Federal financial management system requirements, applicable Federal accounting standards, and the United States Government General Ledger at the transaction level."



Julie L. Williams

Acting Comptroller of the Currency

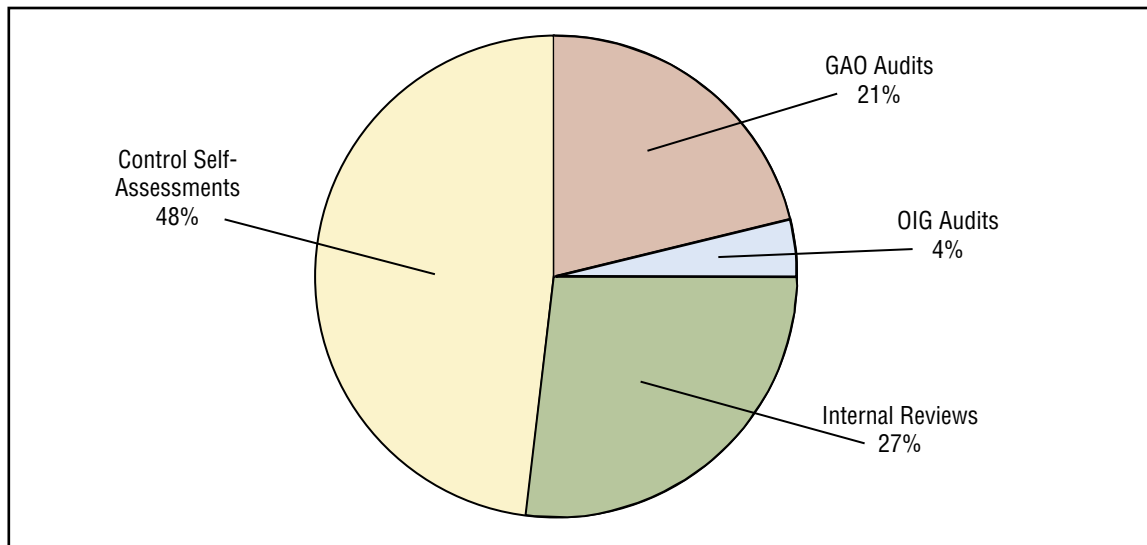
The QM staff evaluated the OCC’s management controls, financial systems, and administrative processes for FY 2004 and determined that OCC programs are operating efficiently and effectively. The review revealed no material management control weaknesses or material non-conformances with law or regulation that either impair the OCC’s ability to fulfill its mission or significantly weaken established safeguards against waste, fraud, or mismanagement.

### **Management Accountability Program**

The OCC’s management accountability program is a continuous internal control improvement process extending to each major program under the oversight of the QM Division. To ensure identified weaknesses are responded to appropriately, the audit subcommittee provides a forum to monitor progress, resolve problems, and develop consensus recommendations about issues that arise from management control reviews, quality assurance activities, and audits. Executive Committee members also have responsibility for protecting the resources under their direction and ensure that new and existing programs are managed efficiently and effectively, including maintaining sufficient controls to safeguard resources from waste, fraud, and mismanagement.

Figure 8 shows the distribution of management control assessments for FY 2004. The OCC’s QM and PAU functions completed 19 internal reviews and administered 33 management control self-assessments during this period. These reviews add to self-initiated program reviews completed at an Executive Committee member’s direction. The GAO issued 15 audit reports resulting in one action item for the OCC. The OIG issued three audit reports resulting in seven recommendations, six of which have been implemented. Corrective actions are ongoing to resolve a small number of open audit recommendations from previous years.

**Figure 8: Management Control Assessments, FY 2004**



### **Executive Committee Program Certifications**

To support the management accountability program, each Executive Committee member submits a departmental certification that, combined with the internal reviews and external audits, form the analytical basis of the annual Assurance Statement. These certifications are based on information gathered from executive management’s personal knowledge of day-to-day operations as supplemented by quality assurance activities, program reviews, and other management-initiated evaluations.

## ***Risk Assessment Program***

During FY 2004, the OCC developed an internal risk assessment model to promote consistency in identifying and ordering of risks across its programs. The risk categories are reputation, strategic, transaction, financial, and compliance. Significant in the risk assessment process is dialogue with each Executive Committee member and, ultimately, presentation of an annual review plan to the audit subcommittee. Annual application of the risk model enables the audit subcommittee to support the management accountability program via a structured program through internal reviews for quality, internal control, alignment with strategic objectives, and cost-effectiveness.

The OCC identified its primary management challenges as: AML, including effective supervision and enforcement of the BSA and implementation of the USA PATRIOT Act; preemption, including the effect of decisions on OCC operations; human capital, including the ability to recruit, train, retain expertise, and deploy it where needed; technology, including the availability and integrity of data used for decision-making; and internal controls, including systems, security, and financial.

## ***Federal Financial Management Improvement Act of 1996***

FFMIA is designed to improve federal management by requiring that financial systems provide reliable financial data in accordance with generally accepted accounting principles and standards. Under FFMIA, financial management systems must comply substantially with: 1) federal financial management system requirements; 2) applicable federal accounting standards; and 3) the U.S. Government Standard General Ledger (SGL) at the transaction level. FFMIA also requires that the independent auditors' report indicate whether the agency's financial management systems comply with these requirements.

An FFMIA-compliant system was implemented in FY 2002 and subsequently upgraded to a Web-based platform during FY 2003. The upgraded system continues to comply substantially with the federal financial management system requirements published by the Joint Financial Management Improvement Program.

## ***Other Key Legal and Financial Regulatory Requirements***

The OCC must implement controls and periodically submit information to the Department of the Treasury in support of its initiatives. Specific examples include compliance under FISMA, IPIA, the Erroneous Payments Recovery Act of 2001, and GPRA. The OCC continues to monitor its performance under these acts. The FY 2004 management control assessment considered the OCC's level of compliance with each of these acts and concluded, with reasonable assurance, that the OCC is achieving satisfactory results in each case. The OCC's results in these areas have been discussed in the pertinent sections of this report.

## **OCC's Next Steps**

The OCC will carry out the regulatory and supervisory recommendations from its FY 2004 review of BSA/AML supervision. The agency also will issue a revised "Bank Secrecy Act" booklet to the *Comptroller's Handbook* and develop two information systems projects to enhance its BSA/AML work. The Quantity of Money Laundering Risk Identification project allows the OCC to gather money laundering risk information for each mid-size and community bank. This information will be used to develop unique supervisory strategies, allocate examiner resources, and quantify money laundering risks across these national banks. The Suspicious Activity Reporting database will increase the OCC's ability to detect existing and emerging operational risks



associated with suspicious activity reported by the banking industry and develop appropriate supervisory responses to those risks. The OCC will continue to coordinate with other federal financial regulators and criminal law enforcement agencies to combat money laundering and terrorist financing activities.

The CAG operations will be staffed to handle expanded operating hours, and the OCC will reinforce its commitment to providing high quality assistance on the resolution of consumer complaints.

The OCC will continue to work with other federal regulators on Basel II, to include a fourth quantitative impact study, scheduled for October 2004, and a notice of proposed rulemaking on possible revisions to the agencies' risk-based capital standards relating to the Framework. Publication of the notice of proposed rulemaking is currently planned for mid-CY 2005. During this same time frame, the agencies also plan to consider and address possible changes to their capital regulations for U.S. institutions not subject to the Framework-based regulations.

The focus for the charter program in FY 2005 is to complete testing electronic versions of the Part 24 CD-1 Community Development Investment application forms for e-Corp deployment. Initially developed in FY 2004, these new forms will be deployed in mid-FY 2005 after internal testing and operating environment upgrades.

The OCC is also reviewing contract proposals for developing the Licensing Information System (LIS). LIS will provide reporting and tracking capability for corporate applications that use new technology and replace the current outmoded, mainframe Corporate Activity Information System (CAIS). LIS will leverage document management, communications, and reference tools currently being developed for SIS and other OCC technology initiatives. A contract for LIS development is scheduled for award prior to the end of FY 2005.

The OCC will continue its aggressive recruitment of new examiners and continue to train new teams of examiners and deploy them to field offices. The OCC will use hiring incentives to attract the experienced examination skills needed in key locations.

The OCC will complete the remaining three security certifications and accreditations for its information technology systems by the third quarter of FY 2005.

A Lean Six Sigma project to improve the disbursement cycle, from requisition to payment, will be conducted during FY 2005, as part of the OCC's Office of Management initiative to become more strategic-based and metrics-driven.

# Independent Auditors' Report



CERTIFIED PUBLIC ACCOUNTANTS | MANAGEMENT CONSULTANTS

## Independent Auditors' Report on Financial Statements

The Comptroller of the Currency:

We have audited the accompanying balance sheets of the Office of the Comptroller of the Currency (OCC) as of September 30, 2004 and 2003 and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. These financial statements are the responsibility of the management of OCC. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the OCC as of September 30, 2004 and 2003, and its net costs, changes in net position, budgetary resources, the reconciliation of budgetary obligations to net costs, and custodial activities for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information in the OCC at-a-Glance, Operations and Accomplishments, and Management sections of OCC's fiscal year 2004 Annual Report is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and accordingly, we express no opinion on it.

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Our audits were conducted for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information included in Appendices A and B is presented for purposes of additional analysis and is not a required part of the financial statements. We did not audit this information and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued reports dated October 22, 2004, on our consideration of the OCC's internal control over financial reporting, and on our tests of its compliance with certain provisions of applicable laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards*, and these reports should be read in conjunction with this report in considering the results of our audits.

*Hardiner, Kamya & Associates, P.C.*

October 22, 2004

## **Independent Auditors' Report on Internal Control over Financial Reporting**

The Comptroller of the Currency:

We have audited the balance sheet of the Office of the Comptroller of the Currency (OCC) as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the year then ended, and have issued our report thereon dated October 22, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

In planning and performing our audit, we considered the OCC's internal control over financial reporting by obtaining an understanding of the OCC's internal control, determined whether internal controls had been placed in operation, assessed control risk, and performed tests of controls in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements. We limited our internal control testing to those controls necessary to achieve the objectives describes in OMB Bulletin No. 01-02 and *Government Auditing Standards*. We did not test all internal controls relevant to operating objectives as broadly defined by the Federal Managers' Financial Integrity Act of 1982, such as those controls relevant to ensuring efficient operations. The objective of our audit was not to provide assurance on internal control over financial reporting. Consequently, we do not provide an opinion on internal control over financial reporting.

Our consideration of internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions. Under standards issued by the American Institute of Certified Public Accountants, reportable conditions are matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the OCC's ability to initiate, record, process, and report financial data consistent with the assertions of management in the financial statements. Material weaknesses are reportable conditions in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Because of

inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected.

However, we noted a certain matter discussed in the following page involving the internal control over financial reporting and its operation that we consider to be a reportable condition. However, we do not consider the reportable condition to be a material weakness.

In addition, with respect to internal control related to performance measures determined by management to be key and reported in the OCC at-a-Glance, Operations and Accomplishments, Management, and Appendix A sections of the OCC's Annual Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal controls over reported performance measures, and, accordingly, we do not provide an opinion on such controls.

We also noted other matters involving internal control and its operation that we have reported to the management of OCC in a separate letter dated October 22, 2004.

This report is intended solely for the information and use of the OCC's management, the Department of the Treasury Office of Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is available as a matter of public record.

*Gardiner, Kamyra & Associates, P.C.*  
October 22, 2004

## REPORTABLE CONDITION

### **Obligations were not accurate and current for some undelivered orders.**

#### **Condition**

For 27 out of 75 Undelivered Orders randomly selected for interim and year-end testing, we found that obligations were not accurate and current. We projected these test results to the total population of Undelivered Orders. As a result, OCC management reduced the balance of Undelivered Orders on the Statement of Budgetary Resources in the amount of \$5,816,463.04.

#### **Criteria:**

Office of Management and Budget (OMB) Circular A-11 (2004), 30.2(a)(1) "*Regular annual estimates* requires that regular annual estimates must reflect all requirements anticipated at the time of budget submission, and should cover:

- Continuing activities, including those that must be reauthorized for the budget year;
- Authorized activities that are proposed for the budget year;
- Amounts necessary to meet specific financial liabilities imposed by law; and
- Decreases for activities proposed for termination."

#### **Cause:**

Procedures were not adequate to ensure that obligations were accurate and current.

#### **Effect:**

The balance in Undelivered Orders is overstated.

#### **Recommendations:**

OCC management should implement policies and procedures to ensure that obligations are accurate and current.

#### **Management Comments:**

Management concurs with your finding and appreciates your recommendation for improvements. We will soon proceed to develop corrective action plans that address the condition you have identified.

In addition, we would like to point out the following actions that we have taken since you brought the finding to our attention:

Prior to September 30, 2004, we corrected all the exceptions that you identified as a result of your interim testing. We also deobligated all Undelivered Orders related to relocation and space leasing activities. We have also recorded the proposed adjustment and reflected it in the FY 2004 financial statements and footnotes.

## Independent Auditors' Report on Compliance with Laws and Regulations

The Comptroller of the Currency:

We have audited the balance sheet of the Office of the Comptroller of the Currency (OCC) as of September 30, 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity, for the year then ended, and have issued our report thereon dated October 22, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements*.

The management of the OCC is responsible for complying with laws and regulations applicable to the OCC. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the OCC's compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain provisions of other laws and regulations specified in OMB Bulletin No. 01-02, including certain requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws and regulations applicable to the OCC. However, providing an opinion on compliance with laws and regulations was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests of compliance with laws and regulations described in the preceding paragraph, exclusive of FFMIA, disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards* and OMB Bulletin No. 01-02.

Under FFMIA, we are required to report whether the OCC's financial management systems substantially comply with (1) Federal financial management systems requirements, (2) applicable federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which the OCC's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

This report is intended solely for the information and use of the OCC's management, the Department of the Treasury Office of the Inspector General, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is available as a matter of public record.

*Hardiner, Kanya & Associates, P.C.*

October 22, 2004



# Financial Statements

## Office of Comptroller of the Currency Balance Sheets As of September 30, 2004 and 2003

	FY 2004	FY 2003
<b>Assets</b>		
<b>Intragovernmental</b>		
Fund balance with Treasury	\$ 1,701,674	\$ 1,219,409
Accounts receivable	144,332	-
Investments and related interest (Note 3)	487,121,232	432,705,466
<b>Total intragovernmental</b>	<b>488,967,238</b>	<b>433,924,875</b>
Cash	25,961	26,092
Accounts receivable, net	112,201	432,773
Property and equipment, net (Note 4)	40,147,991	32,949,644
Advances and prepayments	1,144,599	1,381,230
<b>Total Assets</b>	<b>\$ 530,397,990</b>	<b>\$ 468,714,614</b>
<b>Liabilities and Net Position</b>		
<b>Liabilities</b>		
<b>Intragovernmental</b>		
Accounts payable	\$ 746,371	\$ 986,610
<b>Total intragovernmental</b>	<b>746,371</b>	<b>986,610</b>
Accounts payable	2,280,839	2,711,921
Accrued payroll and employee benefits	16,203,165	13,472,232
Accrued annual leave	24,037,799	23,524,329
Other accrued liabilities	16,582,611	14,518,150
Deferred revenue (Note 5)	125,015,607	117,048,226
Post retirement benefits (Note 7)	10,071,983	9,079,706
<b>Total liabilities</b>	<b>194,938,375</b>	<b>181,341,174</b>
<b>Net position (Note 8)</b>	<b>335,459,615</b>	<b>287,373,440</b>
<b>Total Liabilities and Net Position</b>	<b>\$ 530,397,990</b>	<b>\$ 468,714,614</b>

The accompanying notes are an integral part of these financial statements.

**Office of Comptroller of the Currency  
Statements of Net Cost  
For the Years Ended September 30, 2004 and 2003**

	FY 2004	FY 2003 (Restated) (Note 2)
<b>Program Costs</b>		
<b>Supervise National Banks</b>		
Intragovernmental	\$ 55,013,447	\$ 61,272,570
With the public	337,088,793	352,257,726
<b>Subtotal - Supervise National Banks</b>	<b>\$ 392,102,240</b>	<b>\$ 413,530,296</b>
<b>Regulate National Banks</b>		
Intragovernmental	\$ 9,119,549	\$ 3,842,098
With the public	54,522,477	22,088,240
<b>Subtotal - Regulate National Banks</b>	<b>\$ 63,642,026</b>	<b>\$ 25,930,338</b>
<b>Charter National Banks</b>		
Intragovernmental	\$ 2,418,481	\$ 1,725,149
With the public	14,049,294	9,917,892
<b>Subtotal - Charter National Bank</b>	<b>\$ 16,467,775</b>	<b>\$ 11,643,041</b>
<b>Total Program Costs</b>	<b>\$ 472,212,041</b>	<b>\$ 451,103,675</b>
Less: Earned revenues not attributed to programs	(497,764,476)	(466,110,295)
<b>Net Cost of Operations</b>	<b>\$ (25,552,435)</b>	<b>\$ (15,006,620)</b>

The accompanying notes are an integral part of these financial statements.

**Office of Comptroller of the Currency  
Statements of Changes in Net Position  
For the Years Ended September 30, 2004 and 2003**

	FY 2004	FY 2003
<b>Beginning Balances</b>	\$ 287,373,440	\$ 251,678,048
<b>Other Financing Sources</b>		
Imputed financing from costs absorbed by others (Note 7)	22,533,740	20,688,772
<b>Net Cost of Operations</b>	25,552,435	15,006,620
<b>Ending Balances</b>	<b>\$ 335,459,615</b>	<b>\$ 287,373,440</b>

The accompanying notes are an integral part of these financial statements.

**Office of Comptroller of the Currency  
Statements of Budgetary Resources  
For the Years Ended September 30, 2004 and 2003**

	FY 2004	FY 2003
<b>Budgetary Resources</b>		
Unobligated balance		
Beginning of period	\$ 339,989,380	\$ 312,757,649
Spending authority from offsetting collections:		
Earned		
Collected	507,438,496	471,264,186
Receivable from Federal sources	569,956	229,167
Subtotal	508,008,452	471,493,353
<b>Total Budgetary Resources</b>	<b>\$ 847,997,832</b>	<b>\$ 784,251,002</b>
<b>Status of Budgetary Resources</b>		
Obligations incurred	\$ 449,462,750	\$ 444,261,622
Unobligated balance available	398,535,082	339,989,380
<b>Total Status of Budgetary Resources</b>	<b>\$ 847,997,832</b>	<b>\$ 784,251,002</b>
<b>Relationship of Obligations to Outlays</b>		
Obligated balance, net, beginning of period	82,639,683	67,315,029
Obligated balance, net, end of period:		
Interest and other receivable	(5,690,582)	(5,120,625)
Undelivered orders	16,425,985	23,467,361
Accounts payable and accruals net of assessments refunds	69,922,769	64,292,948
Outlays:		
Disbursements	\$ 450,874,306	\$ 428,707,802
Collections	(507,438,496)	(471,264,186)
<b>Net Collections in Excess of Disbursements</b>	<b>\$ (56,564,190)</b>	<b>\$ (42,556,384)</b>

The accompanying notes are an integral part of these financial statements.

**Office of Comptroller of the Currency**  
**Statements of Financing**  
**For the Years Ended September 30, 2004 and 2003**

	FY 2004	FY 2003
<b>Resources Used to Finance Activities</b>		
Budgetary Resources Obligated		
Obligations incurred	\$ 449,462,750	\$ 444,261,622
Less: Spending authority from offsetting collections	(508,008,452)	(471,493,353)
Net obligations	(58,545,702)	(27,231,731)
Other Resources		
Imputed financing from costs absorbed by others (Note 7)	22,533,740	20,688,772
<b>Total resources used to finance activities</b>	<b>(36,011,962)</b>	<b>(6,542,959)</b>
<b>Resources Used to Finance Items not Part of the Net Cost of Operations</b>		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	7,278,008	(5,848,595)
Resources that finance the acquisition of assets	(16,304,977)	(14,685,716)
Other resources or adjustments to net obligated resources that do not affect net cost of operations	320,570	(85,582)
<b>Total resources used to finance items not part of the net cost of operations</b>	<b>(8,706,399)</b>	<b>(20,619,893)</b>
<b>Total resources used to finance the net cost of operations</b>	<b>(44,718,361)</b>	<b>(27,162,852)</b>
<b>Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period</b>		
Components Requiring or Generating Resources in Future Periods:		
Change in deferred revenue	7,967,380	7,302,491
Change in assessment refunds	-	(819,835)
Total components that will require or generate resources in future periods	7,967,380	6,482,656
Components not Requiring or Generating Resources:		
Depreciation and amortization	8,869,905	6,792,297
Net (increase) decrease in bond premium	2,091,916	(1,118,721)
Other	236,725	-
Total components that will not require or generate resources	11,198,546	5,673,576
<b>Total components of net cost of operations that will not require or generate resources in the current period</b>	<b>19,165,926</b>	<b>12,156,232</b>
<b>Net Cost of Operations</b>	<b>\$ (25,552,435)</b>	<b>\$ (15,006,620)</b>

The accompanying notes are an integral part of these financial statements.

**Office of Comptroller of the Currency**  
**Statements of Custodial Activity**  
**For the Years Ended September 30, 2004 and 2003**

	<b>FY 2004</b>	<b>FY 2003</b>
<b>Revenue Activity</b>		
Revenue Received		
Civil monetary penalties	\$ 25,566,393	\$ 1,035,122
Accrual adjustment	733,784	795,968
Total civil monetary revenue received	24,300,177	1,831,090
Disposition of Custodial Revenue		
Amounts provided to Treasury	(25,577,843)	(951,089)
Decrease (Increase) in amount yet to be transferred	1,277,666	(880,001)
Total disposition for custodial revenue	(24,300,177)	(1,831,090)
<b>Net Custodial Revenue Activity</b>	<b>\$ -</b>	<b>\$ -</b>

The accompanying notes are an integral part of these financial statements.

# Notes to the Financial Statements

## **Note 1 - Organization**

The OCC was created as a bureau within the U.S. Department of the Treasury by an act of Congress in 1863. The OCC was created to establish and regulate a system of federally chartered national banks. The National Currency Act of 1863, rewritten and reenacted as the National Bank Act of 1864, authorized the OCC to supervise national banks and to regulate the lending and investment activities of federally chartered institutions.

The OCC's revenue is derived primarily from assessments and fees paid by national banks and income on investments in U.S. government securities. The OCC does not receive congressional appropriations to fund any of its operations. Therefore, the OCC does not have any unexpended appropriations.

By federal statute 12 USC 481, the OCC's funds are maintained in a U.S. government trust revolving fund. The funds remain available to cover the annual costs of the OCC's operations in accordance with policies established by the Comptroller.

The Departmental Offices (DO), another entity of the U.S. Department of the Treasury, provides certain administrative services to the OCC. The OCC pays the DO for services rendered pursuant to established interagency agreements. Administrative services provided by the DO totaled \$2,467,099 in FY 2004, and \$2,444,650 in FY 2003.

## **Note 2 - Significant Accounting Policies**

### **Basis of Accounting**

The OCC's financial statements have been prepared from its accounting records in conformity with generally accepted accounting principles (GAAP) in the United States of America. The financial statements consist of a balance sheet, and the statements of net cost, changes in net position, budgetary resources, financing, and custodial activity. These financial statements are presented on a comparative basis providing information for FYs 2004 and 2003.

FY 2004 is the first year the OCC prepared the Statement of Custodial Activity to reflect CMP activity. In prior years, CMP information was disclosed in a note to the financial statements. The OCC collects CMPs due to the federal government that are assessed through court enforced legal actions against a national bank and/or its officers. Outstanding CMPs at September 30, 2004 and 2003 amounted to \$1,280,718 and \$2,014,502, respectively.

The financial statements reflect both the accrual and budgetary bases of accounting. Under the accrual method, revenues are recognized when earned, and expenses are recognized when a liability is incurred, without regard to cash receipt or payment. The budgetary method recognizes the obligation of funds according to legal requirements, which, in many cases, is made prior to the occurrence of an accrual-based transaction. Budgetary accounting is essential for compliance with legal constraints and controls over the use of federal funds.

### **Fund Balance with Treasury**

The OCC's cash receipts and disbursements are processed by the U.S. Treasury. Sufficient funds are maintained in a U.S. government trust revolving fund and are available to pay current liabilities. The OCC invests all the funds that are not immediately needed in U.S. government securities (Note 3).

## **Accounts Receivable**

Accounts receivable represent monies owed to the OCC for services and goods provided. Accounts receivable from the public are reduced to their net realizable value by an Allowance for Doubtful Accounts. The OCC reserves an allowance equal to 100 percent of accounts with outstanding balances exceeding one year, and 50 percent of accounts with balances exceeding six months but less than one year. At September 30, 2004 and 2003, accounts receivable from the public amounted to \$147,597 less an allowance of \$35,396 and \$451,767 less an allowance of \$18,994, respectively.

## **Advances and Prepayments**

Advances and prepayments to the public consist of rent and insurance paid. The amounts are recorded as prepaid expenses at the time of payment and are expensed when related goods and services are received.

## **Liabilities**

Liabilities represent the amounts owing or accruing under contractual or other arrangements governing the transactions, including operating expenses incurred but not yet paid. Payments are made in a timely manner in accordance with the Prompt Payment Act. Interest penalties are paid when payments are late. Discounts are taken when cost effective, and the invoice is paid within the discount period.

## **Annual, Sick, and Other Leave**

Annual leave is accrued and funded by the OCC as it is earned, and the accrual is reduced as leave is taken or paid. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. Sick leave and other types of leave are expensed as taken.

## **Program Costs**

In FY 2004, the OCC eliminated analyze risk as a separate program area for managing its operations. The activities that comprised the program were so closely aligned to the objectives and performance goals of the supervise program that maintaining a separate program was no longer meaningful. The FY 2003 Statement of Net Cost has been restated to reflect this change.

## **Use of Estimates**

The preparation of financial statements, in accordance with GAAP, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Such estimates and assumptions could change in the future as more information becomes known, which could affect the amounts reported and disclosed herein.



### Note 3 - Investments and Related Interest

Investments are U.S. Treasury securities stated at amortized cost and the related accrued interest. The OCC plans to hold these investments to maturity. Premiums and discounts are amortized over the term of the investment using the straight-line method, which approximates the effective yield method. The fair market value of investment securities was \$484,401,551 at September 30, 2004, and \$434,739,500 at September 30, 2003.

#### Investments and Related Interest Receivable

	FY 2004	FY 2003
Par Value	\$ 478,652,000	\$421,407,000
Net Unamortized Premium	2,922,982	6,177,841
Net Unamortized Value	481,574,982	427,584,841
Interest Receivable	5,546,250	5,120,625
<b>Total</b>	<b>\$487,121,232</b>	<b>\$432,705,466</b>

#### FY 2004 Investment Portfolio

Maturity	Par Value	Coupon Rate
Overnight	\$27,652,000	1.720%
T-Bill	20,000,000	1.770%
	120,000,000	1.590%
During 2005	55,000,000	5.875%
	40,000,000	6.500%
During 2006	29,000,000	5.750%
	25,000,000	6.875%
During 2007	30,000,000	3.500%
	30,000,000	4.375%
During 2008	30,000,000	3.000%
	30,000,000	2.625%
During 2009	21,000,000	3.375%
	21,000,000	3.875%
<b>Total</b>	<b>\$478,652,000</b>	

#### FY 2003 Investment Portfolio

Maturity	Par Value	Coupon Rate
Overnight	\$177,407,000	0.950%
During 2004	55,000,000	4.250%
	40,000,000	5.250%
During 2005	55,000,000	5.875%
	40,000,000	6.500%
During 2006	29,000,000	5.750%
	25,000,000	6.875%
<b>Total</b>	<b>\$421,407,000</b>	

#### **Note 4 - Property and Equipment, net**

Property and equipment purchased at a cost greater than or equal to the noted thresholds below with useful lives of five years or more are capitalized at cost and depreciated or amortized, as applicable. Leasehold improvements are amortized on a straight-line basis over the lesser of the terms of the related leases or their estimated useful lives. All other property and equipment are depreciated or amortized, as applicable, on a straight-line basis over their estimated useful lives. The tables presented below summarize property and equipment balances as of September 30, 2004, and 2003.

##### **FY 2004 Property and Equipment, net**

<b>Class of Assets</b>	<b>Capitalization Threshold/ Useful Life</b>	<b>Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
Leasehold Improvements	\$50,000 5-20	\$ 25,633,257	\$ (18,780,875)	\$ 6,852,382
Equipment	\$50,000 5-10	11,562,453	(7,265,324)	4,297,129
Furniture and Fixtures	\$50,000 5-10	1,336,778	(907,841)	428,937
Internal Use Software	\$500,000 5-10	30,489,430	(8,201,611)	22,287,819
Internal Use Software-Dev	\$500,000 5-10	5,145,251	-	5,145,251
Leasehold Improvements-Dev	\$50,000 5-20	1,136,473	-	1,136,473
<b>Total</b>		<b>\$75,303,642</b>	<b>\$ (35,155,651)</b>	<b>\$ 40,147,991</b>

##### **FY 2003 Property and Equipment, net**

<b>Class of Assets</b>	<b>Capitalization Threshold/ Useful Life</b>	<b>Cost</b>	<b>Accumulated Depreciation</b>	<b>Net Book Value</b>
Leasehold Improvements	\$ 50,000 5-20	\$ 25,277,761	\$ (16,885,879)	\$ 8,391,882
Equipment	\$50,000 5-10	9,590,672	(6,091,601)	3,499,071
Furniture and Fixtures	\$ 50,000 5-10	1,336,779	(843,805)	492,974
Internal Use Software	\$ 500,000 5-10	21,876,063	(5,603,148)	16,272,915
Internal Use Software-Dev	\$500,000 5-10	4,292,802	-	4,292,802
<b>Total</b>		<b>\$ 62,374,077</b>	<b>\$ (29,424,433)</b>	<b>\$ 32,949,644</b>

#### **Note 5 - Deferred Revenue**

The OCC's activities are primarily financed by assessments on assets held by national banks and the federal branches of foreign banks. These assessments are due January 31 and July 31 of each year based on asset balances as of call reports dated December 31 and June 30, respectively. Assessments are paid in advance and are recognized as earned revenue on a straight-line basis over the six months following the call date. The unearned portions are reduced accordingly.

## Note 6 - Leases

The OCC leases office space for headquarters operations in Washington, D.C., and for district and field operations. The lease agreements expire at various dates. These leases are treated as operating leases.

### FY 2004 Future Lease Payments

Year	Amount
2005	\$ 22,930,047
2006	15,332,707
2007	6,904,679
2008	6,532,164
2009	6,141,103
2010 and beyond	25,968,478
<b>Total</b>	<b>\$ 83,809,178</b>

### FY 2003 Future Lease Payments

Year	Amount
2004	\$ 21,827,454
2005	19,666,349
2006	13,841,164
2007	4,437,938
2008	3,844,151
2009 and beyond	14,705,613
<b>Total</b>	<b>\$ 78,322,669</b>

## Note 7 - Retirement Plans and Other Benefits

### Retirement

OCC employees are eligible to participate in one of two retirement plans. Employees hired prior to January 1, 1984, are covered by the CSRS, unless they elected to join the FERS and Social Security during the election period. Employees hired after December 31, 1983 are automatically covered by FERS and Social Security. The distribution of the OCC's workforce by retirement plan is 67 percent FERS and 32 percent CSRS. The remaining 1 percent of employees qualify only for Social Security benefits. For employees covered by CSRS, the OCC contributes 7 percent of their adjusted base pay to the plan. OCC contributions to CSRS were \$6,582,430 in FY 2004 and \$6,839,400 in FY 2003. For employees covered by FERS, the OCC contributes 10.7 percent of their adjusted base pay. OCC contributions totaled \$15,129,774 in FY 2004, and \$14,390,270 in FY 2003.

Furthermore, the OPM contributed an additional \$22,533,740 toward these retirement plans during FY 2004, and \$20,688,772 in FY 2003. The OCC recognized these contributions as "Imputed Costs Absorbed by Others" and an offset in equal amount to "Imputed Financing from Costs Absorbed by Others" as a result of not having to reimburse the OPM.

The OCC does not report in its financial statements information pertaining to the retirement plans covering its employees. Reporting amounts, such as plan assets, accumulated plan benefits, or unfunded liabilities, if any, are presently the responsibility of the OPM.

## Other Benefits

OCC employees are eligible to participate in the Federal Thrift Savings Plan (TSP). For those employees under FERS, a TSP account is automatically established, and the OCC contributes a mandatory 1 percent of adjusted base pay to this account. In addition, the OCC matches employee contributions up to an additional 4 percent of pay, for a maximum OCC contribution amounting to 5 percent of adjusted base pay. Employees under CSRS may participate in the TSP, but do not receive the automatic (1 percent) and matching employer contributions. The OCC's contributions for the TSP totaled \$6,437,886 in FY 2004 and \$6,132,018 in FY 2003. The OCC also contributed a total of \$12,332,480 for Social Security and Medicare benefits for all eligible employees in FY 2004, and \$11,731,468 in FY 2003.

Employees can elect to contribute up to 10 percent of their adjusted base pay in the OCC 401(K) Plan, subject to Internal Revenue regulations. Prudential Securities Incorporated administers the plan. Currently, the OCC contributes a maximum of 2 percent of the adjusted base pay to the plan for all participating employees. Approximately 2,300 employees are currently enrolled in the plan, which represents a participation rate exceeding 85 percent. The total cost of the OCC's matching contribution plus associated administration fees amounted to \$4,138,146 during FY 2004, and \$3,425,093 in FY 2003.

The OCC sponsors a life insurance benefit plan for current and retired employees. This plan is a defined benefit plan. Premium payments made during FY 2004 totaled \$128,258 and \$134,477 in FY 2003.

### Accrued Post-Retirement Benefit Cost and Net Periodic Post-Retirement Benefit Cost

Component	FY 2004	FY 2003
Accumulated Post-Retirement Benefit Obligation	\$ (12,613,233)	\$ (10,979,016)
Unrecognized Transition Obligation	1,158,542	1,555,545
Unrecognized Net Gain	1,382,708	343,765
<b>Total</b>	<b>\$ (10,071,983)</b>	<b>\$ (9,079,706)</b>
Service Cost	\$ 468,500	\$ 403,456
Interest Cost	663,926	599,490
Amortization of Transition Obligation	172,837	172,837
<b>Total</b>	<b>\$ 1,305,263</b>	<b>\$ 1,175,783</b>

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 6 percent. Gains or losses due to changes in actuarial assumptions are amortized over the service life of the plan.

Employees and retirees of the OCC are eligible to participate in Federal Employees Health Benefits (FEHB) and Federal Employees Group Life Insurance (FEGLI) plans that involve a cost sharing of bi-weekly coverage premiums by employee and employer. Both of these employee benefit plans are administered by the OPM. Total OCC contributions for active employees who participate in the FEHB plans were \$13,589,369 for FY 2004, and \$12,577,572 for FY 2003. OCC contributions for active employees who participate in the FEGLI plan were \$201,697 for FY 2004, and \$201,440 for FY 2003.

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for the OCC's employees under FECA are administered by the U.S. Department of Labor (DOL) and later billed to the OCC. The OCC accrued \$5,564,904 of workers' compensation costs as of September 30, 2004, and \$5,366,500 as of September 30, 2003. This amount includes unpaid costs and an actuarial estimated liability for unbilled costs incurred as of year-end calculated by the DOL.

**Note 8 - Net Position**

The OCC sets aside a portion of its Net Position as Contingency, Special, and Asset Replacement Reserves to be used at the discretion of the Comptroller. In addition, funds are set aside to cover the cost of ongoing operations.

The Contingency Reserve supports the OCC's ability to accomplish its mission in the case of foreseeable but rare events. Foreseeable but rare events are beyond the control of the OCC, such as a major change in the national banking system or a disaster, such as a fire, flood, or significant impairment of its information technology systems.

The Special Reserve supplements revenue from assessments and other sources that are made available to fund the OCC's annual budget. The Special Reserve reduces the effect on operations of unforecasted revenue shortfalls or unbudgeted and unanticipated requirements or opportunities. The Special Reserve was reduced in FY 2003 to provide funding for the OCC's district restructuring efforts and was replenished in FY 2004 from results of operations.

The asset replacement reserve was established in FY 2004. It ensures the incremental funding of leasehold improvements and replacement of furniture and equipment scheduled for future years. A specific amount is accumulated each year based on the expected cost and useful life of the asset to ensure that adequate funds are available when the time comes for the leasehold improvement or asset replacement. The FY 2005 budget authorized the use of approximately \$10 million to fund various capital projects and set a target level for the reserve of \$23,103,757 by September 30, 2005.

**Net Position Availability**

Components	FY 2004	FY 2003
Contingency Reserve	\$ 219,473,390	\$ 196,479,819
Special Reserve	15,000,000	10,856,000
Asset Replacement Reserve	17,532,950	-
Earmarked for Ongoing Operations:		
Undelivered Orders	16,425,985	23,467,361
Consumption of Assets	45,401,954	40,964,927
Capital Investments	17,235,357	5,426,982
District Offices Restructuring	4,389,979	10,178,351
<b>Net Position</b>	<b>\$ 335,459,615</b>	<b>\$ 287,373,440</b>

### **Note 9 - Expenses by Budget Object Classification**

The following table illustrates the OCC's costs by major budget object class for FYs 2004 and 2003.

<b>Budget Object Class</b>	<b>FY 2004</b>	<b>FY 2003</b>
Personnel Compensation	\$ 253,743,442	\$ 246,172,715
Personnel Benefits	72,166,389	66,326,330
Benefits to Former Employees	3,053,268	3,359,129
Travel and Transportation of Persons	27,366,170	26,347,257
Travel and Transportation of Things	1,893,377	1,521,893
Rent, Communication, and Utilities	32,130,835	32,989,698
Printing and Reproduction	914,616	608,477
Other Contractual Services	38,102,100	34,648,286
Supplies and Materials	3,365,474	2,974,034
Equipment	4,811,125	8,478,600
Land and Structures - Leasehold Improvements	2,872,330	128,173
Insurance Claims and Indemnities	152,545	68,014
Depreciation	8,869,905	6,792,297
Loss on Asset Disposal	236,725	-
Imputed Costs	22,533,740	20,688,772
<b>Total</b>	<b>\$ 472,212,041</b>	<b>\$451,103,675</b>

### **Note 10 – Contingencies**

The OCC is party to various administrative proceedings, legal actions, and claims. In the opinion of the management and the Chief Counsel, the probability is remote that the ultimate resolution of these matters, individually or in the aggregate, will have a material adverse effect on the OCC's financial position or the results of its operations.

## Appendix A—FY 2004 Performance Measures and Results

The OCC's FY 2004 performance measures, workload indicators, customer service standards, and results are presented below.

OCC Program	Performance Measure Workload Indicator Customer Service Standard	FY 2001	FY 2002	FY 2003	FY 2004	
					Target	Actual [1]
Supervise	Percentage of national banks that are well-capitalized	98%	99%	99%	95%	<b>99%</b>
	Percentage of national banks with composite CAMELS rating of 1 or 2	94%	95%	94%	90%	<b>94%</b>
	Percentage of critically undercapitalized banks on which responsible action is taken within 90 calendar days after they become critically undercapitalized	N/A	N/A	100%	100%	100%
	Rehabilitated problem national banks as a percentage of prior fiscal year-end's problem national banks (CAMELS 3, 4 or 5)	44%	47%	32%	40%	<b>41%</b>
	Percentage of national banks with consumer compliance rating of 1 or 2	N/A	N/A	96%	94%	<b>96%</b>
	Percentage of community banks that are within one year of its first Large Bank Community Reinvestment Act examination in which the OCC offers to provide consultation on community development opportunities	N/A	N/A	100%	100%	100%
	Percentage of consumer complaints closed within 60 calendar days of receipt	N/A	N/A	87%	80%	74% [2]
	Number of consumer complaints opened/closed during the fiscal year	N/A	N/A	75,114 69,044	75,000 70,000	68,026 68,104
	Average survey response that the examiner-in-charge and the examination team were knowledgeable	N/A	N/A	1.26	≤ 1.5	1.34
	Average survey response that the examiner's requests for information were reasonable and justified by the examination scope	1.36	1.36	1.31	≤ 1.75	1.36
	Average survey response that the examination team conducted the examination in a professional manner	1.21	1.21	1.20	≤ 1.75	1.25
	Average survey response that the examiner-in-charge and examination team clearly and effectively communicated their findings and concerns	1.33	1.32	1.27	≤ 1.75	1.37
	Average survey response that the report of examination clearly communicated examination findings, significant issues and the corrective actions management needed to take	1.31	1.30	1.26	≤ 1.75	1.30
	Average survey response that ongoing communications by the examiner-in-charge with senior management and the board was appropriate	1.29	1.29	1.25	≤ 1.75	1.30
Regulate	Percentage of external legal opinions issued within established time frames	N/A	N/A	87%	85%	87%
	Number of external legal opinions issued during the fiscal year	N/A	N/A	92	110	119

OCC Program	Performance Measure Workload Indicator Customer Service Standard	FY 2001	FY 2002	FY 2003	FY 2004	
					Target	Actual [1]
Charter	Percentage of licensing applications filed electronically	N/A	N/A	8%	15%	34%
	Number of licensing applications filed electronically during the fiscal year	N/A	N/A	182	285	893
	Percentage of licensing applications completed within established time frames	96%	96%	97%	95%	96%
	Number of licensing applications completed during the fiscal year	N/A	N/A	1,918	1,900	2,477
	Average survey rating of OCC's timeliness on licensing applications	1.15	1.19	1.16	≤ 1.5	1.20
	Average survey rating of the knowledge of OCC's licensing staff	1.17	1.19	1.14	≤ 1.5	1.20
	Average survey rating of the professionalism of OCC's licensing staff	1.10	1.12	1.09	≤ 1.5	1.10
	Average survey rating of the overall licensing services provided by OCC	1.16	1.17	1.14	≤ 1.5	1.20

- [1] FY 2004 performance numbers shown in bold italics are estimates. Some performance data is obtained from quarterly call reports from banks. The September 30, 2004 call reports are not due until 30 or 45 days after the end of the period. Additionally, examinations concluded late in the fiscal year are not finalized for another 30 to 60 days. As a result, complete fiscal year data is not yet available and estimates are reported.
- [2] Seventy-four percent of closed consumer complaints were completed within 60 calendar days of receipt, falling short of the 80 percent target. Although the number of consumer complaint cases declined by 9 percent from FY 2003, the increase in complexity of written cases and a decline in the number of cases that could be closed over the phone, contributed to not meeting the performance goal this year. Management expects to meet this goal in FY 2005 by adding staff and increasing the efficient and effective use of technology.



## Appendix B—Glossary of Acronyms

ALI	American Law Institute
ALICE	Automated Learning Information Center
AML	Anti-Money Laundering
ATRR	Allocated Transfer Risk Reserve
BSA	Bank Secrecy Act
CAG	Customer Assistance Group
CAIS	Corporate Activity Information System
CALMA	Capital Assurance and Liquidity Maintenance Agreements
CAMELS	Composite rating standing for Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk
CBCA	Change in Bank Control Act
CBI	Central Bank of Iraq
CD	Compact Disc
CEBA	Competitive Equality Banking Act
CEO	Chief Executive Officer
CFR	Code of Federal Regulations
CMP	Civil Money Penalty
COOP	Continuity of Operations Plan
CPIC	Capital Planning and Investment Control
CPOC	Contingency Planning Oversight Committee
CRA	Community Reinvestment Act
CSRS	Civil Service Retirement System
CY	Calendar Year
DO	Departmental Offices
DOL	Department of Labor
DRC	District Risk Committee
e-CORP	Electronic Corporate Application Process
EDP	Electronic Data Processing
EEO	Equal Employment Opportunity
EFT	Electronic Funds Transfer
EOC	Emergency Operations Center
EV	Examiner View

FAIR	Fair Alternative and Innovative Resolutions Program
FAQ	Frequently Asked Questions
FATF	Financial Action Task Force
FBIIC	Financial and Banking Infrastructure Information Committee
FCRA	Fair Credit Reporting Act
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FECA	Federal Employees' Compensation Act
Fed. Reg.	Federal Register
FEGLI	Federal Employees Group Life Insurance
FEHB	Federal Employees Health Benefits
FERS	Federal Employees Retirement System
FFIEC	Federal Financial Institutions Examination Council
FFMIA	Federal Financial Management Improvement Act
FinCEN	Financial Crimes Enforcement Network
FINDRS	Financial Institution Data Retrieval System
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act of 1989
FISMA	Federal Information Security Management Act of 2002
FM	Financial Management
FMFIA	Federal Managers' Financial Integrity Act
FPP	Financial Policy and Procedure
FRB	Board of Governors of the Federal Reserve System
FTC	Federal Trade Commission
FTE	Full-Time Equivalent
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAO	Government Accountability Office
GLBA	Gramm-Leach-Bliley Act of 1999
GPRA	Government Performance Results Act
IPIA	Improper Payments Information Act of 2002
IT	Information Technology
ITS	Information Technology Services
LBCT	Large Bank Credit Tool
LIS	Licensing Information System
LRDA	Liquidity Reserve Deposit Accounts
MOU	Memorandum of Understanding

NA	National Association
N/A	Not Applicable
NAST	National Association of State Treasurers
NAUPA	National Association of Unclaimed Property Administrators
NCCUSL	National Conference of Commissioners on Uniform State Laws
NCT	National Credit Tool
NCUA	National Credit Union Administration
NRC	National Risk Committee
OCC	Office of the Comptroller of the Currency
OECD	Organization for Economic Cooperation and Development
OIG	Treasury's Office of Inspector General
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OTS	Office of Thrift Supervision
PAU	Program Analysis Unit
PMA	President's Management Agenda
QM	Quality Management
RFA	Request for Applications
SAR	Suspicious Activity Report
SDLC	Systems Development Life Cycle
SEC	Securities and Exchange Commission
SGL	United States Government Standard General Ledger
SIS	Supervisory Information System
SNC	Shared National Credit
TSP	Federal Thrift Savings Plan
UCC	Uniform Commercial Code
U.S.	United States

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