Comptroller of the Currency
Administrator of National Banks

Quarterly Journal

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September 2002

Comptroller . . . . John D. Hawke, Jr.

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Background

The Office of the Comptroller of the Currency (OCC) was established in 1863 as a bureau of the Department of the Treasury. The OCC is headed by the Comptroller, who is appointed by the President, with the advice and consent of the Senate, for a five-year term.

The OCC regulates national banks by its power to:

- Examine the banks;
- Approve or deny applications for new charters, branches, capital, or other changes in corporate or banking structure;
- Take supervisory actions against banks that do not conform to laws and regulations or that otherwise engage in unsound banking practices, including removal of officers, negotiation of agreements to change existing banking practices, and issuance of cease and desist orders; and
- Issue rules and regulations concerning banking practices and governing bank lending and investment practices and corporate structure.

The OCC divides the United States into six geographical districts, with each headed by a deputy comptroller.

The OCC is funded through assessments on the assets of national banks, and federal branches and agencies. Under the International Banking Act of 1978, the OCC regulates federal branches and agencies of foreign banks in the United States.

The Comptroller

Comptroller John D. Hawke, Jr., has held office as the 28th Comptroller of the Currency since December 8, 1998, after being appointed by President Clinton during a congressional recess. He was confirmed subsequently by the U.S. Senate for a five-year term starting on October 13, 1999. Prior to his appointment Mr. Hawke served for 3½ years as Under Secretary of the Treasury for Domestic Finance. He oversaw development of policy and legislation on financial institutions, debt management, and capital markets; served as chairman of the Advanced Counterfeit Deterrence Steering Committee; and was a member of the board of the Securities Investor Protection Corporation. Before joining Treasury, he was a senior partner at the Washington, D.C., law firm of Arnold & Porter, which he joined as an associate in 1962. In 1975 he left to serve as general counsel to the Board of Governors of the Federal Reserve System, returning in 1978. At Arnold & Porter he headed the financial institutions practice. From 1987 to 1995 he was chairman of the firm.

Mr. Hawke has written extensively on the regulation of financial institutions, including *Commentaries on Banking Regulation,* published in 1985. From 1970 to 1987 he taught courses on federal regulation of banking at Georgetown University Law Center. He has also taught courses on bank acquisitions and serves as chairman of the Board of Advisors of the Morin Center for Banking Law Studies. In 1987 Mr. Hawke served on a committee of inquiry appointed by the Chicago Mercantile Exchange to study the role of futures markets in the October 1987 stock market crash. He was a founding member of the Shadow Financial Regulatory Committee and served on it until joining Treasury.

Mr. Hawke was graduated from Yale University in 1954 with a B.A. in English. From 1955 to 1957 he served on active duty with the U.S. Air Force. After graduating in 1960 from Columbia University School of Law, where he was editor-in-chief of the *Columbia Law Review,* Mr. Hawke clerked for Judge E. Barrett Prettyman on the U.S. Court of Appeals for the District of Columbia Circuit. From 1961 to 1962 he was counsel to the Select Subcommittee on Education, U.S. House of Representatives.

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The *Quarterly Journal* is the journal of record for the most significant actions and policies of the Office of the Comptroller of the Currency. It is published four times a year. The *Quarterly Journal* includes policy statements, decisions on banking structure, selected speeches and congressional testimony, material released in the interpretive letters series, statistical data, and other information of interest to the administration of national banks. Send suggestions or questions to Rebecca Miller, Senior Writer-Editor, Communications Division, Comptroller of the Currency, Washington, DC 20219. **Subscriptions are available for $120 a year by writing to Comptroller of the Currency, Attn: Accounts Receivable, MS 4-8, 250 E St., SW, Washington, DC 20219.** The *Quarterly Journal* is on the Web at http://www.occ.treas.gov/qj/qj.htm.

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Comptroller of the Currency

The Administrator of National Banks

Volume 21, Number 3
September 2002

Contents

Condition and Performance of Commercial Banks

Summary

Bank income moved up strongly again during the second quarter, despite weakness in the macro economy, and the continued slide in equity markets. A strong housing market boosted lending and fee income, as low, short-term interest rates and wide spreads between short- and long-term rates kept up net interest income. Return on equity rose again, to an eight-year high. Loan volume rose modestly during the quarter, with nearly all the growth coming in real estate loans made at large banks.

Asset quality continued to decline, with most of the deterioration concentrated in the larger banks. For both small and large banks, commercial and industrial (C&I) loans experienced the greatest deterioration. Loan loss reserves grew year-over-year, but noncurrent loans grew faster, reducing the ratio of loan loss reserves to noncurrent loans.

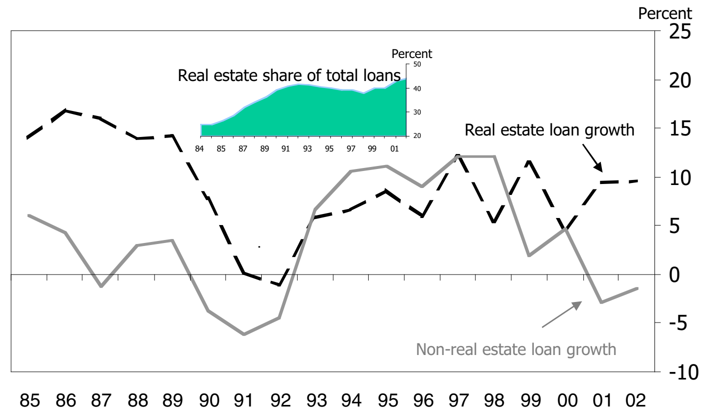
Key Trends

During the second quarter, net income at national banks grew by 5 percent over the previous quarter and 29 percent year-over-year, as low, short-term interest rates and wide spreads between short- and long-term rates continued to be favorable for net interest income, which rose 14 percent year-over-year. Net interest margins finally fell after four consecutive quarterly increases. Return on equity rose to 15.9 percent, just shy of the all-time highs recorded in 1993 and 1994.

Loan volume rose 3 percent for the quarter, with nearly all of the growth coming in real estate loans made at large banks. Real estate has become increasingly important in loan portfolios, as the inset to Figure 1 indicates. Persistent strength in the housing sector, coupled with slow or no growth in other lending, has pushed real estate to 44 percent of the total loan book of national banks. This total would be even higher were it not for the recent growth in securitization, which has moved many mortgage loans off banks' loan books.

Real estate lending has added to bank profits in several ways: lending, refinancing fees, and income from securitization. Over the last four quarters, securitization income at national banks increased by more than 30 percent, and the stock of securitized loans grew by 18 percent, three-quarters of which was for 1- to 4-family residential loans.

Figure 1—Real estate is increasingly important for national banks



Source: Integrated Banking Information System (OCC)

Table 1—Large national banks now outperform smaller ones

Average quarterly return on equity, national non-specialty banks (percent)

	1984Q1–1996Q4	1997Q1–2002Q2
Banks under $1 billion	10.34	12.34
Banks over $1 billion	9.89	14.30
Difference	–0.45	1.96

Source: Integrated Banking Information System (OCC)

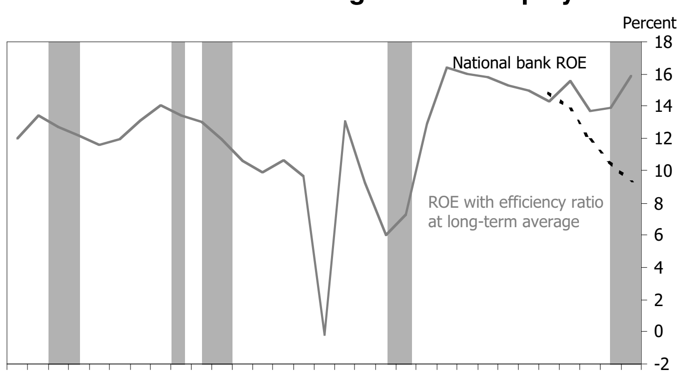
Large banks have benefited from their ability to control noninterest expenses. In 1991 for example, salaries represented about the same share of noninterest expense (30.6 percent) at small banks (under $1 billion in assets) as at large banks (over $1 billion in assets). Since then, large banks have been able to reduce this share to 24.2 percent, while small banks have seen it rise to 33.6 percent.

For the last few years, larger banks have had better efficiency ratios (noninterest expense to net operating revenues), and the pattern is becoming more pronounced. Moreover, this efficiency advantage is not limited to a few large banks, but is a general pattern. For example, in the second quarter of 2002, the fraction of banks with an efficiency ratio below 60 percent was 30 percent for banks with less than $100 million in assets, 45 percent for banks with assets between $100 million and $1 billion, 57 percent for banks with assets between $1 billion and $10 billion, and 77 percent for banks with more than $10 billion in assets.

Large banks have used this advantage in efficiency ratios to gain the edge in earnings. Table 1 shows that between 1984 and 1996, smaller banks (under $1 billion in assets) enjoyed an average return on equity (ROE) 45 points higher than their larger counterparts. Since then, however, while ROE has increased for both small and large banks, large banks have gained more than enough to move ahead of their smaller contemporaries.

Without the recent improvements in large banks' noninterest expense ratios, return on equity would be much lower than it is today. Figure 2 shows return on equity at national banks, with recessions indicated by the gray bands. From 1998 to the present, the dotted line shows what return on equity would have been if the average ratio of noninterest expense to net operating revenue (the "efficiency ratio") had remained at the 1984–2002 average of 63 percent. In this case, ROE would have fallen steadily from 15.0 percent in 1997 to 9.3 in the second quarter of 2002, instead of rising to a near-record 15.9 percent.

Figure 2—Efficiency gains at large national banks contribute to strong return on equity

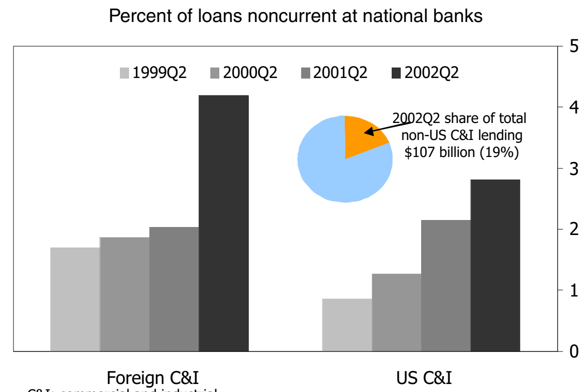


ROE: return on equity
Source: Integrated Banking Information System (OCC)

In the second quarter, loan loss reserves grew by 14 percent year-over-year, while noncurrent loans grew by 23 percent, reducing the ratio of loan loss reserves to noncurrent loans from 135 percent to 124 percent. Asset quality continued to decline, with most of the deterioration concentrated in the larger banks. The noncurrent loan ratio rose by 5 basis points for small banks, from 0.92 to 0.97, and by 29 basis points for large banks, from 1.38 to 1.67. For both small and large banks, commercial and industrial (C&I) loans experienced the greatest deterioration: by 31 basis points for smaller banks, and by 97 basis points for larger banks.

Much of the deterioration in the C&I sector occurred in loans made to companies outside the United States. As the inset to Figure 3 indicates, foreign C&I loans now make up 19 percent of the C&I portfolios of national banks. In the second quarter of 2001, the noncurrent ratios were about equal for domestic and foreign C&I loans: 2.15 percent domestic, compared with 2.03 percent foreign. A year later, the noncurrent ratio had increased to 2.81 percent for domestic loans, but had more than doubled, to 4.19 percent, for foreign loans.

Figure 3—Noncurrent foreign commercial and industrial loans surge

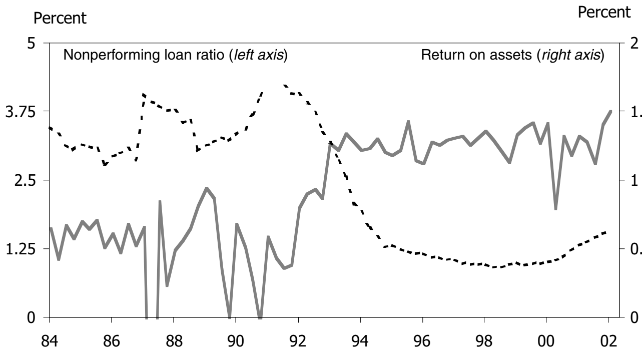


C&I: commercial and industrial
Source: Integrated Banking Information System (OCC)

Although credit quality held up better at small banks than large banks, this aggregate number conceals important differences among the smaller banks. For example, in the second quarter, more than 8 percent of small banks, but only 2 percent of large banks, recorded noncurrent ratios above 3 percent, compared to the national average of about 1 percent. Similarly, about 15 percent of small banks, but only 7 percent of large banks, showed return on assets below 0.5 percent, compared to a national average of 1.5 percent.

Over the last decade, bank earnings have remained stable and high relative to the historical record, either measured as return on equity or return on assets. At the same time, credit quality, as measured by the nonperforming loan (NPL) ratio, has remained generally sound. Figure 4 shows that return on assets (ROA) rose in the early 1990s at the same time that the NPL ratio fell by two-thirds. Since then, ROA has remained high and relatively stable, while the NPL ratio has stayed low, turning up only during the last year or so. The question for the future is whether

Figure 4—Sustained high return on investment corresponds to long economic expansion and stability of credit quality at national banks



Source: Integrated Banking Information System (OCC)

banks can maintain this good earnings performance in an economic environment that may take time to recover from the downturn of 2001.

Several factors will make it difficult for banks to sustain their record performance in the second half of 2002. Net interest margins turned down in the second quarter after four consecutive quarterly increases, and may not move back to the record level of the first quarter of 2002. Neither consumers nor commercial customers are likely to add much to loan growth. If past recessions are a guide, credit quality will probably continue to deteriorate. Finally, if the housing sector, which sustained the economy during the recession, were to falter, banks would feel the effects in both interest and noninterest income.

Key indicators, FDIC-insured national banks
Annual 1998–2001, year-to-date through June 30, 2002, second quarter 2001, and second quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Number of institutions reporting	2,456	2,364	2,230	2,137	2,104	2,176	2,104
Total employees (FTEs)	974,871	983,186	948,652	966,538	986,626	962,387	986,626
Selected income data ($)							
Net income	$37,608	$42,591	$38,958	$44,339	$27,794	$10,995	$14,152
Net interest income	110,985	114,557	115,905	125,655	70,206	30,611	
Provision for loan losses	15,242	15,550	20,559	28,999	16,088	6,250	7,662
Noninterest income	81,344	92,647	96,184	99,532	53,077	24,606	26,585
Noninterest expense	122,604	125,807	128,535	131,145	66,159	32,223	33,105
Net operating income	35,549	42,416	40,209	43,112	27,126	10,770	13,646
Cash dividends declared	25,414	29,870	32,327	27,739	21,571	7,105	8,158
Net charge-offs to loan and lease reserve	14,492	14,179	17,241	25,180	15,980	5,551	7,648
Selected condition data ($)							
Total assets	3,183,385	3,271,262	3,414,442	3,635,533	3,739,495	3,448,286	3,739,495
Total loans and leases	2,015,585	2,127,927	2,227,069	2,272,756	2,325,538	2,255,767	2,325,538
Reserve for losses	36,810	37,684	40,021	45,575	47,357	41,368	47,357
Securities	516,120	537,315	502,297	576,011	616,249	486,424	616,249
Other real estate owned	1,833	1,572	1,553	1,794	1,864	1,684	1,864
Noncurrent loans and leases	19,513	20,818	27,161	34,577	37,834	30,858	37,834
Total deposits	2,137,946	2,154,272	2,250,464	2,384,462	2,410,803	2,285,648	2,410,803
Domestic deposits	1,785,856	1,776,126	1,827,126	2,001,301	2,025,600	1,887,371	2,025,600
Equity capital	274,193	278,011	293,834	340,969	356,019	309,393	356,019
Off-balance-sheet derivatives	10,953,514	12,077,568	15,502,911	20,291,557	22,731,639	17,322,967	22,731,639
Performance ratios (annualized %)							
Return on equity	14.29	15.57	13.71	13.89	15.87	14.30	16.07
Return on assets	1.24	1.35	1.18	1.26	1.51	1.28	1.54
Net interest income to assets	3.67	3.63	3.50	3.56	3.81	3.56	3.78
Loss provision to assets	0.50	0.49	0.62	0.82	0.87	0.73	0.83
Net operating income to assets	1.18	1.35	1.21	1.22	1.47	1.25	1.48
Noninterest income to assets	2.69	2.94	2.91	2.82	2.88	2.86	2.89
Noninterest expense to assets	4.05	3.99	3.88	3.72	3.59	3.75	3.59
Loss provision to loans and leases	0.79	0.76	0.95	1.28	1.39	1.11	1.32
Net charge-offs to loans and leases	0.75	0.70	0.80	1.11	1.38	0.99	1.32
Loss provision to net charge-offs	105.12	109.66	119.24	115.16	100.67	112.58	100.18
Performance ratios (%)							
Percent of institutions unprofitable	5.94	7.06	6.95	7.30	6.70	7.44	6.70
Percent of institutions with earnings gains	61.60	62.14	66.64	56.86	67.87	50.14	68.77
Nonint. income to net operating revenue	42.29	44.71	45.35	44.20	43.05	44.56	43.31
Nonint. expense to net operating revenue	63.75	60.72	60.60	58.24	53.66	58.36	53.93
Condition ratios (%)							
Nonperforming assets to assets	0.68	0.70	0.86	1.02	1.09	0.95	1.09
Noncurrent loans to loans	0.97	0.98	1.22	1.52	1.63	1.37	1.63
Loss reserve to noncurrent loans	188.65	181.02	147.35	131.81	125.17	134.06	125.17
Loss reserve to loans	1.83	1.77	1.80	2.01	2.04	1.83	2.04
Equity capital to assets	8.61	8.50	8.61	9.38	9.52	8.97	9.52
Leverage ratio	7.43	7.49	7.49	7.82	8.04	7.67	8.04
Risk-based capital ratio	11.79	11.71	11.84	12.62	12.81	12.32	12.81
Net loans and leases to assets	62.16	63.90	64.05	61.26	60.92	64.22	60.92
Securities to assets	16.21	16.43	14.71	15.84	16.48	14.11	16.48
Appreciation in securities (% of par)	0.82	–2.45	–0.01	0.48	1.39	0.42	1.39
Residential mortgage assets to assets	20.41	20.60	19.60	22.54	23.19	21.24	23.19
Total deposits to assets	67.16	65.85	65.91	65.59	64.47	66.28	64.47
Core deposits to assets	49.72	47.01	45.61	48.07	47.39	47.01	47.39
Volatile liabilities to assets	31.77	34.81	35.18	31.24	30.76	33.11	30.76

Loan performance, FDIC-insured national banks
Annual 1998–2001, year-to-date through June 30, 2002, second quarter 2001, and second quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Percent of loans past due 30–89 days							
Total loans and leases	1.27	1.16	1.26	1.38	1.20	1.22	1.20
Loans secured by real estate (RE)	1.33	1.22	1.42	1.42	1.06	1.35	1.06
1–4 family residential mortgages	1.50	1.61	1.95	1.80	1.38	1.78	1.38
Home equity loans	0.97	0.77	1.07	0.98	0.58	0.86	0.58
Multifamily residential mortgages	0.94	0.69	0.59	0.75	0.43	0.53	0.43
Commercial RE loans	1.02	0.70	0.72	0.86	0.61	0.72	0.61
Construction RE loans	1.82	1.07	1.12	1.28	1.28	1.25	1.28
Commercial and industrial loans	0.81	0.71	0.71	0.95	1.20	0.79	1.20
Loans to individuals	2.44	2.36	2.40	2.39	1.96	2.15	1.96
Credit cards	2.52	2.53	2.50	2.51	2.37	2.54	2.37
Installment loans and other plans	2.37	2.24	2.31	2.65	1.88	2.06	1.88
All other loans and leases	0.46	0.50	0.58	0.84	0.63	0.60	0.63
Percent of loans noncurrent							
Total loans and leases	0.97	0.98	1.22	1.52	1.63	1.37	1.63
Loans secured by real estate (RE)	0.98	0.87	0.93	1.04	1.06	1.03	1.06
1–4 family residential mortgages	0.95	0.91	1.06	1.05	1.13	1.12	1.13
Home equity loans	0.41	0.32	0.41	0.42	0.35	0.41	0.35
Multifamily residential mortgages	0.88	0.43	0.55	0.49	0.45	0.47	0.45
Commercial RE loans	1.01	0.84	0.77	1.03	1.08	0.95	1.08
Construction RE loans	0.80	0.63	0.82	1.15	1.17	0.94	1.17
Commercial and industrial loans	0.86	1.11	1.66	2.44	3.07	2.13	3.07
Loans to individuals	1.59	1.52	1.46	1.58	1.49	1.42	1.49
Credit cards	2.06	2.00	1.89	2.05	1.95	1.99	1.95
Installment loans and other plans	1.19	1.16	1.06	1.41	1.28	1.10	1.28
All other loans and leases	0.31	0.40	0.85	1.18	1.04	0.76	1.04
Percent of loans charged-off, net							
Total loans and leases	0.75	0.70	0.80	1.11	1.38	0.99	1.32
Loans secured by real estate (RE)	0.05	0.10	0.12	0.26	0.19	0.17	0.17
1–4 family residential mortgages	0.07	0.14	0.14	0.32	0.18	0.21	0.17
Home equity loans	0.16	0.19	0.23	0.35	0.25	0.18	0.25
Multifamily residential mortgages	0.07	0.02	0.03	0.04	0.07	–0.07	0.11
Commercial RE loans	–0.02	0.03	0.07	0.18	0.17	0.12	0.13
Construction RE loans	–0.01	0.03	0.05	0.15	0.16	0.08	0.14
Commercial and industrial loans	0.38	0.54	0.87	1.50	1.78	1.33	1.99
Loans to individuals	2.92	2.65	2.84	3.14	4.32	2.97	3.61
Credit cards	5.03	4.51	4.43	5.07	7.52	5.15	6.00
Installment loans and other plans	1.23	1.27	1.54	1.66	1.79	1.37	1.66
All other loans and leases	0.79	0.47	0.48	0.90	0.58	0.36	0.67
Loans outstanding ($)							
Total loans and leases	$2,015,585	$2,127,927	$2,227,069	$2,272,756	$2,325,538	$2,255,767	$2,325,538
Loans secured by real estate (RE)	764,944	853,141	892,140	976,120	1,025,099	935,835	1,025,099
1–4 family residential mortgages	381,597	433,807	443,002	472,715	483,346	467,577	483,346
Home equity loans	66,091	67,267	82,672	102,094	125,762	88,452	125,762
Multifamily residential mortgages	23,201	26,561	28,026	30,074	33,296	27,724	33,296
Commercial RE loans	200,469	214,145	221,267	236,472	246,947	225,491	246,947
Construction RE loans	56,261	71,578	76,899	91,482	92,532	86,727	92,532
Farmland loans	10,930	11,957	12,350	12,615	12,891	12,686	12,891
RE loans from foreign offices	26,396	27,825	27,923	30,668	30,324	27,179	30,324
Commercial and industrial loans	583,903	622,004	646,988	597,228	568,970	631,757	568,970
Loans to individuals	386,410	348,634	370,363	390,338	423,838	375,796	423,838
Credit cards*	176,408	147,179	176,372	166,998	191,196	162,306	191,196
Other revolving credit plans	NA	NA	NA	29,259	31,590	21,033	31,590
Installment loans	210,003	201,455	193,991	194,082	201,053	192,456	201,053
All other loans and leases	282,367	306,041	319,144	311,001	310,455	313,862	310,455
Less: Unearned income	2,039	1,893	1,565	1,931	2,824	1,483	2,824

*Prior to March 2001, credit cards included “Other revolving credit plans.”

Key indicators, FDIC-insured national banks by asset size
Second quarter 2001 and second quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Number of institutions reporting	1,049	987	956	944	130	131	41	42
Total employees (FTEs)	25,411	23,198	95,853	94,221	116,243	109,214	724,880	759,993
Selected income data ($)								
Net income	$130	$144	$795	$792	$1,206	$1,690	$8,864	$11,526
Net interest income	540	525	2,446	2,498	4,142	4,137	23,482	27,641
Provision for loan losses	41	38	214	203	869	487	5,125	6,933
Noninterest income	255	209	1,317	1,358	2,884	2,766	20,149	22,252
Noninterest expense	565	505	2,476	2,569	4,253	3,920	24,929	26,112
Net operating income	136	142	757	780	1,228	1,659	8,649	11,066
Cash dividends declared	103	79	421	395	1,096	676	5,484	7,007
Net charge-offs to loan and lease reserve	25	25	160	157	785	468	4,582	6,998
Selected condition data ($)								
Total assets	54,363	52,273	250,980	250,321	413,187	413,938	2,729,757	3,022,963
Total loans and leases	32,742	31,277	158,380	155,760	263,825	262,466	1,800,820	1,876,035
Reserve for losses	440	438	2,218	2,222	5,382	4,570	33,328	40,126
Securities	12,767	13,032	58,914	62,760	85,502	87,040	329,240	453,418
Other real estate owned	67	74	232	245	170	220	1,214	1,325
Noncurrent loans and leases	341	364	1,496	1,516	2,593	2,449	26,428	33,505
Total deposits	45,815	43,885	202,484	202,704	271,750	268,260	1,765,599	1,895,953
Domestic deposits	45,815	43,885	202,232	202,617	269,164	265,720	1,370,160	1,513,378
Equity capital	6,146	6,034	25,838	25,796	39,465	44,529	237,945	279,661
Off-balance-sheet derivatives	44	24	2,955	1,361	38,469	36,919	17,502,318	22,999,225
Performance ratios (annualized %)								
Return on equity	8.53	9.77	12.43	12.57	12.30	15.50	14.98	16.61
Return on assets	0.97	1.12	1.28	1.28	1.17	1.64	1.30	1.55
Net interest income to assets	4.02	4.06	3.93	4.04	4.01	4.01	3.45	3.72
Loss provision to assets	0.31	0.30	0.34	0.33	0.84	0.47	0.75	0.93
Net operating income to assets	1.01	1.09	1.22	1.26	1.19	1.61	1.27	1.49
Noninterest income to assets	1.89	1.62	2.12	2.20	2.79	2.68	2.96	2.99
Noninterest expense to assets	4.20	3.90	3.98	4.16	4.11	3.80	3.66	3.51
Loss provision to loans and leases	0.51	0.50	0.55	0.53	1.32	0.74	1.14	1.48
Net charge-offs to loans and leases	0.31	0.32	0.41	0.41	1.19	0.71	1.02	1.50
Loss provision to net charge-offs	163.60	155.81	134.21	129.19	110.75	104.17	111.86	99.07
Performance ratios (%)								
Percent of institutions unprofitable	11.73	10.64	3.35	3.39	4.62	1.53	2.44	4.76
Percent of institutions with earnings gains	42.80	61.30	56.07	75.11	61.54	76.34	63.41	78.57
Nonint. income to net operating revenue	32.04	28.50	35.00	35.22	41.05	40.07	46.18	44.60
Nonint. expense to net operating revenue	71.08	68.79	65.78	66.63	60.53	56.79	57.13	52.33
Condition ratios (%)								
Nonperforming assets to assets	0.75	0.85	0.69	0.71	0.68	0.66	1.02	1.18
Noncurrent loans to loans	1.04	1.17	0.94	0.97	0.98	0.93	1.47	1.79
Loss reserve to noncurrent loans	129.16	120.33	148.20	146.60	207.58	186.58	126.11	119.76
Loss reserve to loans	1.35	1.40	1.40	1.43	2.04	1.74	1.85	2.14
Equity capital to assets	11.30	11.54	10.29	10.31	9.55	10.76	8.72	9.25
Leverage ratio	11.06	11.12	9.78	9.56	8.30	9.39	7.32	7.66
Risk-based capital ratio	17.84	18.16	15.08	15.09	13.69	15.28	11.87	12.30
Net loans and leases to assets	59.42	59.00	62.22	61.34	62.55	62.30	64.75	60.73
Securities to assets	23.49	24.93	23.47	25.07	20.69	21.03	12.06	15.00
Appreciation in securities (% of par)	1.25	1.87	1.23	1.92	0.92	2.05	0.11	1.17
Residential mortgage assets to assets	21.71	22.20	24.26	24.76	26.31	26.62	20.18	22.61
Total deposits to assets	84.28	83.95	80.68	80.98	65.77	64.81	64.68	62.72
Core deposits to assets	70.71	70.92	67.15	68.31	55.53	55.03	43.39	44.20
Volatile liabilities to assets	15.41	14.96	18.09	16.87	25.84	24.54	35.94	33.04

Loan performance, FDIC-insured national banks by asset size
Second quarter 2001 and second quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Percent of loans past due 30–89 days								
Total loans and leases	1.49	1.35	1.28	1.12	1.29	1.09	1.20	1.22
Loans secured by real estate (RE)	1.33	1.13	1.01	0.87	0.92	0.84	1.48	1.12
1–4 family residential mortgages	1.60	1.42	1.26	1.14	0.85	0.98	2.00	1.47
Home equity loans	0.81	0.53	0.68	0.46	0.84	0.54	0.87	0.59
Multifamily residential mortgages	0.64	0.67	0.44	0.41	0.74	0.40	0.49	0.44
Commercial RE loans	1.06	0.80	0.82	0.68	0.75	0.62	0.68	0.59
Construction RE loans	1.49	1.39	1.07	0.98	1.71	1.17	1.14	1.36
Commercial and industrial loans	1.83	1.72	1.47	1.45	1.53	1.35	0.68	1.17
Loans to individuals	2.20	2.24	2.44	2.12	2.11	1.72	2.14	1.98
Credit cards	2.66	2.45	5.65	4.40	2.51	1.80	2.46	2.41
Installment loans and other plans	2.22	2.27	1.87	1.83	1.93	1.81	2.11	1.89
All other loans and leases	0.93	0.92	0.86	0.86	0.87	0.63	0.57	0.61
Percent of loans noncurrent								
Total loans and leases	1.04	1.17	0.94	0.97	0.98	0.93	1.47	1.79
Loans secured by real estate (RE)	0.87	1.02	0.81	0.81	0.73	0.76	1.13	1.14
1–4 family residential mortgages	0.75	0.87	0.70	0.70	0.63	0.71	1.27	1.26
Home equity loans	0.34	0.32	0.36	0.27	0.40	0.38	0.41	0.35
Multifamily residential mortgages	0.39	0.82	0.50	0.52	0.47	0.37	0.47	0.44
Commercial RE loans	0.96	1.12	0.92	0.94	0.86	0.88	0.99	1.16
Construction RE loans	0.74	0.81	0.97	0.85	0.86	0.94	0.97	1.29
Commercial and industrial loans	1.74	1.89	1.37	1.57	1.44	1.39	2.24	3.34
Loans to individuals	0.75	0.76	1.02	0.90	1.32	1.10	1.48	1.58
Credit cards	1.45	1.99	3.75	3.78	2.17	1.59	1.92	1.97
Installment loans and other plans	0.73	0.72	0.50	0.49	0.73	0.80	1.26	1.45
All other loans and leases	1.20	1.32	0.83	1.08	0.60	0.62	0.76	1.07
Percent of loans charged-off, net								
Total loans and leases	0.31	0.32	0.41	0.41	1.19	0.71	1.02	1.50
Loans secured by real estate (RE)	0.07	0.09	0.06	0.07	0.16	0.09	0.19	0.20
1–4 family residential mortgages	0.04	0.09	0.05	0.07	0.35	0.07	0.21	0.20
Home equity loans	0.02	0.15	0.12	0.05	–0.57	0.16	0.27	0.27
Multifamily residential mortgages	0.06	0.23	0.06	0.04	0.00	0.04	–0.12	0.13
Commercial RE loans	0.14	0.11	0.05	0.07	0.07	0.11	0.15	0.16
Construction RE loans	0.05	0.11	0.08	0.06	0.11	0.07	0.07	0.18
Commercial and industrial loans	0.68	0.82	0.62	0.65	1.34	1.07	1.37	2.17
Loans to individuals	1.03	0.88	1.80	2.03	3.82	2.25	2.92	3.92
Credit cards	6.24	4.76	7.47	10.85	7.05	3.83	4.72	6.22
Installment loans and other plans	0.82	0.71	0.70	0.76	1.29	1.03	1.47	1.86
All other loans and leases	0.17	0.15	0.34	0.35	0.35	0.33	0.36	0.71
Loans outstanding ($)								
Total loans and leases	$32,742	$31,277	$158,380	$155,760	$263,825	$262,466	$1,800,820	$1,876,035
Loans secured by real estate (RE)	18,986	18,505	98,991	101,504	137,118	140,417	680,740	764,673
1–4 family residential mortgages	8,554	8,040	41,115	38,855	62,312	62,598	355,597	373,853
Home equity loans	488	498	4,178	4,741	8,952	9,989	74,834	110,535
Multifamily residential mortgages	420	440	3,460	3,752	4,946	5,468	18,898	23,636
Commercial RE loans	5,527	5,645	36,057	38,988	42,686	44,075	141,220	158,238
Construction RE loans	1,841	1,698	9,944	10,644	16,167	16,406	58,776	63,785
Farmland loans	2,157	2,184	4,234	4,522	1,897	1,759	4,398	4,426
RE loans from foreign offices	0	0	3	1	160	123	27,016	30,200
Commercial and industrial loans	5,600	5,163	28,853	27,374	52,014	49,046	545,290	487,387
Loans to individuals	4,418	3,981	20,891	17,724	55,197	50,829	295,290	351,305
Credit cards*	177	167	3,402	2,282	23,786	21,930	134,942	166,817
Other revolving credit plans	73	70	427	348	1,776	2,347	18,757	28,825
Installment loans	4,167	3,744	17,063	15,094	29,635	26,552	141,591	155,663
All other loans and leases	3,799	3,674	9,851	9,353	19,597	22,263	280,616	275,165
Less: Unearned income	61	45	205	194	101	89	1,115	2,496

Key indicators, FDIC-insured national banks by region
Second quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Number of institutions reporting	234	291	422	433	501	223	2,104
Total employees (FTEs)	296,335	254,656	208,833	64,955	56,997	104,850	986,626
Selected income data ($)							
Net income	$3,912	$3,643	$3,155	$1,073	$560	$1,808	$14,152
Net interest income	9,964	8,453	7,675	2,800	1,588	4,320	34,800
Provision for loan losses	3,762	1,010	1,445	718	106	620	7,662
Noninterest income	10,105	5,903	4,741	2,240	664	2,932	26,585
Noninterest expense	10,390	8,072	6,715	2,699	1,395	3,833	33,105
Net operating income	3,901	3,505	2,851	1,066	534	1,790	13,646
Cash dividends declared	1,087	2,230	2,832	429	319	1,260	8,158
Net charge-offs to loan and lease reserve	3,619	1,163	1,419	699	76	671	7,648
Selected condition data ($)							
Total assets	1,013,578	1,036,730	923,699	227,423	159,037	379,028	3,739,495
Total loans and leases	616,780	604,336	600,900	155,499	90,635	257,388	2,325,538
Reserve for losses	16,467	9,985	11,452	2,904	1,452	5,097	47,357
Securities	162,388	171,170	172,062	29,832	41,564	39,232	616,249
Other real estate owned	265	638	550	104	129	178	1,864
Noncurrent loans and leases	14,296	8,250	9,856	1,792	940	2,700	37,834
Total deposits	683,942	681,840	555,085	131,916	128,318	229,702	2,410,803
Domestic deposits	433,075	617,054	511,699	117,863	127,263	218,645	2,025,600
Equity capital	97,185	99,199	77,847	23,887	16,065	41,837	356,019
Off-balance-sheet derivatives	7,863,247	12,459,342	1,568,187	7,251	9,170	824,442	22,731,639
Performance ratios (annualized %)							
Return on equity	16.22	14.82	16.38	18.34	14.26	17.48	16.07
Return on assets	1.57	1.42	1.39	1.90	1.42	1.94	1.54
Net interest income to assets	4.00	3.31	3.38	4.96	4.01	4.62	3.78
Loss provision to assets	1.51	0.39	0.64	1.27	0.27	0.66	0.83
Net operating income to assets	1.57	1.37	1.26	1.89	1.35	1.92	1.48
Noninterest income to assets	4.05	2.31	2.09	3.97	1.68	3.14	2.89
Noninterest expense to assets	4.17	3.16	2.96	4.79	3.53	4.10	3.59
Loss provision to loans and leases	2.44	0.67	0.96	1.87	0.47	0.98	1.32
Net charge-offs to loans and leases	2.35	0.77	0.94	1.82	0.34	1.06	1.32
Loss provision to net charge-offs	103.96	86.82	101.86	102.71	138.86	92.36	100.18
Performance ratios (%)							
Percent of institutions unprofitable	7.26	10.65	4.98	5.08	4.59	12.11	6.70
Percent of institutions with earnings gains	72.22	70.79	70.62	65.13	68.46	66.82	68.77
Nonint. income to net operating revenue	50.35	41.12	38.18	44.44	29.50	40.43	43.31
Nonint. expense to net operating revenue	51.77	56.23	54.09	53.56	61.95	52.85	53.93
Condition ratios (%)							
Nonperforming assets to assets	1.50	0.86	1.15	0.84	0.67	0.77	1.09
Noncurrent loans to loans	2.32	1.37	1.64	1.15	1.04	1.05	1.63
Loss reserve to noncurrent loans	115.18	121.02	116.20	162.05	154.45	188.81	125.17
Loss reserve to loans	2.67	1.65	1.91	1.87	1.60	1.98	2.04
Equity capital to assets	9.59	9.57	8.43	10.50	10.10	11.04	9.52
Leverage ratio	8.30	7.62	7.42	9.38	8.51	8.94	8.04
Risk-based capital ratio	12.96	12.46	12.24	13.88	14.02	13.71	12.81
Net loans and leases to assets	59.23	57.33	63.81	67.10	56.08	66.56	60.92
Securities to assets	16.02	16.51	18.63	13.12	26.14	10.35	16.48
Appreciation in securities (% of par)	1.01	1.18	1.37	2.39	2.12	2.40	1.39
Residential mortgage assets to assets	14.05	28.72	26.48	21.55	27.36	23.77	23.19
Total deposits to assets	67.48	65.77	60.09	58.00	80.68	60.60	64.47
Core deposits to assets	35.05	53.30	49.32	47.17	67.48	51.17	47.39
Volatile liabilities to assets	42.45	24.40	28.14	30.14	18.37	28.89	30.76

Loan performance, FDIC-insured national banks by region
Second quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Percent of loans past due 30–89 days							
Total loans and leases	1.33	0.90	1.37	1.50	1.11	1.06	1.20
Loans secured by real estate (RE)	0.97	0.89	1.46	0.93	0.96	0.82	1.06
1–4 family residential mortgages	1.21	1.19	2.12	1.03	1.15	0.85	1.38
Home equity loans	0.43	0.58	0.75	0.44	0.44	0.41	0.58
Multifamily residential mortgages	0.27	0.40	0.55	0.27	0.65	0.28	0.43
Commercial RE loans	0.43	0.50	0.90	0.80	0.66	0.39	0.61
Construction RE loans	0.46	0.71	1.43	1.25	1.33	2.53	1.28
Commercial and industrial loans	1.27	1.04	1.29	1.56	1.20	1.04	1.20
Loans to individuals	2.16	1.31	1.89	2.26	1.64	1.90	1.96
Credit cards	2.50	2.40	1.95	2.50	0.90	2.00	2.37
Installment loans and other plans	2.33	1.37	2.04	1.71	1.76	2.02	1.88
All other loans and leases	0.61	0.33	0.80	1.06	0.83	0.58	0.63
Percent of loans noncurrent							
Total loans and leases	2.32	1.37	1.64	1.15	1.04	1.05	1.63
Loans secured by real estate (RE)	1.39	0.77	1.55	0.61	0.85	0.57	1.06
1–4 family residential mortgages	1.58	0.71	2.10	0.43	0.73	0.40	1.13
Home equity loans	0.32	0.25	0.49	0.30	0.51	0.23	0.35
Multifamily residential mortgages	0.34	0.48	0.49	0.28	0.67	0.33	0.45
Commercial RE loans	0.78	1.02	1.54	1.04	0.93	0.67	1.08
Construction RE loans	0.99	1.18	1.21	0.61	0.91	1.48	1.17
Commercial and industrial loans	3.74	3.27	2.82	1.51	1.60	2.17	3.07
Loans to individuals	2.26	0.41	0.69	1.68	0.65	1.38	1.49
Credit cards	2.08	1.57	1.40	1.96	0.60	1.75	1.95
Installment loans and other plans	3.60	0.42	0.61	0.96	0.69	0.58	1.28
All other loans and leases	1.35	0.86	0.90	0.97	1.25	0.77	1.04
Percent of loans charged-off, net							
Total loans and leases	2.35	0.77	0.94	1.82	0.34	1.06	1.32
Loans secured by real estate (RE)	0.12	0.11	0.37	0.04	0.09	0.04	0.17
1–4 family residential mortgages	0.11	0.13	0.38	0.01	0.08	0.04	0.17
Home equity loans	0.04	0.19	0.48	0.00	0.16	0.09	0.25
Multifamily residential mortgages	0.11	0.12	0.15	0.03	0.08	0.00	0.11
Commercial RE loans	0.00	0.04	0.35	0.11	0.11	0.05	0.13
Construction RE loans	0.12	0.11	0.29	0.20	0.05	–0.08	0.14
Commercial and industrial loans	2.53	2.25	1.60	1.14	0.60	1.42	1.99
Loans to individuals	5.06	1.01	2.09	4.74	0.89	3.68	3.61
Credit cards	6.31	9.23	5.87	6.38	2.27	4.68	6.00
Installment loans and other plans	3.06	0.93	1.43	0.41	0.86	1.34	1.66
All other loans and leases	1.06	0.23	0.74	0.21	0.28	0.44	0.67
Loans outstanding ($)							
Total loans and leases	$616,780	$604,336	$600,900	$155,499	$90,635	$257,388	$2,325,538
Loans secured by real estate (RE)	166,972	321,564	287,270	62,094	50,263	136,935	1,025,099
1–4 family residential mortgages	69,817	169,497	125,615	35,379	18,969	64,069	483,346
Home equity loans	22,522	35,734	44,801	4,125	1,340	17,240	125,762
Multifamily residential mortgages	3,892	9,574	12,097	1,628	1,728	4,377	33,296
Commercial RE loans	34,470	74,457	69,487	13,474	18,703	36,354	246,947
Construction RE loans	8,658	26,304	31,712	4,379	7,838	13,641	92,532
Farmland loans	479	2,821	3,543	3,108	1,685	1,254	12,891
RE loans from foreign offices	27,133	3,176	14	0	0	1	30,324
Commercial and industrial loans	180,395	149,956	143,422	24,255	22,869	48,073	568,970
Loans to individuals	169,515	59,800	76,891	53,081	12,388	52,164	423,838
Credit cards	102,850	558	11,739	39,038	282	36,728	191,196
Other revolving credit plans	19,585	2,878	5,012	853	659	2,602	31,590
Installment loans	47,079	56,364	60,140	13,190	11,447	12,833	201,053
All other loans and leases	102,072	73,354	93,406	16,083	5,214	20,326	310,455
Less: Unearned income	2,174	338	88	14	99	111	2,824

Key indicators, FDIC-insured commercial banks
Annual 1998–2001, year-to-date through June 30, 2002, second quarter 2001, and second quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Number of institutions reporting	8,773	8,579	8,315	8,080	7,966	8,178	7,966
Total employees (FTEs)	1,626,978	1,657,602	1,670,861	1,705,135	1,738,770	1,690,443	1,738,770
Selected income data ($)							
Net income	$61,784	$71,543	$71,002	$73,986	$45,305	$19,097	$23,440
Net interest income	182,752	192,141	203,960	215,182	117,624	53,202	58,843
Provision for loan losses	22,215	21,817	30,013	43,466	22,432	8,847	10,861
Noninterest income	123,688	144,450	153,453	157,134	84,184	39,050	42,541
Noninterest expense	194,131	204,208	216,104	222,347	113,396	55,202	57,035
Net operating income	59,226	71,308	72,591	71,160	44,102	18,545	22,605
Cash dividends declared	41,004	51,936	53,854	54,169	33,901	12,519	14,169
Net charge-offs to loan and lease reserve	20,740	20,367	24,787	36,552	21,636	7,934	10,561
Selected condition data ($)							
Total assets	5,442,531	5,735,160	6,244,610	6,569,074	6,749,662	6,360,020	6,749,662
Total loans and leases	3,238,287	3,491,659	3,819,516	3,895,580	3,971,537	3,859,003	3,971,537
Reserve for losses	57,262	58,767	64,145	72,413	74,325	65,757	74,325
Securities	979,855	1,046,530	1,078,983	1,179,694	1,237,108	1,056,279	1,237,108
Other real estate owned	3,150	2,796	2,912	3,568	3,874	3,204	3,874
Noncurrent loans and leases	31,253	33,002	42,942	54,956	58,424	48,684	58,424
Total deposits	3,681,428	3,831,104	4,179,634	4,391,610	4,448,144	4,244,727	4,448,144
Domestic deposits	3,109,395	3,175,515	3,472,967	3,762,105	3,807,239	3,562,316	3,807,239
Equity capital	462,142	479,731	530,721	597,137	623,994	557,102	623,994
Off-balance-sheet derivatives	33,007,227	34,819,179	40,571,148	45,057,985	50,073,941	47,772,886	50,073,941
Performance ratios (annualized %)							
Return on equity	13.93	15.31	14.02	13.05	14.85	13.83	15.24
Return on assets	1.19	1.31	1.19	1.15	1.37	1.21	1.41
Net interest income to assets	3.51	3.51	3.41	3.35	3.55	3.36	3.54
Loss provision to assets	0.43	0.40	0.50	0.68	0.68	0.56	0.65
Net operating income to assets	1.14	1.30	1.21	1.11	1.33	1.17	1.36
Noninterest income to assets	2.37	2.64	2.57	2.44	2.54	2.46	2.56
Noninterest expense to assets	3.73	3.73	3.61	3.46	3.42	3.48	3.43
Loss provision to loans and leases	0.72	0.66	0.82	1.13	1.14	0.92	1.10
Net charge-offs to loans and leases	0.67	0.61	0.67	0.95	1.10	0.83	1.07
Loss provision to net charge-offs	104.81	107.11	121.08	118.92	103.68	111.50	102.84
Performance ratios (%)							
Percent of institutions unprofitable	6.11	7.51	7.34	8.09	6.24	8.20	6.68
Percent of institutions with earnings gains	61.22	62.82	67.34	56.32	68.94	49.36	70.17
Nonint. income to net operating revenue	40.36	42.92	42.93	42.20	41.71	42.33	41.96
Nonint. expense to net operating revenue	63.35	60.67	60.46	59.72	56.19	59.84	56.26
Condition ratios (%)							
Nonperforming assets to assets	0.65	0.63	0.74	0.92	0.96	0.82	0.96
Noncurrent loans to loans	0.97	0.95	1.12	1.41	1.47	1.26	1.47
Loss reserve to noncurrent loans	183.22	178.07	149.38	131.77	127.22	135.07	127.22
Loss reserve to loans	1.77	1.68	1.68	1.86	1.87	1.70	1.87
Equity capital to assets	8.49	8.36	8.50	9.09	9.24	8.76	9.24
Leverage ratio	7.54	7.79	7.70	7.79	8.00	7.73	8.00
Risk-based capital ratio	12.23	12.16	12.12	12.72	12.95	12.41	12.95
Net loans and leases to assets	58.45	59.86	60.14	58.20	57.74	59.64	57.74
Securities to assets	18.00	18.25	17.28	17.96	18.33	16.61	18.33
Appreciation in securities (% of par)	1.07	–2.31	0.20	0.82	1.65	0.68	1.65
Residential mortgage assets to assets	20.93	20.78	20.20	21.70	22.02	20.71	22.02
Total deposits to assets	67.64	66.80	66.93	66.85	65.90	66.74	65.90
Core deposits to assets	49.39	46.96	46.39	48.80	48.09	46.88	48.09
Volatile liabilities to assets	31.68	34.94	34.97	31.39	31.54	33.93	31.54

Loan performance, FDIC-insured commercial banks
Annual 1998–2001, year-to-date through June 30, 2002, second quarter 2001, and second quarter 2002

(Dollar figures in millions)

	1998	1999	2000	2001	Preliminary 2002YTD	2001Q1	Preliminary 2002Q1
Percent of loans past due 30–89 days							
Total loans and leases	1.26	1.14	1.26	1.37	1.17	1.21	1.17
Loans secured by real estate (RE)	1.26	1.09	1.26	1.31	1.03	1.19	1.03
1–4 family residential mortgages	1.44	1.43	1.72	1.67	1.34	1.53	1.34
Home equity loans	0.98	0.75	0.98	0.91	0.57	0.81	0.57
Multifamily residential mortgages	0.86	0.57	0.55	0.69	0.43	0.53	0.43
Commercial RE loans	0.99	0.69	0.74	0.90	0.72	0.77	0.72
Construction RE loans	1.50	0.98	1.06	1.21	1.03	1.14	1.03
Commercial and industrial loans	0.88	0.79	0.83	1.02	1.13	0.93	1.13
Loans to individuals	2.43	2.33	2.47	2.47	2.05	2.19	2.05
Credit cards	2.58	2.59	2.66	2.69	2.55	2.61	2.55
Installment loans and other plans	2.33	2.18	2.34	2.56	1.92	2.08	1.92
All other loans and leases	0.51	0.54	0.65	0.84	0.62	0.65	0.62
Percent of loans noncurrent							
Total loans and leases	0.97	0.95	1.12	1.41	1.47	1.26	1.47
Loans secured by real estate (RE)	0.91	0.79	0.81	0.96	0.95	0.91	0.95
1–4 family residential mortgages	0.88	0.82	0.90	0.96	1.00	0.96	1.00
Home equity loans	0.42	0.33	0.37	0.39	0.32	0.40	0.32
Multifamily residential mortgages	0.83	0.41	0.44	0.43	0.38	0.42	0.38
Commercial RE loans	0.95	0.77	0.72	0.96	0.97	0.87	0.97
Construction RE loans	0.81	0.67	0.76	1.06	1.08	0.90	1.08
Commercial and industrial loans	0.99	1.18	1.66	2.41	2.87	2.03	2.87
Loans to individuals	1.52	1.42	1.41	1.49	1.40	1.37	1.40
Credit cards	2.22	2.05	2.01	2.12	2.02	2.07	2.02
Installment loans and other plans	1.06	1.04	0.98	1.22	1.13	1.03	1.13
All other loans and leases	0.34	0.39	0.69	0.96	0.89	0.76	0.89
Percent of loans charged-off, net							
Total loans and leases	0.67	0.61	0.67	0.95	1.10	0.83	1.07
Loans secured by real estate (RE)	0.05	0.08	0.09	0.19	0.15	0.13	0.14
1–4 family residential mortgages	0.07	0.11	0.11	0.22	0.14	0.16	0.15
Home equity loans	0.14	0.15	0.18	0.27	0.20	0.16	0.20
Multifamily residential mortgages	0.05	0.02	0.03	0.04	0.06	0.01	0.07
Commercial RE loans	0.00	0.03	0.05	0.14	0.14	0.10	0.12
Construction RE loans	0.01	0.04	0.05	0.14	0.12	0.08	0.11
Commercial and industrial loans	0.42	0.58	0.81	1.43	1.60	1.20	1.76
Loans to individuals	2.69	2.32	2.43	2.72	3.49	2.56	3.05
Credit cards	5.19	4.45	4.39	5.14	7.05	5.11	5.98
Installment loans and other plans	1.04	1.04	1.18	1.28	1.36	1.08	1.26
All other loans and leases	0.78	0.51	0.46	0.82	0.52	0.34	0.59
Loans outstanding ($)							
Total loans and leases	$3,238,287	$3,491,659	$3,819,516	$3,895,580	$3,971,537	$3,859,003	$3,971,537
Loans secured by real estate (RE)	1,345,589	1,510,342	1,673,325	1,802,309	1,886,961	1,736,990	1,886,961
1–4 family residential mortgages	668,706	737,110	790,030	811,982	824,572	808,330	824,572
Home equity loans	96,647	102,339	127,694	154,303	188,315	135,476	188,315
Multifamily residential mortgages	43,242	53,168	60,406	64,136	69,381	60,488	69,381
Commercial RE loans	370,544	417,633	466,453	506,581	532,653	478,185	532,653
Construction RE loans	106,719	135,632	162,613	193,082	198,640	184,666	198,640
Farmland loans	29,096	31,902	34,096	35,530	36,989	35,140	36,989
RE loans from foreign offices	30,635	32,558	32,033	36,695	36,411	34,705	36,411
Commercial and industrial loans	898,556	969,257	1,051,992	983,516	938,726	1,027,834	938,726
Loans to individuals	570,863	558,424	606,663	631,563	662,454	610,682	662,454
Credit cards*	228,781	212,051	249,372	232,818	250,395	226,296	250,395
Other revolving credit plans	NA	NA	NA	34,327	36,822	25,679	36,822
Installment loans	342,081	346,373	357,291	364,418	375,237	358,707	375,237
All other loans and leases	427,397	457,309	490,448	481,302	487,225	486,265	487,225
Less: Unearned income	4,117	3,673	2,912	3,110	3,830	2,768	3,830

*Prior to March 2001, credit cards included Other revolving credit plans.

Key indicators, FDIC-insured commercial banks by asset size
Second quarter 2001 and second quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Number of institutions reporting	4,685	4,374	3,101	3,194	313	320	79	78
Total employees (FTEs)	96,010	88,815	294,518	298,544	253,437	253,232	1,046,478	1,098,179
Selected income data ($)								
Net income	$537	$595	$2,421	$2,669	$2,864	$3,407	$13,276	$16,769
Net interest income	2,203	2,190	7,776	8,431	8,778	9,029	34,444	39,194
Provision for loan losses	161	160	647	730	1,590	1,180	6,450	8,791
Noninterest income	610	620	3,073	3,111	5,330	5,356	30,037	33,454
Noninterest expense	1,953	1,897	6,887	7,150	8,312	8,188	38,051	39,801
Net operating income	532	585	2,347	2,629	2,742	3,348	12,925	16,044
Cash dividends declared	339	309	1,238	1,157	2,802	1,960	8,141	10,743
Net charge-offs to loan and lease reserve	92	106	477	525	1,362	1,141	6,003	8,788
Selected condition data ($)								
Total assets	227,949	219,576	789,809	831,484	899,643	935,170	4,442,620	4,763,431
Total loans and leases	141,372	136,003	516,396	542,724	574,496	579,407	2,626,738	2,713,404
Reserve for losses	1,974	1,953	7,338	7,894	10,820	10,463	45,625	54,016
Securities	52,552	53,517	173,563	191,411	193,988	220,934	636,176	771,246
Other real estate owned	269	324	782	1,008	450	652	1,703	1,890
Noncurrent loans and leases	1,526	1,587	4,664	5,218	6,044	6,039	36,450	45,579
Total deposits	192,498	185,233	644,366	677,652	624,200	638,576	2,783,663	2,946,683
Domestic deposits	192,497	185,233	642,640	676,317	610,955	627,811	2,116,223	2,317,878
Equity capital	25,380	24,426	77,397	82,370	85,428	96,251	368,898	420,947
Off-balance-sheet derivatives	103	61	6,479	4,781	71,781	82,083	48,134,526	50,490,897
Performance ratios (annualized %)								
Return on equity	8.51	9.92	12.65	13.29	13.58	14.44	14.50	16.10
Return on assets	0.95	1.09	1.24	1.30	1.28	1.47	1.20	1.43
Net interest income to assets	3.91	4.03	3.98	4.11	3.91	3.90	3.11	3.35
Loss provision to assets	0.28	0.29	0.33	0.36	0.71	0.51	0.58	0.75
Net operating income to assets	0.94	1.08	1.20	1.28	1.22	1.45	1.17	1.37
Noninterest income to assets	1.08	1.14	1.57	1.52	2.38	2.31	2.71	2.86
Noninterest expense to assets	3.47	3.49	3.52	3.49	3.71	3.53	3.43	3.40
Loss provision to loans and leases	0.46	0.48	0.51	0.55	1.11	0.82	0.98	1.30
Net charge-offs to loans and leases	0.27	0.32	0.37	0.39	0.95	0.79	0.91	1.30
Loss provision to net charge-offs	173.66	150.42	135.62	139.13	116.76	103.38	107.44	100.03
Performance ratios (%)								
Percent of institutions unprofitable	11.91	9.85	3.22	2.76	3.51	3.44	2.53	2.56
Percent of institutions with earnings gains	43.37	65.75	56.59	75.77	64.22	73.44	62.03	75.64
Nonint. income to net operating revenue	21.68	22.07	28.33	26.95	37.78	37.23	46.58	46.05
Nonint. expense to net operating revenue	69.43	67.52	63.47	61.94	58.92	56.92	59.01	54.79
Condition ratios (%)								
Nonperforming assets to assets	0.79	0.88	0.69	0.75	0.73	0.73	0.87	1.04
Noncurrent loans to loans	1.08	1.17	0.90	0.96	1.05	1.04	1.39	1.68
Loss reserve to noncurrent loans	129.33	123.08	157.35	151.26	179.02	173.24	125.17	118.51
Loss reserve to loans	1.40	1.44	1.42	1.45	1.88	1.81	1.74	1.99
Equity capital to assets	11.13	11.12	9.80	9.91	9.50	10.29	8.30	8.84
Leverage ratio	10.86	10.72	9.35	9.33	8.45	9.06	7.13	7.42
Risk-based capital ratio	17.13	16.99	14.19	14.24	13.17	14.37	11.80	12.33
Net loans and leases to assets	61.15	61.05	64.45	64.32	62.66	60.84	58.10	55.83
Securities to assets	23.05	24.37	21.98	23.02	21.56	23.63	14.32	16.19
Appreciation in securities (% of par)	1.29	1.86	1.24	1.93	0.81	1.80	0.44	1.53
Residential mortgage assets to assets	21.27	21.64	23.56	23.75	25.53	26.09	19.19	20.93
Total deposits to assets	84.45	84.36	81.59	81.50	69.38	68.28	62.66	61.86
Core deposits to assets	70.94	71.32	67.64	67.99	55.55	55.43	40.20	42.11
Volatile liabilities to assets	15.18	14.79	18.13	17.54	26.86	25.65	39.13	35.91

Loan performance, FDIC-insured commercial banks by asset size
Second quarter 2001 and second quarter 2002

(Dollar figures in millions)

	Less than $100M		$100M to $1B		$1B to $10B		Greater than $10B	
	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1	2001Q1	2002Q1
Percent of loans past due 30–89 days								
Total loans and leases	1.60	1.48	1.29	1.14	1.26	1.14	1.16	1.17
Loans secured by real estate (RE)	1.44	1.30	1.08	0.92	0.92	0.87	1.30	1.09
1–4 family residential mortgages	1.77	1.66	1.35	1.24	0.96	1.03	1.70	1.41
Home equity loans	0.96	0.75	0.79	0.53	0.87	0.55	0.81	0.57
Multifamily residential mortgages	0.58	0.66	0.61	0.45	0.75	0.46	0.43	0.40
Commercial RE loans	1.22	0.96	0.86	0.73	0.72	0.77	0.71	0.66
Construction RE loans	1.37	1.38	1.20	0.91	1.32	0.94	1.02	1.10
Commercial and industrial loans	1.89	1.81	1.51	1.38	1.44	1.35	0.74	1.04
Loans to individuals	2.51	2.43	2.29	2.23	2.22	1.97	2.15	2.03
Credit cards	2.69	2.36	5.25	5.32	2.71	2.46	2.48	2.49
Installment loans and other plans	2.55	2.48	1.95	1.92	2.01	1.81	2.09	1.90
All other loans and leases	0.95	0.97	0.90	0.97	0.93	0.69	0.60	0.57
Percent of loans noncurrent								
Total loans and leases	1.08	1.17	0.90	0.96	1.05	1.04	1.39	1.68
Loans secured by real estate (RE)	0.93	1.00	0.77	0.83	0.79	0.83	0.99	1.02
1–4 family residential mortgages	0.81	0.87	0.69	0.74	0.77	0.81	1.09	1.11
Home equity loans	0.32	0.30	0.37	0.28	0.42	0.33	0.41	0.32
Multifamily residential mortgages	0.58	0.65	0.44	0.48	0.45	0.28	0.39	0.38
Commercial RE loans	1.04	1.11	0.80	0.91	0.83	0.86	0.91	1.05
Construction RE loans	0.89	0.98	0.92	0.99	0.91	1.12	0.88	1.11
Commercial and industrial loans	1.66	1.82	1.35	1.43	1.63	1.75	2.19	3.28
Loans to individuals	0.93	0.94	0.91	0.83	1.21	1.01	1.49	1.55
Credit cards	2.06	1.43	3.26	3.07	2.20	1.74	2.00	2.03
Installment loans and other plans	0.91	0.94	0.60	0.58	0.64	0.65	1.23	1.35
All other loans and leases	1.11	1.31	1.00	1.26	0.89	0.82	0.71	0.85
Percent of loans charged-off, net								
Total loans and leases	0.27	0.32	0.37	0.39	0.95	0.79	0.91	1.30
Loans secured by real estate (RE)	0.05	0.09	0.06	0.08	0.12	0.13	0.16	0.17
1–4 family residential mortgages	0.05	0.09	0.07	0.08	0.21	0.09	0.17	0.18
Home equity loans	0.10	0.05	0.09	0.04	–0.21	0.13	0.24	0.23
Multifamily residential mortgages	0.01	0.06	0.04	0.02	0.05	0.10	–0.01	0.08
Commercial RE loans	0.07	0.12	0.05	0.08	0.08	0.18	0.13	0.12
Construction RE loans	0.03	0.17	0.06	0.09	0.13	0.10	0.07	0.12
Commercial and industrial loans	0.59	0.80	0.72	0.78	1.24	1.38	1.27	1.98
Loans to individuals	0.83	0.88	1.56	1.79	3.27	2.48	2.60	3.37
Credit cards	4.06	4.05	7.29	9.80	6.80	5.19	4.65	6.00
Installment loans and other plans	0.73	0.79	0.78	0.82	1.11	1.00	1.16	1.42
All other loans and leases	0.23	0.16	0.37	0.43	0.51	0.45	0.33	0.64
Loans outstanding ($)								
Total loans and leases	$141,372	$136,003	$516,396	$542,724	$574,496	$579,407	$2,626,738	$2,713,404
Loans secured by real estate (RE)	81,480	80,584	335,349	365,261	312,569	329,401	1,007,593	1,111,715
1–4 family residential mortgages	36,382	34,258	129,892	128,122	127,828	126,427	514,229	535,766
Home equity loans	2,145	2,362	14,206	17,214	18,508	21,862	100,618	146,877
Multifamily residential mortgages	1,797	1,857	11,233	12,965	12,631	14,795	34,827	39,764
Commercial RE loans	23,114	24,322	126,200	145,503	107,758	119,154	221,113	243,674
Construction RE loans	7,659	7,393	39,906	45,849	41,251	42,493	95,851	102,905
Farmland loans	10,384	10,392	13,873	15,575	4,258	4,175	6,625	6,847
RE loans from foreign offices	0	0	39	33	336	495	34,330	35,883
Commercial and industrial loans	24,650	23,112	93,739	94,850	126,089	115,850	783,355	704,915
Loans to individuals	18,317	16,344	60,323	55,076	101,145	96,107	430,897	494,926
Credit cards*	541	452	7,311	5,990	38,106	34,070	180,338	209,883
Other revolving credit plans	305	316	1,740	1,570	2,911	3,952	20,722	30,985
Installment loans	17,470	15,577	51,272	47,517	60,127	58,085	229,837	254,058
All other loans and leases	17,107	16,093	27,641	28,123	35,284	38,553	406,233	404,457
Less: Unearned income	181	131	656	586	590	504	1,340	2,609

Key indicators, FDIC-insured commercial banks by region
Second quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Number of institutions reporting	634	1,371	1,708	2,074	1,315	864	7,966
Total employees (FTEs)	540,694	460,906	330,785	117,303	106,777	182,305	1,738,770
Selected income data ($)							
Net income	$7,178	$5,845	$4,722	$1,573	$961	$3,161	$23,440
Net interest income	17,528		14,311	11,648	4,314	2,847	8,196
58,843							
Provision for loan losses	4,961	1,713	1,831	878	214	1,264	10,861
Noninterest income	18,284	9,514	6,635	2,586	1,056	4,465	42,541
Noninterest expense	20,557	13,716	10,036	3,759	2,411	6,556	57,035
Net operating income	7,000	5,641	4,380	1,555	929	3,100	22,605
Cash dividends declared	3,188	3,970	3,791	654	490	2,075	14,169
Net charge-offs to loan and lease reserve	4,840	1,743	1,720	844	146	1,268	10,561
Selected condition data ($)							
Total assets	2,323,272	1,658,571	1,378,966	376,962	280,085	731,805	6,749,662
Total loans and leases	1,157,081	1,024,151	896,653	257,281	163,856	472,514	3,971,537
Reserve for losses	26,074	16,148	15,725	4,551	2,470	9,358	74,325
Securities	403,771	298,925	267,241	62,886	74,084	130,200	1,237,108
Other real estate owned	585	1,326	896	297	332	437	3,874
Noncurrent loans and leases	23,467	12,064	13,137	2,857	1,693	5,208	58,424
Total deposits	1,457,075	1,126,081	882,048	253,485	227,897	501,558	4,448,144
Domestic deposits	985,303	1,046,172	822,084	239,432	226,825	487,423	3,807,239
Equity capital	200,767	157,588	119,352	38,873	28,054	79,359	623,994
Off-balance-sheet derivatives	34,956,564	12,571,429	1,662,807	9,326	9,936	863,880	50,073,941
Performance ratios (annualized %)							
Return on equity	14.47	15.04	16.05	16.53	14.03	16.14	15.24
Return on assets	1.26	1.43	1.39	1.68	1.38	1.75	1.41
Net interest income to assets	3.08	3.50	3.43	4.61	4.10	4.53	3.54
Loss provision to assets	0.87	0.42	0.54	0.94	0.31	0.70	0.65
Net operating income to assets	1.23	1.38	1.29	1.66	1.34	1.71	1.36
Noninterest income to assets	3.22	2.32	1.95	2.77	1.52	2.47	2.56
Noninterest expense to assets	3.62	3.35	2.96	4.02	3.47	3.62	3.43
Loss provision to loans and leases	1.72	0.67	0.82	1.38	0.53	1.09	1.10
Net charge-offs to loans and leases	1.68	0.69	0.77	1.33	0.36	1.09	1.07
Loss provision to net charge-offs	102.50	98.29	106.48	104.07	146.61	99.62	102.84
Performance ratios (%)							
Percent of institutions unprofitable	9.78	9.26	4.98	4.97	4.94	10.42	6.68
Percent of institutions with earnings gains	72.24	75.64	71.84	67.45	68.37	65.97	70.17
Nonint. income to net operating revenue	51.06	39.93	36.29	37.48	27.06	35.27	41.96
Nonint. expense to net operating revenue	57.40	57.57	54.89	54.47	61.79	51.78	56.26
Condition ratios (%)							
Nonperforming assets to assets	1.12	0.81	1.04	0.84	0.73	0.78	0.96
Noncurrent loans to loans	2.03	1.18	1.47	1.11	1.03	1.10	1.47
Loss reserve to noncurrent loans	111.11	133.85	119.70	159.30	145.90	179.68	127.22
Loss reserve to loans	2.25	1.58	1.75	1.77	1.51	1.98	1.87
Equity capital to assets	8.64	9.50	8.66	10.31	10.02	10.84	9.24
Leverage ratio	7.48	7.93	7.81	9.39	8.79	9.15	8.00
Risk-based capital ratio	12.98	12.48	12.42	13.90	14.37	14.02	12.95
Net loans and leases to assets	48.68	60.78	63.88	67.04	57.62	63.29	57.74
Securities to assets	17.38	18.02	19.38	16.68	26.45	17.79	18.33
Appreciation in securities (% of par)	1.18	2.14	1.52	2.16	2.01	1.85	1.65
Residential mortgage assets to assets	15.97	27.13	25.61	20.88	26.23	21.80	22.02
Total deposits to assets	62.72	67.89	63.96	67.24	81.37	68.54	65.90
Core deposits to assets	34.06	55.15	52.00	56.59	67.18	57.58	48.09
Volatile liabilities to assets	44.90	23.43	27.19	23.72	19.21	24.40	31.54

Loan performance, FDIC-insured commercial banks by region
Second quarter 2002

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Percent of loans past due 30–89 days							
Total loans and leases	1.24	0.99	1.28	1.45	1.16	1.04	1.17
Loans secured by real estate (RE)	1.07	0.91	1.30	0.98	0.99	0.78	1.03
1–4 family residential mortgages	1.26	1.26	1.83	1.13	1.25	0.91	1.34
Home equity loans	0.46	0.54	0.68	0.57	0.48	0.52	0.57
Multifamily residential mortgages	0.24	0.50	0.63	0.42	0.63	0.22	0.43
Commercial RE loans	0.76	0.62	0.92	0.84	0.77	0.48	0.72
Construction RE loans	0.67	0.65	1.31	1.14	1.08	1.61	1.03
Commercial and industrial loans	1.03	1.01	1.26	1.55	1.27	1.18	1.13
Loans to individuals	2.24	1.85	1.81	2.45	1.81	1.79	2.05
Credit cards	2.66	3.48	1.94	2.83	1.42	1.95	2.55
Installment loans and other plans	2.19	1.67	1.92	1.82	1.89	1.74	1.92
All other loans and leases	0.54	0.36	0.79	1.05	0.91	0.63	0.62
Percent of loans noncurrent							
Total loans and leases	2.03	1.18	1.47	1.11	1.03	1.10	1.47
Loans secured by real estate (RE)	1.09	0.76	1.32	0.73	0.88	0.64	0.95
1–4 family residential mortgages	1.10	0.76	1.70	0.55	0.79	0.42	1.00
Home equity loans	0.27	0.26	0.43	0.32	0.43	0.27	0.32
Multifamily residential mortgages	0.29	0.37	0.50	0.38	0.78	0.22	0.38
Commercial RE loans	0.94	0.88	1.31	0.92	0.93	0.72	0.97
Construction RE loans	1.03	0.96	1.27	0.94	0.82	1.26	1.08
Commercial and industrial loans	3.83	2.63	2.47	1.46	1.50	2.27	2.87
Loans to individuals	2.05	0.76	0.66	1.61	0.69	1.21	1.40
Credit cards	2.23	1.86	1.39	2.04	0.86	1.70	2.02
Installment loans and other plans	2.21	0.61	0.59	0.86	0.71	0.44	1.13
All other loans and leases	0.88	0.78	0.85	1.11	1.45	1.05	0.89
Percent of loans charged-off, net							
Total loans and leases	1.68	0.69	0.77	1.33	0.36	1.09	1.07
Loans secured by real estate (RE)	0.08	0.11	0.29	0.08	0.11	0.07	0.14
1–4 family residential mortgages	0.09	0.13	0.32	0.03	0.10	0.04	0.15
Home equity loans	0.04	0.17	0.38	0.08	0.16	0.07	0.20
Multifamily residential mortgages	0.10	0.08	0.10	–0.02	0.09	0.00	0.07
Commercial RE loans	–0.01	0.07	0.28	0.15	0.14	0.12	0.12
Construction RE loans	0.09	0.09	0.21	0.24	0.07	0.00	0.11
Commercial and industrial loans	2.15	1.85	1.33	0.93	0.65	1.98	1.76
Loans to individuals	4.01	1.43	1.76	4.50	0.91	3.40	3.05
Credit cards	6.46	4.60	5.63	6.76	3.08	4.74	5.98
Installment loans and other plans	1.76	0.95	1.19	0.45	0.85	1.17	1.26
All other loans and leases	0.76	0.28	0.70	0.26	0.39	0.52	0.59
Loans outstanding ($)							
Total loans and leases	$1,157,081	$1,024,151	$896,653	$257,281	$163,856	$472,514	$3,971,537
Loans secured by real estate (RE)	376,801	579,327	454,826	121,179	94,457	260,370	1,886,961
1–4 family residential mortgages	181,255	261,587	190,458	56,289	34,636	100,348	824,572
Home equity loans	37,507	58,839	60,892	6,059	1,729	23,289	188,315
Multifamily residential mortgages	15,615	17,235	19,102	3,441	2,866	11,121	69,381
Commercial RE loans	87,322	160,990	125,576	33,100	36,398	89,267	532,653
Construction RE loans	20,990	70,397	49,658	10,781	14,673	32,140	198,640
Farmland loans	1,339	7,103	9,079	11,509	4,155	3,804	36,989
RE loans from foreign offices	32,772	3,176	62	0	0	401	36,411
Commercial and industrial loans	316,986	226,968	218,730	42,474	37,551	96,017	938,726
Loans to individuals	266,371	122,883	102,159	63,575	22,032	85,434	662,454
Credit cards	125,522	16,466	13,262	41,399	609	53,137	250,395
Other revolving credit plans	21,049	4,475	5,586	1,004	764	3,943	36,822
Installment loans	119,801	101,942	83,310	21,172	20,659	28,354	375,237
All other loans and leases	199,343	95,568	121,113	30,094	9,986	31,121	487,225
Less: Unearned income	2,420	595	175	41	171	429	3,830

Glossary

Data Sources

Data are from the Federal Financial Institutions Examination Council (FFIEC) Reports of Condition and Income (call reports) submitted by all FDIC-insured, national-chartered and state-chartered commercial banks and trust companies in the United States and its territories. Uninsured banks, savings banks, savings associations, and U.S. branches and agencies of foreign banks are excluded from these tables. All data are collected and presented based on the location of each reporting institution's main office. Reported data may include assets and liabilities located outside of the reporting institution's home state.

The data are stored on and retrieved from the OCC's Integrated Banking Information System (IBIS), which is obtained from the FDIC's Research Information System (RIS) database.

Computation Methodology

For performance ratios constructed by dividing an income statement (flow) item by a balance sheet (stock) item, the income item for the period was annualized (multiplied by the number of periods in a year) and divided by the average balance sheet item for the period (beginning-of-period amount plus end-of-period amount plus any interim periods, divided by the total number of periods). For "pooling-of-interest" mergers, prior period(s) balance sheet items of "acquired" institution(s) are included in balance sheet averages because the year-to-date income reported by the "acquirer" includes the year-to-date results of "acquired" institutions. No adjustments are made for "purchase accounting" mergers because the year-to-date income reported by the "acquirer" does not include the prior-to-merger results of "acquired" institutions.

Definitions

Commercial real estate loans—loans secured by nonfarm nonresidential properties.

Construction real estate loans—includes loans for all property types under construction, as well as loans for land acquisition and development.

Core deposits—the sum of transaction deposits plus savings deposits plus small time deposits (under $100,000).

IBIS—OCC's Integrated Banking Information System.

Leverage ratio—Tier 1 capital divided by adjusted tangible total assets.

Loans to individuals—includes outstanding credit card balances and other secured and unsecured installment loans.

Net charge-offs to loan and lease reserve—total loans and leases charged off (removed from balance sheet because of uncollectibility), less amounts recovered on loans and leases previously charged off.

Net loans and leases to assets—total loans and leases net of the reserve for losses.

Net operating income—income excluding discretionary transactions such as gains (or losses) on the sale of investment securities and extraordinary items. Income taxes subtracted from operating income have been adjusted to exclude the portion applicable to securities gains (or losses).

Net operating revenue—the sum of net interest income plus noninterest income.

Noncurrent loans and leases—the sum of loans and leases 90 days or more past due plus loans and leases in nonaccrual status.

Nonperforming assets—the sum of noncurrent loans and leases plus noncurrent debt securities and other assets plus other real estate owned.

Number of institutions reporting—the number of institutions that actually filed a financial report.

Off-balance-sheet derivatives—the notional value of futures and forwards, swaps, and options contracts; beginning March 31, 1995, new reporting detail permits the exclusion of spot foreign exchange contracts. For March 31, 1984 through December 31, 1985, only foreign exchange futures and forwards contracts were reported; beginning March 31, 1986, interest rate swaps contracts were reported; beginning March 31, 1990, banks began to report interest rate and other futures and forwards contracts, foreign exchange and other swaps contracts, and all types of option contracts.

Other real estate owned—primarily foreclosed property. Direct and indirect investments in real estate ventures are excluded. The amount is reflected net of valuation allowances.

Percent of institutions unprofitable—the percent of institutions with negative net income for the respective period.

Percent of institutions with earnings gains—the percent of institutions that increased their net income (or decreased their losses) compared to the same period a year earlier.

Reserve for losses—the sum of the allowance for loan and lease losses plus the allocated transfer risk reserve.

Residential mortgage assets—the sum of 1 4 family residential mortgages plus mortgage-backed securities.

Return on assets (ROA)—net income (including gains or losses on securities and extraordinary items) as a percentage of average total assets.

Return on equity (ROE)—net income (including gains or losses on securities and extraordinary items) as a percentage of average total equity capital.

Risk-based capital ratio—total capital divided by risk weighted assets.

Risk-weighted assets—assets adjusted for risk-based capital definitions which include on-balance-sheet as well as off-balance-sheet items multiplied by risk weights that range from zero to 100 percent.

Securities—excludes securities held in trading accounts. Effective March 31, 1994 with the full implementation of Financial Accounting Standard (FAS) 115, securities classified by banks as "held-to-maturity" are reported at their amortized cost, and securities classified a "available-for-sale" are reported at their current fair (market) values.

Securities gains (losses)—net pre-tax realized gains (losses) on held-to-maturity and available-for-sale securities.

Total capital—the sum of Tier 1 and Tier 2 capital. Tier 1 capital consists of common equity capital plus noncumulative perpetual preferred stock plus minority interest in consolidated subsidiaries less goodwill and other ineligible intangible assets. Tier 2 capital consists of subordinated debt plus intermediate-term preferred stock plus cumulative long-term preferred stock plus a portion of a bank's allowance for loan and lease losses. The amount of eligible intangibles (including mortgage servicing rights) included in Tier 1 capital and the amount of the allowance included in Tier 2 capital are limited in accordance with supervisory capital regulations.

Volatile liabilities—the sum of large-denomination time deposits plus foreign-office deposits plus federal funds purchased plus securities sold under agreements to repurchase plus other borrowings. Beginning March 31, 1994, new reporting detail permits the exclusion of other borrowed money with original maturity of more than one year; previously, all other borrowed money was included. Also beginning March 31, 1994, the newly reported "trading liabilities less revaluation losses on assets held in trading accounts" is included.

Recent Corporate Decisions

The OCC publishes monthly, in its publication *Interpretations and Actions*, corporate decisions that represent a new or changed policy, or present issues of general interest to the public or the banking industry. In addition, summaries of selected corporate decisions appear in each issue of the *Quarterly Journal*. In the second quarter of 2002, the following corporate decisions were of particular importance because they were precedent-setting or otherwise represented issues of importance. The OCC's decision documents for these decisions may be found in *Interpretations and Actions* using the decision number at the end of each summary.

Mergers

On June 26, 2002, the OCC granted conditional approval for Household Bank (SB), N.A. ("HBSB"), Las Vegas, Nevada, to merge Household Bank (Nevada), N.A., Las Vegas, Nevada, into HBSB under 12 USC 215a and 1828(c). The conditional approval also included permission to purchase assets of Beneficial National Bank, U.S.A., New Castle, Delaware, and transfer ownership of the HBSB affiliate to Household Finance Company under 12 CFR 5.33. The approval requires HBSB to enter into an Operating Agreement with the OCC. [Conditional Approval Letter No. 537]

During the quarter, the OCC granted approval of four applications to undertake reorganizations pursuant to 12 USC 215a-2 and 12 CFR 7.2000(a). This recently enacted amendment to 12 USC 215 provides a streamlined process for national banks to effect holding company reorganizations through an exchange of the bank's stock for cash or securities of a bank holding company.

Also during the quarter, the OCC granted approval of two applications for national banks to merge with nonbank subsidiaries or affiliates pursuant to 12 USC 215a-3. This recently enacted amendment to 12 USC 215 expressly authorizes such mergers. This section was adopted to facilitate the ability of banking organizations to effect corporate restructuring between national banks and their subsidiaries and affiliates in the most efficient way possible, while preserving regulatory oversight by requiring OCC approval.

Operating Subsidiaries

On June 21, 2002, the OCC granted conditional approval for Citibank USA, N.A., to acquire three subsidiaries from a nonbank affiliate. The companies consist of two auto clubs, one of which has a subsidiary in Mexico, that operate and administer typical emergency roadside assistance and provide limited travel services through programs with auto rental companies, auto manufacturers, and a traditional retail member fee-based auto club. The third company is a credit card registration/notification company. The approval contained conditions relating to obtaining third-party insurance to cover the potential excess of costs over revenues in the retail member auto club program, and providing annual operational data for the retail member auto club permitting the OCC to determine whether divestiture may be required if its operation and administration is no longer convenient and useful. [Conditional Approval Letter No. 535]

On June 28, 2002, the OCC granted approval for Extraco Bank, N.A., Waco, Texas, to expand the activities of an operating subsidiary of the bank. We granted approval for the operating subsidiary to provide customers with advice and consultation on the technology (including installation and maintenance) used to access its banking services. The advisory and consulting services are limited to technology processing advice and consultation for the type of banking, financial, and economic data that the bank would be permitted to process on behalf of its customers discussed under 12 CFR 7.5006. [Corporate Decision No. 2002-11]

Special Supervision/Fraud and Enforcement Activities

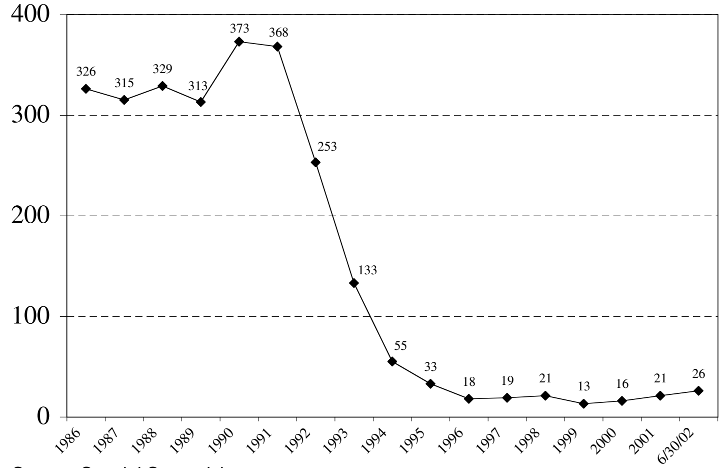
The Special Supervision/Fraud division of the Mid-Size/Community Bank Supervision department supervises the resolution of critical problem banks through rehabilitation or orderly failure management, monitors the supervision of nondelegated problem banks, coordinates fraud/white collar crime examinations, provides training, disseminates information, and supports OCC supervisory objectives as an advisor and liaison to OCC management and field staff on emerging problem bank and fraud/white collar crime related issues. Fraud experts are located throughout the United States representing each of the OCC's district offices, and they also provide support to the OCC's largest supervised banks.

This section includes information on problem national banks, national bank failures, and enforcement actions. Data on problem banks and bank failures is provided by OCC's Special Supervision/Fraud division and the FDIC's Department of Resolutions in Washington. Information on enforcement actions is provided by the Enforcement and Compliance division (E&C) of the law department. The latter is principally responsible for presenting and litigating administrative actions on the OCC's behalf against banks requiring special supervision.

Problem National Banks and National Bank Failures

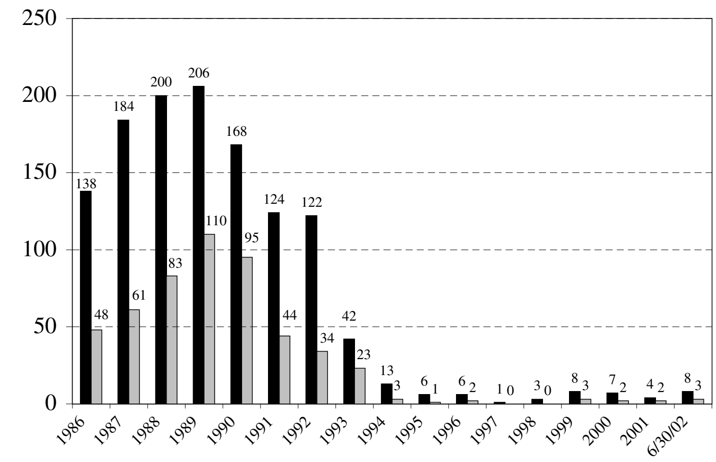
Problem banks represented approximately 1 percent of the national bank population as of June 30, 2002. The volume of problem banks, those with a CAMELS rating of 4 or 5, is now increasing. The CAMELS rating is the composite bank rating based on examiner assessment of capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. The total number of 4 and 5 rated banks is 26, up from 21 at December 31, 2001 and 16 at June 30, 2001. Levels haven't been this high since 1995. Additionally, the volume of banks rated 3 is also increasing. These banks total 105 at June 30, 2002 compared to 92 at year-end 2001. This increasing volume of problem banks reflects current economic conditions. Three national bank failures occurred during the first half of 2002 out of a total of eight commercial bank failures.

Figure 1—Problem national bank historical trend line



Source: Special Supervision

Figure 2—Total bank failures compared to OCC failures



Source: FDIC Department of Resolution

Enforcement Actions

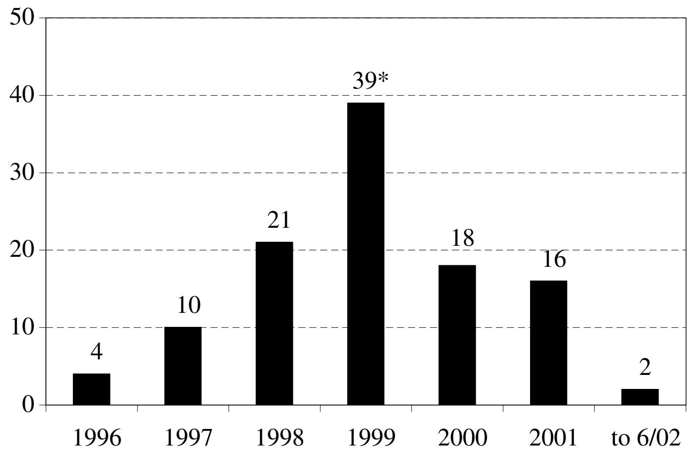
The OCC has a number of remedies with which to carry out its supervisory responsibilities. When it identifies safety and soundness or compliance problems, these remedies range from advice and moral suasion to informal and formal enforcement actions. These mechanisms are designed to achieve expeditious corrective and remedial action to return the bank to a safe and sound condition.

The OCC takes enforcement actions against national banks, individuals affiliated with national banks, and agents and servicing companies that provide data processing and other services to national banks. The OCC's informal enforcement actions against banks include commitment letters and memorandums of understanding (MOUs). Informal enforcement actions are meant to handle less serious supervisory problems identified by the OCC in its supervision of national banks.

Failure to comply with informal enforcement actions will provide strong evidence of the need for the OCC to take formal enforcement action. The charts below show total numbers of the various types of enforcement actions completed by the OCC against national banks in the last several years. Year-2000 (Y2K) related actions taken in 1999 are noted in parentheses.

The most common types of formal enforcement actions issued by the OCC against national banks over the past several years have been formal agreements and cease-and-desist orders. Formal agreements are documents signed by a national bank's board of directors and the OCC in which specific corrective and remedial measures are enumerated as necessary to return the bank to a safe and sound condition. Cease-and-desist orders (C&Ds), sometimes issued as consent orders, are similar in content to formal agreements, but may be enforced either through assessment of civil money penalties (CMPs) or by an action for injunctive relief in federal district court. The OCC may also initiate the safety and soundness order process under 12 CFR 30, which begins when the OCC issues a notice of deficiency. The notice of deficiency notifies the affected bank that it needs to submit a plan for bringing its operations into compliance with safety and soundness standards. The OCC issued no CMPs against national banks from January 1, 2002, to June 30, 2002, nor issued any notices of deficiency.

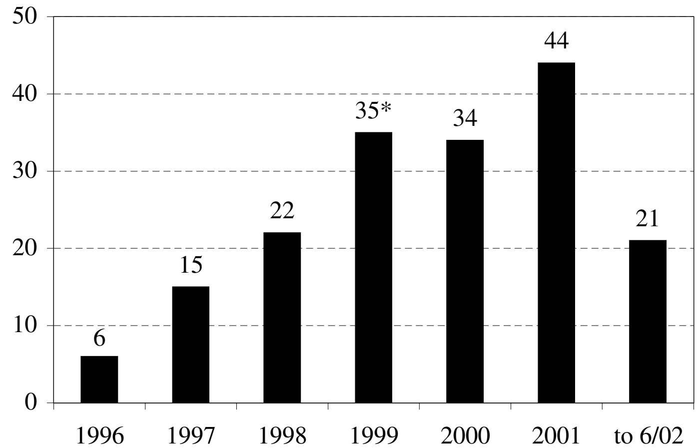
Figure 3—Commitment letters



Source: OCC Supervisory Monitoring System (SMS) and Examiner View (EV). Note that SMS totals for previous years' completed enforcement actions may be adjusted to reflect revised aggregates.

*6 of which are for year-2000 problems

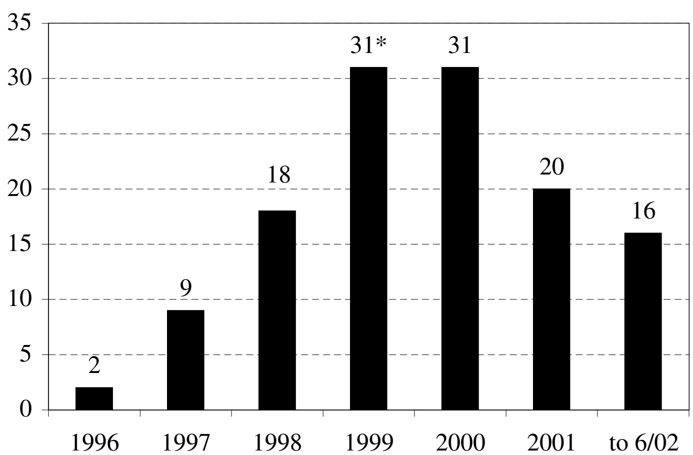
Figure 5—Formal agreements



Source: SMS & EV. Note that SMS totals for previous years' completed enforcement actions may be adjusted to reflect revised aggregates.

*2 of which are for year-2000 problems

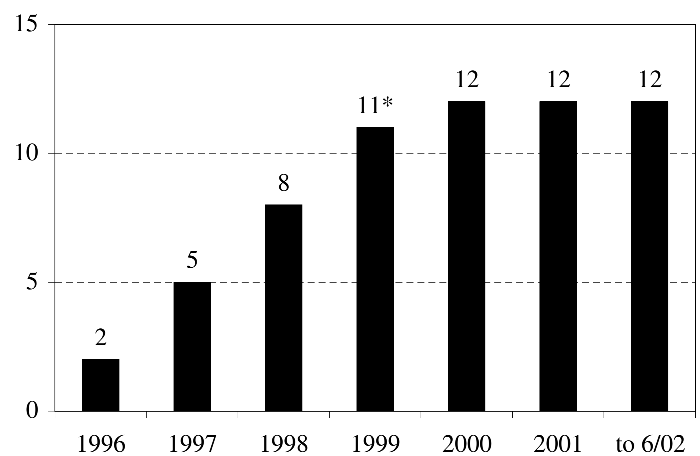
Figure 4—Memorandums of understanding



Source: SMS & EV. Note that SMS totals for previous years' completed enforcement actions may be adjusted to reflect revised aggregates.

*6 of which are for year-2000 problem

Figure 6—Cease-and-desist orders against banks



Source: SMS & EV. Note that SMS totals for previous years' completed enforcement actions may be adjusted to reflect revised aggregates.

*1 of which is for year-2000 problems

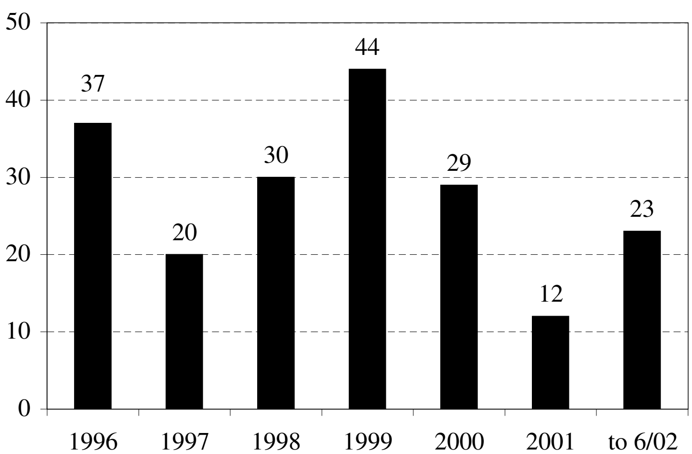
The most common enforcement actions against individuals are civil money penalties (CMPs), personal C&Ds, and removal and prohibition orders. CMPs are authorized for violations of laws, rules, regulations, formal written agreements, final orders, conditions imposed in writing, and under certain circumstances, unsafe or unsound banking practices and breaches of fiduciary duty. Personal C&Ds may be used to restrict individuals' activities and to order payment of restitution. Removal and prohibition actions, which are used in the most serious cases, result in lifetime bans from the banking industry.

Recent Enforcement Cases

In January 2002, the OCC assessed a civil money penalty of $10 million against one of the federal branches of the Bank of China located in New York City. At the same time, the bank also consented to pay another $10 million penalty to its home-country regulator, the People's Bank of China, which cooperated with the OCC in the investigation. After a lengthy investigation, the OCC uncovered a series of questionable transactions at the branch, extending back several years. The transactions resulted in significant losses to the New York branch and included several that showed preferential treatment to certain customers of the New York branch who had personal relationships with some members of the New York branch's prior management. In addition to the penalty, the OCC also issued a consent order to the bank, which covered the New York branch where the transactions occurred, the bank's other branch in New York, and its branch in Los Angeles. The consent order required numerous remedial measures and imposed restrictions to prevent recurrence of these actions. The bank's current management, which has cooperated with the investigation, has also removed officers suspected of misconduct, uncovered and reported acts of misconduct to the two regulatory agencies, and required the U.S. branches to implement several action plans over the past 18 months to correct actions of prior management.

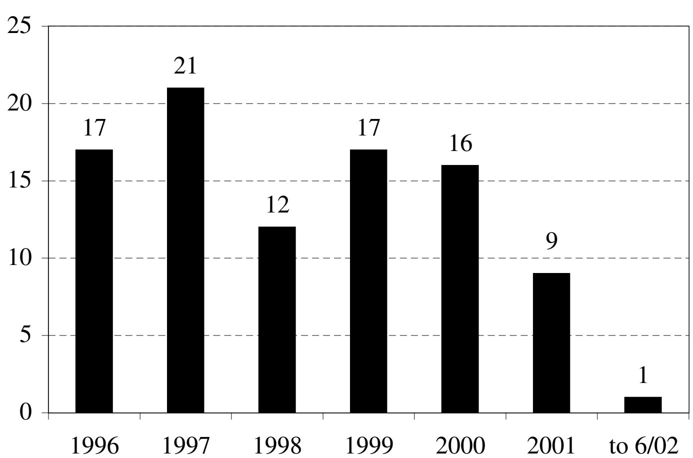
In January 2002, the OCC issued supervisory letters and letters of reprimand to several officers and directors of a national bank in Florida. The bank, which was placed into receivership in the same month, had failed to comply with several provisions of a cease and desist order that the OCC had issued in September 2000. The directors were charged with causing the bank to violate the order and to file materially inaccurate Reports of Condition, in violation of 12 USC 161.

Figure 7—Civil money penalties against individuals



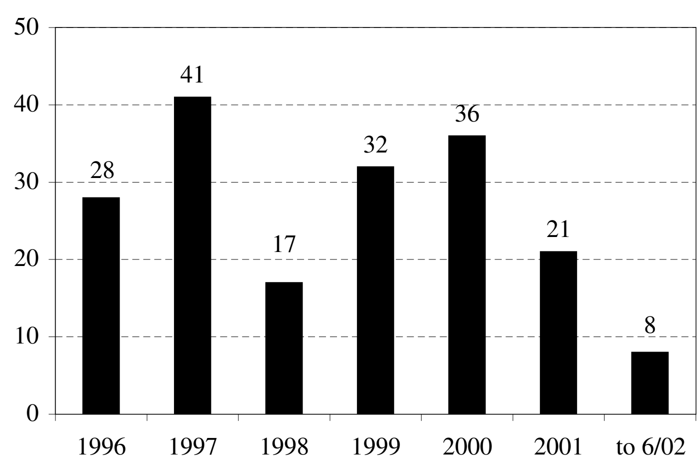
Source: SMS & EV. Note that SMS totals for previous years' completed enforcement actions may be adjusted to reflect revised aggregates

Figure 8—Cease-and-desist orders against individuals



Source: SMS. Note that SMS totals for previous years' completed enforcement actions may be adjusted to reflect revised aggregates.

Figure 9—Removal and prohibition orders



Source: SMS. Note that SMS totals for previous years' completed enforcement actions may be adjusted to reflect revised aggregates.

In January 2002, the OCC issued a prohibition order with the consent of the former senior loan officer of a national bank in California. The loan officer improperly released the guarantee supporting a bank loan within a day or two of when the loan was originated. He then falsely reported to the bank and to the OCC that the guarantee was still in place. The bank did not discover his actions until it after had advanced additional funds to the borrower. The bank lost approximately $3 million on the loan.

In February 2002, the OCC issued a prohibition order and assessed a $4,000 civil money penalty with the consent of a former senior portfolio manager at a national bank in Utah. The portfolio manager purchased unsuitably risky and volatile securities for several asset management accounts, cross-sold some of these securities between accounts to hide losses, and misstated the value of the securities on the bank's pricing sheet and on monthly statements to clients. The bank ultimately reimbursed various harmed investors for approximately $650,000 in resulting losses.

In February 2002, the OCC issued a prohibition and restitution order to the former president of a national bank in Texas. The former president, who consented to the order, agreed to pay $100,000 in restitution. The former president caused the bank to violate its legal lending limit under 12 USC 84, violated 12 CFR 32, and made and concealed several nominee loans and overdrafts that contributed to the bank's failure.

In February 2002, the OCC received a favorable decision from the administrative law judge (ALJ) who presided over a challenge to a now-dismissed OCC enforcement action. The challenge, brought under the Equal Access to Justice Act (EAJA), alleged that the OCC lacked a good-faith basis for the civil money penalty action it brought last year against the former president and compliance officer of a national bank in Missouri. Subsequent to commencing the action, the OCC dropped the case on the motion of OCC Enforcement counsel. The administrative law judge hearing the EAJA challenge held that the OCC was substantially justified in issuing the Notice of Assessment of a Civil Money Penalty and, therefore, the plaintiff was not entitled to relief under the EAJA. The ALJ's recommended decision was adopted by the Comptroller and the plaintiff has appealed the Comptroller's decision to the DC Circuit Court. The appellate court has yet not ruled on the appeal.

In March 2002, the OCC issued a prohibition order and assessed a civil money penalty of $100,000 with the consent of a former senior vice president and loan officer of a national bank in Louisiana. While at the bank, the officer originated at least three fictitious loans, and then used the proceeds of the loans for his personal benefit.

In March 2002, the OCC assessed civil money penalties against two former officers of an operating subsidiary of a national bank in California. The former officers consented to pay the penalties, $10,000 and $3,000, respectively, for their role in causing the subsidiary to employ one of the officers, despite his prior felony conviction.

In April 2002, the OCC entered into a formal agreement with a national bank in Arizona in connection with its credit card lending program. The bank suffered from numerous unsafe or unsound practices in its risk management and underwriting policies, as well as its management information systems and accounting.

In May 2002, the OCC entered into a cease-and-desist order with a CEBA credit card bank. The order included provisions that require the bank to correct its record-keeping and affiliate transaction deficiencies and to go out of business by December 31, 2002. In addition, the bank's ultimate parent established a $120 million escrow account for the defeasance of the bank's deposits and a $78 million letter of credit to cover the risk associated with the funding of credit card receivables for the bank's merchant parent. The merchant affiliates also agreed to amend their contracts to ensure that the bank did not fund the credit card remittances until and unless it received payment from the merchant affiliates. The consent order also required the bank to establish a $15 million liquidity reserve deposit.

Fast Track Enforcement Cases

The OCC continued its Fast Track Enforcement Program, initiated in 1996, which ensures that bank insiders who have engaged in criminal acts in banks, but who are not being criminally prosecuted, are prohibited from working in the banking industry. As part of the Fast Track Enforcement Program, E&C secured four consent prohibition orders against institution-affiliated parties in the first half of 2002. Some of these orders also incorporated restitution payments to the appropriate banks for losses incurred. In addition, E&C sent out ten notifications to former bank employees who were convicted of crimes that federal law prohibits them from working again in a federally insured depository institution.

As a typical example of a Fast Track case, the OCC issued a prohibition order in April 2002 against a former branch manager of a national bank in New Jersey. The branch manager defrauded the bank and agreed to the OCC's prohibition order, which was handled through the OCC's Fast Track program.

Appeal Composite and CAMELSI Component Ratings

Background

A bank operating under a formal agreement appealed the composite rating and each of the CAMELSI component ratings (capital, asset quality, management, earnings, liquidity, sensitivity to market risk, and information technology), 3/3343233, respectively. Additionally, the bank expressed a desire to appeal many of the conclusions in the report of examination (report) that supported the ratings.

The directors and management also expressed concern with the lack of objectivity in the report and an alleged bias by the supervisory office in their assessment of the bank's condition. Additionally, there was a concern over the difficult communications between the supervisory office and bank management. Management and the board were explicit in stressing that they endeavored to work through their disagreements with the supervisory office over a number of years. Their decision to file an appeal after the most recent examination was made after concluding that third party intervention by the ombudsman was the only way to restore balance to the supervisory process. Finally, the appeal requested the ombudsman facilitate a change in supervisory office.

Discussion

The OCC Bulletin 2002-9, "National Bank Appeals Process: Guidance for Bankers," February 25, 2002, (bulletin), makes clear that banks cannot seek ombudsman review of agency decisions for which banks are provided with an appeal mechanism by statute or OCC regulation, or where the decision is subject to judicial review. These include agency decisions to pursue formal enforcement action or recommended decisions following formal or informal adjudications pursuant to the Administrative Procedures Act, 5 USC 701 et seq., agency actions that are subject to judicial review, and decisions made to disapprove directors and senior executive officers pursuant to Section 914 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, 12 USC 1831i.

While the bulletin does not allow appeals of the underlying facts of an enforcement action, it does permit material supervisory determinations to be appealed even when an enforcement action has been taken. In such circumstances, the OCC's ombudsman, without engaging in additional fact-finding, applies relevant OCC policies and standards to the existing facts to determine whether the agency's conclusions are consistent with those policies and standards.

The bank's correspondence explained that their appeal was not requesting the ombudsman's involvement with supervisory decisions pertaining to compliance with the existing formal enforcement action or any subsequent decisions to pursue additional enforcement actions.

The ombudsman conducted a comprehensive review of the information submitted by the bank and documentation from the supervisory office. The review included meetings with members of the bank's board of directors, senior management team, and legal counsel. The ombudsman also met with members of the supervisory office. The ombudsman review focused on whether there was adequate support for the assigned ratings and whether the ratings reflected the condition of the bank at the time of the examination.

Conclusion

The ombudsman determined that the assigned composite and CAMELSI component ratings were appropriate at the time of the examination. The report of examination also appropriately addressed the need to strengthen the bank's risk management systems. However, the ombudsman identified several instances where the report lacked proper balance. The wording and tone of the report was too harsh and did not give recognition for the bank's positive actions. Further, the report did not consider the unique aspects of the bank's operating environment. Given the length of time since the onsite examination, the ombudsman decided a new examination was needed as opposed to rewriting the report.

The ombudsman held discussions with the district deputy comptroller to encourage measures that would ensure appropriate balance during the next examination, recognizing the unique aspects of the bank's operating environment. Bank management was encouraged to aggressively direct their attention and efforts toward institutionalizing a culture that is reflective of strong risk management systems and internal control processes throughout the bank. Such an effort would yield huge dividends internally as well as eliminating the basis of most of the prior OCC criticisms and recommendations.

Speeches and Congressional Testimony

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Of the Comptroller of the Currency

Of the First Senior Deputy Comptroller and Chief Counsel

Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the Consumer Bankers Association, on the benefits of financial literacy programs, Arlington, Virginia, April 8, 2002

Financial Literacy: A Key to New Banking Markets

It's a pleasure to join you at your annual Community Reinvestment Act conference—another opportunity for CBA to reaffirm its standing as one of the premier banking organizations in this country. A large share of the credit for your success goes to Joe Belew, who over the years has led with intelligence, conviction, and style.

One of the most important of your products is your survey of the industry's financial literacy efforts. When it was first released last summer, the survey confirmed what many of us already knew: that thousands of Americans have been smarter financial consumers—and more successful participants in the economy—because they attended educational programs developed, financed, and carried out by banks across the country.

This year's survey reflects an even more impressive variety of bank-sponsored programs: credit counseling, small business development, in-school tutoring, foreclosure prevention, and more. Of the banks surveyed—a group that represented almost 60 percent of the industry's total assets—nearly all said that they contributed to the war on financial illiteracy in some way, with more than half serving as primary sponsors of the programs in which they participated.

Clearly, bank-sponsored financial education programs have not only benefited the people who have enrolled in them, they've also earned respect and good will for the industry.

Yet when you think about it, the wonder is not that financial institutions have been so busy and active in promoting financial literacy, it's that there are still banks out there that aren't involved.

There are certainly plenty of reasons for public-spirited bankers to become involved in the effort to promote financial literacy. Evidence confirms that people who have been through well-designed and well-executed financial education programs are more likely to make sound economic choices for themselves and their families.

They're more likely to own their own homes and to keep them, with all of the social and economic advantages that go with homeownership. They're more likely to accumulate assets and less likely to be burdened by excessive debt. As Treasury Secretary Paul H. O'Neill recently said, "Ownership, independence, and access to wealth should not be the privilege of a few. They should be the hope of every American. Financial literacy is an essential tool to make that hope a reality."

Studies also tell us that financial education is an indispensable element of any strategy to combat the rise of predatory lending. I don't need to tell you that abusive lending has become a serious public policy concern—and a serious concern for the financial services industry.

Although those who engage in predatory practices are relatively few in number—and only rarely include regulated depository institutions—they've done real harm to the reputation of all financial institutions. It's therefore very much in the industry's interests to assist in efforts to oust the bad actors.

One of the best ways we've found to do that is through education, with programs that focus on the most common victims of predatory lending—particularly the poor, the elderly, and minority groups—programs that provide information on predatory practices and on non-predatory financial options. I was encouraged to see that more than half of the respondents in the current CBA survey reported addressing predatory lending issues in their financial literacy programs.

The predatory lending problem illustrates what I think is a point of surpassing importance: altruism that's reinforced by self-interest is most likely to produce results. And I believe that banks have a strong self-interest in promoting financial literacy.

High among the reasons why banks serve themselves when they serve others through participation in financial literacy efforts are regulatory considerations, and particularly CRA considerations.

We and other financial regulators give CRA credit for financial literacy programs in assessing your record of serving the needs of low- and moderate-income individuals. Banks' participation in these programs may receive consideration under the CRA regulations.

For example, the Interagency Q&As offer a long list of activities that would qualify for consideration under the CRA service test. The list includes such things as:

- providing technical assistance on financial matters to small businesses;
- providing credit counseling, home buyer and home maintenance counseling, financial planning or other financial services education to promote community development; and
- establishing school savings programs and developing or teaching financial education curricula for low- and moderate-income individuals.

Regarding the investment test, the Interagency Q&As note that when financial institutions make investments in or grants to non-profit organizations that provide counseling for credit, home-ownership, home maintenance, and other financial services education, such investments will qualify for CRA consideration.

Clearly, financial literacy activities can play a big part in any financial institution's overall CRA strategy. And we know that some of our largest institutions already play such a role.

But banks should not get involved in the financial literacy crusade merely as a matter of public spirit or regulatory obligation. They should do it because it makes good business sense—because a financially literate public is the natural market for bank products and services.

It's now well known that there's a large pool of unbanked Americans—people who may use the banking system for a casual transaction or two, or maybe not at all. By definition, they don't have a savings or checking account, and they rely on nonbank financial providers when they need to cash a check or buy a money order. According to some estimates, this group may constitute up to ten percent of all American households.

Then there are the underbanked, as I call them—millions of people who may have a bank account, but who rely to a greater or lesser extent on high-cost, short-term credit provided by nonbank lenders, often in the form of payday loans.

There are significant differences between these two groups. But they also have a lot in common. Both generally pay more than they should have to for financial services in a fully competitive market. Both would benefit from more comprehensive banking relationships. And for both, financial literacy programs may hold the key to getting there.

Let me emphasize again that for banks, this should be a matter of enlightened self-interest. This a lucrative market that we're talking about. Overall, those who serve the unbanked and the underbanked do exceedingly well at it. In 2000, Americans cashed 180 million checks at 11,000 check-cashing outlets, generating fees of $1.5 billion. And the payday loan industry has been booming. Today up to 10,000 outlets nationwide make payday loans—and earn fees that may total as much as $2.2 billion.

While many will say that fees for these services are unreasonably high, bankers in this country can't afford to ignore the number of consumers using these services. They clearly demonstrate a market opportunity.

Is it realistic to think that bankers can gain a bigger share of this promising market? Clearly, it won't be easy. The nonbank providers that currently control the market possess a number of advantages—not the least of which is public acceptance.

Check cashers and payday lenders have attracted customers for a reason—or for a host of reasons. They keep longer hours than banks. They tend to be more conveniently located. They speak their customers' languages. They don't ask for a lot of intrusive paperwork. They frequently offer more of the retail products and services these customers need than banks do—including money orders, wire transfers, and bill payments, as well as short-term, low-denomination loans.

They're set up to work fast—a fact of paramount importance to many payday borrowers, who are usually impatient for their money and won't wait days or weeks for a loan to be approved. In short, they're more user-friendly. And nonbank providers can often claim—correctly—that their services cost no more—and sometimes less—than the same services provided by banks—that is, when those services are even *available* at banks.

Yet banks have some significant competitive advantages that should position them to be far greater rivals than they are for these fringe providers. Banks alone have access to the payments system. They alone can hold transaction balances. They alone have deposit insurance coverage and access to the discount window. They alone are eligible to accept direct deposits. And they alone can offer banking services in conjunction with a variety of other services.

Add the many intangible benefits that banking relationships offer—institutional advice and support, opportunities to build formal credit histories, and so on—and you have a powerful set of reasons for banks to go after this business.

Of course, banks have enjoyed these advantages for years. Yet that hasn't prevented the estrangement of millions of Americans from the banking system. So the problem becomes one of ensuring that these advantages are understood by—and made accessible to—the individuals who would benefit from them.

The answer—or part of it—lies in something that *is* relatively new. I have long suggested that technology is an essential component of any viable strategy to extend the benefits of banking to the underbanked. I'm pleased to see that this view is beginning to take hold both among consumer advocates and among bankers themselves.

For example, last week a large national bank introduced a no-frills, "checkless" account that gives customers unlimited access to their funds through the bank's automated teller machine (ATM) network and eliminates the need to cash payroll checks.

This is one of those cases where government has led effectively by example. Consider the case of the ETA—the Electronic Transfer Account—that was developed by the Treasury Department when I was Under Secretary for Domestic Finance. ETAs are now being offered by hundreds of banks around the country—including the six largest—and have already drawn thousands of previously unbanked Americans into the banking system. More than 26,000 ETA accounts have been opened since the program began. To be sure, that's not an earth-shaking number. But it's a good start.

When we developed the ETA model, we had two principal goals in mind. First, it was designed to facilitate the transition—mandated by law—from paper to electronic delivery of federal payments. Obviously, people can't receive electronic payments unless they have a bank account to do so.

The transition to electronic direct deposit was expected to save the government tens of millions of dollars—as indeed it has done. Over the past decade, in fact, the government has saved more than $2 billion by converting from paper checks to electronic payments.

But we also hoped and expected that the ETA—a cheap, no-frills, utilitarian account—would serve as a model for financial institutions seeking to establish or expand a foothold in the unbanked market.

Taking advantage of their ability to batch remittances, some banks are beginning to develop electronic accounts that combine direct deposit with debit card access and bill payment options. Such accounts are proving attractive to individuals accustomed to spending several dollars per month for money orders or electronic bill payments. Because such accounts largely dispense with paper, they can be offered at low cost—lower in many cases than the customer would pay for the same set of services at a nonbank outlet.

But it's not only their competitive pricing that makes such accounts attractive to those who would otherwise be dealing with a nonbank. They provide a safe and cheap repository for funds. No more lost or stolen checks; no more hassles to cash a payment check; no more risk of carrying around a wad of cash and becoming a target for predators. The paycheck goes directly into the bank account, and with a debit card the customer can draw funds as she needs them, at an ATM or at point of sale. And if the bank has been innovative, the customer may even be able to make basic payments from the account by electronic transfer, either without cost or at a cost far less than a money order.

For the bank there are also important benefits: no processing of paper checks, no risk of overdrafts, the opportunity to establish new customer relationships that may be developed into something more.

For example, if such customers need small loans, for a car or appliance purchases—or even payday-type credit—a direct deposit account, which already enjoys cost advantages over a paper-based account, offers the possibility of prearranged electronic debits, significantly reducing not only the processing cost, but the bank's risk of default, as well. And they are favorably considered in a bank's CRA evaluation.

Banks are also taking the initiative to address the short-term borrowing needs of their customers, and here again, technology can be a big part of the solution.

In one noteworthy development, a prominent national bank has begun to offer a product that provides access to low-cost cash advances for direct deposit customers. Funds can be obtained directly from the bank's ATM network or by speaking to a telephone agent who will transfer the funds into the customer's account. The bank has also automated the underwriting process, cutting costs for both parties to the transaction and virtually eliminating the waiting period for established customers—a matter of considerable importance, as we've seen, for the emergency borrower.

Let me commend those of you who have added such innovative products to your offerings—and challenge those of you who haven't done so to think of even better ways of delivering these services.

But despite what Emerson said, it's not enough to build a better mousetrap; the world has to know about it before anyone will beat a path to your door. You have to give people a reason to break old patterns and habits; you have to let them know that they do have better options. And that brings me back to the importance of financial literacy.

A quick cautionary note is in order here. There can be a fine line between education and marketing, and it's a line that should be heeded in an educational setting. But this is an instance in which the facts—plain and uninflated—are on your side. Bank products and services—and the value of banking relationships—should sell themselves to informed consumers.

Coupled with innovative, technology-based approaches to product delivery, I believe that educational outreach holds tremendous potential for reducing the ranks of the underbanked. The potential rewards—for the economy and the banking system—certainly make the effort worthwhile.

It's not an effort we expect the industry to undertake on its own, of course. As with technology, we in government are leading by example, and we're working in partnership with others to promote the cause of financial literacy. I'm proud to report that the Treasury Department and its bureaus—especially the OCC—have been extremely active in this effort.

OCC has published resource guides and advisories to banks and others in search of ideas about where to obtain financial education and about how to help. We participate in the National Forum to Promote Low-Income Savings, an effort directed by the Consumer Federation of America to increase the savings rate in local communities. The OCC is one of only four federal agencies to have a formal partnership with the National Academy Foundation, a nonprofit organization dedicated to preparing young people for careers in the fields of finance, travel and tourism, and information technology.

And, of course, we work closely with banks, individually and through organizations like CBA, encouraging them to expand the scope and quality of their financial literacy activities.

Indeed, I believe it says something about our success in regard to numbers—numbers of banks participating and number of clients served, for example—that we're turning more to the question of program quality. Success in the financial literacy area cannot be measured simply in terms of raw statistics. We have to develop qualitative measures of our programs' effectiveness. We must set standards and measure outcomes where appropriate. I'm encouraged to see that many banks are engaging their community-based partners and other independent parties to evaluate the effectiveness of their programs.

Let me close by once again commending CBA and the banking industry for your important work in reaching out to the unbanked, the underbanked, and those in need of more and better information about their financial options. But we can't stop here, because the truth is that your work—our work—has just begun. There are millions more who remain outside the banking system—and outside the mainstream of our economy. We will never achieve our full potential as a nation as long as that's the case. And the banking industry will miss out on opportunities to serve, to grow, and to profit.

Reach out because it is the right thing to do; reach out because the American people need you. But do it most of all because it's good business. After all, doing good by doing well is the American way.

Statement of John D. Hawke, Jr., Comptroller of the Currency, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, on ending inequitable treatment of national banks, Washington, D.C., April 23, 2002

Statement required by 12 USC 250: The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Introduction

Chairman Sarbanes, Senator Gramm, and members of the committee, I am pleased to have this opportunity to present the views of the Office of the Comptroller of the Currency (OCC) on deposit insurance reform. As the current and most recent past chairmen of the Federal Deposit Insurance Corporation (FDIC) have noted—and as I strongly agree—the system of federal deposit insurance adopted by the Congress in the early 1930s has served this nation well for the greater part of a century. No massive overhaul of the system is required to ensure that it will continue to contribute to financial confidence and stability in the twenty-first century.

Nonetheless, the efforts so far undertaken to address the weaknesses in the system uncovered during the banking and thrift crises of the late 1980s and early 1990s have not been entirely adequate to the task. Indeed, the legislation adopted in response to those crises has actually constrained the FDIC from taking sensible and necessary actions. This is particularly the case with respect to the FDIC's ability to price deposit insurance in a way that reflects the risks posed by different depository institutions, and to the funds' ability to absorb material losses over the business cycle without causing sharp increases in premiums. Failure to address these issues in the current financial environment poses the danger that the next major domestic financial crisis will be exacerbated rather than ameliorated by the federal deposit insurance system.

Current legislative proposals in the House and Senate to reform deposit insurance address most, albeit not all, of the issues raised by the FDIC staff in its excellent and wide-ranging *Options Paper* released in August 2000. Among these issues are (1) how much discretion the FDIC should have to set premiums reflecting the risks posed by individual institutions to the insurance funds; (2) whether strict limits on the size of the insurance funds result in excessive volatility of deposit insurance premiums; (3) whether the deposit insurance coverage limit should be increased and/or indexed to changes in the price level; and (4) whether the Bank Insurance Fund (BIF) should be merged with the Savings Association Insurance Fund (SAIF).

In summary, the OCC recommends that (1) the FDIC be provided with the authority to implement a risk-based premium system for all banks; (2) the current fixed designated reserve ratio (DRR) be replaced with a range to allow the FDIC more flexibility in administering the deposit insurance premium structure; (3) coverage limits on deposits should not be increased; and (4) the BIF and SAIF should be merged.

We believe that deposit insurance reform also provides an opportunity to strengthen our supervisory structure by eliminating a distortion and unfairness in the current system of funding bank supervision. Currently, a portion of the earnings on the insurance funds, which state and national banks paid into, is diverted to fund the federal supervision of only one class of institutions, state banks supervised by the FDIC. The FDIC has elected not to pass those costs on to the banks they supervise. As a consequence, state nonmember banks pay only a small percentage of the costs of their supervision. In contrast, national banks pay over $400 million each year to cover the full costs of their supervision by the OCC. Ending this anomaly is not just a matter of fairness to national banks. It is a necessary component of allocating the costs and benefits of deposit insurance in an equitable and efficient manner among insured banks. For that reason, in addition to our views on the issues addressed by the legislative proposals to reform deposit insurance, my testimony today will include our suggestion for remedying the inequity that exists in the funding of supervision.

Eliminating Constraints on Risk-Based Pricing

The ability of the FDIC to set premiums for deposit insurance that reflect the risks posed by individual institutions to the insurance funds is one of the most important issues in the deposit insurance reform debate. The banking and thrift crises of the 1980s revealed the weaknesses of a flat-rate deposit insurance system in which the great majority of sound, prudently managed institutions subsidize the risks assumed by a few institutions. The Congress responded to this glaring deficiency by enacting the Federal Deposit Insurance

Corporation Improvement Act (FDICIA) of 1991, which required the FDIC to establish a risk-based system of deposit insurance premiums, thereby bringing the pricing of deposit insurance more in line with the practices of private insurance companies. The FDIC's initial efforts to implement such a system made meaningful, actuarially based distinctions among institutions based on the risk each institution posed to the insurance funds, but fell short of creating a well-differentiated structure.

Unfortunately, the Deposit Insurance Fund Act (DIFA) of 1996 diminished the FDIC's discretion to maintain, let alone improve, the risk-based structure of deposit insurance premiums. DIFA effectively prohibited the FDIC from charging a positive premium to any institution in the 1A category—that is, well-capitalized institutions with composite CAMELS ratings of 1 or 2—whenever the reserves of the deposit insurance funds are at or above the designated reserve ratio (DRR) of 1.25 percent of insured deposits. As a result, at December 31, 2001, 92.5 percent of all insured banks fell into that category, and therefore pay nothing for their deposit insurance—even though their risk of loss may be far above zero. Thus, today many institutions—some of which have never paid any deposit insurance premiums—receive a valuable government service free, and very well-managed institutions in effect subsidize riskier, less well-managed institutions. Moreover, quite apart from the risk that a specific bank might present, banks are not required to pay even a minimum "user" fee for the governmentally provided benefit represented by the deposit insurance system—a benefit without which, as a practical matter, no bank could engage in the business of taking deposits from the public.

Aside from the obvious inequity to institutions that contributed heavily to recapitalize the funds after the losses of the 1980s and 1990s, a system in which the vast majority of institutions pays no insurance premium forgoes one of the major benefits of a risk-based pricing system—creating an incentive for good management by rewarding institutions that pose a low risk to the insurance funds. A mandated zero premium precludes the FDIC from charging different premiums to banks with different risks within the 1A category, despite the fact that within the 1A category there are banks that pose very different risks to the funds.[1]

Whenever the reserve ratio of the BIF falls below 1.25 percent, however, FDICIA requires the FDIC to charge an assessment rate to all banks high enough to bring it back to the DRR within one year. If that is not feasible, the FDIC must impose an assessment rate of at least 23 basis points. This sharp rise in premiums, or "cliff effect," would hit banks the hardest when they are most vulnerable to earnings pressure. To avoid creating this procyclical volatility in deposit insurance premiums, it would be preferable to offset losses to the funds through more gradual changes in premiums based on the level of the insurance fund relative to the FDIC's assessment of current risk in the banking system. In short, we believe that as risks in the banking system change relative to the level of the insurance funds, the FDIC should have the authority to adjust premiums on all banks.

Increasing Coverage Limits

The question of deposit insurance coverage limits is a challenging one, in part because it is extremely easy for depositors to obtain full insurance of deposits in virtually unlimited amounts through multiple accounts. Along with most academic economists and other bank regulators, we are convinced that the sharp increase in the deposit insurance limit from $40,000 to $100,000 in 1980—at a time when the thrift industry was virtually insolvent—was a serious public policy mistake that increased moral hazard and contributed to the weakening of market discipline that exacerbated the banking and thrift crises of the 1980s and 1990s. By encouraging speculative behavior, it ultimately increased losses to the deposit insurance funds and taxpayers.

Proponents of an increase in coverage assert that it would ease liquidity pressures on small community banks and better enable small banks to compete with large institutions for deposits. None of these assertions, however, is supported by substantial evidence.

First, we see no compelling evidence that increased coverage levels would offer depositors substantial benefits. Anyone who wants to use insured bank deposits as a means of holding their wealth can do so today virtually without limits, subject only to the minor inconvenience of having to open accounts at multiple banks. Despite the ability of depositors to achieve almost unlimited coverage at banks, money market mutual funds, which have some of the same features as bank transactions accounts and generally offer higher returns than bank deposits, today hold over $2 trillion. Because these funds could easily be placed in insured accounts, these facts suggest that many depositors are not concerned about the

[1] In its August 2000, deposit insurance reform *Options Paper*, the FDIC reported that "the 5-year failure rate for CAMELS 2-rated institutions since 1984 was more than two-and-a-half times the failure rate for 1-rated institutions" (p. 13). As shown in chart 1 on page 12, the five-year failure rate for CAMELS 1-rated institutions (commercial and savings banks) was 0.7 percent, while that for CAMELS 2-rated institutions was 1.8 percent (www.fdic.gov/deposit/insurance/initiative/Options_080700m.pdf).

additional risk involved in holding their liquid funds in uninsured form and that households are comfortable with the *status quo*.

Second, it is not at all clear that increasing deposit insurance coverage would result in an increase in the deposits of the banking system. One effect could be to cause a shift in deposits among banks. It is far from clear that any such redistribution of existing deposits would favor community banks. Depositors who multiply insurance coverage today by using multiple banks might consolidate their deposits in a single institution if coverage were raised, but there is no way of determining which institutions would be the ultimate beneficiaries when the switching process ended. Moreover, it is quite possible that larger, more aggressive institutions might use the expanded coverage to offer even more extensive governmentally protected investment vehicles to wealthy customers. That could cause an even greater shift of deposits away from community banks and increase the liquidity pressures felt by some.

For many of the same reasons that we object to an increase in the general insurance limit, we are also concerned about proposals to use the federal deposit insurance system to favor particular classes of depositors such as municipal depositors. For instance, at year-end 2001, commercial banks had $162 billion in municipal deposits. The FDIC estimated in 1999 that less than one-third of municipal deposits was insured. Applying that 1999 ratio to the 2001 total suggests that nearly $115 billion of municipal deposits at banks are uninsured. A significant increase in the insurance limit for municipal deposits, therefore, would undoubtedly raise the level of insured deposits and put pressure on the DRR. In addition, an increase in insured coverage could spur riskier lending because banks would no longer be required to collateralize the municipal deposits with low-risk securities.

Merger of the BIF and the SAIF

One of the least controversial issues of deposit insurance reform is the merger of the BIF and the SAIF. The financial conditions of thrifts and banks have converged in recent years, as have the reserve ratios of the two funds, removing one of the primary objections to a merger of the funds. As of the fourth quarter of 2001, the reserve ratio of the BIF was 1.26 percent, while that of the SAIF was 1.37 percent. The reserve ratio of a combined fund would have been 1.29 percent as of the same date. As is described in greater detail below, many institutions now hold some deposits insured by each fund. But under the current structure, BIF and SAIF deposit insurance premiums could differ significantly depending on the relative performance of the two funds, raising the possibility that institutions with similar risks could pay very different insurance premiums. This would unfairly penalize low-risk institutions insured by the fund charging the higher premiums.

Despite the tendency for the activities of the banking and thrift industries to converge in recent years, substantial differences remain in their portfolio composition. For example, residential mortgage loans constitute 51 percent of the assets of insured savings institutions but only 15 percent of the assets of insured commercial banks. Largely because of these differences, merger of the two funds would result in significant diversification of risks.

A related development affecting the potential for diversification is industry consolidation, which has led to an increased concentration of insured deposits in a relatively few institutions and increased the risks to the deposit insurance funds. According to the FDIC staff, the three largest SAIF-insured institutions held over 15 percent of SAIF-insured deposits in 2001, while the corresponding share of the top three BIF-insured banks was over 13 percent. Merging the funds would reduce these concentrations, and thereby the risk that the failure of a few large institutions could seriously impair the insurance fund.

Further, there is significant overlap in the types of institutions insured by the two funds. As of March 2001, 874 banks and thrifts were members of one fund but also held deposits insured by the other fund, and BIF-member institutions held 41 percent of SAIF-insured deposits. Finally, merger of the BIF and the SAIF would undoubtedly result in operational savings as the two funds were combined into one.

Increased Flexibility for the Deposit Insurance Funds

The OCC supports giving the FDIC the authority to establish a range for the DRR to replace the present arbitrary fixed DRR of 1.25 percent. The FDIC should have the authority to set the range based on its assessment of the overall level of risk in the banking system. We also believe that in establishing the range the FDIC should provide notice and an opportunity for the public to comment on the proposed range. Adoption of a range and elimination of the 23 basis point "cliff effect" would allow the FDIC more flexibility in administering the premium structure and would minimize the likelihood of sharp increases in premiums during economic downturns when banks can least afford them.

When the funds exceed the upper boundary of the DRR range set by the FDIC, the FDIC should be authorized to pay rebates or grant credits against future premiums. To ensure that rebates or credits to insured institutions are equitable, the FDIC should have the authority to assess the nature of the institutions' claims on the funds. Institutions that have paid little or no insurance premiums to the funds have far less of a claim on rebates or credits than those that contributed to building up the funds.

While such rebates or credits seem reasonable on their face, there are two obvious principles that should be observed in determining their size and allocation. First, a system of rebates and credits should not undermine the risk-based premium system. Institutions that paid high insurance premiums because they posed a higher risk to the funds should not receive larger rebates than less risky institutions of the same size. The fact that these high-risk institutions did not fail during that period does not alter the fact that they subjected the funds to greater than average risks.

The second principle is that the payment of rebates and credits should not have the unintended consequence of exacerbating the disparity in supervisory fees that now exists between state and nationally chartered banks. Today, the FDIC charges the insurance funds for its costs of supervising state-chartered institutions. National banks, in contrast, pay the full cost of their supervision despite the fact that they have contributed almost 55 percent of the amount in the BIF. For example, in 2001, in addition to $400 million in assessments that national banks paid to the OCC for their own supervision, national banks can be viewed as contributing 55 percent, or about $273 million, of the $525 million that the FDIC spent on state nonmember bank supervision. Failure to take this into account in fashioning a rebate program would be unconscionable.

Fee Disparity

State banks, on average, pay only modest assessments to state regulators, which represent about 20 percent of the total costs of state bank supervision. Far and away the largest component of state bank supervision is that provided by their federal regulators—the Federal Reserve, in the case of state banks that are members of the Federal Reserve, and the FDIC, in the case of nonmember state banks. In 2001, the Federal Reserve and FDIC together spent over $900 million on state bank supervision. None of this was recovered directly from the banks they supervise. The FDIC absorbs the cost of its supervisory and regulatory activities through charging the BIF and SAIF, while the Federal Reserve uses its interest earnings to absorb its supervisory and regulatory costs. Neither the Federal Reserve nor the FDIC assesses state banks for their costs in providing exactly the same supervisory functions as the OCC provides for—and assesses—national banks. As a result of this subsidy provided by the Federal Reserve and the FDIC, there is a continuing incentive for national banks to convert to state charters. Indeed, state supervisors aggressively proselytize for such conversions, heavily exploiting fee disparity as a major part of their sales pitch.

It should be emphasized that fee disparity has no relationship to the relative efficiency of national and state bank supervision. It is entirely a consequence of the fact that state banks are not charged for the major portion of their supervision costs—that provided by their federal regulators. Indeed, the OCC has a strong externally imposed incentive to run its operations efficiently, for if it fails to do so, and must turn to its banks to pick up additional costs, it runs the risk of causing increased conversions of banks from national charters to state charters. Still, the effectiveness of supervision can suffer, and serious inequities can result, when unavoidable pressures on supervisors' budgets are created. For example, during the wave of large bank failures in the late 1980s and 1990s—a period of stress in the banking system that had not been seen since the Great Depression—significant resource demands were placed on bank supervisors in responding to severe problems in the banking system. Yet just as these demands were being felt, the banking system was under severe earnings pressure.

At the OCC this meant significant increases in direct assessments on national banks—14 percent in 1989, another 11 percent in 1991, and 30 percent in 1992. While there were reductions in assessments in subsequent years, one conclusion is inescapable: the OCC assessment mechanism works procyclically in times of stress in the banking system. At the Federal Reserve and the FDIC, similar cost increases were easily absorbed—at the FDIC out of insurance funds and at the Federal Reserve out of revenues that otherwise would have been paid over to the Treasury Department. In other words, the OCC faces the threat of reduced supervisory resources at the very time they are most likely to be needed. National banks face a higher burden of supervisory costs at the very time they are facing a troubled economy. Just as the need to address the 23 basis point "cliff effect" has gained attention, so also should the procyclical distortions raised by the present system of funding supervision.

The question, of course, is what to do about this disparity. Proposals to level the playing field by requiring the

Federal Reserve and the FDIC to impose new fees on state banks have been dead on arrival in Congress. We believe it is necessary to come up with a new method of funding bank supervision—a method that will strengthen both the state and the federal supervisory processes and ensure that all supervisors have adequate, predictable resources available to carry out effective supervisory programs without imposing additional fees on state banks.

Solution

There are a number of alternative approaches to solving this problem that one might consider, and we believe that now is the ideal time to do so, as the whole topic of the role of deposit insurance is being reexamined. An idea that we think has considerable appeal would draw on the earnings of the FDIC's insurance funds to cover the costs of both state and national bank supervision. Today, with the level of the combined funds at about $42 billion and generating earnings of around $2.5 billion per year, there are considerably more funds available to defray the costs of FDIC, OCC, and state supervision than those agencies today spend in total. Working together, and using the present costs of supervision as a baseline, state and federal supervisors could develop a nondiscretionary allocation formula that would reflect not only the breadth of responsibilities of the agencies, but the condition, risk profile, size, and operating environment of the banks they supervise. All agencies would remain free to impose supplemental assessments if they chose, but competitive pressures would presumably work to keep these charges at a minimum.

This arrangement would offer some meaningful advantages. First, it would remedy the inequity to national banks that exists today, resulting from the fact that the FDIC funds the supervision of only one class of banks, state nonmember banks, out of the earnings of the deposit insurance funds, to which all banks have contributed. As I mentioned earlier, we estimate that national banks have accounted for more than half of the contributions to the Bank Insurance Fund.

Another major advantage to a system under which the OCC and the state supervisory agencies would be funded out of the earnings on the insurance funds is that it would reinvigorate the dual banking system. It would create a regulatory system under which banks choose their charters on the basis of factors such as regulatory philosophy, access, and the perceived quality of supervision. The result would be competition based on characteristics of supervisors that are relevant to maintaining a safe and sound banking system.

Conclusion

The OCC supports a merger of the BIF and the SAIF and proposals to eliminate the current constraints on deposit insurance premiums. We favor elimination of the current fixed DRR (designated reserve ratio) and its replacement with a range that would allow the FDIC more flexibility in administering the deposit insurance premium structure. We oppose an increase in deposit insurance coverage limits at this time. Finally, as the entire role of deposit insurance is being subjected to scrutiny by policymakers and legislators, it is an opportune time to address the distortions and unfairness in the current system of funding bank supervision that I have highlighted in my testimony today.

Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the 38th Annual Conference on Bank Structure and Competition, on the growing consensus that fee disparity problem must be fixed, Chicago, Illinois, May 9, 2002

The independence of bank supervision is not likely to find its way on to the list of America's great contributions to popular government. But given what we increasingly know about the vital role that independent supervision plays in maintaining financial stability, it may be time for a new list. The importance of supervisory independence—and what we must do to *keep* U.S. supervision effective and independent—are the subjects I'd like to discuss with you this afternoon.

Certainly the subject has a long history. In 1829, when New York State legislators created the nation's first truly professional bank supervisory agency, they took steps to ensure that it would be able to operate free of political influences and pressures. So did the legislators who created the national banking system in the 1860s. They created the Office of the Comptroller of the Currency as a "separate bureau" within the Treasury Department. They provided the Comptroller with a five-year term and protections against premature removal from office. The first bill that passed Congress forbade the Comptroller's removal except with the approval of the Senate—an extraordinary requirement. But in amended legislation, that "advice and consent" requirement was dropped—not because of second thoughts about the importance of protecting the Comptroller's independence, but in recognition of the practical difficulty of reassembling a recessed Senate—in those days, the Senate was not in virtually continuous session, as it is today—to deal with a Comptroller whose conduct merited removal. Indeed, the Senate recognized "the force of the argument that [the Comptroller] ought to be in a great degree independent."

Congress even contemplated moving the OCC to New York or Philadelphia, so the Comptroller would not have to contend with the bleating and pleading of the lobbyist crowd. And the founders of the national banking system expressed their commitment to supervisory independence when they chose to fund the examination of national banks from fees and assessments on the banks themselves, rather than entangling the OCC's performance of bank supervision in the political give-and-take of the federal budget and appropriations process.

The legislative debate on the National Bank Act of 1864 may have been brief, but supervisory independence—and how best to safeguard it—was central to it. And the authors of that legislation took great pride in the success they believed they had achieved in promoting it.

It's important to note, moreover, that the independence of supervision is not simply an interesting bit of historical trivia. It has been reinforced repeatedly by Congress, even up to recent years. Within the past decade, for example, Congress has passed additional measures forbidding the Treasury Department from intervening in any matter or proceeding before the OCC, or from delaying or preventing the issuance of any rule or regulation by the OCC, and it has expressly permitted the agency to submit legislative recommendations and testimony to Congress without prior approval or review in the Executive Branch.

It's also important to note that this is not an issue of purely domestic relevance. Experience in other countries, where the tradition of supervisory independence may be weak or nonexistent, reminds us that there's a steep price to be paid when supervisors are unable or unwilling to conduct their business independently.

Indeed, the absence of supervisory independence has been implicated in almost every national financial crisis the world has recently seen. In Argentina, South Korea, Thailand, Japan, Turkey, and Indonesia, bank supervisors were unable to operate with the independence their responsibilities demanded. In each case, supervisors became instruments of government or central bank policies that subordinated the safety and soundness of financial institutions to other goals. In each case, banks were permitted—or even encouraged—to make loans in defiance of good credit practices in order to promote certain policy objectives, such as protecting inefficient industries. Moreover, in each case, the result was the same: supervision was discredited; the condition of the banking system deteriorated; the national economy suffered; and the process of recovery was seriously impeded by a crippled banking system. Some countries are still struggling with the consequences of such ill-advised supervisory policies.

These experiences help explain why, when the Basel Committee on Banking Supervision adopted its core principles for effective supervision in 1997, "operational independence and adequate resources" headed the list. And the experiences of other countries remind us of the importance of vigilance in defending supervisory independence here at home.

Supervisory independence in this country has also seen its share of challenges. During the Great Depression of the 1930s, for example, there was strong sentiment that federal bank supervisors should align themselves behind the monetary and macroeconomic policies of the Treasury Department and the Federal Reserve. Many people thought that the Comptroller of the Currency should encourage national banks to make loans to good borrowers and bad borrowers alike, and to look the other way as credit quality deteriorated. This view was frequently expressed in terms of countercyclicality—that bank examiners ought to promote the cause of growth and easy credit when the economy was in a slump and enforce credit restraint when the economy was in danger of overheating.

Fortunately, the firewalls erected by Congress in the 1860s and buttressed over the years thereafter held strong during the banking crisis of the Great Depression. The OCC was able to continue supervising national banks objectively and independently, and the banking system subsequently regained its strength.

That experience was not lost on a generation of bank supervisors, who came away convinced that combining monetary policy and supervision would undermine both. For people like J.L. Robertson, who served as a bank supervisor for 30 years, first as a deputy comptroller of the currency and then as a governor of the Federal Reserve System, it became an article of faith that "bank examiners should never be obliged to switch from rose-colored glasses to black ones, and bank and forth again, in an effort to implement the monetary policy of the moment."

However, the notion that federal bank examiners might be pressed into service of some larger political or economic agenda lived on—and it lives on today, after a fashion. For evidence one need look no further than the introduction to our own conference program, where, sure enough, you'll find the question whether "regulation and supervision [should] attempt to smooth the business cycle" on the list of current supervisory issues.

I believe it's a matter of considerable significance, however, that while we may still debate the idea of using bank supervision as a macroeconomic tool in forums like this one, the question has essentially been laid to rest in government circles. Indeed, it has never come up in any official discussion in which I have participated, either as Under Secretary of the Treasury for Domestic Finance or as Comptroller of the Currency. The statutory constraints that limit the ability of Treasury to become involved in matters at the OCC have been well understood and scrupulously respected during my experience in the Department. As a practical matter, I believe, the principle of operational independence for bank supervisors in this country is no longer open to question.

There's another dimension of supervisory independence—independence from the institutions we supervise. In this regard, the chartering and regulatory choices available to U.S. banks—the dual banking system and the tripartite division of federal regulatory responsibility—create certain tensions. The problem was highlighted over 30 years ago by Federal Reserve Chairman Arthur Burns, who decried what he saw as a dangerous "competition in laxity," not only between state and national bank supervisors, but among the various federal regulators as well, each having an incentive to pursue supervisory and regulatory strategies that would attract constituents to their particular jurisdictions.

In the game of regulatory competition, a gain to one supervisor usually means a loss to another, with varying consequences. While it is true, for example, that a wholesale exodus of banks away from the national charter could decimate the OCC, a threat equally if not more imposing might face the Federal Reserve System if there were to be a wholesale exodus away from state member status. In such an event the Federal Reserve Banks—already facing competitive pressures in other aspects of their operations—could face the need to downsize significantly their role in supervision. Not only would this have implications for the Fed's monetary policy and discount window functions, but, as the Reserve Banks were forced to shrink and become less substantial participants in the financial system, it would have implications for an important foundation stone of the Fed's independence.

We have been willing for many years, in the name of federalism, to accept whatever implications the mere existence of the dual banking system might have for supervisory independence, and I am a supporter of the dual system. But there is an aspect of the dual system—the way in which the costs of supervision are allocated—that presents an even greater threat to the independence of bank supervisors than dual banking in and of itself—a threat that has disproportionately serious implications for the OCC.

No one would ever accuse the United States of not taking literally the Basel principle that bank supervisors should have adequate resources at their disposal. In 2001, the total of supervisory expenditures in this country amounted to nearly two *billion* dollars—a substantial sum by any standard. That covers the supervisory expenses of the OCC (for national banks), the Federal Reserve (for bank holding companies and state member banks), and FDIC (for state nonmembers), as well as the expenses of the 50 state banking authorities.

It's how we raise and allocate that vast sum that introduces irrationality into our system, that potentially undermines its safety and soundness, and that destabilizes our dual banking system. There's nothing terribly complicated about it. National banks must bear the entire cost of their supervision, in the form of assessments paid to the OCC. State banks, by contrast, receive the federal portion of their supervision—far and away the largest component of state bank supervision—at no cost.

To be sure, state banks pay relatively modest fees to their state supervisors, reflecting the comparatively modest role that many states play in the supervision of federally insured state banks, compared to the pervasive roles played by the Fed and the FDIC. As a consequence, national banks pay on average two and a quarter times more in supervisory fees than do state banks. While national banks fully shoulder their costs of supervision, state banks pay only about 22 percent of the costs of their supervision.

That's not all. National banks actually subsidize the supervision of their state-chartered competitors. The FDIC draws on the insurance fund to cover the expenses of supervising state nonmember banks, yet 55 percent of the balance in the fund reflects insurance premiums paid by national banks. Thus, 55 percent of the subsidy that the FDIC affords state banks by absorbing their cost of supervision is, in effect, provided by national banks. A similar subsidy is delivered by the Federal Reserve to state member banks, since the costs of Fed supervision are not passed on to the banks they supervise. In this case, however, it is taxpayers that bear the cost of the subsidy, since the funds that the Federal Reserve draws on to absorb the costs of supervision would otherwise be returned to the Treasury.

Operating in tandem, the freedom that banks have to choose a state or national charter and to choose their federal regulator, *and* the disparity in the allocation of the costs of supervision caused by the federal subsidization of state banks, create a system in which financial institutions have a potential influence in their relationships with their supervisors.

This influence can be exercised overtly or tacitly—and, I hasten to say, it is not an influence that may be directed only at the OCC. Fee disparity simply becomes a cost factor for banks to weigh in the balance. If a bank feels "oppressed" by the OCC to the point that the combined cost of the higher fees and the supervisory "oppression" outweigh the advantages of the national charter, the bank has an incentive to convert. By the same token, if a state bank feels "oppressed," either because state law or its federal regulator limits its flexibility to conduct its business in the manner it desires, the incremental cost of higher assessments might be outweighed by the appeal of the national charter.

Fee disparity can have a particularly insidious impact on the OCC, however, because, unlike our self-funded sister agencies, we must tax our bankers to maintain our agency. Thus, to the extent fee disparity encourages conversions to state charter, there is a direct impact on the OCC's budget. In times of severe stress in the economy, this impact could have serious consequences. As a deteriorating economy translated into increased problems for banks, supervisors would be confronted with the need to expand their resources to cope with worsening conditions. At the OCC this would likely create a need for increased assessments—with a commensurate increase in the financial burden on national banks. Those national banks in the best condition, facing the prospect of larger assessments needed to deal with problem institutions, would thus have a strong incentive to convert to the subsidized state charter, leaving a diminishing number of national banks to bear the costs of an increasing OCC workload. And of course such conversions do not change at all the systemic costs of supervision, since the agencies assuming jurisdiction must pick up the costs of expanding their own supervisory resources to deal with the converted banks. Conversions thus simply transfer those costs from the national banks to either taxpayers generally or to all insured banks. The implications for the independence of the OCC in such a scenario are self-evident, I believe.

I'm encouraged to see that there's a growing understanding of these issues, and a consensus that the problems I've been discussing are problems that must be fixed. The question, of course, is how we should do that. Any solution we propose must meet several basic criteria. First and foremost, it should protect and preserve the independence of bank supervisors. It must also make our system of supervisory funding fairer, more secure, and more predictable. National banks should not be forced to subsidize their state-chartered competitors and taxpayers should not be expected to defray the cost of supervising one favored class of banks, as is now the case with state member banks that receive free supervision from the Federal Reserve.

Both state supervisors and the OCC must be freed from the uncertainty that currently surrounds their funding. At present, we are subject not only to fluctuations in the economy, but to changes in the structure of the banking system. Declining on-balance sheet assets mean declining revenues. And industry consolidation means an increasing reliance on a shrinking number of institutions. In half the states, a single bank accounts for 25 percent or more of the asset base on which state supervisors assess fees. The loss of such a large bank, through either failure or conversion, could have a crippling effect on a state supervisor's ability to provide quality supervision. Of course, the OCC could find itself in the same fix.

One suggestion made recently was that the OCC's funding concerns should be addressed through the use of appropriated funds. But if this means subjecting the supervision of national banks to the budget and appropriations process, it would clearly be a step in the wrong direction.

As I described earlier, since the very inception of the national banking system Congress has scrupulously insulated bank supervision from the political process—just as it has the formulation and execution of monetary policy. Injecting political considerations into supervision through the appropriations process would clearly run the risk of bringing to bear pressures that could undermine the objectivity and integrity of the critically important work that supervisors perform, and would make the direction and strength of supervision subject to the varying priorities of partisan politics. That would be no more desirable in the area of bank supervision than in respect of monetary policy.

Certainly, if there were any serious case for subjecting bank supervision to the kind of political oversight involved in the budget and appropriations process—and I see none whatsoever—it would be impossible to rationalize treating *only* national banks in this fashion, while leaving federal supervision of state banks to be self-funded through the use of the Federal Reserve's earnings and the FDIC insurance fund, with no outside oversight whatsoever.

Of course, the funding of supervision could be rationalized in the context of legislation reforming the entire structure of federal supervision of financial institutions—a challenge that has repeatedly been taken up over the past three or four decades. Experience in the United Kingdom and other countries that have altered their supervisory structures suggests that serious structural change is not an impossible goal. Nonetheless, past efforts in the United States have foundered for at least four reasons:

- First, the states have always felt that if there were a monolithic federal regulator for all banks, the attractiveness of the state charter would diminish. Now state banks can choose between the Fed and the FDIC as their federal regulator, or they can choose to go to a national charter. Those options would be lost under any proposal that sought to unify supervision.

- Second, a key element of past proposals has generally been to take the Fed out of bank supervision. This aspect of restructuring has had to confront two major objections: the explicit objection that removing the Fed from supervision would deprive it of a "window into the banking system," and thus impair its effectiveness in implementing monetary policy; and the implicit objection that taking the Fed out of supervision would decimate the Reserve Banks and thus undermine an important pillar of the Fed's independence.

- Third, there has never been any appreciable public constituency for such change. The banking industry and other interest groups have learned to live with—and take advantage of—the existing system, and they have not been anxious to change things. One does not even hear a clamor from public interest or consumer groups for such change.

- Finally, as illogical as it might be, the present system works pretty well, and enhanced cooperation and coordination in recent years has made it work even better.

While the challenge of addressing the funding problem in the context of regulatory restructuring is a formidable one, there are alternative approaches that should be considered—measured steps targeted to the problem that would avoid the difficulties presented by more far-reaching proposals to dismantle and reassemble the current supervisory structure.

I have proposed that we replace the system under which the OCC and state supervisors fund themselves through direct assessments, with a system that would draw on the earnings of the insurance fund. Such an approach would have multiple advantages:

- First, it would be supremely logical. After all, protection of the insurance fund is a major purpose of bank supervision. Charging the costs of supervision to the fund would place supervision on a sounder and fairer footing, relieving national banks of the unique and discriminatory burden of directly funding the costs of their own supervision—and of the grossly unfair burden of subsidizing the cost of supervision of their state bank competitors.

- Second, it would promote the equitable and efficient allocation of the costs and benefits of deposit insurance, and ensure that all supervisors have the resources necessary to provide effective bank supervision, regardless of changes in the economy or the structure of the banking system.

- Finally, it would revitalize the dual banking system by eliminating the distorting effects of a selective subsidy, while retaining the element of charter choice that has long been its hallmark.

Under our proposal, federal and state agencies would jointly formulate an allocation formula initially calibrated to provide the OCC and state agencies with resources equivalent to their current levels. This "baseline" allocation would be adjusted annually under the formula to take account of changes in the composition and condition of each agency's constituent banks, so that allocations from the fund would be automatic and nondiscretionary. The great benefit of this proposal is that it would significantly reduce, if not eliminate, reliance on the federal subsidy to state banks as a major determinant of charter choice. Banks would then make charter decisions based on such considerations as the quality of supervision and the suitability of the charter for their business objectives—a far healthier environment for the dual banking system than at present. It would provide the basis for restoration of salutary competition among the regulators—a "competition in excellence," that would restore the focus to the qualitative aspects of charter choice, rather than competition based on subsidized pricing.

There are some who believe that the national charter is so far superior to the state charter that an equitable allocation of the costs of supervision would result in a massive outflow of banks from state systems, and on this ground they oppose our suggested solution. But while I bow to no one in my enthusiasm for the national charter, the state charter has significant attributes of its own. Many states have been very innovative in granting powers to their banks that national banks do not yet have, and many states have adopted "wild card" laws that allow their banks to exercise many powers permissible for national banks. No comparable "reverse wild card" law affords reciprocal benefits for national banks. In the area of interstate branching, state supervisors have been very resourceful in reducing the burdens of duplicative regulation on banks operating in multiple states, and Congress has enacted "equalization" provisions giving state banks with interstate branches many of the benefits that national banks have in that connection.

Whatever one's view might be of the relative merits of the two charters, however, I think it's fair to say that the state charter is not in such a state of decrepitude that it needs almost a billion dollars a year in federal subsidies to shore it up—particularly subsidies that are delivered not pursuant to congressional mandate, but through the discretionary decisions of those federal regulators who have a self-interest in maintaining these banks as their constituents. If, indeed, an elimination of these subsidies would result in a major outflow of state banks to the national charter, we should all be alarmed, and we should focus on more fundamental concerns about state systems. Similarly, maintenance of a subsidy that is intended to protect the role of the Federal Reserve Banks in supervision diverts attention from what may be more significant structural issues in the Federal Reserve System. If there *is* reason to have such concerns, we should address them more forthrightly, and we should not obscure them with subsidy practices that have the purpose or effect of maintaining a particular regulatory share of market.

But I do not for a minute think that elimination of the subsidy would cause an exodus of state banks. Supervisory costs are naturally a concern for all banks, but I don't believe that major banking organizations make their charter choice simply on the basis of supervisory fees. I see no reason, to put a somewhat finer point on it, why the Federal Reserve should be concerned that its perfectly legitimate interest in being meaningfully involved with the banking system would be undermined if the discriminatory cost burden now borne by national banks were eliminated.

When we began to talk about the fee disparity issue in public nearly two years ago, it was the target of a fair amount of derision. Predictably, those who derided it most were many of the same people who were benefiting most from the subsidies I've been discussing.

Now I think it's widely acknowledged that we do need to revisit the way we fund bank supervision. But the changes needn't—and shouldn't—be radical ones. Ungainly though it is, our system of supervision has been too successful to scuttle. Indeed, our goal should be to strengthen our supervisory system by preserving and enhancing independence.

I believe that the proposal I have sketched today meets that standard. I commend it to your attention—and look forward to continuing the dialogue well under way with everyone who has a stake in the issue.

Remarks by Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, before the Local Initiatives Support Corporation annual staff conference, on the beneficial relationships between banks and community development corporations, Cleveland, Ohio, April 10, 2002

Thank you very much for inviting me to address Local Initiatives Support Corporation's (LISC's) national staff conference. I am honored to be here and I am delighted to have the opportunity to talk about the important role of community development corporations today, particularly the mutually beneficial relationships being forged between banks and community development corporations (CDCs). LISC has been instrumental in structuring many of these relationships, which hold great promise for economic revitalization of communities across the country. And I particularly want to congratulate all of you here today for the enormously important—and sometimes unrecognized—work that each of you do to foster community revitalization. You give hope to individuals who have been left on the shore of our economic mainstream.

Also, before I begin, I want to again thank Michael Rubinger, Buzz Roberts, and Oramenta Newsome for organizing a fascinating community development tour for Comptroller of the Currency Jerry Hawke, myself, and other OCC staff in Washington, D.C., in October 2000. On many occasions after that, we have reflected on, and spoken about, what we learned during that tour.

I don't have to tell you that LISC has long been a leader in the community development field. If only for its national scope and for the resources it brings to bear, LISC exerts much influence over the efforts of numerous community development corporations—CDCs—operating at the local level. But even more than these formidable assets, LISC's professional standards, expertise, and its day-to-day operating policies and practices are examples that local CDCs emulate and rely upon.

I thought it would be timely to discuss three topics with you today. First, since I am, after all, a *bank* regulator, I will review some perspectives on the mutually beneficial relationships that *banks* have developed with CDCs. Second, I will discuss some of the challenges we see CDCs facing in their relationships with banks, especially with regard to performance measures for the industry. Finally, I'll offer some thoughts about the new initiatives that CDCs and banks may be able to develop, such as through the New Markets Tax Credit Program.

Bank and CDC Partnerships

Over the past several years, we have seen a significant increase in the level of bank involvement with CDCs. The National Community Capital Association reports that bank investments as a proportion of CDFI-borrowed capital dollars more than doubled from 12 percent to 25 percent between 1994 and 2000. We at the OCC have seen large increases in bank investments under our Part 24 community development investment authority, which allows national banks to make equity investments in CDCs, community development projects, and other public welfare activities. National banks made more than $5 billion of Part 24 investments since 1995, almost 10 times more than the amount invested during the previous 30 years since Part 24 was established.

Much of this growth has occurred through bank investments in Low Income Housing Tax Credit projects with nonprofit sponsors, such as those planned and assisted by many of you here today. LISC has an impressive track record in this area, having raised some $3 billion in Housing Tax Credit investments—over three quarters of which has come from banks.

Banks have found that these types of investments and their relationships with CDCs can dramatically further their own ability to provide a presence in targeted segments of their markets, especially segments in which banks are underrepresented. Working with CDCs, banks find lending opportunities in these areas and bring needed capital to small business expansion, affordable housing development, and social services facilities. CDCs can help evaluate the repayment ability of the borrowers and also leverage bank investments with public and philanthropic funding in order to assemble the funding mix needed for these projects. Because of their mission, CDCs provide the resources and personnel to do the necessary work to make these projects work. In fact, CDCs often bring "the deal" to the bank.

In 2000, the OCC issued the results of a survey aimed at determining the practices that contribute to banks' community development success in the housing and small business sectors. We found that community development efforts are most likely to succeed when they are supported by multi-pronged partnerships of local governments, community organizations, philanthropic and religious groups, businesses, and other relevant stakeholders in the community.

Driving factors for bank participation exist when a CDC partner does an effective job of screening deals to bring good ones to the table, and when the CDC works with potential borrowers to devise business plans and credit proposals that meet banks' underwriting requirements. This helps banks reduce transaction costs and allows the bank to deploy its own personnel and resources in the most effective manner.

Our study also found that CDCs often play a key role, not only as project managers, but also as intermediaries and facilitators, making them valuable partners for banks. For example, many CDCs provide basic financial literacy education that can help the unbanked build relationships with traditional financial institutions. CDCs have been particularly effective at tailoring these educational programs to the needs and interests of specific groups within their communities. CDCs also provide pre- and post-purchase counseling for homebuyers. This counseling may be the best way to minimize default risk, or, quite simply, keep people in their homes. CDCs provide similar counseling to entrepreneurs who have taken out loans to start or expand a small business.

In addition to the project management role which CDCs play in many affordable housing developments financed by Low-Income Housing Tax Credits, CDCs increasingly also provide a range of social services for residents including day care, after-school programs, and job training resources. These services help enable residents of these developments to find an affordable place to live and provide support mechanisms to help them find ways to increase their income. This can increase the likelihood for success of affordable multifamily developments in certain markets.

Of course, the ability of CDCs to pull together complex financing packages, with funding from a number of third-party sources, is legendary. This skill is especially appreciated by small and mid-size banks that may have less experience with the complexities of community development financing. And even the largest banks recognize the benefit of the specialized expertise that CDCs can bring to structuring the multi-part financing packages that some projects require. As a result of this technical financing knowledge, CDCs can find new opportunities for banks to participate in projects, either as lenders or investors, that banks would not have been able to arrange on their own. By designing innovative financing structures, CDCs are able to involve banks in funding projects such as shopping centers, charter schools, small business incubators, or commercial office space. Banks are able to participate in capacities that make sense for them from a business and community reinvestment perspective, local community development needs are served, and, by improving the local environment and economy, banks may gain new customers and new markets.

Challenges in a Changing Economic Landscape

Yet, today the community development industry faces important challenges that arise from changes in the broader environment in which they operate. Among these changes are the shrinking and consolidation of the banking industry. Many CDCs have come to depend a great deal on banks for operating funding as well as for loans and investments, but its seems inevitable that in the future CDCs will have fewer banks to rely on for funding. Moreover, in economic downturns, as profit margins are squeezed, at least some of those remaining banks will be forced to trim their community development grant budgets. These factors bear directly on the future health of the CDC industry.

On the other hand, the federal government is changing its funding strategies in ways that favor continuing support for CDCs. Federal set-asides for nonprofits in HOME (HOME Investment Partnerships Program) funding and Low-Income Housing Tax Credits, for example, provide critical operating and project support to CDCs. And the New Markets Tax Credit is likely to spur the development of more Community Development Entities. Indeed, the authorizing legislation calls for their creation. But none of these federal programs is designed to be the sole source of funding for CDCs. All leverage private money, which frequently comes from banks. This leads to some thoughts on factors that banks are likely to view as significant as they evaluate potential CDC relationships.

Evaluating CDCs

In a landscape where there may be fewer private sector investors to turn to, the CDCs with the soundest fundamental elements are the ones most likely to survive and to continue developing fruitful community development partnerships. Quantifying the soundness of a particular CDC is already an exercise many banks undertake when evaluating their CDC partnerships. As the supervisor of national banks that lend to and invest in these entities, we have an interest in mechanisms and initiatives that enhance the performance of CDCs and enable banks to evaluate CDCs' performance.

The primary mission of my agency, the OCC, is to ensure a safe, sound, and competitive banking system that supports the *citizens, communities, and economy* of the United States. There are many facets of what bank supervision encompasses, but at its core, effective oversight of banks has to rely in large measure on the ability of banks themselves to establish effective systems for monitoring the risks and returns associated with their various lines of business. For example, we mandate that banks develop systems to monitor the quality of their loans. So, regardless of the line of business—from traditional lending to the most sophisticated capital markets activities—we make it clear to the banks we supervise that they must have systems and controls in place, appropriate to the size and complexity of their business, that enable them to monitor, measure and manage their activities.

The ground rules are no different for banks' partnerships with CDCs. Banks need information to be able to monitor, measure, and manage their loans to and investments in CDCs. Loans should be repaid, investments should generate returns, and grants should improve conditions in the markets in which the bank operates. We ask our banks to perform due diligence on all their investments, including ones in CDCs, because we want our banks to achieve successful results in their community development activities, just as in their other endeavors.

Banks can assess potential partnerships with CDCs more easily when the CDCs themselves have already instituted performance standards and measures. I recognize that measuring results is a challenge in many industries, and this is particularly true for CDCs. The traditional measures of dollars invested and units of housing built provide some sense of a CDC's capacity, but further measures are needed for investors to assess, for example, how well CDCs manage themselves and how their work affects the quality of life in their communities. Banks need to know that sound fundamentals back their business decisions—and investments in CDCs are not an exception to that rule. When you consider that a Housing Tax Credit investment normally remains on the bank's books for 15 years, banks need to be confident that their CDC partners have the staying power to manage the asset through to maturity.

It is those CDCs who have sound fundamental operating procedures, who have proven themselves to be insightful managers of their internal organizations as well as their external products and services, that will be sought out by banks. So, what are some of the "sound fundamental elements" that intermediaries such as LISC can help promote?

- ***Demonstrable results***. Measurable outcomes and careful tracking allow CDC boards and management to make decisions about which programs to pursue and what changes to make, and it allows them to assess the success of the CDC's overall efforts. These same measures help successful CDCs communicate their accomplishments to their financial institution partners, funders, policymakers, and to the public at large. This is *particularly* important to banks and thrifts, which must demonstrate to their regulators how CDC activities they have financed serve the needs of communities within their assessment areas under CRA. CDCs that are able to assemble geographic, income, and demographic data regarding the beneficiaries of their activities can provide bank partners with the information that bank regulators need to review as part of CRA compliance examinations. To the extent that this helps banks document their CRA performance, the more likely that CDCs that can provide such information will be sought after by additional banking industry partners.

- ***Sound financial management***. On the most basic level, CDCs must have accurate and timely financial information and effective financial management systems that will allow boards of directors and management to make sound, well-informed decisions. CDCs manage important, often scarce, resources in low-income communities. Careful stewardship of these resources is a public trust.

- ***Talented staff.*** The effectiveness of CDCs depends in great part on their staffs. Many talented people who come to the community development field do so because they are committed to the mission of CDCs. Planning for the succession of these talented and accomplished people ought to be high on the priority lists of CDCs and their boards of directors.

- ***Watchful, thoughtful boards of directors.*** Whether it be a bank or CDC, organizations involved with the complexities of community and real estate development need boards of directors embodying a diversity of talent and points of view—and enough relevant expertise to effectively serve their function as overseers of the organization's management. And while continuity among board members provides needed stability to such an organization, continuity must be leavened with periodic infusions of new blood to bring in new energy and new ideas.

- ***Operational integrity.*** CDC managers and directors owe duties of care and loyalty to the organization they serve—just as do managers and directors of banks. This means they must undertake their functions with care and diligence and execute their duties with undivided loyalty to the interests of their organization. In practice, CDCs should have written policies, which are carefully monitored, covering potential trouble areas such as conflicts of interest, board member compensation, and hiring or contracting with relatives. These policies help to ensure that the organization is not inappropriately used by the employees or directors as a source of private gain. Failure to comply with duties of care and loyalty can result in unfavorable consequences ranging from negative news reports, to financial penalties under recently enacted tax laws, and could even jeopardize an organization's federal tax exemption. The good name and reputation of any nonprofit organization is a priceless asset, on which its future may hinge. It should be safeguarded with the same vigor as the organization's financial assets.

A challenge facing the CDC industry is for more CDCs to systematically incorporate the fundamentals I have just described in their planning and operations. In this regard, the work of the National Community Development Initiative (NCDI) to promote capacity building and accountability within the CDC industry has advanced the industry significantly. As you know, NCDI combines the funding of corporations, foundations, and the Department of Housing and Urban Development and channels these monies to LISC and the Enterprise Foundation to leverage CDC activities at the local level. LISC makes these funds available through its Operating Support Collaboratives, which provide financial support for capacity building, strategy development, technical assistance, and training. The Operating Support Collaboratives also help the CDCs identify organizational strengths and weaknesses, and the receipt of these monies are usually made contingent upon the CDC's achievement of mutually agreed-upon performance objectives.

In 1998, the Urban Institute studied the activities of CDCs in the 23 cities participating in the NCDI and found CDC capacity growing strongly by a number of measures. Capacity is important to investors because it enables CDCs to have a greater impact, thereby generating greater return on their investments. The number of CDCs capable of producing more than 10 housing units per year grew from 104 in 1991 to 184 in 1997. The study also found that the NCDI helped produce a 45 percent increase in the number of "top tier" CDCs with consistent production records, strong internal management, and diverse funding sources.

The Urban Institute cited the clear articulation of performance standards as a key driver of the NCDI's success. Naturally, performance standards backed by a track record of results create a degree of comfort for banking partners and their regulators. NCDI and LISC's Operating Support Collaboratives do not automatically fund every CDC nor allow the funding to be seen as an entitlement. Funding is not renewed to organizations that do not show progress in meeting standards, and disbursement of funds can be held until CDCs are able to show progress in key areas. Because of the program's effectiveness, LISC and Enterprise have been able to raise more than $350 million from foundations, banks, corporations, and the federal government under the National Community Development Initiative over the past 11 years.

I understand that through LISC's capacity-building work with the Operating Support Collaboratives, you have developed a new CDC performance assessment tool—*Cap*Map—a capacity mapping approach that is being rolled-out at this conference. *Cap*Map has been designed to help CDCs create and track measures of success and also plan for growth based on their operating capabilities. I am particularly intrigued by the prospects for this tool that would allow for a more consistent set of criteria to be used in assessing capacity of CDCs across the country on critical success factors. *Cap*Map will be a true success if it can help a CDC more clearly chart its current stage of organizational capacity and what milestones it must achieve to realistically undertake further growth.

New Initiatives

So what does the future hold for the continued relationships between banks and CDCs? I am probably preaching to the choir when I say that I believe the next frontier lies in the extension of the successful partnerships we have seen in using housing tax credits to ones that will use the New Markets Tax Credit. You can successfully build homes and apartments in distressed communities, but if you are not able to change the surrounding neighborhood, your efforts will have fallen short.

As the Low Income Housing Tax Credit addressed the equity gap needed to develop affordable housing, we hope the New Markets Tax Credit will encourage capital to flow to businesses and other ventures in low-income areas. The New Markets Tax Credit will provide $15 billion over the next six years to promote investment in low-income areas, by allocating tax credits in support of for-profit enterprise development in low-income communities. Over the life of a seven-year investment, investors will be able to realize a tax credit equal to 39 percent of the amount that they have invested. To be eligible for an allocation of tax credits, an entity must obtain certification as a Community Development Entity (CDE) from the Department of the Treasury's CDFI Fund. The certification process entails providing a clear explanation of its business plan for making investments in targeted communities. By increasing their capital base, this tax credit will enable CDEs to lend and invest more, to attract additional outside capital, and to bring even more private-sector engagement to their market-priming activities.

The CDFI Fund has reported that it hopes to determine the awarding of allocations by the close of this calendar year. From our initial discussions with banks, many intend to be investors in New Markets Tax Credits. I hope to see LISC and its affiliates as active users of this new investment tool.

Conclusion

Today I've discussed the types of productive partnerships that CDCs and banks have established, shared some thoughts on challenges facing the CDC industry in order to continue its effectiveness in the years ahead, and I've described the potential that the New Markets Tax Credits provide. While most of the work that will determine continued success will occur at the individual CDC level, intermediaries such as LISC are playing a crucial role in maximizing the impact of bank/CDC partnerships in our communities. Your work is important not only through funding CDCs, but also by your efforts providing information and promoting best practices that are building a solid base for success for CDCs in the future.

Thank you, and I truly look forward to seeing more of the fruits of your good work.

Interpretations—April 1 to June 30, 2002

Interpretive Letters

930—March 11, 2002

12 CFR 1

Subject: Legal Permissibility of Purchasing Bonds Convertible into Equity

Dear [ ]:

This letter addresses whether the *[State1]* federal branch of [ ] (bank) legally purchased bonds convertible into equity. The purchase of the bonds was legally permissible under its Part 1 investment authority if the analysis the branch undertook at the time supported its conclusion that the bonds were the credit equivalent of investment grade and marketable, or if at the time it purchased the bonds, it underwrote them as loans in accordance with the standards of OCC Banking Circular 181.[1] In either case, the branch's examiner-in-charge (EIC) or the appropriate supervisory office must find the branch's conclusion or analysis to be sufficient, as documented by the branch prior to the purchase.

I. Background

In September 2000, the bank and its *[State1]* and *[State2]* federal branches (the branches) engaged in three interrelated transactions: the purchase of bonds convertible into equity, an interest rate swap, and the sale of a call option on the bonds (collectively, the "transactions"). This letter focuses on the bond purchase made by the *[State1]* branch (branch).

A. The Transactions

The transactions comprise a callable asset swap. An asset swap is a synthetic structure that enables an investor to purchase a fixed rate bond and hedge the interest rate risk by swapping the fixed rate payments for floating rate payments using an interest rate swap. The swap converts the asset yield on the bonds from fixed to floating. The sale of the call option enhances the yield. The asset swap is "callable" where, as here, the investor sells call options on the bond and the exercise of the options terminate the swap.

The callable asset swap is described in detail below.

(1) The Bonds

[SPV], a Special Purpose Vehicle, issued $550 million in seven-year Eurobonds, convertible after 12 months, at the option of the purchaser, into 8.708 million shares of *[Co]* stock *("[SPV]* bonds"). The *[SPV]* bonds are Eurodollar bonds quoted daily in the market. The convertible *[SPV]* bonds bear a coupon rate of 4.75 percent. *[Co2]* wholly owns *[SPV]* and guarantees the outstanding principal and accrued interest on the bonds. The bank and the branches purchased $15 million of *[SPV]* bonds. The *[SPV]* bonds have embedded call options that give *[SPV]* the right to call the bonds. The bonds are not rated.

(2) The Interest Rate Swap

Simultaneously with the purchase of the *[SPV]* bonds, the bank and its branches entered into an interest rate swap with *[Co3]*. Under the interest rate swap, the bank and the branches pay *[Co3]* the fixed rate of 4.75 percent, the coupon rate of the bonds, semiannually. In return, *[Co3]* agreed to pay the bank a floating rate of LIBOR[2] plus a spread of 165 basis points, quarterly. The swap terminates in seven years or when the *[SPV]* bonds are called by *[SPV],* or upon *[Co3]'s* exercise of call options it purchased from the bank and the branches (described below). The bank and the branches secured their obligations under the swap by pledging the *[SPV]* bonds to *[Co3].*

(3) The Call Options

The bank and the branches, in connection with the purchase of the *[SPV]* bonds and the interest rate swap, each sold a seven-year call option on the bonds to *[Co3]*. *[Co3]'s* exercise of the options entitles *[Co3]* to purchase all the *[SPV]* bonds purchased by the bank and its branches at a predetermined "strike price." If the *[SPV]* bonds are called, exchanged or redeemed under the terms of the bonds, *[Co3]* is deemed to have exercised its call options and the swap terminates. Under the options' terms,

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[1] The OCC requires banks to implement "satisfactory controls" over loans, including: [1] written lending policies and procedures governing those transactions; [2] an independent analysis of credit quality by the purchasing bank; [3] agreement by the obligor to make full credit information available to the selling bank; [4] agreement by the selling bank to provide available information on the obligor to the purchaser; and [5] written documentation of recourse arrangements outlining the rights and obligations of each party. OCC Banking Circular No. 181 (Rev.) (August 2, 1984) (BC–181).

[2] "LIBOR" refers to the London Inter Bank Offered Rate, an interest rate that major international banks charge each other for large loans of dollars outside of the United States.

the bank and its branches are prohibited from converting the *[SPV]* bonds into *[Co]* stock while the transactions remain outstanding.

B. Analysis of the Transactions

As discussed in section II of this letter, a national bank may purchase debt securities as investment securities if the bonds are the credit equivalent of investment grade and marketable. The EIC must be satisfied that the information contained in the credit file demonstrates, at the time of the bond's purchase, appropriate support for the branch to treat the bonds as the credit equivalent of investment grade and marketable.

Here, the bank and the branch analyzed the *[SPV]* bonds in connection with the interest rate asset swap and call option, prior to the purchase of the bonds.[3] The bank and the branch approved the bond purchase based on *[Co2]'s* (the guarantor's) bond guarantee,[4] financial strength, and good market reputation and the convertibility of the *[SPV]* bonds into *[Co]* stock. Based on their financial review, the bank and the branches assigned the transactions an internal rating of 3, equivalent to a long term debt rating of "A," prior to the purchase of the bonds. The bonds were also quoted daily in the market.

II. Applicable Law

A. Permissible Purchases of Debt Securities

National banks may purchase "investment securities" for their own account in an amount that generally may not exceed 10 percent of the bank's capital and surplus.[5] "Investment securities" are "marketable obligations, evidencing the indebtedness of any person, copartnership, association, or corporation in the form of bonds, notes and/or debentures, commonly known as 'investment securities.'" An "investment security" is "a marketable debt obligation that is not predominantly speculative in nature."[6]

To qualify as a Type III security, a bond must be rated investment grade or, if not rated, the credit equivalent of investment grade, and marketable.[7] "Investment grade" means a security that is rated in one of the four highest rating categories by two or more nationally recognized statistical rating organizations (NRSROs) or by one NRSRO if the security is rated only by one NRSRO.[8] A security is the credit equivalent of a security rated investment grade if the bank, after a sufficient analysis, reaches that determination.[9] A debt security is "marketable" if it can be sold with reasonable promptness at a price that corresponds reasonably to its fair value.[10]

A national bank may purchase a debt security as an investment security, even if the security does not qualify as a Type III security, based on the bank's reliable estimates that the obligor will be able to satisfy its obligations under that security.[11] If so, the "reliable estimates" provision allows a bank to invest in a below-investment-grade security or one not determined to be the credit equivalent of investment grade, if the bank satisfies itself that the securities may be sold with reasonable promptness at a price that corresponds reasonably to their fair value.[12] National banks may purchase securities under the "reliable estimates" standard in an aggregate amount no greater than 5 percent of their capital and surplus.[13] This limit applies against all securities in their portfolios acquired on the basis of reliable estimates, rather than on a per-issuer basis.[14]

Banks purchasing securities permitted under Part 1 must adhere to safe and sound banking practices and consider, as appropriate, interest rate, credit, liquidity, price, foreign exchange, transaction, compliance, strategic, and reputation risk the purchases present.[15] Any investments must be appropriate for national banks.[16]

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[3] The bonds are not rated or registered under the federal securities laws. The bank and the branches considered the transactions as "parts of one single transaction." Although the bank and the branches did a formal credit analysis on the issuer, they did not assign a credit rating on the bonds separate and apart from the interest rate swap they entered into with, and the call options they sold to, *[Co3]*. As a general matter, however, debt securities should be assigned their own separate rating.

[4] *[Co2]* provides an irrevocable, unconditional, and unsubordinated guarantee for all amounts payable under the bonds.

[5] 12 USC 24(Seventh). The investment limitations in 12 CFR Part 1 based on the capital stock and surplus of a national bank, when applied to a federal branch or agency, refer to the dollar equivalent of the capital stock and surplus of the foreign bank, and all the business of the foreign bank and federal branches is aggregated in determining compliance with the limitation. *See* 12 USC 3102(b).

[6] 12 CFR 1.2(e). A security is not predominantly speculative in nature if it is rated investment grade. When a security is not rated, the security must be the credit equivalent of a security rated investment grade. *Id.*

[7] *See* 12 CFR 1.2(e) and (f)(2).

[8] *See* 12 CFR 1.2(d) and (h).

[9] *See* OCC Interpretive Letter No. 912 (July 3, 2001), *reprinted in* [Current Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–437.

[10] *See* 12 CFR 1.2(f)(4).

[11] *See* 12 CFR 1.3(i)(1).

[12] *Id.*

[13] *See* 12 CFR 1.3(i)(2).

[14] *Id.*

[15] S*ee* 12 CFR 1.5(a).

[16] *Id.*

Alternatively, a national bank may purchase and hold debt securities, including below-investment-grade securities, as loans under its general lending powers, consistent with safety and soundness considerations.[17] National banks that purchase debt securities under their lending authority must comply with the lending limit restrictions in 12 USC 84[18] and generally may not purchase them in an amount exceeding 15 percent of the bank's capital and surplus.[19] Bank purchasers also must adhere to the prudential standards of BC-181, to the extent applicable, including the requirement that they perform an independent credit analysis of the loans to satisfy themselves that the credits meet their own credit standards.[20]

III. Discussion

A. Determination of Credit Equivalent of Investment Grade and Marketable

To qualify as a Type III security, a bond must be rated investment grade or, if not rated, the credit equivalent of investment grade and marketable. The *[SPV]* bonds are not rated. Accordingly, the bank and its branches could only purchase the *[SPV]* bonds as Type III securities, subject to a 10 percent limitation, if, at the time of purchase, they determined the bonds were the credit equivalent of investment grade and marketable. The branch's EIC or supervisory office must find the branch's conclusion or analysis to be sufficient, as documented by the branch at the time of purchase. The subsequent sale of call options on the bonds by the bank and the branches would not affect a determination that the bonds were marketable.

B. The Debt Securities' Conversion Feature is not Prohibited by Part 1

National banks generally may not purchase investment securities that are convertible into equity at the option of the issuer.[21] However, a national bank may acquire convertible debt securities, provided that it disposes of the securities before the date the conversion option comes into effect.[22] A national bank also may purchase debt securities convertible to equity securities at the bank's option where the bank does not exercise the conversion feature.[23]

The branch would not be prohibited from holding the *[SPV]* bonds on the basis of the conversion feature because the conversion feature is in its control. Moreover, because the branch is prohibited from converting the bonds into equities under the callable asset swap, the convertibility of the bonds is not at issue.

C. The Bonds May be Purchased as Loans

The branch may rely on its lending authority to hold the bonds if it underwrote them as loans at the time of purchase, in accordance with the standards of BC-181. The branch's EIC or appropriate supervisory office must find the branch's conclusion or analysis under those standards to be sufficient, as documented by the branch at the time of purchase.

[17] *See* OCC Interpretive Letter No. 834 (July 8, 1998), *reprinted in* [1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–288; OCC Interpretive Letter No. 833 (July 8, 1998), *reprinted in* [1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–287; OCC Interpretive Letter No. 600 (July 31, 1992), *reprinted in* [1992–1993 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,427; OCC Interpretive Letter No. 579 (March 24, 1992), *reprinted in* [1991–1992 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,349; OCC Interpretive Letter No. 182 (March 10, 1981), *reprinted in* [1981–1982 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,263.

[18] The lending limits in 12 USC 84 based on the capital stock and surplus of a national bank, when applied to a federal branch or agency, refers to the dollar equivalent of the capital stock and surplus of the foreign bank, and all the business of the foreign bank and federal branches is aggregated in determining compliance with the limitation. *See* 12 USC 3102(b).

[19] *See* OCC Interpretive Letter No. 834, *supra*; OCC Interpretive Letter No. 833, *supra*; OCC Interpretive Letter No. 579, *supra*.

[20] *See* OCC Interpretive Letter No. 663 (June 8, 1995), *reprinted in* [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,611; OCC Interpretive Letter No. 579, *supra*.

[21] *See* 12 CFR 1.6.

[22] OCC Interpretive Letter No. 359 (April 9, 1986), *reprinted in* [1985–1987 Transfer Binder] CCH ¶ 85,529; OCC Investment Securities Letter No. 55 (August 5, 1991), *reprinted in* [1991–1992 Transfer Binder] CCH ¶ 83,328.

[23] If an option is not exercised, there is no conversion and no resultant equity holdings. The OCC similarly has permitted national banks to own real estate as principal in various contexts, notwithstanding the general prohibition in 12 USC 29 against banks owning real property. OCC Corporate Decision No. 99-07 (March 26, 1999) (ownership of real property interests as incidental to permitted financing transactions); OCC Conditional Approval Order No. 295 and OCC Corporate Decision No. 98-17 (March 23, 1998) (same); OCC Interpretive Letter No. 806 (October 17, 1997), *reprinted in* [1997–1998 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,253 (ownership of real property in a net lease transaction that is a loan substitute for Islamic customer); 12 CFR 1.100(b) (municipal leases). In addition, the OCC has permitted national banks to own various types of personal property in order to engage in lease-financing activities. *See* 12 CFR 23.20; *see also,* Letter from Robert Herman, Deputy Comptroller (October 4, 1994) (unpublished) (ownership of an interest in trust that purchased hydrocarbon producer payments in connection with financing transaction). In all these contexts, the prohibitions otherwise applicable to ownership of these assets by a national bank as principal are not applicable because owning the asset is deemed necessary for the national bank to engage in a permissible banking activity or transaction.

IV. Conclusion

The branch's purchase of the bonds was legally permissible under its Part 1 investment authority if the analysis the branch undertook at the time supported its conclusion that the bonds were the credit equivalent of investment grade and marketable, or if at the time it purchased the bonds, it underwrote them as loans in accordance with the standards of BC-181. In either case, the branch's EIC or the appropriate supervisory office must find the branch's conclusion or analysis to be sufficient, as documented by the branch at the time of purchase. The branch must clearly document in its credit files the authority it relies on to make debt acquisitions at the time of purchase.

I trust the foregoing is responsive to your inquiry. If you have additional questions, please do not hesitate to contact Tena M. Alexander, Special Counsel, Securities and Corporate Practices Division at (202) 874-5210.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

931—March 15, 2002

12 USC 24(7)

Re: Purchases of Perpetual Preferred Stock by [ ] (Bank)

Dear [ ]:

This responds to the bank's request that the OCC determine whether a national bank may hold two issues of perpetual preferred stock as investment securities under 12 CFR Part 1. For the reasons described below, we conclude that a national bank may invest in perpetual preferred stock issued by the Federal National Mortgage Association ("Fannie Mae") and by the Federal Home Loan Mortgage Corporation ("Freddie Mac") without limit, subject to safety and soundness considerations.

I. Background

The bank is interested in holding Fannie Mae and Freddie Mac perpetual preferred stock. Both securities are rated A or better by two nationally recognized statistical rating organizations (NRSROs). Both issuers may declare dividends quarterly, out of funds legally available. The holders of both issues do not participate or share in the profits of the issuers. Rather, their return is limited to stated dividends. Both securities are noncumulative. If the issuers do not declare a dividend in a quarter, holders do not have a right to receive that quarter's dividend in the future. Both issues are redeemable by their issuers, starting in 2006, at $50 per share plus accrued dividends for the quarter. Both preferred issues are senior to the issuers' common stock. The issuers may not declare a dividend on common stock in a particular quarter without first paying a dividend on the preferred stock. In the event of a dissolution or liquidation, holders of both issues will receive out of assets available for distribution up to $50 per share plus a pro-rata share of the dividend for the quarter before any distributions to common shareholders. The preferred shares are nonvoting, except that Fannie Mae preferred shareholders may vote on limited matters regarding preferred stock.

II. Discussion

The plain language of section 24(Seventh) authorizes national banks to purchase and hold preferred stock of Freddie Mac and Fannie Mae without quantitative limits.

Section 24(Seventh) permits national banks to hold "mortgages, obligations, or *other securities* which are or ever have been sold by [Freddie Mac] pursuant to section 305 or section 306 of the Federal Home Loan Mortgage Corporation Act" (emphasis added).[1] Section 306(g) of the Federal Home Loan Mortgage Corporation Act empowers Freddie Mac to issue "preferred stock on such terms and conditions as the board of directors shall prescribe."[2] Freddie Mac preferred stock is a "security"[3] that national banks may hold under section 24(Seventh).

Section 24(Seventh) also authorizes banks to purchase and hold Fannie Mae perpetual preferred stock. Section 24(Seventh) permits national banks to hold "obligations, participations, or other instruments of or issued by" Fannie Mae. Since the term "instrument" is commonly defined to include securities,[4] we believe this language affords a basis for national banks to purchase and hold Fannie Mae perpetual preferred stock.

Section 24(Seventh) generally restricts national banks' dealing, underwriting, purchasing, and selling securities.

[1] Indeed, the OCC previously relied on this same language in section 24(Seventh) in concluding that national banks may purchase and hold preferred stock of Freddie Mac. OCC Interpretive Letter No. 577, *reprinted in* [1991–1992 Transfer Binder] Fed. Banking Law. Rep. (CCH) ¶ 83,347 (April 6, 1992).

[2] 12 USC 1455(f).

[3] OCC Interpretive Letter No. 577, *supra*.

[4] *Black's Law Dictionary,* 5th ed. (West 1979).

Section 24(Seventh) exempts Freddie Mac "securities" and Fannie Mae "instruments" from these restrictions. Thus, banks' holdings of Freddie Mac and Fannie Mae preferred securities are not subject to quantitative limits, other than safety and soundness considerations. Examples of the prudential controls the OCC would expect to see in a bank investing in these instruments include: implementation of appropriate diversification principles, adoption of concentration limits on the securities of any one issuer, and consideration of the impact on the bank's overall interest rate and liquidity risk profiles.

III. Conclusion

Accordingly, a national bank may invest in perpetual preferred stock issued by Fannie Mae and by Freddie Mac. This investment is not subject to quantitative limits on the amount of such stock that the bank may hold, but the amount is subject to safety and soundness considerations, including the prudential controls noted above. If you have any questions, please contact me at (202) 874-5210.

Nancy Worth
Counsel
Securities and Corporate Practices Division

932—August 17, 2001

12 USC 24(7)

12 CFR 7.4002(a) and (b)

Subject: [ ] Non-Relationship Customer Check Cashing Fees

Dear [ ]:

This responds to your letter of July 12, 2001, in which you explain that [ ] (the bank) proposes to commence charging a non-accountholder ("non-relationship customer")[1] a convenience fee for using a bank teller to cash an "on us check," which is a check drawn upon the account of one of the bank's customers. The bank intends to apply this convenience fee with respect to checks drawn on business accounts. This convenience fee is essentially compensating the bank for making cash immediately available to the payee. Otherwise, the payee would have to wait for the check to clear through the payment system.

You request the concurrence of this office that the bank is authorized to charge this fee under section 24(Seventh) of the National Bank Act (12 USC 24(Seventh)) and 12 CFR 7.4002(a).[2] Based on our review of your letter and supporting materials submitted and the relevant procedural considerations set forth in 12 CFR 7.4002(b), we agree that the bank is authorized to charge this convenience fee, in its discretion, pursuant to section 24(Seventh) and section 7.4002(a).[3]

National Bank Charges and Fees Are Authorized Under 12 USC 24(Seventh) and 12 CFR 7.4002

Section 24(Seventh) authorizes a national bank to engage in activities that are part of, or incidental to, the business of banking[4] as well as to engage in certain specified activities listed in the statute. "[N]egotiating . . . drafts" is one of the activities specified in section 24(Seventh). A bank's authority to provide products or services to its customers necessarily encompasses the ability to charge a fee for the product or service.[5]

This ability to charge a fee for the bank's services is expressly reaffirmed in 12 CFR 7.4002(a), which provides:

[1] The bank defines "non-relationship customers" as customers that do not have a mortgage, credit card, other loan, checking account, savings account, or certificate of deposit account with the bank or a loan or other account with an affiliate or subsidiary of the bank.

[2] We note that the authority of the bank and other national banks to charge particular fees is not conditioned on obtaining an individual confirming opinion, since national banks are authorized to charge non-interest fees and charges as an inherent element of their authority to conduct the business of banking.

[3] Your letter noted that the State of Texas has recently enacted legislation that takes effect on September 1, 2001, and that would require banks located in Texas to cash checks drawn on one of the institution's accounts without charging any fee. You have not requested our opinion, and we accordingly express no view, about whether the Texas law you describe or any similar state law would apply to national banks.

[4] The powers clause of section 24(Seventh) provides that a national bank may "exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking . . ." 12 USC′ 24(Seventh). *See NationsBank* v. *Variable Annuity Life Ins. Corp.*, 513 U.S. 251 (1995) (the "business of banking" is not limited to the list of powers enumerated in section 24(Seventh)).

[5] *Cf. Franklin National Bank* v. *New York*, 347 U.S. 373, 377 (1954) (stating, in the context of bank advertising, "We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business").

(a) *Authority to impose charges and fees*. A national bank may charge its customers non-interest charges and fees, including deposit account service charges.[6]

The bank's authority in this, as in all other, areas must be exercised in a manner that is consistent with safe and sound banking practices. Paragraph (b) of section 7.4002[7] sets out the factors that the bank should consider to ensure that its process for setting its fees and charges is consistent with safety and soundness:

(b) *Considerations*. (1) All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.

(2) The establishment of non-interest charges and fees, their amounts, and the method of calculating them are business decisions to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A national bank establishes non-interest charges and fees in accordance with safe and sound banking principles if the bank employs a decision-making process through which it considers the following factors, among others:

(i) The cost incurred by the bank in providing the service;

(ii) The deterrence of misuse by customers of banking services;

(iii) The enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and

(iv) The maintenance of the safety and soundness of the institution.

If a bank uses a decisionmaking process that takes these factors into consideration, then there is no supervisory impediment to the bank exercising its discretionary authority to charge non-interest fees and charges—such as the non-relationship customer check cashing fees at issue here—pursuant to section 7.4002(a).

The Bank's Consideration of the Section 7.4002(b) Factors

The bank has provided analysis and supporting documentation demonstrating that it has considered each of the four factors listed in section 7.4002(b)(2)(i)–(iv). The materials provided, for which the bank requests confidential treatment,[8] include information on various costs incurred by the bank in cashing checks for non-relationship customers. These include the bank's current losses attributable to non-relationship customer check-cashing, the number of non-relationship checks cashed annually, and the cost per check to process them. The bank notes that in many instances, these costs are projected to increase. The bank has concluded that its proposed non-relationship customer check cashing fee is necessary to help defray these costs.

The bank also has concluded that the convenience fee will help deter misuse because it will reduce check-based fraud. In particular, the bank expects that the fee will serve as an incentive for non-relationship customers to use other payment channels. The bank has described several programs directed toward non-relationship customers that it offers, or is developing, as alternatives to the use by these customers of tellers to cash checks over the counter. These include electronic accounts for cashing federal payments and access to direct deposit payments, which reduce the opportunity for check-based fraud. You have represented that the bank also intends to give written notices to non-relationship customers standing in line to cash payroll checks that they may avoid the proposed fee entirely—and receive the full face value of a check drawn on the bank—by opening an account at the bank or another institution or by electing to use the alternative payment methods offered by the bank.

The bank's submission discusses how charging non-relationship customers this convenience fee relates to its overall business strategy. The bank has provided analysis of the impact that non-relationship check cashing has on the service that the bank provides its account holders. The bank's submission demonstrates that non-relationship

[6] 12 CFR 7.4002(a). As used in section 7.4002(a), "customer" simply means any party that obtains a product or service from the bank. The OCC recently adopted amendments to section 7.4002 to eliminate certain ambiguities in the text of the regulation. *See* 66 Fed. Reg. 34784 (July 2, 2001). As indicated in the preamble to the final rule, however, these amendments do not affect the substance of the regulation or the way it operates. *Id*. at 34787. Citations to section 7.4002 in this letter are to the regulation as revised. The revisions took effect on August 1, 2001.

[7] 12 CFR 7.4002(b).

[8] The bank's submission includes information that the bank believes to be exempt from disclosure under the Freedom of Information Act (FOIA). 12 USC 552(b). The FOIA exempts matters constituting "trade secrets and commercial or financial information obtained from a person and privileged and confidential."

check cashing, by increasing costs associated with fraud losses and increasing the waiting time in teller lines, has the potential to affect negatively the quality of service the bank provides to its accountholders. The bank's submission shows that deterrence of this potential negative effect was a factor considered by the bank in proposing its non-relationship check cashing fee.

In discussing how the fees would enhance the competitive position of the bank, the bank notes as a threshold matter that superior convenience for its accountholders is a "key competitive ingredient" for the bank. The bank then discusses the impact that these fees will have on the bank's ability to provide superior convenience, through physical and alternative service delivery channels, for both its relationship customers and non-relationship customers. The bank asserts that the proposed non-relationship check cashing fee will promote greater convenience for its customers by allowing the bank to reduce delays in customer service and develop and implement advanced fraud protection systems best suited for the risk of check cashing. Moreover, the bank believes that the fee will enhance its competitive position by creating an incentive for non-accountholders and accountholders to use delivery channels for their banking services that are less costly than the bank's physical banking centers. The bank notes that its proposed fee approximates what a non-relationship customer may pay to use an automated teller machine and is less expensive than what many of its competitors charge for cashing a check presented by a non-accountholder.

Finally, the bank provided analysis on the impact that the fees it charges to access its services have on the bank's safety and soundness, particularly the bank's ability to control costs and increasing exposure to fraud losses. The bank has attempted to avoid misunderstandings with its customers (which could present, among other things, reputation risk to the bank) by disclosing in its deposit agreement that the bank "may" charge a convenience fee for cashing on us checks. The bank also will send a notice to affected customers, 30 days before such a fee goes into effect in a particular state, that the fee will, in fact, be charged.

In addition, as part of its consideration of the safety and soundness implications of initiating a non-relationship customer check cashing convenience fee, the bank analyzed whether the proposed fee would constitute a "wrongful dishonor" of a check or impair the check's negotiability under the Uniform Commercial Code (UCC).

According to the analysis furnished by the bank, whether a customer could challenge the non-relationship check cashing fee as a wrongful dishonor depends on the terms of the deposit agreement between the bank and the customer. *Menicocci* v. *Archer National Bank of Chicago*, 67 Ill. App.3d 388, 391 (1st Dist. 1978) (the terms of a bank's relationship with its customer is governed by the terms of the deposit contract). The deposit agreement for the business accounts to which the bank's proposed non-relationship check cashing fee would apply provides:

> You agree that we may impose additional requirements we deem necessary or desirable on a payee or other holder who presents for cashing an item drawn on your account which is otherwise properly payable, and if that person fails or refuses to satisfy such requirements, our refusal to cash the item will not be considered wrongful. You agree that, subject to applicable law, such requirements may include (but are not necessarily limited to) physical and/or documentary identification, check cashing fees, and requirements that such items may be cashed only at specified locations.

Thus, because the bank's deposit agreement clearly provides for check cashing fees, the bank has concluded that the application of the proposed non-relationship customer check cashing fee would not constitute a wrongful dishonor of a check under the UCC.[9]

The bank also asserts that the application of the proposed non-relationship customer check cashing fee would not impair the negotiability of a check presented for payment. Section 3–104 of the Uniform Commercial Code defines a negotiable instrument as:

> . . . an unconditional promise to pay or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:
>
> (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
>
> (2) is payable on demand or at a definite time; and
>
> (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment on money. . . .

The bank asserts that a non-relationship customer check cashing fee does not alter a check's negotiabilty because

[9] *Cf. Your Style Publication, Inc.* v. *Mid Town Bank & Trust Co.*, 501 N.E.2d 805, 810 (Ill. Ct. App. 1986) (defendant banks exceeded their contractual authority because depositor agreements did not clearly provide for check cashing fees and banks' customers would have no reason to believe that their own checks would be subjected to this fee).

the check does not contain on its face an express condition to payment and the fee is not assessed for negotiation of the check. A check is an unconditional promise to pay unless an express condition to payment appears on the face of the check:[10]

> One of the essentials of a negotiable check is that it be payable without condition. This means that a statement must not appear on the check that it is subject to any other order, promise, or condition. There must be no additional order or promise on the check itself; it must merely be an order on a bank for the payment of a sum of money.

Henry J. Bailey and Richard B. Hagedorn, *Brady on Bank Checks*, ¶2.04 (2000)

As explained in the bank's submission, when a bank charges a non-relationship customer check cashing fee, there is no reference to the fee on the face of the check. The fee only applies to over-the-counter check cashings by a non-customer, and is not assessed when the check is deposited or negotiated to another holder. The holder of the check has many choices about how to negotiate the check, and over-the-counter cashing is the only choice under which the fee is assessed. Therefore, the bank concludes that the fee is not assessed for negotiation and does not affect the unconditional nature of the promise to pay.

The bank's conclusion is supported by *Sexton* v. *PNC Bank, N.A.*, 43 UCC Rep.2d 341 (Pa. Ct. Com. Pl. 2000), in which the court found that a similar check cashing fee does not affect the negotiability of checks. In that case, the court found that the fee—

> is not assessed upon the negotiation of a check; it is merely a charge collected by the Bank in exchange for the service of turning a check into cash. A non-customer who deposits a check drawn on PNC into his or her account at another financial institution will receive the full face amount of the check. The same non-customer may also (assuming an agreeable recipient) endorse the check over to another person, who will then receive its full face value upon depositing the check into his (or her) own account, whether at PNC or elsewhere.

Id. at 341. The court went on to conclude:

> Section 3–104 further provides that an order that is payable on demand and drawn on a bank, and that complies with provisions (2) and (3) [thereof] is both a check and a negotiable instrument. Because PNC's $3.00 fee neither alters the payable-on-demand character of checks presented for cashing, nor constitutes an undertaking or instruction by the drawer over and above the promise to pay, the fee does not impair the negotiability of those checks, and its imposition does not violate the law.

Id. at 341.[11]

Conclusion

We therefore conclude that the bank is authorized, under 12 USC 24(Seventh) and 12 CFR 7.4002(a), to charge the non-relationship customer check cashing convenience fee and that the bank's process for considering the establishment of the fee is consistent with the considerations required by section 7.4002(b).

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

933—August 17, 2001

12 USC 24(7)

12 CFR 7.4002(a) and (b)

Subject: Request for Concurrence that [ ] is Authorized to Charge Fees to Cash Checks Drawn on the Bank for Non-Accountholders

Dear [ ]:

This responds to your letter of July 31, 2001, in which you request the concurrence of this office that [ ], a national banking association with its main office in

[10] Section 3–106 of the UCC provides that:

> . . . a promise or order is unconditional unless it states
> (i) an express condition to payment,
> (ii) that the promise or order is subject to or governed by another writing, or
> (iii) that rights or obligations with respect to the promise or order are stated in another writing.

[11] *See also Hayes* v. *First Commerce Corp.*, 763 S.2d 733, 43 UCC Rep.2d 335 (La. Ct. App. 2000), in which the court rejected a claim that a check cashing convenience fee constituted misappropriation, finding that the payee had voluntarily chosen to do business with the payor bank and that there is nothing illegal about charging a check cashing fee. In discussing the *Hayes* and *Sexton*, Barkley Clark, a leading commentator on negotiable instruments and bank deposits, stated, "We think both the Louisiana and Pennsylvania decisions hit the target in the middle." Barkley Clark, *Clark's Bank Deposits and Payments Monthly*, Vol. 9, No. 8 (February 2001).

[City, State], and with branch offices in *[State 1, State 2],* and *[State 3]* ("the bank"), is authorized, pursuant to 12 USC 24(Seventh) and 12 CFR 7.4002, to charge non-accountholders convenience fees to cash checks drawn on the bank ("on-us checks").[1] The bank's deposit agreements reserve the right to charge this convenience fee with respect to checks drawn on any deposit accounts. This fee is essentially compensating the bank for making cash immediately available to the payee. Otherwise, the payee would have to wait for the check to clear through the payment system. Based on our review of your letter and supporting materials submitted and the relevant procedural considerations set forth in 12 CFR 7.4002(b), we agree that the bank is authorized to charge this convenience fee, in its discretion, pursuant to section 24(Seventh) and section 7.4002(a).[2]

National Bank Charges and Fees Are Authorized Under 12 USC 24(Seventh) and 12 CFR 7.4002

Section 24(Seventh) authorizes a national bank to engage in activities that are part of, or incidental to, the business of banking[3] as well as to engage in certain specified activities listed in the statute. "[N]egotiating . . . drafts" is one of the activities specified in section 24(Seventh). A bank's authority to provide products or services to its customers necessarily encompasses the ability to charge a fee for the product or service.[4]

This ability to charge a fee for the bank's services is expressly reaffirmed in 12 CFR 7.4002(a), which provides:

> (a) *Authority to impose charges and fees*. A national bank may charge its customers non-interest charges and fees, including deposit account service charges.[5]

The bank's authority in this, as in all other, areas must be exercised in a manner that is consistent with safe and sound banking practices. Paragraph (b) of section 7.4002[6] sets out the factors that the bank should consider to ensure that its process for setting its fees and charges is consistent with safety and soundness:

> (b) *Considerations*. (1) All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.
>
> (2) The establishment of non-interest charges and fees, their amounts, and the method of calculating them are business decisions to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A national bank establishes non-interest charges and fees in accordance with safe and sound banking principles if the bank employs a decision-making process through which it considers the following factors, among others:
>
> (i) The cost incurred by the bank in providing the service;
>
> (ii) The deterrence of misuse by customers of banking services;
>
> (iii) The enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and
>
> (iv) The maintenance of the safety and soundness of the institution.

If a bank uses a decision-making process that takes these factors into consideration, then there is no supervisory impediment to the bank exercising its discretionary

[1] We note that the authority of the bank and other national banks to charge particular fees is not conditioned on obtaining an individual confirming opinion, since national banks are authorized to charge non-interest fees and charges as an inherent element of their authority to conduct the business of banking.

[2] Your letter noted that the State of Texas has recently enacted legislation that takes effect on September 1, 2001, and that would require banks located in Texas to cash checks drawn on one of the institution's accounts without charging any fee. You have not requested our opinion, and we accordingly express no view, about whether the Texas law you describe or any similar state law would apply to national banks.

[3] The powers clause of section 24(Seventh) provides that a national bank may "exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking. . . ." 12 USC ′24(Seventh). *See NationsBank* v. *Variable Annuity Life Ins. Corp.*, 513 U.S. 251 (1995) (the "business of banking" is not limited to the list of powers enumerated in section 24(Seventh)).

[4] *Cf. Franklin National Bank* v. *New York*, 347 U.S. 373, 377 (1954) (stating, in the context of bank advertising, "We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business").

[5] 12 CFR 7.4002(a). As used in section 7.4002(a), "customer" simply means any party that obtains a product or service from the bank. The OCC recently adopted amendments to section 7.4002 to eliminate certain ambiguities in the text of the regulation. *See* 66 Fed. Reg. 34784 (July 2, 2001). As indicated in the preamble to the final rule, however, these amendments do not affect the substance of the regulation or the way it operates. *Id*. at 34787. Citations to section 7.4002 in this letter are to the regulation as revised. The revisions took effect on August 1, 2001.

[6] 12 CFR 7.4002(b).

authority to charge non-interest fees and charges—such as the on-us check cashing fees at issue here—pursuant to section 7.4002(a).

The Bank's Consideration of the Section 7.4002(b) Factors

The bank has provided analysis and supporting documentation demonstrating that it has considered each of the four factors listed in section 7.4002(b)(2)(i)–(iv). The materials provided, for which the bank has claimed confidential treatment,[7] include information on various costs incurred by the bank in cashing on-us checks. These include personnel, processing, auditing, and overhead expenses as well as losses attributable to on-us check cashing. The bank notes that it can charge accountholders monthly service fees to cover their use of the bank's check cashing services but the only way to charge non-accountholders for their use of such services is to charge a transaction fee at the teller window. The bank states that the only alternatives would be to provide non-accountholders such services at a loss or to increase the service fees paid by accountholders and thereby require them to subsidize non-accountholders.

The bank demonstrates that it faces significantly greater risks—through the practices of drawing checks on insufficient funds and check fraud—in cashing on-us checks for non-accountholders than in accepting such checks for deposit or in paying them upon presentation through the payment system. As the United States District Court for the Northern District of Illinois recently explained (in dismissing a claim that the bank's on-us check cashing fee violated the anti-tying provisions of the Bank Holding Company Act):

> When a non-customer presents a check to be cashed by the drawee bank, the non-customer expects immediate payment in cash. Cash payments are final in the strictest sense. These final transactions pose substantial risk to banks, such as the possibility of overdraft, forgery or fraud. Should one of these occur, the bank is left with no recourse after a final cash transaction.[8]

In contrast, when holders of on-us checks deposit the checks in their bank accounts and the checks are cleared and paid through the payment system, the banks have protections against these risks and can delay or revoke payment.[9] When a bank cashes an on-us check over the counter for a non-accountholder, these protections do not apply. The bank has concluded that its convenience fee is necessary to defray the costs and offset the risks associated with on-us check cashing.[10]

The bank has also concluded that the fee will help deter misuse because it will reduce check-based fraud. In particular, the bank expects that the fee will serve as an incentive for non-accountholders to deposit checks in their bank accounts or, if they do not have bank accounts, to open one either at the bank or elsewhere. The bank's tellers frequently inform people who are cashing payroll checks that they may avoid the proposed fee entirely by opening an account at the bank. We encourage the bank to continue this practice as widely as is practicable.

The bank's submission discusses how charging the fees relates to its overall business strategy. By charging these fees, the bank hopes to shorten teller lines and thereby provide accountholders better service and ensure that its accountholders are not required to subsidize check cashing services for non-accountholders. By doing so, the bank believes its competitive position will be enhanced.

Finally, the bank has provided analysis on the impact that the fees have on the bank's safety and soundness, particularly the bank's ability to recover its costs and cover its risks in providing non-accountholders this service. The fee also serves as an incentive to non-accountholders to present checks for payment through the payment system, which, as discussed above, helps protect the bank from forgery, fraud, and overdrafts. The bank has attempted to avoid misunderstandings with its customers (which could present, among other things, reputation risk to the bank) by disclosing in its deposit agreement that the bank "may charge a person who cashes your check a fee if that person is not a deposit or loan (excluding credit cards) customer of the bank or another [   ] company."

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[7] The bank's submission includes information that the bank believes to be exempt from disclosure under the Freedom of Information Act (FOIA). 12 USC 552(b). The FOIA exempts matters constituting "trade secrets and commercial or financial information obtained from a person and privileged and confidential."

[8] *Batten* v. *Bank One, N.A.*, 2000 WL 1364408 (N.D. Ill. Sept. 15, 2000).

[9] When a check is presented through the payment system, a bank has the right under the Uniform Commercial Code (UCC) to defer deciding whether to make final payment, or to return the item unpaid, until the banking day following the day of presentment. *See* UCC 4–104(a)(10), 4–301(a), 4–301(b), and 4–402(c). Under Regulation CC, a bank need not make funds deposited by means of an on-us check available for withdrawal until the following banking day. 12 CFR 229.10(c)(vi).

[10] *See also Batten* v. *Bank One, N.A.*, 2000 WL at— ("Bank One's practice [of charging non-accountholders a fee for this service] offsets these risks . . . [by generating] funds to cover any losses due to forgery or fraud.").

In addition, as part of its consideration of the safety and soundness implications of initiating an on-us check cashing convenience fee, the bank analyzed whether the proposed fee would constitute a "wrongful dishonor" of a check or impair its negotiability under the Uniform Commercial Code (UCC).

According to the analysis furnished by the bank, whether a customer could challenge the on-us check cashing fee as a wrongful dishonor depends on the terms of the deposit agreement between the bank and the customer. *Menicocci* v. *Archer National Bank of Chicago*, 67 Ill. App.3d 388, 391 (1st Dist. 1978) (the terms of a bank's relationship with its customer is governed by the terms of the deposit contract). As noted above, the deposit agreement for the accounts to which the bank's on-us check cashing fee applies includes a provision that the bank "may charge a person who cashes your check a fee if that person is not a deposit or loan (excluding credit cards) customer of the bank or another [   ] company." Thus, because the bank's deposit agreement clearly provides for check cashing fees, the bank has concluded that the application of the on-us check cashing fee would not constitute a wrongful dishonor of a check under the UCC.[11]

The bank also asserts that the application of the on-us check cashing fee would not impair the negotiability of a check presented for payment. Section 3–104 of the Uniform Commercial Code defines a negotiable instrument as:

> . . . an unconditional promise to pay or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order, if it:
>
> (1) is payable to bearer or to order at the time it is issued or first comes into possession of a holder;
>
> (2) is payable on demand or at a definite time; and
>
> (3) does not state any other undertaking or instruction by the person promising or ordering payment to do any act in addition to the payment on money. . . .

The bank asserts that an on-us check cashing fee does not alter a check's negotiability because the check does not contain on its face an express condition to payment and the fee is not assessed for negotiation of the check. A check is an unconditional promise to pay unless an express condition to payment appears on the face of the check:[12]

> One of the essentials of a negotiable check is that it be payable without condition. This means that a statement must not appear on the check that it is subject to any other order, promise, or condition. There must be no additional order or promise on the check itself; it must merely be an order on a bank for the payment of a sum of money.

Henry J. Bailey and Richard B. Hagedorn, *Brady on Bank Checks*, ¶2.04 (2000).

As explained in the bank's submission, when a bank charges an on-us check cashing fee, there is no reference to the fee on the face of the check. The fee only applies to over-the-counter check cashings by a non-customer, and is not assessed when the check is deposited or negotiated to another holder. The holder of the check has many choices about how to negotiate the check, and over-the-counter cashing is the only choice under which the fee is assessed. Therefore, the bank concludes that the fee is not assessed for negotiation and does not affect the unconditional nature of the promise to pay.

The bank's conclusion is supported by *Sexton* v. *PNC Bank, N.A.*, 43 UCC Rep.2d 341 (Pa. Ct. Com. Pl. 2000), in which the court found that an on-us check cashing fee does not affect the negotiability of checks. In that case, the court found that the fee—

> is not assessed upon the negotiation of a check; it is merely a charge collected by the bank in exchange for the service of turning a check into cash. A non-customer who deposits a check drawn on PNC into his or her account at another financial institution will receive the full face amount of the check. The same non-customer may also (assuming an agreeable recipient) endorse the check over to another person, who will then receive its full face value upon depositing the check into his (or her) own account, whether at PNC or elsewhere.

[11] *Cf. Your Style Publication, Inc.* v. *Mid Town Bank & Trust Co.*, 501 N.E.2d 805, 810 (Ill. Ct. App. 1986) (defendant banks exceeded their contractual authority because depositor agreements did not clearly provide for check cashing fees and banks' customers would have no reason to believe that their own checks would be subjected to this fee).

[12] Section 3–106 of the UCC provides that:

> . . . a promise or order is unconditional unless it states
>
> (i) an express condition to payment,
>
> (ii) that the promise or order is subject to or governed by another writing, or
>
> (iii) that rights or obligations with respect to the promise or order are stated in another writing.

Id. at 341. The court went on to conclude:

> Section 3–104 further provides that an order that is payable on demand and drawn on a bank, and that complies with provisions (2) and (3) [thereof] is both a check and a negotiable instrument. Because PNC's $3.00 fee neither alters the payable-on-demand character of checks presented for cashing, nor constitutes an undertaking or instruction by the drawer over and above the promise to pay, the fee does not impair the negotiability of those checks, and its imposition does not violate the law.

Id. at 341.[13]

Conclusion

We therefore conclude that the bank is authorized, under 12 USC 24(Seventh) and 12 CFR 7.4002(a), to charge the convenience fee and that the bank's process for considering the establishment of the fee is consistent with the considerations required by section 7.4002(b).

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

934—August 20, 2001

12 USC 24(7)

12 CFR 7.4002(a) and (b)

Subject: Request for Concurrence that [ ] is Authorized to Charge Fees to Cash Checks Drawn on the Bank for Non-Accountholders

Dear [ ]:

This responds to your letter of August 16, 2001, in which you request the concurrence of this office that [ ] ("the bank") is authorized, pursuant to 12 USC 24(Seventh) and 12 CFR 7.4002, to charge non-accountholders fees to cash checks drawn on the bank ("on-us checks").[1] The bank's deposit agreements reserve the right to charge a convenience fee with respect to checks drawn on all deposit accounts at the bank. This convenience fee is essentially compensating the bank for making cash immediately available to the payee. Otherwise, the payee would have to wait for the check to clear through the payment system. Based on our review of your letter and supporting materials submitted and the relevant procedural considerations set forth in 12 CFR 7.4002(b), we agree that the bank is authorized to charge this convenience fee, in its discretion, pursuant to section 24(Seventh) and section 7.4002(a).[2]

National Bank Charges and Fees Are Authorized Under 12 USC 24(Seventh) and 12 CFR 7.4002

Section 24(Seventh) authorizes a national bank to engage in activities that are part of, or incidental to, the business of banking[3] as well as to engage in certain specified activities listed in the statute. "[N]egotiating . . . drafts" is one of the activities specified in section 24(Seventh). A bank's authority to provide products or services to its customers necessarily encompasses the ability to charge a fee for the product or service.[4]

This ability to charge a fee for the bank's services is expressly reaffirmed in 12 CFR 7.4002(a), which provides:

[13] *See also Hayes* v. *First Commerce Corp.*, 763 S.2d 733, 43 UCC Rep.2d 335 (La. Ct. App. 2000), in which the court rejected a claim that an on-us check cashing fee constituted misappropriation, finding that the payee had voluntarily chosen to do business with the payor bank, and that there is nothing illegal about charging a check cashing fee. In discussing the *Hayes* and *Sexton*, Barkley Clark, a leading commentator on negotiable instruments and bank deposits, stated, "We think both the Louisiana and Pennsylvania decisions hit the target in the middle." Barkley Clark, *Clark's Bank Deposits and Payments Monthly*, Vol. 9, No. 8 (February 2001).

[1] We note that the authority of the bank and other national banks to charge particular fees is not conditioned on obtaining an individual confirming opinion, since national banks are authorized to charge non-interest fees and charges as an inherent element of their authority to conduct the business of banking.

[2] We note that the State of Texas has recently enacted legislation that takes effect on September 1, 2001, and that would require banks located in Texas to cash checks drawn on one of the institution's accounts without charging any fee. You have not requested our opinion, and we accordingly express no view, about whether the Texas law you describe or any similar state law would apply to national banks.

[3] The powers clause of section 24(Seventh) provides that a national bank may "exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking. . . ." 12 USC 24(Seventh). *See NationsBank* v. *Variable Annuity Life Ins. Corp.*, 513 U.S. 251 (1995) (the "business of banking" is not limited to the list of powers enumerated in section 24(Seventh)).

[4] *Cf. Franklin National Bank* v. *New York*, 347 U.S. 373, 377 (1954) (stating, in the context of bank advertising, "We cannot believe that the incidental powers granted to national banks should be construed so narrowly as to preclude the use of advertising in any branch of their authorized business").

(a) *Authority to impose charges and fees*. A national bank may charge its customers non-interest charges and fees, including deposit account service charges.[5]

The bank's authority in this, as in all other, areas must be exercised in a manner that is consistent with safe and sound banking practices. Paragraph (b) of section 7.4002[6] sets out the factors that the bank should consider to ensure that its process for setting its fees and charges is consistent with safety and soundness:

(b) *Considerations*. (1) All charges and fees should be arrived at by each bank on a competitive basis and not on the basis of any agreement, arrangement, undertaking, understanding, or discussion with other banks or their officers.

(2) The establishment of non-interest charges and fees, their amounts, and the method of calculating them are business decisions to be made by each bank, in its discretion, according to sound banking judgment and safe and sound banking principles. A national bank establishes non-interest charges and fees in accordance with safe and sound banking principles if the bank employs a decision-making process through which it considers the following factors, among others:

(i) The cost incurred by the bank in providing the service;

(ii) The deterrence of misuse by customers of banking services;

(iii) The enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and

(iv) The maintenance of the safety and soundness of the institution.

If a bank uses a decisionmaking process that takes these factors into consideration, then there is no supervisory impediment to the bank exercising its discretionary authority to charge non-interest fees and charges such as the on-us check cashing fees at issue here pursuant to section 7.4002(a).

The Bank's Consideration of the Section 7.4002(b) Factors

The bank has provided analysis and supporting documentation demonstrating that it has considered each of the four factors listed in section 7.4002(b)(2)(i)–(iv). The bank's submission, for which the bank requests confidential treatment,[7] explains that prior to implementing the fee program, it formed a task force, including a marketing representative and various levels of management from those areas that would be affected by the fee (*e.g*., community banking presidents, a district manager, and a business banking manager). As part of its evaluation, the task force considered the various costs incurred by the bank in cashing on-us checks.

The bank's submission states that the task force considered teller services in evaluating the costs incurred in cashing on-us checks. On paydays, the teller lines in many of the bank's branches are heavily impacted by the employees of the bank's commercial customers who want to cash their payroll checks. According to the bank's submission, the task force believes that this activity negatively affects the ability of those offices to serve their deposit customers expeditiously. The task force therefore concluded that the bank's convenience fee is necessary to offset the negative effects on its services for accountholders that result from on-us check cashing.

The bank's submission also explains that its task force concluded that the fee will help deter misuse because it will serve as an incentive for non-accountholders to deposit checks in their bank accounts or, if they do not have bank accounts, to open one either at the bank or elsewhere. The bank provides notices to non-accountholders, through brochures and lobby posters printed in English and Spanish, that they may avoid the fee by opening an account with the bank.

The bank also states that the task force discussed how charging convenience fees relates to its overall business strategy. The task force considered the practices of other financial institutions regarding the imposition of this type

[5] 12 CFR 7.4002(a). As used in section 7.4002(a), "customer" simply means any party that obtains a product or service from the bank. The OCC recently adopted amendments to section 7.4002 to eliminate certain ambiguities in the text of the regulation. *See* 66 Fed. Reg. 34784 (July 2, 2001). As indicated in the preamble to the final rule, however, these amendments do not affect the substance of the regulation or the way it operates. *Id*. at 34787. Citations to section 7.4002 in this letter are to the regulation as revised. The revisions took effect on August 1, 2001.

[6] 12 CFR 7.4002(b).

[7] The bank's submission includes information that the bank believes to be exempt from disclosure under the Freedom of Information Act (FOIA). 12 USC 552(b). The FOIA exempts matters constituting "trade secrets and commercial or financial information obtained from a person and privileged and confidential."

of fee and reviewed the fees charged by persons primarily engaged in the check cashing business. The task force concluded that the bank should establish its fees at the low end of that market in order to remain competitive.

Finally, the task force evaluated the impact that the fees have on the bank's safety and soundness. In order to assess possible reputational and litigation risks, the task force considered both the results of internal focus groups (conducted to help gauge the likely reactions of the persons impacted by the fee and the appropriate responses to those risks) and the experiences of an affiliate that had previously implemented a similar fee. The bank has attempted to avoid misunderstandings with its customers (which could present, among other things, reputation risk to the bank) by disclosing in its deposit agreement that the bank "may charge a fee to the person presenting the check. . . ." The bank also sends letters to affected customers in advance of implementing the fee program.

In addition, the bank has analyzed the legal risks (which could raise safety and soundness concerns) arising from whether the proposed fee would constitute a "wrongful dishonor" of a check or impair its negotiability under the Uniform Commercial Code (UCC).

According to the analysis furnished by the bank, whether a customer could challenge the convenience fee as a wrongful dishonor depends on the terms of the deposit agreement between the bank and the customer. *Menicocci v. Archer National Bank of Chicago*, 67 Ill. App.3d 388, 391 (1st Dist. 1978) (the terms of a bank's relationship with its customer is governed by the terms of the deposit contract). The deposit agreement for the accounts to which the bank's fee applies includes a provision that "[i]f a check drawn against your account is presented over the counter for payment by a person who is not a deposit customer of the bank, the bank may charge a fee to the person presenting the check as a condition for payment for the check." Thus, because the bank's deposit agreement clearly provides for check-cashing fees, the bank concluded that the application of the fee would not constitute a wrongful dishonor of a check under the UCC.[8]

The bank asserts that a convenience fee does not alter a check's negotiability, because the check does not contain on its face an express condition to payment and the fee is not assessed for negotiation of the check. A check is an unconditional promise to pay unless an express condition to payment appears on the face of the check:[9]

> One of the essentials of a negotiable check is that it be payable without condition. This means that a statement must not appear on the check that it is subject to any other order, promise, or condition. There must be no additional order or promise on the check itself; it must merely be an order on a bank for the payment of a sum of money.

Henry J. Bailey and Richard B. Hagedorn, *Brady on Bank Checks*, ¶2.04 (2000).

As explained in the bank's submission, when a bank charges a fee for cashing an on-us check, there is no reference to the fee on the face of the check. The fee only applies to over-the-counter check cashings by a non-customer and is not assessed when the check is deposited or negotiated to another holder. The holder of the check has many choices about how to negotiate the check, and over-the-counter cashing is the only choice under which the fee is assessed. Therefore, the bank concludes that the fee is not assessed for negotiation and does not affect the unconditional nature of the promise to pay.

The bank's conclusion is supported by *Sexton* v. *PNC Bank, N.A.*, 43 UCC Rep.2d 341 (Pa. Ct. Com. Pl. 2000), in which the court found that a convenience fee for cashing an on-us check does not affect the negotiability of checks. In that case, the court found that the fee

> is not assessed upon the negotiation of a check; it is merely a charge collected by the bank in exchange for the service of turning a check into cash. A non-customer who deposits a check drawn on PNC into his or her account at another financial institution will receive the full face amount of the check. The same non-customer may also (assuming an agreeable recipient) endorse the check over to another person, who will then receive its full face value upon depositing the check into his (or her) own account, whether at PNC or elsewhere.

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[8] *Cf. Your Style Publication, Inc.* v. *Mid Town Bank & Trust Co.*, 501 N.E.2d 805, 810 (Ill. Ct. App. 1986) (defendant banks exceeded their contractual authority because depositor agreements did not clearly provide for check cashing fees and banks' customers would have no reason to believe that their own checks would be subjected to this fee).

[9] Section 3–106 of the UCC provides that:

> . . . a promise or order is unconditional unless it states
> (i) an express condition to payment,
> (ii) that the promise or order is subject to or governed by another writing, or
> (iii) that rights or obligations with respect to the promise or order are stated in another writing.

Id. at 341. The court went on to conclude:

> Section 3–104 further provides that an order that is payable on demand and drawn on a bank, and that complies with provisions (2) and (3) [thereof], is both a check and a negotiable instrument. Because PNC's $3.00 fee neither alters the payable-on-demand character of checks presented for cashing, nor constitutes an undertaking or instruction by the drawer over and above the promise to pay, the fee does not impair the negotiability of those checks, and its imposition does not violate the law.

Id. at 341.[10]

Conclusion

We therefore conclude that the bank is authorized, under 12 USC 24(Seventh) and 12 CFR 7.4002(a), to charge the convenience fee and that the bank's process for considering the establishment of the fee is consistent with the considerations required by section 7.4002(b).

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

935—May 14, 2002

12 USC 24(7)

Subject: Holding Securities for Hedging Purposes

Dear [ ]:

This letter confirms oral advice provided by OCC legal and supervisory staff concerning the program established by [ ] (the bank) to hedge risks arising from bank permissible, customer-driven derivative transactions. You asked whether the bank can short equities under its hedging program and if the 5 percent limit applies to voting but not nonvoting stock. You also questioned how the bank may settle and terminate its hedges and whether the bank can cross-hedge. You also asked whether the standards applicable to equity hedges apply to commodity and below-investment-grade debt hedges. Our responses are set forth below.

I. Background

The OCC has determined that it is legally permissible for a national bank to purchase and hold equity securities that banks do not generally have authority to purchase to hedge customer-driven, bank permissible equity derivative transactions.[1] A national bank may hold these securities to hedge bank permissible equity derivative transactions if the activities comply with the standards set forth below, which include obtaining the approval of its examiner-in-charge (EIC). Before establishing an equity hedging program, a national bank must provide written documentation to its EIC that evidences compliance with the following standards, and obtain the EIC's approval. The documentation should establish to the satisfaction of the EIC that:

- the bank will hold the securities solely to hedge risks arising from bank permissible derivative transactions originated by customers for the customers' valid and independent business purposes;
- the bank will not hold the securities for speculative purposes;
- the securities will offer a cost-effective means to hedge risks arising from permissible banking activities;
- the bank will not take anticipatory, or maintain residual, positions in the securities except as necessary for the orderly establishment or unwinding of a hedging position;
- the bank will not acquire equity securities for hedging purposes that constitute more than 5 percent of a class of securities of any issuer; and
- the bank has an appropriate risk management process in place, satisfactory to the EIC, for its hedging activities.

Your EIC has approved the bank's hedging program under these standards.

[10] *See also Hayes* v. *First Commerce Corp.*, 763 S.2d 733, 43 UCC Rep.2d 335 (La. Ct. App. 2000), in which the court rejected a claim that an on-us check cashing fee constituted misappropriation, finding that the payee had voluntarily chosen to do business with the payor bank, and that there is nothing illegal about charging a check cashing fee. In discussing the *Hayes* and *Sexton*, Barkley Clark, a leading commentator on negotiable instruments and bank deposits, stated, "We think both the Louisiana and Pennsylvania decisions hit the target in the middle." Barkley Clark, *Clark's Bank Deposits and Payments Monthly*, Vol. 9, No. 8 (February 2001).

[1] *See* OCC Interpretive Letter No. 892 (September 13, 2000), *reprinted in* [2000–2001 Transfer Binder] Fed. Banking Law Rep. (CCH) ¶ 81–411.

II. Discussion

You have asked a number of questions concerning the bank's hedging program. Our responses to your questions are described below.

A. Shorting Equities

You asked if the bank may short equities for hedging purposes under the EIC's approval of its hedging program. The answer is yes. National banks may hedge risks arising from bank permissible equity derivative transactions with either long or short positions in an equity or basket of equities. A national bank can protect itself against changes in the value of the security underlying an equity derivative transaction by taking an offsetting (long or short, as appropriate) position in that equity. So, for example, a national bank may hedge changes in certain equity derivative transactions through delta hedging.[2] Delta is a hedge ratio banks calculate to determine the amount of equity it must be long or short, so that for small changes in the price of an equity, the bank's equity hedge position and its equity derivative contract with a customer will change by equal, and offsetting, amounts.[3] The objective of delta hedging is to have the change in the value of the equity hedge offset the change in value of the customer derivative transaction.

B. Nonvoting Corporate Stock

You inquired whether the 5 percent limit applies to nonvoting corporate stock. The OCC has applied the 5 percent limit only to each separate class of voting shares of a company. A national bank may not acquire securities that, in the aggregate, result in the bank's control of more than 5 percent of the outstanding shares of any class of a company's voting securities. The OCC evaluates a particular bank's hedging program under the criteria described in this letter in order to determine whether the 5 percent limit should also apply to a class of nonvoting securities.

C. Cash- and Physically Settled Hedges

You questioned whether the OCC's approval for hedging permissible equity derivative transactions with equity securities allows the bank to both cash- and physically settle its equity derivative transactions. A national bank with an EIC-approved hedging program may execute cash- and physically settled equity derivative transactions.[4]

D. Hedging Residual Positions

You asked whether the bank may hedge the risks arising from a hedge that remain when a counterparty terminates the underlying hedged transaction. A bank must prudently manage the risk in its equity derivative program and may, in the event of an unforeseen termination of a hedged transaction, hedge exposures from the remaining hedge. We believe that if a national bank holds equities to hedge a bank permissible equity derivative transaction, and a counterparty terminates the initial transaction, the bank must dispose of the equity holdings immediately, except as necessary for the orderly unwinding of the hedge position.[5] During any time required to dispose of the equity holdings, a national bank may enter into an appropriate offsetting equity derivative transaction to hedge the bank's initial hedge transaction, *i.e.,* a reverse hedge. The reverse hedge should terminate as close in time as possible to the disposal of the equity holdings.

E. Physical Commodity Transactions

You inquired whether the standards for examiner review and approval of national bank equity hedge programs apply to commodity hedge programs. No, the standards set forth in OCC Interpretive Letter No. 892 apply to security, but not commodity, hedges. The OCC's process for permitting national banks to hold commodities to hedge derivative transactions is set forth in a number of precedents separate from OCC Interpretive Letter No. 892.[6] Banking Circular 277, for example, describes how national banks may hold commodities as hedges.[7] The analysis governing commodity holdings as hedges is similar in several respects to that underlying the OCC's approval for hedging permissible equity derivative transactions. In both cases, the OCC made clear that

[2] Delta hedging typically involves equity options. *See* United Stated General Accounting Office (GAO), *Equity Hedging: OCC Needs to Establish Policy on Publishing Interpretive Decisions*, GAO-01-945 (August 2001) at 4, 26.

[3] *See Id.*

[4] The OCC has previously recognized that a national bank may hedge equity derivative transactions with cash-settled hedges. *See* OCC Interpretive Letter No. 652 (September 13, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,600.

[5] *See* OCC Interpretive Letter No. 892, *supra.*

[6] *See* OCC Interpretive Letter No. 684 (August 4, 1995), *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,632; OCC Interpretive Letter No. 632 (June 30, 1993), *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,516.

[7] *See* OCC Banking Circular 277 (October 27, 1993) (BC–277). *See also* OCC *Comptroller's Handbook,* "Risk Management of Financial Derivatives" (January 1997 [print version; rev. for Web only, October 2001, available at http://www.occ.treas.gov/handbook/deriv.pdf]).

national banks should not engage in these activities without the prior approval of the OCC. The ability of banks to hold commodities and equities as hedges depends on the existence of customer-driven, bank-permissible derivative transactions. Also, the bank must have acceptable risk monitoring systems to handle the activities in a safe and sound manner. Conversely, commodity hedges differ materially from equity hedges, and therefore the process for engaging in these transactions is different. For example, holding commodities as hedges pose storage (*e.g.*, storage tanks, pipelines), transportation (*e.g.*, tankers, barges, pipelines), environmental (*e.g.*, pollution, fumigation, leakage, contamination), and insurance risks (*e.g.*, damage to persons and property, contract breach, spillage) not associated with the physical possession of equities.

F. Cross-Hedges

You questioned whether the bank can hedge equity derivatives with cross-hedges. In limited circumstances, a national bank can cross-hedge its equity derivatives where consistent with the bank's OCC approved hedging risk management process. Generally, an equity hedge is used to protect a position in a security by the purchase or sale of the security. Cross-hedging is the use of one security or a basket of securities to hedge the risk arising from a transaction involving another, different security. A cross-hedge is based on the premise that, although certain securities are not the same, the securities are similar and their price movements strongly correlate. Sometimes cross-hedges are used when securities have similar characteristics and there is a deeper, more liquid market for securities other than the security underlying the transaction to be hedged. In some circumstances, cross-hedging may be the most effective risk management tool available to a national bank, enabling it to operate more efficiently, compete more effectively with entities that engage in similar hedging strategies, offer customers the least costly and most attractive products and services, and operate prudently.[8] Bank management must be able to justify its cross-hedge, *i.e.*, that the instrument used for cross-hedging provides a reasonable substitute for the security exposure arising from the derivative being hedged. Examiners evaluating the reasonableness of a cross-hedge consider the accuracy of the cross-hedge, its cost-effectiveness, and its liquidity in the market in comparison to the security involved in the initial transaction.

[8] *See* OCC Interpretive Letter No. 892, *supra*.

G. Below-Investment-Grade Bond Hedges

You asked whether the bank may hedge risks arising from permissible derivative activities using bonds that are rated below investment grade. A national bank may hold long or short positions in equity or below-investment-grade debt securities to hedge bank-permissible derivative transactions, if the activities comply with OCC standards *and* the bank obtains the approval of its EIC. The standards set forth in OCC Interpretive Letter No. 892 that apply to hedging with equity securities also apply to hedging with below-investment-grade debt securities. Because a bank's EIC must approve a bank's use of below-investment-grade debt securities for hedging purposes, and such hedging programs must have an appropriate risk management process in place satisfactory to the EIC, the EIC may impose a prudential limit on such holdings. Accordingly, a national bank can use below-investment-grade bonds to hedge the risks arising from permissible derivative transactions if in accordance with its EIC-approved hedging program.

We understand that your EIC has addressed the above issues with the bank. If you have additional questions, please do not hesitate to contact Donald N. Lamson, assistant director, or Tena M. Alexander, special counsel, Securities and Corporate Practices Division at (202) 874-5210.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

936—May 22, 2002

12 CFR 9.18

Re: Proposed Creation of the [ ] Fund

Dear [ ]:

This letter confirms our February 13, 2002, teleconference and responds to your letter dated March 5, 2002, regarding the establishment by [ ] (bank), as trustee, of the [ ] (fund). You have inquired whether the OCC would object to an aspect of the fund's operations under the OCC's rules governing collective investment funds at 12 CFR 9.18. Specifically, you have inquired whether the bank, as trustee, may allow participant withdrawals from the fund at the sole discretion of the bank, or when a participant becomes ineligible to continue as a participant in the fund. Based on your representations, and for the reasons described below, the OCC does not object to this aspect of the fund's operations under the OCC's rules governing collective investment funds at 12 CFR 9.18.[1]

I. Proposal

The bank seeks to establish the fund for the collective investment of money contributed to the fund by the bank in its capacity as trustee of certain tax-exempt charitable trusts. The bank is forming the fund in order to enable several small trusts for which it serves as trustee to invest in private equity limited partnerships (PELP). However, the trusts cannot invest in the PELP directly because an appropriate private equity investment for these trusts would not satisfy the minimum investment requirement of the limited partnership. The fund will pool the investments of several tax-exempt trusts that are "qualified purchasers,"[2] allowing the fund to satisfy the minimum requirement of the limited partnership.

Under the bank's proposal, fund participants will be unable to make discretionary withdrawals from the fund.[3] Sections 6.2(a), (b), (c), and (e) of the Declaration of Trust provide:

> (a) Unless otherwise limited hereunder, the decision on when to allow, the form of, and the timing of all fund withdrawals shall be within the sole discretion of the trustee;
>
> (b) Participants will not have the right to withdraw from the fund at any particular time or interval;
>
> (c) At the time of the creation of a fund, the trustee does not anticipate allowing any withdrawals from the fund prior to the termination and liquidation of the [private equity investments] of the fund; and
>
> (e) Upon the occurrence of an event that renders a participant ineligible to continue as a participant in the fund,[4] within one year of such event the trustee shall redeem such participant's units in the fund, in kind, with a proportionate share of the [private equity investments] and the other assets of the fund; subject, however, to any liens for incurred and unpaid capital contributions, debts, fees and expenses.

You represented during our February 13, 2002, teleconference that the fund will be valued semi-annually on April 1 and October 1. The bank will use the valuation reports provided by the PELP's general partner to determine the fund's fair value. To comply with 12 CFR 9.18(b)(4)(ii), and as provided in section 5.3(f) of the Declaration of Trust, the bank will determine whether the valuation provided by the PELP's general partner represents the fair value of the fund's assets as of the date of the valuation.

II. Discussion

The OCC's regulation governing collective investment funds does not mandate the frequency of admissions and withdrawals from collective investment funds. The regulation requires that the written plan governing the administration of the collective investment fund include appropriate provisions related to the terms and conditions governing the admission and withdrawal of participating accounts.[5]

In addition, the regulation provides that admissions and withdrawals may only be "on the basis of the valuation described in paragraph (b)(4)." Section 9.18(b)(4), in turn, provides in part that,

> A bank administering a collective investment fund shall determine the value of the fund's assets at least once *every three months.* However, in the case of a fund described in paragraph (a)(2) of this section that is invested primarily in real estate or other assets that are not readily marketable, the bank shall determine the value of the fund's assets *at least once a year.*[6]

[1] We limit our no-objection to the bank's proposal to allow participant withdrawals from the fund at the sole discretion of the bank, or when a participant becomes ineligible to continue as a participant in the fund. We offer no views on whether other aspects of the fund's operations comply with the provisions of 12 CFR 9.18 or with applicable fiduciary law.

[2] While the Investment Company Act of 1940 ("1940 Act") is not applicable to the bank's proposal, the bank represents that if the 1940 Act were applicable to the bank's proposal, the tax-exempt trusts for which the bank is trustee would meet the definition of "qualified purchasers" under section 2(a)(51) of the 1940 Act.

[3] The bank represents that it will provide appropriate disclosures to the board of directors or the trustee(s) of the beneficiaries of each fund participant with respect to the nature of the fund's investments and capital calls, and that fund participants will not have the right to withdraw from the fund at any particular time or time interval.

[4] The bank represents that the only way a participant would cease to be eligible to continue as a participant in the fund would be if the bank was removed, for cause, as trustee of the participating account.

[5] The regulation also provides that certain funds may require a prior notice period of up to one year for withdrawals. 12 CFR 9.18(b)(5)(iii).

[6] 12 CFR 9.18(b)(4)(i). Section 9.18(b)(4) also establishes the method of valuation. In general, bank trustees are required to value fund assets at market value as of the date set for valuation, unless the bank cannot readily ascertain market value, in which case the bank shall use a fair value determined in good faith. *See* 12 CFR 9.18(b)(4)(ii)(A). Different valuation methods apply to short-term investment funds. *See* 12 CFR 9.18(b)(4)(ii)(B).

These provisions require that bank trustees use the valuation derived under section 9.18(b)(4) to determine the amount participants are entitled to when they are admitted to or withdraw from a fund. It does not mandate the frequency of admissions and withdrawals.[7] National banks and institutions that must comply with this regulation to receive favorable tax treatment should have valid reasons for limiting admissions and withdrawals, however. In addition, the admissions and withdrawal policies must be consistent with fiduciary duties.

In this case, the bank does not anticipate allowing any withdrawals from the fund prior to the termination and liquidation of the underlying trust investments because the fund might fail to satisfy the minimum investment requirement of the PELP if the fund permitted discretionary withdrawals from the fund. In addition, you represent that the bank will limit admissions to, and withdrawals from, the fund, because the fund's private equity investments will be in limited partnerships that will be illiquid over their projected 10- to 15-year business cycles. Specifically, the limited partnership interests are not transferable without the permission of the general partner. You have also represented that the amount of the investment that each participating trust will make in the fund will not impair the liquidity of the participating trusts. The fund is designed as, and will be used as, only one part of an overall investment strategy for the participating trusts.

Based on your representations and consistent with applicable law, the bank may permit a participant to withdraw from the fund solely at the bank's discretion, or when a participant becomes ineligible to continue as a participant in the fund.[8]

I trust this is responsive to your inquiry. Please do not hesitate to contact me if you have any questions.

Asa L. Chamberlayne
Counsel
Securities and Corporate Practices Division

[7] OCC Trust Interpretive Letters interpreting the prior version of 12 CFR 9.18 concluded that admissions and withdrawals must occur as frequently as valuations. *See e.g.*, Trust Interpretive Letter No. 13 (February 14, 1986). Upon closer examination of the regulation, however, we have concluded that the regulation does not mandate the frequency of admissions and withdrawals. *See* OCC Interpretive Letter No. 920 (December 6, 2001).

[8] *See* footnote 4, *supra*.

937—June 27, 2002

12 USC 24(7)

Re: Authority of a National Bank to Engage in Financial Intermediation Transactions

Dear [ ]:

This responds to your request that the Office of the Comptroller of the Currency (OCC) confirm the opinion of [ ] (the bank) that it is permissible for the bank to engage in financial intermediation transactions, where the payments between parties are based on the price of electricity.[1] For the reasons discussed below and subject to the limitations described herein, we believe that the proposed transactions are permissible for the bank.

I. Background

The bank currently engages in a variety of financial intermediation transactions involving exchanges of payments based on interest rates, and the value of equities and commodities. The bank's financial intermediation derivative transactions involve a wide range of energy-related commodities, including petroleum, natural gas, and other hydrocarbon products. These transactions provide risk management tools to meet customers' financial needs. For example, oil and gas derivatives offer users and producers protection against increases and decreases in the price of oil or gas.

The bank proposes to add transactions based on the price of electricity to its existing financial intermediation derivatives business. Similar to its existing financial intermediation derivatives business involving energy commodities, the electricity derivative business will be a customer-driven rather than a proprietary trading business. The bank's electricity financial intermediation activities will involve exchanges of payments, similar to other financial intermediary transactions presently engaged in by the bank. The transactions will be cash-settled and the bank will not physically receive or deliver electricity.

The transactions in which the bank proposes to engage will enable customers to meet legitimate financial and

[1] For the purposes of this letter, the term "electricity derivative transactions" includes cash-settled electricity-linked transactions of every type—including derivative products such as futures, forwards, options, swaps, caps, floors, and collars, and options thereon—in which a portion of the return (including interest and/or principal and/or payment streams) is linked to the price of electricity.

risk management needs. Representative examples of these transactions described below, include swaps, options, and forwards contracts. The bank represents that each of these cash-settled transactions is used by market participants (including generators, industrial consumers, and marketers) in their management of price risks in a competitive and deregulated environment.[2]

Example 1: An electricity producer has contracts to provide electricity to manufacturers at market prices over the next two years. The electricity producer wants to receive fixed payments for electricity it produces over that period and obtain protection against price declines.

To eliminate electricity price risk, the producer enters into a cash-settled, electricity derivative swap with the bank. Under the swap, the producer pays the bank the floating market price for a notional amount of electricity over the next two years, and receives a fixed price for the same notional amount of electricity. Alternatively, the producer may achieve the same result through a series of cash-settled forward transactions with the bank. Under the cash-settled, forward transactions, the producer pays the bank the market value of a specified notional amount of electricity at a future date, and receives a fixed price for the same notional amount of electricity.

Example 2: An industrial consumer of electricity wants to fix its cost of electricity over the next two years and protect itself against price increases. The consumer enters into a cash-settled, electricity swap with the bank. Under the swap, the consumer pays the bank a fixed price for a notional amount of electricity over the next two years, and receives the floating market price for the same notional amount of electricity. Alternatively, the consumer may achieve the same result through a series of cash-settled forward transactions with the bank. Under the forward transactions, the customer pays a fixed price for a notional amount of electricity, and the customer receives the market value of the same notional amount of electricity at a future date.

Example 3: An electricity consumer determines it will meet earnings projections only if the cost of a notional amount of electricity is $30 or lower. The consumer wants protection against prices rising over $30 and wants to retain the benefits of prices declining below $30. To achieve this protection, the consumer enters into a cash-settled cap option with the bank that entitles the consumer, for a fee, to receive the difference between $30 and a higher market price for electricity.

As the bank's book of electricity derivative transactions increases, much of the market risk exposures from transactions with customers may offset each other. Consequently, the bank will not need to hedge each transaction individually. It will manage market risks on a "portfolio basis," and hedge the resulting net risk exposures. There will normally be some residual market risk that is left unhedged, which will be subject to risk management limits as discussed below. However, this risk will be *de minimis* relative to the bank's earnings and capital and will be consistent with a customer-driven business strategy. The bank's hedges will include cash-settled electricity swaps, forwards, and options.

The bank represents that deregulation dramatically changed the operation of the power markets. For wholesale market participants, the price of power is a market rate variable that presents a risk profile analogous to that of interest rates, natural gas prices or equity prices. If left unmanaged, power prices can introduce volatility into a customer's earnings. Moreover, as deregulation proceeds, the variety of customers exposed to power prices will broaden. At present, power generators and distributors face substantial electricity price risks. Institutional and corporate consumers (such as chemical companies, refineries, and heavy manufacturers) are also exposed. The bank has well-established relationships with these types of customers.

The bank's proposed financial intermediary initiative relates exclusively to wholesale energy and power markets, and does not in any way relate to a business

[2] In support of the bank's representation, it references the discussion in the *Primer on Electricity Futures and Other Derivatives* (U.S. Department of Energy-funded study by the Environmental Energy Technologies Division of the University of California Ernest Orlando Lawrence Berkeley National Laboratory, January 1998) (referred to as the "Electricity Derivatives Primer") of all three of these instruments and their use in electricity markets, as follows. *Swaps* enable a customer (either a generator or an end-user) to lock in a specific price for the electricity in question, and can be tailored to meet the needs of the buyer and the seller (*e.g.,* delivery points, time periods, etc.). Generators and end-users use both *put-options ("floors")* and *call-options ("caps")*—or a combination of puts and calls *("collars")*—to ensure a particular price range for the electricity in question. Under a *forward contract,* one party is obligated to buy, and the other to sell, a specified quantity of electricity at a fixed price on a given date in the future. At the maturity of a forward contract, the seller will deliver the electricity and the buyer will pay the purchase price. If, at that time, the market price of the electricity is higher than the price specified in the contract, then the buyer will have protected itself from price volatility. Conversely, if the market price is lower than the contract price, then the seller will have benefited from the terms of the contract. The "Electricity Derivatives Primer" emphasizes (at 43) that "[t]hese types of instruments work well because they can be tailored to the unique circumstances of generators, end users, and marketers."

with retail clients or to actual power procurement. Furthermore, because the bank proposes to solely engage in cash-settled electricity derivative transactions, the bank represents it will not be required to register as a power marketer with, or otherwise become subject to the supervision or jurisdiction of, the Federal Energy Regulatory Commission or any regional transmission or other organization which operates as a power exchange or power pool. And, as previously stated, the bank will *not* receive or deliver actual power as a result of any cash-settled electricity derivative transaction that it enters.

The bank believes that financial intermediation activities based on the price of electricity are a natural extension of the bank's existing financial intermediation activities involving energy commodities. The bank states that energy derivative customers have requested that the bank offer electricity derivative transactions for many years. The bank's electricity derivatives business will provide the bank's customers risk management tools in substantively the same manner as the bank provides such tools in connection with its existing petroleum, natural gas, and related derivatives business. Essentially, the bank will offer electricity derivative transactions to customers as an additional means for them to meet their legitimate financial and risk management needs.

The bank has expertise in conducting cash-settled energy commodity derivative transactions. Consistent with this expertise, the bank has well-established policies, procedures, and controls that it applies to its commodity derivatives businesses. For example, the bank: (i) hedges the price risk arising from cash-settled commodity derivatives on a portfolio basis and values transactions using data sets and models implemented in accordance with bank standards; (ii) records credit exposure against customer credit limits; (iii) documents cash-settled customer transactions using the ISDA Master Agreement, with appropriate confirmations; and (iv) uses operations systems that permit booking and settlement of cash-settled commodity derivative transactions. The bank represents that it will conduct the proposed activities in customer-driven, cash-settled electricity derivatives consistent with the same policies, procedures, and controls it applies to its existing energy commodity derivatives business ("Electricity Derivative Product Controls").

The bank commits that it will not commence its new cash-settled electricity derivatives business without first putting in place and implementing all necessary policies, procedures, and controls (including the "Electricity Derivative Product Controls") to assure that (i) its electricity derivative business is customer-driven, cash-settled, and meets all required regulatory standards for conducting a customer-driven derivative business, and (ii) the bank has in place all appropriate mechanisms to identify, monitor, limit, and control the risks inherent in conducting this business so that it complies with all applicable OCC guidance and requirements.[3]

The bank specifically acknowledges that, as contemplated by the OCC "Derivatives" handbook booklet and BC-277, an effective risk management process includes appropriate oversight and supervision, managerial and staff expertise, comprehensive policies and operating procedures, risk identification, measurement and management information systems, and effective risk control functions that oversee and ensure the continuing appropriateness of the risk management process. To manage the risks in its proposed cash-settled electricity derivatives business, the bank represents it will implement those policies, procedures, and controls set forth in OCC guidance, *e.g.,* OCC "Derivatives" handbook booklet and BC-277, to assure the ongoing function and maintenance of an effective risk management process. In implementing those policies, procedures, and controls, the bank commits to conducting a full evaluation of (i) pricing, hedging (including portfolio hedging), processing, recordkeeping, documentation, accounting, "back office," and risk management; (ii) the development of adequate knowledge, staff, oversight management, and technology (including contingency planning) to accommodate the activity; (iii) the implementation of appropriate controls (including the "Electricity Derivative Product Controls" discussed above); (iv) the establishment, implementation, and monitoring of appropriate risk management limits with respect to various types of risks—such as market risk, credit risk, and liquidity risk—associated with a customer-driven, cash-settled derivatives activity;[4] and (v) Compliance Department training of personnel and development of a supervisory framework designed to ensure compliance with policies and procedures, including trading practices. Such a framework will strictly prohibit

[3] *See, e.g.*, OCC *Comptroller's Handbook,* "Risk Management of Financial Derivatives" (January 1997 [print version; rev. for Web only, October 2001, available at http://www.occ.treas.gov/handbook/deriv.pdf]) (referred to as the OCC "Derivatives" handbook booklet); OCC Banking Circular No. 277 (October 27, 1993), *reprinted in* CCH Fed. Banking L. Rep. ¶ 62–152 (BC–277); OCC Bulletin 94–31 (May 10, 1994), *reprinted in* CCH Fed. Banking L. Rep. ¶ 62–152.

[4] For example, in the context of market and related risks of electricity derivatives, the bank will specifically address such matters as price volatility and concentration of market participants on a geographic and power exchange/power pool/individual customer basis. In the context of options, it will specifically address all of those characteristics identified in the OCC "Derivatives" handbook booklet (*e.g.*, at 20–21 and Appendix B) as primary component measures of option sensitivity.

manipulative practices of any kind, including patterns of trading related to so-called "round tripping" of electricity derivatives transactions.[5] Risk control, operations, accounting, legal, compliance, audit, and senior and line management will all be involved in assuring that the risks undertaken by the bank are comparable to, and are addressed in ways comparable to those applicable to, the bank's existing energy-based derivative products and business.

The bank further commits that: [1] it will *not* engage in any electricity derivatives transactions that might physically settle without the OCC's permission, [2] any trading in derivatives will be limited to cash-settled derivatives and done primarily to hedge residual open positions arising from customer transactions, and [3] its electricity derivative business will be customer driven; it will *not* be operated as a proprietary trading business. Transactions in electricity markets will permit the bank to manage and hedge, within well-controlled limits, the risks arising from valid, customer-driven, derivative transactions.

II. Discussion

In our opinion, the bank may establish a customer-driven, cash-settled electricity derivative business and hedge risks arising from these permissible banking activities, provided the bank has established an appropriate risk measurement and management process for its electricity derivative and hedging activities. This process is necessary for the bank to achieve its customer risk management objectives in a safe and sound manner and, thus, must be established before the OCC can determine that the proposed activities are permissible as part of the business of banking.

A. Financial Intermediation Transactions Involving Commodities are Authorized as Part of the Business of Banking

The OCC has previously concluded in a variety of contexts that national banks may engage in customer-driven, cash-settled financial intermediation transactions they are authorized to conduct as part of the business of banking under 12 USC 24(Seventh). The OCC has recognized, for example, that commodity and commodity index derivatives are a modern form of traditional financial intermediation functions performed by banks and, based in part on that lineage, has concluded that national banks may make payments to, or receive payments from, customers under commodity derivative contracts in the event of a gain or loss in a metal or energy product or index thereon. These derivative transactions thus have been recognized as permissible for national banks as a financial intermediation activity.[6]

In these arrangements, national banks act as financial intermediaries between customers that want to manage risks resulting from the variations in the price of a particular commodity or commodity index. Customers do not deal directly with one another, but instead make payments to the intermediary bank.[7] Under these authorities, the OCC has determined that national banks may engage in matched and unmatched commodity price index swaps and manage and warehouse them on a portfolio basis and originate, trade, and make markets in certain swap products and in other derivative instruments such as futures and options.[8]

Based on similar reasoning, the OCC has permitted national banks to engage in various commodity-linked transactions involving oil, gas, other hydrocarbons, and metals.[9] "Commodity-linked transactions" include making

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[5] For example, the head of the electricity derivatives desk will be provided with a "supervisory checklist" that describes the responsibilities of the position in monitoring transactions for market manipulation, including round-tripping. This individual will receive daily position and activity reports to review and monitor consistent with the best practices policy. The bank's Compliance Division will also receive and review on a daily basis, position and activity reports and, on a quarterly basis, will test the appropriateness of derivative transactions and hedges and review documentary support. Bank employees involved in this business will be subject to applicable "Standards of Professional Conduct" and be required to attend annual compliance training.

[6] *See* OCC No-Objection Letter No. 90–1 (February 16, 1990), *reprinted in* [1989–1990 Transfer Binder] Fed. Banking L. Rep. ¶ 83,095 ("*Unmatched Commodity Swap Letter*"); OCC No-Objection Letter No. 87–5 (July 20, 1987), *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 84,034 ("*Matched Commodity Swap Letter*"). The *Unmatched Commodity Swap Letter* and the Ma*tched Commodity Swap Letter* predate *NationsBank of North Carolina* v. *Variable Annuity Life Insurance Co.*, 513 U.S. 251 (1995) and characterized the commodity price index swaps as a financial intermediary activity incidental to a bank's express power to engage in deposit and lending activities under 12 USC 24(Seventh). The OCC has since concluded that swap and funds intermediation activities are part of the business of banking. *See* OCC Interpretive Letter No. 892 (September 13, 2000), *reprinted in* [2000–2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–411; OCC Letter from Ellen Broadman, director, Securities and Corporate Practices Division, OCC, to Barbara Moheit, regional counsel, FDIC (October 20, 1998) (unpublished) *("Broadman Letter").*

[7] In the event of a customer default on a commodity swap, the bank makes payments in place of a defaulting customer's obligation. The bank's payment is an advance of funds for which the defaulting customer is obligated to reimburse the bank or is an exercise of a national bank's authority to make loans.

[8] OCC Letter from Jimmy F. Barton, deputy comptroller, Multinational Banking, to Carl Howard, associate general counsel, Citibank, N.A. (May 13, 1992) (unpublished); Unmatched Commodity Swap Letter, supra; Matched Commodity Swap Letter, supra.

[9] *See, e.g.,* OCC Interpretive Letter No. 684 (August 4, 1995), *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,632; OCC Letter from Robert Herman, Deputy Comptroller (October 4, 1994) (unpublished); OCC Interpretive Letter No. 632 (June 30, 1993), *reprinted in* [1993–1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,516.

loans, taking deposits, and issuing debt instruments having terms related to commodity prices, sales, or indices, or measured in relation to the future; and entering into swaps, forwards, and other transactions relating to commodity prices and indices, or any combination thereof, in order to assist customers of the bank in managing their financial exposures.[10] National banks may also originate, trade, and make markets in swap contracts and related derivative products, including cash-settled commodity swaps, caps, collars, floors, swaptions, captions, and other option-like products, based on their deposit taking, lending, and financial intermediation authority.[11]

Moreover, Congress has recognized the authority of national banks to engage in commodity derivative transactions. Under the Gramm–Leach–Bliley Act,[12] banks may offer "identified banking products" without registration under the Securities Exchange Act of 1934,[13] subject to banking law requirements and supervision. "Identified banking products" include certain swap agreements, defined as "any individually negotiated contract, agreement, warrant, note or option that is based, in whole or in part, on the value of, any interest in, or any quantitative measure or the occurrence of any event relating to, one or more *commodities,*[14] securities, currencies, interest or other rates, indices, or other assets."[15] The GLBA conference report further observes that these products are among the "activities in which banks have traditionally engaged."[16] Congress' recognition that banks engage in commodity derivative transactions and exemption of these activities from certain securities regulations is consistent with the OCC's longstanding position that national banks have the authority to engage in customer-driven, cash-settled commodity derivative transactions, subject to safety and soundness considerations.

[10] OCC Interpretive Letter No. 632, *supra*.

[11] OCC Letter from Horace Sneed, Senior Attorney, LASD, (March 2, 1992) (unpublished) ("*Commodity Swap Portfolio Letter*").

[12] Pub. L. No. 106–102 (1990) (effective May 12, 2001) (GLBA).

[13] 15 USC 78a *et seq*.

[14] The Commodity Futures Trading Commission has recognized that entities engage in derivative instruments on various commodities, including crude oil, refined oil products, natural gas, metals, and *electricity* (emphasis added). *See, e.g.,* 2000 CFTC Ltr. LEXIS 248 (December 4, 2000).

[15] (emphasis added). See P.L. 106–102, 113 Stat. 1338 (1999), sections 201, 202, 206.

[16] H.R. Rep. No. 106–434 at 163 (1999) (Summary of Title II in Managers' Statement).

B. The Bank's Proposed Cash-Settled Electricity Derivative Business is Functionally Equivalent to other Bank Permissible Commodity Derivative Transactions

Electricity derivative transactions are a natural extension of the bank's existing energy derivative products, *e.g.,* petroleum, natural gas, and other hydrocarbon derivative products. Electricity swaps, forwards and options are the operational, structural, and functional equivalents of commodity derivative transactions the OCC has previously determined are permissible for national banks. Customer-driven, cash-settled commodity swaps, forwards, and options, whether based on metals or energy, including electricity, are privately negotiated contracts between the parties to the transactions. As such, the terms of the swaps, forwards, and options may be individually tailored to the specific risk sensitivities of customers, *e.g.,* limiting exposure to price fluctuations and market uncertainties. And, by entering into a swap, forward, or option contract, the parties agree to make payments based on the performance of a particular commodity or commodity index, whether the commodity at issue is an energy product, such as petroleum, natural gas, a hydrocarbon or electricity, or metal, such as aluminum, lead, nickel, tin, zinc cobalt, iridium, and rhodium.

All of these contracts involve exchanges of payments akin to those that a bank makes and receives in connection with its role as a financial intermediary. Cash-settled electricity swaps are agreements between two counterparties that allow them to exchange fixed or floating payments based on a notional amount of electricity. Banks' authority to enter into cash-settled swaps is well established.[17]

[17] In the 1980s the OCC opined on the permissibility of national banks engaging in interest rate, currency, and commodity price index swaps and caps. *See* Matched Commodity Swap Letter; OCC Interpretive Letter No. 462 (December 19, 1988), *reprinted in* [1988–1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,686; OCC Letter from J. Michael Shepherd, senior deputy comptroller, Corporate and Economic Programs (July 7, 1988) (unpublished). Then, in the 1990s, the OCC recognized that national banks may advise, structure, arrange, and execute transactions, as agent or principal, in connection with interest rate, basis rate, currency, currency coupon, and cash-settled commodity and equity swaps; swaptions, captions, and other option-like products; forward rate agreements, rate locks and spread locks, as well as similar products that national banks are permitted to originate and trade in and in which they may make markets. *See* OCC Interpretive Letter No. 725 (May 10, 1996), *reprinted in* [1995–1996 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81,040; OCC Interpretive Letter No. 652 (September 13, 1994), *reprinted in* [1994 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,600; OCC Letter from Jimmy F. Barton, deputy comptroller, Multinational Banking, to Carl Howard, associate general counsel, Citibank, N.A. (May 13, 1992) (unpublished); *Commodity Swap Portfolio Letter*; *Unmatched Commodity Swap Letter, supra.*

Similar exchanges of payments may be achieved using forwards or options. For example, cash-settled electricity and other swaps are basically portfolios of cash-settled forwards. Each forward embedded in a swap transaction is an agreement to exchange payments based on a fixed or floating price at a certain future date. To illustrate, an electricity swap might consist of an exchange of payments based on a notional amount of electricity every month for the next five years. The instrument is a swap because the parties exchange the net of two offsetting payment streams, once a month. The swap is nothing more than a series of 60 separate forward contracts (12 months × 5 years). Although forward contracts may provide for physical delivery, cash-settled forwards are functionally equivalent to cash-settled swaps and permissible under banks' deposit, lending and financial intermediary authorities.

Cash-settled options are similar to those cash-settled contracts, and thus permissible for national banks, in that options permit the holder to decide to execute a transaction in the future with the seller at a price determined today. Cash-settled options also are similar to cash-settled swaps and forwards in that two options—a cap and a floor—can replicate the cash flow of swap transactions. The same legal reasoning that allows national banks to engage in cash-settled electricity swaps applies to cash-settled forwards and options. Expansion of the bank's existing commodity derivatives business to include cash-settled electricity-linked transactions will not effect any substantive change in the *type* or *nature* of the activity conducted, but only in their underlying *basis (i.e.,* the particular commodity in question).

Finally, GLBA supports the permissibility of national banks entering into cash-settled electricity transactions, by not limiting the types of commodity derivative transactions exempt from registration under the 1934 [Securities Exchange] Act. Of course, for any commodity derivative transaction to be permissible for national banks, it must be permissible under national banking law, which requires, as discussed below, the bank to have appropriate risk measurement and management processes in place to conduct the activity.

As described in Section I, the bank's proposal to engage in customer-driven, cash-settled electricity derivative business is intended to build on the bank's existing client product offerings in petroleum, natural gas, and other energy-related financial instruments, and to provide to customers sophisticated risk management tools directly related to the accommodation of customer needs. Bank customers seek a creditworthy, sophisticated, and focused counterparty to assist them in meeting their electricity price management needs and to act as an intermediary in derivative transactions on their behalf. The bank's entry into the electricity derivatives business will provide customers a new, high credit quality counterparty for these transactions that is a trusted and known quantity to them and has significant experience, knowledge, and expertise. The bank's ability to engage in a customer-driven, cash-settled, electricity derivative business will also benefit the bank's customers by reducing customers' financial risks associated with fluctuations in the prices of commodities.[18]

In addition, the bank will benefit from an electricity derivative business that enables it to diversify, expand its customer base, and increase revenues. The bank's proposed cash-settled electricity derivative business will pose risks similar to those inherent in other types of cash-settled electricity derivatives transactions with which it is already familiar and for which it has demonstrated the ability to successfully manage, *e.g.,* counterparty, price, basis, liquidity, credit, and compliance risks.

C. Hedging Risks Arising from Bank Permissible Commodity Derivative Activities Is Integral to Those Permissible Activities

The OCC has long recognized that using derivatives to hedge against the risks associated with bank permissible activities is an integral part of those permissible banking activities.[19] Indeed, the OCC has determined that national banks may hedge bank permissible commodity derivative transactions with other commodity derivatives, such as futures, and swaps and options, and other over-the-counter (OTC) instruments, when conducted in a safe and sound manner as provided in OCC guidance.[20] Hence, as with other commodity derivatives, national banks may hedge bank permissible electricity derivative transactions with

[18] *See, e.g., Unmatched Commodity Swap Letter.*

[19] Through hedging activities, national banks serve in a financial intermediation capacity. Longstanding OCC precedent recognizes the authority of national banks to act as financial intermediaries, engaging in permissible derivative transactions and assuming offsetting positions or hedges. In so doing, the bank protects itself against risks arising from established, permissible banking activities. As a result of hedging, a bank becomes an intermediary, by interposing itself between customers initiating bank permissible derivative transactions and those providing offsetting returns. Thus, because hedging is an integral part of financial intermediation services, the activity is permissible for national banks. OCC Interpretive Letter No. 896 (August 21, 2000), *reprinted in* [2000–2001 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 81–415; *Broadman Letter, supra.*

[20] OCC Interpretive Letter No. 684, *supra*; OCC Interpretive Letter No. 683 (July 28, 1995), *reprinted in* [1994–1995 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 83,631; OCC Interpretive Letter No. 632, *supra*; *Commodity Swap Portfolio Letter, supra.*

electricity futures, and swaps and options and OTC derivative instruments. Further, the OCC has specifically endorsed the hedging of commodity transactions on a transaction-by-transaction or portfolio basis.[21] The principles that the OCC has articulated in hedging commodity derivatives and related contexts are equally applicable to hedging customer-driven, cash-settled electricity derivative transactions.[22]

D. The Customer-Driven, Cash-Settled Electricity Derivative Transactions and Hedges Must Be Conducted in a Safe and Sound Manner

Engaging in customer-driven, cash-settled derivative transactions and hedges does not automatically qualify the activity as part of the business of banking. The nature of the electricity derivative activity proposed requires sophisticated risk measurement and management capacities on the part of a bank and qualified personnel, in order for the activity to actually function as described and to operate in a safe and sound manner. Thus, in order for the OCC to conclude that this proposed activity is permissible for the bank as "part of the business of banking" the bank must demonstrate to the satisfaction of the OCC that the bank has established an appropriate risk measurement and management process for its electricity derivative activity. As detailed further in the OCC "Derivatives" handbook booklet and BC-277, an effective risk measurement and management process includes board supervision, managerial and staff expertise, comprehensive policies and operating procedures, risk identification and measurement, and management information systems, as well as an effective risk control function that oversees and ensures the appropriateness of the risk management process.

[21] *See, e.g., Swap Portfolio Letter*, *supra*; *Unmatched Commodity Swap Letter*, supra; *Matched Commodity Swap Letter*, supra.

[22] Indeed, the Federal Reserve Board, in recognizing that "[b]anking organizations have developed a number of commodity . . . linked transactions . . . including commodity-indexed deposits, loans, debt issues, and derivative products, such as *forwards, options,* and *swaps,"* has noted that banks enter "into exchange-traded commodity or stock index futures and options in order to hedge the exposure inherent in these transactions." (emphasis added). 12 CFR 208.128 (repealed so as to broaden the authority of state member banks to engage in derivative transactions without prior Federal Reserve Board approval; *See* 62 Fed. Reg. 15272, 15276 (Mar. 31, 1997) (discussing proposed repeal of section 208.128); *see also* 63 Fed. Reg. 37630 (July 13, 1998)). The OCC recognizes the similarity of different financial instruments, stating, for example, that "[d]espite their difference in form, options, futures and options on futures serve a similar function: enabling banks and investors to hedge against risk of . . . price changes relating to the underlying instruments." OCC Interpretive Letter No. 896, *supra.* In the equity context, the OCC "Derivatives" handbook booklet makes clear (at 71) that banks that enter into swap transactions may hedge these transactions with "futures contracts, options, and similar over-the-counter instruments." *See also* note 3 above.

In addition to a risk management program, the bank's process must include an independent compliance monitoring program to ensure ongoing compliance with the specific commitments made by the bank, including its commitment to conduct its financial intermediation activities in electricity as a customer-driven, and non-proprietary trading business.[23] The bank must have an adequate and effective compliance monitoring program that includes policies, training, independent surveillance, and well-defined exception approval and reporting procedures.

The OCC will make these determinations though the bank's examiner-in-charge (EIC), and the bank may not commence the proposed activities unless and until its EIC has concluded that the foregoing standards are met.

III. Conclusion

The bank may conduct the proposed customer-driven, cash-settled electricity derivative business and hedge risks arising from these permissible banking activities as an extension of its existing energy-related commodities derivatives business, provided the bank has established, to the satisfaction of its EIC, an appropriate risk measurement and management process for its electricity derivative and hedging activities.

Julie L. Williams
First Senior Deputy Comptroller and Chief Counsel

[23] The OCC has long considered safety and soundness issues when determining whether an activity is part of, or incidental to the business of banking. *See e.g.*, OCC Interpretive Letter No. 892, *supra* (national bank may engage in equity hedging activities only if it has an appropriate risk management process in place); OCC Banking Bulletin 96–5 (September 20, 1996) (replaced by OCC Bulletin 2000–23 (July 20, 2000)) (national bank's purchase of life insurance is incidental to banking if it is convenient or useful in connection with the conduct of the bank's business and consistent with safe and sound banking practices); OCC Interpretive Letter No. 684, *supra* (commodity hedging is a permissible banking activity provided the activity is conducted in accordance with safe and sound banking practices); *Decision of the Office of the Comptroller of the Currency on the Request by Chase Manhattan Bank, N.A. to Offer the Chase Market Index Investment Deposit Account* (August 8, 1988) (national banks have the authority to establish the amount of the payments to be made and received under their deposit and loan contracts and may determine the amount of those payments by reference to any index or standard as long as the bank complies with safe and sound banking principles and, in the case of loans, with state usury laws); OCC Interpretive Letter No. 376 (October 22, 1986) *reprinted in* [1985–1986 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,600 (indemnification from losses resulting from participation in the bank's fiduciary securities lending program is a permissible incidental activity provided the indemnification is consistent with OCC guidance and safety and soundness); OCC Interpretive Letter No. 274 (December 2, 1983) *reprinted in* [1983–1984 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,438 (a national bank's authority to lease its office space provides the authority for it to establish appropriate lease terms if consistent with safe and sound banking practices).

Mergers—April 1 to June 30, 2002

Mergers—April 1 to June 30, 2002

Most transactions in this section do not have accompanying decisions. In those cases, the OCC reviewed the competitive effects of the proposals by using its standard procedures for determining whether the transaction has minimal or no adverse competitive effects. The OCC found the proposals satisfied its criteria for transactions that clearly had no or minimal adverse competitive effects. In addition, the Attorney General either filed no report on the proposed transaction or found that the proposal would not have a significantly adverse effect on competition.

Nonaffiliated mergers (mergers consummated involving two or more nonaffiliated operating banks), from April 1 to June 30, 2002

Title and location (charter number)	Total assets
California	
Union Bank of California, National Association, San Francisco (021541)	35,591,168,000
and First Western Bank, Simi Valley, California	208,216,000
merged on May 13, 2002 under the title of **Union Bank of California, National Association, San Francisco** (021541)	35,799,384,000
Georgia	
First National Bank of Griffin, Griffin (015572)	248,038,000
and American Community Bank of Georgia, McDonough, Georgia	59,017,000
merged on May 31, 2002 under the title of **First National Bank of Griffin, Griffin** (015572)	307,055,000
New York	
Bath National Bank, Bath (010235)	357,004,000
and Bank of Avoca, Avoca, New York	18,413,000
merged on May 1, 2002 under the title of **Bath National Bank, Bath** (010235)	297,000,000
The National Bank of Florida, Florida (013825)	100,364,000
and Provident Interim Bank, Montebello, New York	1,000
merged on April 23, 2002 under the title of **The National Bank of Florida, Florida** (013825)	100,364,000
Texas	
Independence Bank, National Association, Houston (018076)	106,927,000
and Regions Interim Bank, Birmingham, Alabama	1,000
merged on May 16, 2002 under the title of **Independence Bank, National Association, Houston** (018076)	106,927,000

Affiliated mergers (mergers consummated involving affiliated banks), from April 1 to June 30, 2002

Title and location (charter number)	Total assets
Arizona	
BNC National Bank of Arizona, Tempe (024224)	14,728,000
and BNC National Bank, Minneapolis, Minnesota (022973)	573,163,000
merged on April 8, 2002 under the title of **BNC National Bank, Tempe** (024224)	584,286,000
Colorado	
The First National Bank of Longmont, Longmont (011253)	308,064,000
and First State Bank of Fort Collins, Fort Collins, Colorado	97,529,000
merged on June 21, 2002 under the title of **The First National Bank of Longmont, Longmont** (011253)	405,593,000
Illinois	
MB Financial Bank, National Association, Chicago (013684)	60,000
and The First National Bank of Lincolnwood, Lincolnwood, Illinois (014752)	239,562,000
and MB Financial Bank, National Association, Chicago, Illinois (013684)	3,080,603,000
merged on April 5, 2002 under the title of **MB Financial Bank, National Association, Chicago** (013684)	3,320,165,000
Bank One, National Association, Chicago (000008)	161,022,572,000
and Bank One, Michigan, Detroit, Michigan	20,825,649,000
merged on June 21, 2002 under the title of **Bank One, National Association, Chicago** (000008)	181,848,221,000
Kansas	
TeamBank, National Association, Paola (003350)	371,820,000
and Community Bank, Chapman, Kansas	55,186,000
merged on June 21, 2002 under the title of **TeamBank, National Association, Paola** (003350)	427,006,000
Horizon National Bank, Leawood (023748)	107,385,000
and Winterset State Bank, Harrisonville, Missouri	36,520,000
merged on June 26, 2002 under the title of **Horizon National Bank, Leawood** (023748)	143,905,000
Minnesota	
Signal Bank National Association, Eagan (023582)	719,454,000
and Associated Bank Minnesota, Minneapolis, Minnesota	719,299,000
and Signal Bank South National Association, Red Wing, Minnesota (007307)	339,588,000
merged on June 14, 2002 under the title of **Associated Bank Minnesota National Association, Minneapolis** (023582)	1,778,341,000
Nebraska	
Cornerstone Bank, National Association, York (002683)	296,013,000
and Citizens State Bank, Polk, Nebraska	10,374,000
merged on April 4, 2002 under the title of **Cornerstone Bank, National Association, York** (002683)	306,387,000
New Jersey	
Valley National Bank, Passaic (015790)	7,956,604,000
and VNB DEL, Inc., Wayne, New Jersey	1,000
merged on December 26, 2001 under the title of **Valley National Bank, Passaic** (015790)	7,956,604,000
New Mexico	
Wells Fargo Bank New Mexico, National Association, Albuquerque (006187)	4,467,817,000
and Bank of Santa Fe, National Association, Santa Fe, New Mexico (024317)	160,669,000
merged on June 15, 2002 under the title of **Wells Fargo Bank New Mexico, National Association, Albuquerque** (006187)	4,645,991,000
North Carolina	
First Union National Bank, Charlotte (000001)	232,195,000,000
and Wachovia Bank, National Association, Winston-Salem, North Carolina (001559)	73,264,000,000
merged on April 1, 2002 under the title of **Wachovia Bank, National Association, Charlotte** (000001)	303,659,000,000

Affiliated mergers (continued)

Title and location (charter number)	Total assets
Ohio	
Charter One Bank, National Association, Cleveland (024340)	38,432,256,000
and Charter One Commercial, Albany, New York	316,836,000
merged on May 16, 2002 under the title of **Charter One Bank, National Association, Cleveland** (024340)	38,809,538,000
Oklahoma	
Shamrock Bank, National Association, Coalgate (012529)	42,480,000
and Shamrock Bank, National Association, Mountain View, Oklahoma (005656)	27,330,000
merged on March 22, 2002 under the title of **Shamrock Bank, National Association, Coalgate** (012529)	69,810,000
Tennessee	
First National Bank of Pulaski, Pulaski (014619)	341,142,000
and Bank of Belfast, Belfast, Tennessee	22,314,000
merged on April 12, 2002 under the title of **First National Bank of Pulaski, Pulaski** (014619)	363,456,000
Texas	
Wells Fargo Bank Texas, National Association, San Antonio (014208)	21,131,093,000
and The First National Bank of Texas, Decatur, Texas (013623)	390,720,000
and First State Bank of Texas, Denton, Texas	2,160,328,000
merged on June 15, 2002 under the title of **Wells Fargo Bank Texas, National Association, San Antonio** (014208)	23,913,786,000
Virginia	
Salem Bank and Trust, National Association, Salem (021516)	252,007,000
and FNB—Southwest, National Association, Roanoke, Virginia (024274)	88,429,000
merged on May 6, 2002 under the title of **FNB Salem Bank & Trust, National Association, Salem** (021516)	340,436,000
Wisconsin	
Associated Trust Company, National Association, Milwaukee (023250)	21,182,000
and Signal Trust Company National Association, Eagan, Minnesota (023624)	1,971,000
merged on April 1, 2002 under the title of **Associated Trust Company, National Association, Milwaukee** (023250)	23,153,000

Affiliated mergers—thrift (mergers consummated involving affiliated national banks and savings and loan associations), from April 1 to June 30, 2002

Title and location (charter number)	Total assets
Ohio	
First National Bank, Orrville (013742)	198,309,000
and Peoples Federal Savings & Loan Association of Massillon, Massillon, Ohio	108,840,000
merged on April 3, 2002 under the title of **First National Bank, Orrville** (013742)	297,834,000
Peoples Bank, National Association, Marietta (005552)	1,198,581,000
and The Guernsey Bank, FSB, Cambridge, Ohio	110,000,000
merged on June 15, 2002 under the title of **Peoples Bank, National Association, Marietta** (005552)	1,308,581,000
Tennessee	
Union Planters Bank, National Association, Memphis (013349)	32,257,447,000
and Jefferson Heritage Bank, Denton, Texas	451,406,000
merged on June 21, 2002 under the title of **Union Planters Bank, National Association, Memphis** (013349)	32,708,853,000

Tables on the Corporate Structure of the National Banking System

Changes in the corporate structure of the national banking system, by state, January 1 to June 30, 2002

	In operation January 1, 2002	Organized and open for business	Merged	Voluntary liquidations	Payouts	12 USC 214 Converted to non-national institutions	12 USC 214 Merged with non-national institutions	In operation June 30, 2002
Alabama	23	0	0	0	0	1	0	22
Alaska	4	0	0	0	0	0	0	4
Arizona	18	1	2	0	1	0	0	16
Arkansas	42	1	0	0	0	0	0	43
California	92	3	4	0	0	1	1	89
Colorado	55	1	2	0	0	0	1	53
Connecticut	10	1	0	0	0	0	0	11
Delaware	22	0	1	0	0	0	1	20
District of Columbia	5	0	0	0	0	0	0	5
Florida	80	0	0	0	2	2	0	76
Georgia	60	6	3	0	0	0	0	63
Hawaii	1	0	0	0	0	0	0	1
Idaho	2	0	0	0	0	0	0	2
Illinois	186	0	3	0	0	0	1	182
Indiana	36	0	0	0	0	1	0	35
Iowa	48	3	0	0	0	0	0	51
Kansas	105	0	0	0	0	0	0	105
Kentucky	54	0	1	0	0	0	0	53
Louisiana	17	0	0	0	0	0	0	17
Maine	7	0	0	0	0	0	0	7
Maryland	13	0	0	0	0	1	0	12
Massachusetts	23	2	1	0	0	0	0	24
Michigan	28	1	0	0	0	0	0	29
Minnesota	130	3	4	0	0	0	1	128
Mississippi	20	0	0	0	0	0	0	20
Missouri	46	2	0	0	0	0	0	48
Montana	18	0	2	0	0	0	0	16
Nebraska	79	1	1	0	0	0	2	77
Nevada	8	0	0	0	0	0	0	8
New Hampshire	7	0	1	0	0	0	0	6
New Jersey	24	2	1	0	0	0	0	26
New Mexico	15	1	1	0	0	0	0	15
New York	62	1	2	0	0	0	1	59
North Carolina	8	0	1	0	0	0	0	7
North Dakota	15	0	0	0	0	0	0	15
Ohio	92	2	1	0	0	0	2	91
Oklahoma	99	0	1	0	0	2	0	96
Oregon	4	0	0	0	0	0	0	4
Pennsylvania	86	1	1	0	0	0	2	84
Rhode Island	4	0	0	0	0	0	0	5
South Carolina	25	0	0	0	0	0	0	25
South Dakota	20	1	0	0	0	0	0	21
Tennessee	28	0	0	0	0	0	0	28
Texas	346	4	1	0	0	4	5	340
Utah	7	0	0	0	0	0	0	7
Vermont	12	0	4	0	0	0	0	8
Virginia	38	0	2	0	0	0	0	36
Washington	17	1	1	0	0	0	1	16
West Virginia	24	0	0	0	0	1	1	22
Wisconsin	52	0	0	0	0	1	0	51
Wyoming	20	0	0	0	0	0	0	20
United States:	2,238	38	41	0	3	14	19	2,199

Notes: The column "organized and opened for business" includes all state banks converted to national banks as well as newly formed national banks. The column titled "merged" includes all mergers, consolidations, and purchases and assumptions of branches in which the resulting institution is a nationally chartered bank. Also included in this column are immediate FDIC-assisted "merger" transactions in which the resulting institution is a nationally chartered bank. The column titled "voluntary liquidations" includes only straight liquidations of national banks. No liquidation pursuant to a purchase and assumption transaction is included in this total. Liquidations resulting from purchases and assumptions are included in the "merged" column. The column titled "payouts" includes failed national banks in which the FDIC is named receiver and no other depository institution is named as successor. The column titled "merged with non-national institutions" includes all mergers, consolidations, and purchases and assumptions of branches in which the resulting institution is a non-national institution. Also included in this column are immediate FDIC-assisted "merger" transactions in which the resulting institution is a non-national institution.

Applications for new, full-service national bank charters, approved and denied, by state, January 1 to June 30, 2002

Title and location	Approved	Denied
Arizona		
Community Bank of Arizona, National Association, Wickenburg	January 3, 2002	
California		
Landmark National Bank, Solana Beach	February 25, 2002	
Orange County Business Bank, National Association, Newport Beach	April 29, 2002	
Pacific Commerce Bank, National Association, Los Angeles	April 29, 2002	
Florida		
Infinity Bank, National Association, West Palm Beach	May 21, 2002	
Iowa		
United Bank & Trust National Association, Marshalltown	March 20, 2002	
Kansas		
First Commerce Bank, National Association, Marysville	June 5, 2002	
Kentucky		
First National Bank of Lexington, Lexington	May 17, 2002	
Missouri		
Community National Bank, Monett	June 12, 2002	
New Jersey		
Grand Bank, National Association, Hamilton	January 22, 2002	
South Carolina		
Carolina National Bank and Trust Company, Columbia	March 28, 2002	
Texas		
Community National Bank, Bellaire	January 14, 2002	
Worthington National Bank, Arlington	May 14, 2002	
Virginia		
Bank of Louisa, National Association, Louisa	March 15, 2002	
Citizens National Bank, Windsor	January 18, 2002	
California		
LaSalle Interim Bank National Association, San Diego	January 15, 2002	
Minnesota		
Securian Trust Company, National Association, St. Paul	January 9, 2002	

New, full-service national bank charters issued, January 1 to June 30, 2002

Title and location	Charter number	Date opened
Arizona		
Community Bank of Arizona, National Association, Wickenburg	024320	January 29, 2002
California		
Pacific Capital Bank, National Association, Santa Barbara	024319	March 29, 2002
Granite Community Bank, National Association, Granite Bay	024289	June 4, 2002
Colorado		
Southern Colorado National Bank, Pueblo	024253	March 1, 2002
Georgia		
First National Bank West Metro, Dallas	024261	March 25, 2002
First Southern National Bank, Statesboro	024254	February 5, 2002
The National Bank of Gainesville, Gainesville	024169	March 25, 2002
SouthBank, National Association, Woodstock	024152	May 20, 2002
Iowa		
United Bank & Trust National Association, Marshalltown	024346	June 17, 2002
Massachusetts		
Leader Bank, National Association, Arlington	024131	May 8, 2002
Nebraska		
Citizens National Bank in Loup City, Loup City	024280	January 28, 2002
New Jersey		
Grand Bank, National Association, Hamilton	024268	March 1, 2002
New Mexico		
Bank of Santa Fe, National Association, Santa Fe	024317	January 21, 2002
Ohio		
Signature Bank, National Association, Toledo	024264	April 2, 2002
Texas		
Community National Bank, Bellaire	024303	June 17, 2002
The Right Bank For Texas, National Association, Houston	024263	May 13, 2002
Washington		
Eastside Commercial Bank, National Association, Bellevue	024180	April 3, 2002

New, limited-purpose national bank charters issued, January 1 to June 30, 2002

Title and location	Charter number	Date opened
California		
LaSalle Interim Bank National Association, San Diego	024330	January 31, 2002
Georgia		
U.S. Bank Trust National Association, Atlanta	024315	January 10, 2002
Massachusetts		
Family Capital Trust Company, National Association, Boston	024130	March 1, 2002
Minnesota		
Securian Trust Company, National Association, St. Paul	024310	February 22, 2002
Missouri		
Country Club Trust Company, National Association, Kansas City	024290	March 8, 2002
New Jersey		
Alger National Trust Company, Morristown	024231	January 28, 2002
Pennsylvania		
First National Trust Company, Hermitage	024283	January 18, 2002

State-chartered banks converted to full-service national banks, January 1 to June 30, 2002

Title and location (charter number)	Effective date	Total assets
Arkansas		
First National Bank (024333)		
conversion of First Bank of Montgomery County, Mt. Ida	April 1, 2002	77,601,000
Iowa		
Western Bank & Trust National Association (024328)		
conversion of Western Bank & Trust, Moville	January 1, 2002	58,620,000
First National Bank Midwest		
conversion of Iowa Trust & Savings Bank, Oskaloosa (024267)	January 22, 2002	98,498,000
Minnesota		
Merchants Bank, National Association (024302)		
conversion of Hampton Bank, Hampton	February 1, 2002	94,512,000
Merchants Bank, National Association (024301)		
conversion of La Crescent State Bank, La Crescent	February 1, 2002	42,439,000
Missouri		
UMB Bank, Warsaw, National Association (024273)		
conversion of UMB Bank, Warsaw, Warsaw	January 29, 2002	73,298,000
Texas		
Friona State Bank, National Association (024321)		
conversion of Friona State Bank, Friona	January 31, 2002	79,303,000

State-chartered banks converted to limited-purpose national banks, January 1 to June 30, 2002

Title and location (charter number)	Effective date	Total assets
Connecticut		
Phoenix National Trust Company (024247)		
conversion of Phoenix Charter Oak Trust Company, Hartford	January 9, 2002	21,011,800,000
Georgia		
Synovus Trust Company, National Association (024350)		
conversion of Synovus Trust Company, Columbus	June 1, 2002	16,125,000
Michigan		
CB Wealth Management, National Association (024305)		
conversion of Citizens Bank, Flint	March 1, 2002	2,600,000
South Dakota		
Citibank USA, National Association (024281)		
conversion of Hurley State Bank, Sioux Falls	January 3, 2002	323,200,000
Texas		
Legacy Trust Company, National Association (024338)		
conversion of Legacy Trust Company, Houston	March 29, 2002	835,000,000

Nonbanking institutions converted to full-service national banks, January 1 to June 30, 2002

Title and location (charter number)	Effective date	Total assets
Ohio		
Charter One Bank, National Association (024340) conversion of Charter One Bank, F.S.B., Cleveland	May 7, 2002	37,178,142,000

Nonbanking institutions converted to limited-purpose national banks, January 1 to June 30, 2002

Title and location (charter number)	Effective date	Total assets
New York		
UBS PaineWebber Trust Company, National Association (024286) conversion of UBS PaineWebber Trust Company, New York	January 31, 2002	5,387,000

Applications for national bank charters, by state and charter type, January 1 to June 30, 2002

					Charters issued				
	Received	Approved	Denied	New, full-service national bank charters issued	New, limited-purpose national bank charters issued	Full-service national charters issued to converting state-chartered banks	Limited-purpose national charters issued to converting state-chartered banks	Full-service national charters issued to converting nonbanking institutions	Limited-purpose national charters issued to converting nonbanking institutions
Alabama	0	0	0	0	0	0	0	0	0
Alaska	0	0	0	0	0	0	0	0	0
Arizona	0	1	0	1	0	0	0	0	0
Arkansas	0	0	0	0	0	1	0	0	0
California	4	4	0	2	1	0	0	0	0
Colorado	0	0	0	1	0	0	0	0	0
Connecticut	0	0	0	0	0	0	1	0	0
Delaware	0	0	0	0	0	0	0	0	0
District of Columbia	0	0	0	0	0	0	0	0	0
Florida	1	2	1	0	0	0	0	0	0
Georgia	0	0	0	4	1	0	1	0	0
Hawaii	0	0	0	0	0	0	0	0	0
Idaho	0	0	0	0	0	0	0	0	0
Illinois	0	0	0	0	0	0	0	0	0
Indiana	0	0	0	0	0	0	0	0	0
Iowa	1	1	0	1	0	2	0	0	0
Kansas	0	1	0	0	0	0	0	0	0
Kentucky	1	1	0	0	0	0	0	0	0
Louisiana	0	0	0	0	0	0	0	0	0
Maine	0	0	0	0	0	0	0	0	0
Maryland	0	0	0	0	0	0	0	0	0
Massachusetts	0	0	0	1	1	0	0	0	0
Michigan	0	0	0	0	0	0	1	0	0
Minnesota	1	1	0	0	1	2	0	0	0
Mississippi	0	0	0	0	0	0	0	0	0
Missouri	1	1	0	0	1	1	0	0	0
Montana	0	0	0	0	0	0	0	0	0
Nebraska	1	0	0	1	0	0	0	0	0
Nevada	1	0	0	0	0	0	0	0	0
New Hampshire	0	0	0	0	0	0	0	0	0
New Jersey	0	1	0	1	1	0	0	0	0
New Mexico	0	0	0	1	0	0	0	0	0
New York	0	0	0	0	0	0	0	0	1
North Carolina	0	0	0	0	0	0	0	0	0
North Dakota	0	0	0	0	0	0	0	0	0
Ohio	0	0	0	1	0	0	0	1	0
Oklahoma	0	0	0	0	0	0	0	0	0
Oregon	0	0	0	0	0	0	0	0	0
Pennsylvania	0	0	0	0	1	0	0	0	0
Rhode Island	0	0	0	0	0	0	0	0	0
South Carolina	1	1	0	0	0	0	0	0	0
South Dakota	0	0	0	0	0	0	1	0	0
Tennessee	1	0	0	0	0	0	0	0	0
Texas	2	2	0	2	0	1	1	0	0
Utah	0	0	0	0	0	0	0	0	0
Vermont	0	0	0	0	0	0	0	0	0
Virginia	0	2	0	0	0	0	0	0	0
Washington	0	0	0	1	0	0	0	0	0
West Virginia	0	0	0	0	0	0	0	0	0
Wisconsin	0	0	0	0	0	0	0	0	0
Wyoming	0	0	0	0	0	0	0	0	0
Total	15	18	0	17	7	7	5	1	1

*These figures may also include new national banks chartered to acquire a failed institution, trust company, credit card bank, and other limited-charter national banks.

Failed national bank paid out by the Federal Deposit Insurance Corporation, January 1 to June 30, 2002

Title and location (charter number)	Charter number	Effective date
Arizona		
NextBank, National Association, Phoenix	016595	February 7, 2002
Florida		
Net First National Bank, Boca Raton	020923	March 1, 2002
Hamilton Bank, National Association, Miami	017675	January 11, 2002

National banks merged out of the national banking system, January 1 to June 30, 2002

Title and location	Charter number	Effective date
California		
Pacific Century Bank, National Association, Encino	018152	December 28, 2001
Colorado		
The Berthoud National Bank, Berthoud	007995	December 31, 2001
Delaware		
Sun National Bank, Delaware, Wilmington	023728	November 16, 2001
Illinois		
PlainsBank of Illinois, National Association, Des Plaines	014820	January 15, 2002
Minnesota		
The First National Bank of Bovey, Bovey	011054	January 2, 2002
Nebraska		
First Western Bank, National Association, Atkinson	006489	March 1, 2002
Marquette Bank Nebraska, National Association, O'Neill	003424	March 1, 2002
New York		
The National Bank of Florida, Florida	013825	April 23, 2002
Ohio		
The Citizens Banking Company, Sandusky	011275	April 1, 2002
Wheeling National Bank, St. Clairsville	016696	March 1, 2002
Pennsylvania		
The Second National Bank of Masontown, Masontown	014333	January 31, 2002
Community Banks, National Association, Millersburg	002252	December 31, 2001
Texas		
First Mercantile Bank, National Association, Dallas	023466	March 28, 2002
NBC Bank, National Association, Eagle Pass	004490	December 31, 2001
Independence Bank, National Association, Houston	018076	May 17, 2002
Texas Guaranty Bank, National Association, Houston	018421	May 8, 2002
The First National Bank of Shamrock, Shamrock	007306	March 29, 2002
Washington		
AmericanWest Bank, National Association, Ephrata	021728	December 3, 2001
West Virginia		
The South Branch Valley National Bank, Moorefield	003029	January 18, 2002

National banks converted out of the national banking system, January 1 to June 30, 2002

Title and location (charter number)	Effective date	Total assets
Alabama		
The First National Bank, Brewton (015797)	December 31, 2001	112,258,000
California		
Six Rivers National Bank, Eureka (021925)	January 2, 2002	199,535,000
Florida		
The First National Bank of the Florida Keys, Marathon (016641)	January 28, 2002	223,380,000
Gulf Coast National Bank, Naples (022798)	January 28, 2002	354,097,000
Indiana		
Peoples National Bank, Washington (003842)	March 5, 2002	189,695,000
Maryland		
The National Bank of Rising Sun, Rising Sun (002481)	June 14, 2002	102,000,000
Oklahoma		
Interbank, National Association, Elk City (009959)	December 26, 2001	108,337,000
Territory National Bank, Muskogee (006511)	May 15, 2002	8,400,000
Texas		
First Community Bank, National Association, Alice (017619)	June 15, 2002	84,700,000
First Citizens Bank, National Association, Dallas (023050)	April 30, 2002	38,000,000
Riverbend Bank, National Association, Fort Worth (020193)	April 1, 2002	36,583,000
Rio National Bank, McAllen (018554)	June 3, 2002	41,239,000
West Virginia		
United National Bank, Parkersburg (001427)	March 23, 2002	3,462,529,000
Wisconsin		
Peoples National Bank, Hayward (012644)	June 14, 2002	166,413,000

Federal branches and agencies of foreign banks in operation, January 1 to June 30, 2002

	In operation January 1, 2002	Opened January 1–June 30, 2002	Closed January 1–June 30, 2002	In operation June 30, 2002
Federal branches				
California	1	0	0	1
Connecticut	1	0	0	1
District of Columbia	1	0	0	1
New York	36	0	0	36
Washington	1	0	0	1
Limited federal branches				
California	7	0	0	7
District of Columbia	1	0	0	1
New York	3	0	0	3
Federal agency				
Illinois	1	0	0	1
Total United States	**52**	**0**	**0**	**52**

Tables on the Financial Performance of National Banks

Page

Assets, liabilities, and capital accounts of national banks
June 30, 2001 and June 30, 2002

(Dollar figures in millions)

	June 30, 2001	June 30, 2002	Change June 30, 2001–June 30, 2002 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	**2,176**	**2,104**	**(72)**	**(3.31)**
Total assets	**$3,448,286**	**$3,739,495**	**$291,209**	**8.45**
Cash and balances due from depositories	**192,355**	**192,951**	**596**	**0.31**
Noninterest-bearing balances, currency and coin	150,396	142,702	(7,694)	(5.12)
Interest bearing balances	41,958	50,249	8,290	19.76
Securities	**486,424**	**616,249**	**129,825**	**26.69**
Held-to-maturity securities, amortized cost	27,397	26,170	(1,227)	(4.48)
Available-for-sale securities, fair value	459,027	590,079	131,052	28.55
Federal funds sold and securities purchased	**139,854**	**146,374**	**6,520**	**4.66**
Net loans and leases	**2,214,399**	**2,278,181**	**63,782**	**2.88**
Total loans and leases	2,255,767	2,325,538	69,771	3.09
Loans and leases, gross	2,257,250	2,328,362	71,112	3.15
Less: Unearned income	1,483	2,824	1,341	90.48
Less: Reserve for losses	41,368	47,357	5,989	14.48
Assets held in trading account	**115,604**	**159,377**	**43,773**	**37.86**
Other real estate owned	**1,684**	**1,864**	**179**	**10.66**
Intangible assets	**72,051**	**89,817**	**17,767**	**24.66**
All other assets	**225,916**	**254,682**	**28,766**	**12.73**
Total liabilities and equity capital	**3,448,286**	**3,739,495**	**291,209**	**8.45**
Deposits in domestic offices	1,887,371	2,025,600	138,229	7.32
Deposits in foreign offices	398,277	385,203	(13,075)	(3.28)
Total deposits	**2,285,648**	**2,410,803**	**125,154**	**5.48**
Noninterest-bearing deposits	446,110	490,412	44,302	9.93
Interest-bearing deposits	1,839,539	1,920,391	80,852	4.40
Federal funds purchased and securities sold	**242,413**	**259,632**	**17,219**	**7.10**
Other borrowed money	**349,769**	**377,073**	**27,305**	**7.81**
Trading liabilities less revaluation losses	**22,120**	**27,246**	**5,126**	**23.17**
Subordinated notes and debentures	**64,681**	**67,401**	**2,720**	**4.20**
All other liabilities	**174,262**	**241,321**	**67,059**	**38.48**
Trading liabilities revaluation losses	51,490	76,560	25,070	48.69
Other	122,772	164,761	41,989	34.20
Total equity capital	**309,393**	**356,019**	**46,626**	**15.07**
Perpetual preferred stock	586	2,698	2,112	NM
Common stock	13,265	12,941	(324)	(2.44)
Surplus	162,242	194,451	32,209	19.85
Retained earnings and other comprehensive income	133,911	150,445	16,534	12.35
Other equity capital components	(32)	(38)	(6)	NM

NM indicates calculated percent change is not meaningful.

Quarterly income and expenses of national banks
Second quarter 2001 and second quarter 2002

(Dollar figures in millions)

	Second quarter 2001	Second quarter 2002	Change Second quarter 2001–second quarter 2002 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	**2,176**	**2,104**	**(72)**	**(3.31)**
Net income	**$10,995**	**$14,152**	**$3,157**	**28.72**
Net interest income	**30,611**	**34,800**	**4,190**	**13.69**
Total interest income	58,079	51,951	(6,128)	(10.55)
On loans	44,895	39,729	(5,165)	(11.51)
From lease financing receivables	1,940	1,832	(108)	(5.57)
On balances due from depositories	704	455	(248)	(35.29)
On securities	7,679	7,939	260	3.39
From assets held in trading account	991	923	(68)	(6.85)
On federal funds sold and securities repurchased	1,562	745	(817)	(52.31)
Less: Interest expense	27,469	17,150	(10,318)	(37.56)
On deposits	18,540	11,570	(6,969)	(37.59)
Of federal funds purchased and securities sold	2,737	1,339	(1,397)	(51.06)
On demand notes and other borrowed money*	5,201	3,415	(1,786)	(34.34)
On subordinated notes and debentures	991	826	(165)	(16.67)
Less: Provision for losses	**6,250**	**7,662**	**1,412**	**22.59**
Noninterest income	**24,606**	**26,585**	**1,979**	**8.04**
From fiduciary activities	2,248	2,259	11	0.48
Service charges on deposits	4,401	4,878	477	10.84
Trading revenue	1,551	2,140	589	37.97
From interest rate exposures	530	725	195	36.67
From foreign exchange exposures	882	957	74	8.40
From equity security and index exposures	59	270	211	NM
From commodity and other exposures	76	191	115	NM
Investment banking brokerage fees	1,194	1,217	23	1.89
Venture capital revenue	126	24	(102)	NM
Net servicing fees	2,667	2,611	(56)	(2.10)
Net securitization income	2,747	3,606	859	31.27
Insurance commissions and fees	341	500	158	46.37
Net gains on asset sales	866	810	(56)	(6.45)
Sales of loans and leases	692	780	88	12.74
Sales of other real estate owned	(5)	25	30	NM
Sales of other assets(excluding securities)	179	4	(174)	NM
Other noninterest income	8,464	8,623	160	1.89
Gains/losses on securities	**480**	**532**	**53**	**10.94**
Less: Noninterest expense	**32,223**	**33,105**	**883**	**2.74**
Salaries and employee benefits	12,782	13,532	750	5.87
Of premises and fixed assets	3,868	3,906	38	0.97
Other noninterest expense	14,129	14,650	521	3.69
Less: Taxes on income before extraordinary items	**6,130**	**7,155**	**1,024**	**16.71**
Income/loss from extraordinary items, net of income taxes	**(99)**	**156**	**255**	**NM**
Memoranda:				
Net operating income	10,770	13,646	2,876	26.70
Income before taxes and extraordinary items	17,224	21,151	3,927	22.80
Income net of taxes before extraordinary items	11,093	13,996	2,903	26.17
Cash dividends declared	7,105	8,158	1,053	14.82
Net charge-offs to loan and lease reserve	5,551	7,648	2,096	37.76
Charge-offs to loan and lease reserve	6,630	8,984	2,354	35.50
Less: Recoveries credited to loan and lease reserve	1,079	1,337	258	23.87

*Includes mortgage indebtedness

NM indicates calculated percent change is not meaningful.

Year-to-date income and expenses of national banks
Through June 30, 2001 and through June 30, 2002

(Dollar figures in millions)

	June 30, 2001	June 30, 2002	Change June 30, 2001– June 30, 2002 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
Number of institutions	**2,176**	**2,104**	**(72)**	**(3.31)**
Net income	**$22,345**	**$27,794**	**$5,449**	**24.39**
Net interest income	**60,179**	**70,206**	**10,027**	**16.66**
Total interest income	118,988	103,533	(15,454)	(12.99)
On loans	92,135	79,544	(12,591)	(13.67)
From lease financing receivables	3,962	3,667	(295)	(7.45)
On balances due from depositories	1,523	937	(586)	(38.48)
On securities	15,671	15,536	(134)	(0.86)
From assets held in trading account	1,949	1,672	(277)	(14.24)
On federal funds sold and securities repurchased	3,242	1,497	(1,745)	(53.83)
Less: Interest expense	58,809	33,328	(25,481)	(43.33)
On deposits	39,294	22,396	(16,898)	(43.00)
Of federal funds purchased and securities sold	6,018	2,674	(3,344)	(55.57)
On demand notes and other borrowed money*	11,397	6,631	(4,766)	(41.82)
On subordinated notes and debentures	2,099	1,627	(472)	(22.50)
Less: Provision for losses	**11,566**	**16,088**	**4,522**	**39.10**
Noninterest income	**49,575**	**53,077**	**3,503**	**7.07**
From fiduciary activities	4,512	4,461	(52)	(1.14)
Service charges on deposits	8,378	9,475	1,097	13.09
Trading revenue	3,701	3,820	119	3.21
From interest rate exposures	1,610	1,342	(268)	(16.64)
From foreign exchange exposures	1,709	1,737	28	1.62
From equity security and index exposures	246	522	275	NM
From commodity and other exposures	133	221	88	66.28
Investment banking brokerage fees	2,337	2,432	95	4.08
Venture capital revenue	75	193	117	NM
Net servicing fees	5,210	5,540	330	6.33
Net securitization income	5,353	7,178	1,825	34.08
Insurance commissions and fees	774	966	192	24.82
Net gains on asset sales	2,395	2,017	(378)	(15.79)
Sales of loans and leases	1,259	2,069	810	64.28
Sales of other real estate owned	(9)	15	24	NM
Sales of other assets (excluding securities)	1,145	(67)	(1,211)	NM
Other noninterest income	16,838	16,995	158	0.94
Gains/losses on securities	**945**	**890**	**(55)**	**(5.85)**
Less: Noninterest expense	**64,232**	**66,159**	**1,927**	**3.00**
Salaries and employee benefits	25,356	27,374	2,018	7.96
Of premises and fixed assets	7,710	7,792	82	1.06
Other noninterest expense	28,481	29,072	590	2.07
Less: Taxes on income before extraordinary items	**12,190**	**14,209**	**2,019**	**16.56**
Income/loss from extraordinary items, net of income taxes	**(366)**	**77**	**443**	**NM**
Memoranda:				
Net operating income	22,078	27,126	5,048	22.87
Income before taxes and extraordinary items	34,901	41,926	7,024	20.13
Income net of taxes before extraordinary items	22,711	27,717	5,006	22.04
Cash dividends declared	14,051	21,571	7,519	53.51
Net charge-offs to loan and lease reserve	10,336	15,980	5,644	54.61
Charge-offs to loan and lease reserve	12,395	18,568	6,173	49.80
Less: Recoveries credited to loan and lease reserve	2,059	2,587	529	25.67

*Includes mortgage indebtedness
NM indicates calculated percent change is not meaningful.

Assets of national banks by asset size
June 30, 2002

(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Total assets	**$3,739,495**	**$52,273**	**$250,321**	**$413,938**	**$3,022,963**	**$6,749,662**
Cash and balances due from	**192,951**	**3,066**	**11,615**	**21,552**	**156,717**	**362,158**
Securities	**616,249**	**13,032**	**62,760**	**87,040**	**453,418**	**1,237,108**
Federal funds sold and securities purchased	**146,374**	**2,812**	**9,056**	**17,578**	**116,929**	**321,497**
Net loans and leases	**2,278,181**	**30,839**	**153,538**	**257,896**	**1,835,909**	**3,897,212**
Total loans and leases	2,325,538	31,277	155,760	262,466	1,876,035	3,971,537
Loans and leases, gross	2,328,362	31,322	155,954	262,555	1,878,531	3,975,367
Less: Unearned income	2,824	45	194	89	2,496	3,830
Less: Reserve for losses	47,357	438	2,222	4,570	40,126	74,325
Assets held in trading account	**159,377**	**6**	**66**	**866**	**158,439**	**380,525**
Other real estate owned	**1,864**	**74**	**245**	**220**	**1,325**	**3,874**
Intangible assets	**89,817**	**181**	**1,845**	**6,385**	**81,406**	**129,568**
All other assets	**254,682**	**2,263**	**11,197**	**22,401**	**218,822**	**417,719**
Gross loans and leases by type:						
Loans secured by real estate	**1,025,099**	**18,505**	**101,504**	**140,417**	**764,673**	**1,886,961**
1–4 family residential mortgages	483,346	8,040	38,855	62,598	373,853	824,572
Home equity loans	125,762	498	4,741	9,989	110,535	188,315
Multifamily residential mortgages	33,296	440	3,752	5,468	23,636	69,381
Commercial RE loans	246,947	5,645	38,988	44,075	158,238	532,653
Construction RE loans	92,532	1,698	10,644	16,406	63,785	198,640
Farmland loans	12,891	2,184	4,522	1,759	4,426	36,989
RE loans from foreign offices	30,324	0	1	123	30,200	36,411
Commercial and industrial loans	**568,970**	**5,163**	**27,374**	**49,046**	**487,387**	**938,726**
Loans to individuals	**423,838**	**3,981**	**17,724**	**50,829**	**351,305**	**662,454**
Credit cards*	191,196	167	2,282	21,930	166,817	250,395
Other revolving credit plans	31,590	70	348	2,347	28,825	36,822
Installment loans	201,053	3,744	15,094	26,552	155,663	375,237
All other loans and leases	**310,455**	**3,674**	**9,353**	**22,263**	**275,165**	**487,225**
Securities by type:						
U.S. Treasury securities	**17,643**	**678**	**2,653**	**4,046**	**10,266**	**51,946**
Mortgage-backed securities	**384,019**	**3,567**	**23,125**	**47,603**	**309,725**	**661,372**
Pass-through securities	286,717	2,537	14,170	27,894	242,116	438,140
Collateralized mortgage obligations	97,302	1,030	8,955	19,708	67,609	223,233
Other securities	**169,638**	**8,764**	**36,668**	**32,121**	**92,086**	**426,834**
Other U.S. government securities	60,641	6,095	21,003	14,336	19,208	210,525
State and local government securities	43,982	2,098	10,976	9,061	21,846	98,269
Other debt securities	56,169	414	3,368	7,221	45,166	97,776
Equity securities	8,846	158	1,321	1,503	5,865	20,264
Memoranda:						
Agricultural production loans	20,029	3,131	5,308	2,986	8,604	47,647
Pledged securities	283,636	5,012	27,652	39,611	211,361	591,456
Book value of securities	608,334	12,839	61,783	85,459	448,253	1,218,927
Available-for-sale securities	582,164	10,595	52,671	76,824	442,075	1,122,677
Held-to-maturity securities	26,170	2,244	9,113	8,635	6,178	96,250
Market value of securities	616,769	13,079	62,970	87,212	453,509	1,239,099
Available-for-sale securities	590,079	10,787	53,647	78,405	447,240	1,140,858
Held-to-maturity securities	26,691	2,292	9,323	8,807	6,269	98,241

*Prior to March 2001, also included "Other revolving credit plans."

Past-due and nonaccrual loans and leases of national banks by asset size
June 30, 2002

(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Loans and leases past due 30–89 days	**$27,948**	**$421**	**$1,740**	**$2,862**	**$22,925**	**$46,528**
Loans secured by real estate	**10,852**	**210**	**885**	**1,183**	**8,575**	**19,369**
1–4 family residential mortgages	6,656	114	443	614	5,484	11,038
Home equity loans	735	3	22	54	656	1,070
Multifamily residential mortgages	143	3	16	22	103	300
Commercial RE loans	1,516	45	264	272	935	3,811
Construction RE loans	1,185	24	104	192	866	2,045
Farmland loans	141	21	36	29	55	373
RE loans from foreign offices	476	0	0	0	476	733
Commercial and industrial loans	**6,846**	**89**	**398**	**663**	**5,697**	**10,587**
Loans to individuals	**8,305**	**89**	**377**	**876**	**6,963**	**13,575**
Credit cards	4,523	4	100	395	4,023	6,387
Installment loans and other plans	3,782	85	276	480	2,940	7,188
All other loans and leases	**1,945**	**34**	**80**	**141**	**1,690**	**2,996**
Loans and leases past due 90+ days	**8,589**	**110**	**373**	**815**	**7,291**	**13,246**
Loans secured by real estate	**2,982**	**59**	**179**	**194**	**2,550**	**4,574**
1–4 family residential mortgages	2,382	32	90	119	2,141	3,208
Home equity loans	106	1	3	9	93	164
Multifamily residential mortgages	28	0	2	4	21	60
Commercial RE loans	220	13	49	41	118	612
Construction RE loans	162	3	18	14	126	323
Farmland loans	44	10	16	7	10	155
RE loans from foreign offices	41	0	0	0	41	51
Commercial and industrial loans	**852**	**23**	**85**	**126**	**618**	**1,600**
Loans to individuals	**4,427**	**15**	**79**	**474**	**3,859**	**6,539**
Credit cards	3,298	3	42	313	2,940	4,324
Installment loans and other plans	1,130	12	38	161	919	2,215
All other loans and leases	**328**	**12**	**29**	**23**	**264**	**533**
Nonaccrual loans and leases	**29,156**	**254**	**1,143**	**1,633**	**26,126**	**45,034**
Loans secured by real estate	**7,841**	**129**	**645**	**876**	**6,190**	**13,354**
1–4 family residential mortgages	3,099	38	182	323	2,556	5,007
Home equity loans	332	1	9	29	293	439
Multifamily residential mortgages	120	3	17	16	83	206
Commercial RE loans	2,437	50	318	346	1,723	4,554
Construction RE loans	918	10	72	140	695	1,822
Farmland loans	188	26	47	22	93	426
RE loans from foreign offices	747	0	0	0	747	901
Commercial and industrial loans	**16,632**	**74**	**345**	**555**	**15,657**	**25,303**
Loans to individuals	**1,871**	**15**	**81**	**86**	**1,689**	**2,732**
Credit cards	426	0	45	35	346	725
Installment loans and other plans	1,445	15	36	51	1,343	2,007
All other loans and leases	**2,901**	**36**	**72**	**116**	**2,677**	**3,789**

Liabilities of national banks by asset size
June 30, 2002

(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Total liabilities and equity capital	**3,739,495**	**52,273**	**250,321**	**413,938**	**3,022,963**	**6,749,656**
Deposits in domestic offices	2,025,600	43,885	202,617	265,720	1,513,378	3,807,239
Deposits in foreign offices	385,203	0	88	2,540	382,575	640,905
Total deposits	**2,410,803**	**43,885**	**202,704**	**268,260**	**1,895,953**	**4,448,144**
Noninterest bearing	490,412	7,105	31,726	46,165	405,416	826,577
Interest bearing	1,920,391	36,780	170,978	222,095	1,490,537	3,621,321
Federal funds purchased and securities sold	**259,632**	**530**	**6,187**	**40,483**	**212,432**	**523,164**
Other borrowed funds	**377,073**	**1,391**	**12,299**	**46,995**	**316,389**	**586,945**
Trading liabilities less revaluation losses	**27,246**	**0**	**0**	**216**	**27,030**	**80,953**
Subordinated notes and debentures	**67,401**	**3**	**183**	**2,825**	**64,390**	**93,716**
All other liabilities	**241,321**	**431**	**3,152**	**10,631**	**227,108**	**392,741**
Equity capital	**356,019**	**6,034**	**25,796**	**44,529**	**279,661**	**623,994**
Total deposits by depositor:						
Individuals and corporations	1,881,050	27,677	141,873	213,369	1,498,130	3,464,424
U.S., state, and local governments	101,174	3,739	15,195	16,701	65,539	200,871
Depositories in the U.S.	75,280	670	2,132	3,282	69,196	100,762
Foreign banks and governments	60975.776	2	65	1,171	59,737	127,507
Domestic deposits by depositor:						
Individuals and corporations	1600404.783	27,677	141,865	211,463	1,219,399	2,994,859
U.S., state, and local governments	101,174	3,739	15,195	16,701	65,539	200,871
Depositories in the U.S.	27,682	670	2,092	3,281	21,639	47,612
Foreign banks and governments	4,454	2	25	546	3,881	9,873
Foreign deposits by depositor:						
Individuals and corporations	280644.81	0	8	1,906	278,731	469,565
Depositories in the U.S.	47597.594	0	40	0	47,558	53,150
Foreign banks and governments	56,522	0	40	626	55,856	117,634
Deposits in domestic offices by type:						
Transaction deposits	**351,124**	**13,321**	**49,103**	**40,225**	**248,476**	**654,429**
Demand deposits	285,487	7,031	28,195	32,356	217,905	497,688
Savings deposits	**1,070,656**	**9,764**	**65,782**	**134,279**	**860,831**	**1,867,618**
Money market deposit accounts	782123.899	5,431	38,517	92,801	645,375	1,331,551
Other savings deposits	288531.794	4,333	27,265	41,478	215,456	536,067
Time deposits	**603,820**	**20,800**	**87,732**	**91,216**	**404,072**	**1,285,178**
Small time deposits	350,183	13,989	56,106	53,305	226,783	724,082
Large time deposits	253,638	6,811	31,626	37,912	177,289	561,096

Off-balance-sheet items of national banks by asset size
June 30, 2002

(Dollar figures in millions)

	All national banks	National banks: Less than $100 million	National banks: $100 million to $1 billion	National banks: $1 billion to $10 billion	National banks: Greater than $10 billion	Memoranda: All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Unused commitments	**$3,783,926**	**$79,204**	**$439,068**	**$358,534**	**$2,907,120**	**$5,185,964**
Home equity lines	160,583	359	4,261	10,274	145,689	228,433
Credit card lines	2,532,552	74,956	411,057	294,485	1,752,054	3,228,588
Commercial RE, construction and land	79,131	983	7,312	13,197	57,639	157,616
All other unused commitments	1,011,660	2,906	16,439	40,577	951,738	1,571,327
Letters of credit:						
Standby letters of credit	**156,586**	**124**	**1,480**	**5,364**	**149,618**	**261,522**
Financial letters of credit	126,531	83	909	3,991	121,548	215,842
Performance letters of credit	30,055	41	572	1,372	28,070	45,681
Commercial letters of credit	**16,975**	**29**	**399**	**496**	**16,052**	**25,352**
Securities lent	**111,388**	**27**	**94**	**8,950**	**102,317**	**585,050**
Spot foreign exchange contracts	**305,890**	**0**	**0**	**473**	**305,417**	**503,881**
Credit derivatives (notional value)						
Reporting bank is the guarantor	93,092	0	25	0	93,067	255,902
Reporting bank is the beneficiary	112,097	0	50	0	112,047	236,361
Derivative contracts (notional value)	**22,731,639**	**24**	**1,361**	**36,446**	**22,693,808**	**50,073,941**
Futures and forward contracts	5,621,547	13	266	1,299	5,619,969	10,268,896
Interest rate contracts	3,445,531	13	226	951	3,444,341	6,458,169
Foreign exchange contracts	2,068,566	0	40	349	2,068,177	3,619,960
All other futures and forwards	107,451	0	0	0	107,451	190,767
Option contracts	4,670,257	6	214	11,502	4,658,535	10,242,271
Interest rate contracts	3,954,455	6	202	11,022	3,943,224	8,469,778
Foreign exchange contracts	537,751	0	0	372	537,379	1,014,028
All other options	178,051	0	12	108	177,931	758,464
Swaps	12,234,646	5	805	23,644	12,210,191	29,070,511
Interest rate contracts	11,681,546	5	799	19,272	11,661,470	27,767,692
Foreign exchange contracts	502,140	0	2	4,144	497,994	1,175,626
All other swaps	50,960	0	4	229	50,727	127,194
Memoranda: Derivatives by purpose						
Contracts held for trading	20,913,376	0	38	7,689	20,905,650	47,543,881
Contracts not held for trading	1,613,075	24	1,248	28,757	1,583,045	2,037,796
Memoranda: Derivatives by position						
Held for trading—positive fair value	308,398	0	0	123	308,275	740,384
Held for trading—negative fair value	301,790	0	0	115	301,675	726,583
Not for trading—positive fair value	17,330	0	5	375	16,949	25,519
Not for trading—negative fair value	11,774	0	26	243	11,506	16,704

Quarterly income and expenses of national banks by asset size
Second quarter 2002

(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Net income	**$14,152**	**$144**	**$792**	**$1,690**	**$11,526**	**$23,440**
Net interest income	**34,800**	**525**	**2,498**	**4,137**	**27,641**	**58,843**
Total interest income	51,951	795	3,775	6,018	41,362	90,405
On loans	39,729	607	2,889	4,663	31,570	66,769
From lease financing receivables	1,832	3	22	67	1,740	2,643
On balances due from depositories	455	7	14	24	411	912
On securities	7,939	162	791	1,114	5,872	15,482
From assets held in trading account	923	0	1	11	912	2,372
On fed. funds sold & securities repurchased	745	12	41	92	600	1,575
Less: Interest expense	17,150	270	1,278	1,881	13,721	31,562
On deposits	11,570	252	1,112	1,241	8,965	21,570
Of federal funds purchased & securities sold	1,339	2	31	203	1,103	2,713
On demand notes & other borrowed money*	3,415	15	131	401	2,868	6,179
On subordinated notes and debentures	826	0	3	38	785	1,100
Less: Provision for losses	**7,662**	**38**	**203**	**487**	**6,933**	**10,861**
Noninterest income	**26,585**	**209**	**1,358**	**2,766**	**22,252**	**42,541**
From fiduciary activities	2,259	10	160	371	1,718	5,381
Service charges on deposits	4,878	62	296	434	4,086	7,468
Trading revenue	2,140	0	(2)	11	2,131	3,366
From interest rate exposures	725	0	2	1	722	1,559
From foreign exchange exposures	957	0	0	1	955	1,346
From equity security and index exposures	270	0	0	7	263	490
From commodity and other exposures	191	0	0	0	191	(26)
Investment banking brokerage fees	1,217	1	17	63	1,136	2,397
Venture capital revenue	24	(0)	(0)	(0)	25	(83)
Net servicing fees	2,611	51	75	313	2,172	3,363
Net securitization income	3,606	2	76	301	3,227	4,648
Insurance commissions and fees	500	7	20	41	432	894
Net gains on asset sales	810	6	71	101	631	1,453
Sales of loans and leases	780	7	67	158	548	1,378
Sales of other real estate owned	25	0	1	2	23	27
Sales of other assets(excluding securities)	4	(0)	4	(59)	60	48
Other noninterest income	8,623	70	645	1,132	6,777	13,737
Gains/losses on securities	**532**	**3**	**16**	**45**	**468**	**1,008**
Less: Noninterest expense	**33,105**	**505**	**2,569**	**3,920**	**26,112**	**57,035**
Salaries and employee benefits	13,532	247	1,079	1,418	10,787	24,660
Of premises and fixed assets	3,906	62	299	393	3,152	7,172
Other noninterest expense	14,650	193	1,169	2,011	11,276	23,968
Less: Taxes on income before extraord. items	**7,155**	**49**	**308**	**851**	**5,947**	**11,216**
Income/loss from extraord. items, net of taxes	**77**	**0**	**(4)**	**0**	**81**	**39**
Memoranda:						
Net operating income	13,646	142	780	1,659	11,066	22,605
Income before taxes and extraordinary items	21,151	194	1,099	2,540	17,317	34,497
Income net of taxes before extraordinary items	13,996	144	792	1,690	11,370	23,281
Cash dividends declared	8,158	79	395	676	7,007	14,169
Net loan and lease losses	7,648	25	157	468	6,998	10,561
Charge-offs to loan and lease reserve	8,984	34	202	591	8,158	12,494
Less: Recoveries credited to loan & lease resv.	1,337	10	44	123	1,160	1,933

* Includes mortgage indebtedness

Year-to-date income and expenses of national banks by asset size
Through June 30, 2002

(Dollar figures in millions)

	National banks					Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Net income	**$27,794**	**$274**	**$1,513**	**$3,383**	**$22,624**	**$45,305**
Net interest income	**70,206**	**1,025**	**4,894**	**8,213**	**56,074**	**117,624**
Total interest income	103,533	1,581	7,501	12,028	82,423	179,782
On loans	79,544	1,203	5,732	9,333	63,276	133,372
From lease financing receivables	3,667	6	46	135	3,480	5,288
On balances due from depositories	937	14	30	41	851	1,856
On securities	15,536	323	1,576	2,201	11,437	30,575
From assets held in trading account	1,672	0	1	22	1,648	4,256
On fed. funds sold & securities repurchased	1,497	25	84	198	1,189	3,198
Less: Interest expense	33,328	556	2,608	3,815	26,349	62,158
On deposits	22,396	521	2,283	2,528	17,064	42,714
Of federal funds purchased & securities sold	2,674	5	63	396	2,210	5,310
On demand notes & other borrowed money*	6,631	30	255	816	5,529	11,921
On subordinated notes and debentures	1,627	0	6	74	1,547	2,212
Less: Provision for losses	**16,088**	**67**	**399**	**1,179**	**14,442**	**22,432**
Noninterest income	**53,077**	**402**	**2,614**	**5,808**	**44,254**	**84,184**
From fiduciary activities	4,461	19	316	748	3,378	10,586
Service charges on deposits	9,475	119	564	847	7,945	14,498
Trading revenue	3,820	0	(1)	35	3,787	6,519
From interest rate exposures	1,342	0	3	18	1,321	3,058
From foreign exchange exposures	1,737	0	0	2	1,734	2,560
From equity security and index exposures	522	0	0	12	509	896
From commodity and other exposures	221	0	0	0	221	(3)
Investment banking brokerage fees	2,432	3	34	119	2,277	4,697
Venture capital revenue	193	(0)	(0)	0	193	(46)
Net servicing fees	5,540	101	147	678	4,613	7,028
Net securitization income	7,178	4	162	617	6,395	9,213
Insurance commissions and fees	966	13	36	78	839	1,727
Net gains on asset sales	2,017	10	134	422	1,451	3,217
Sales of loans and leases	2,069	10	127	410	1,521	3,206
Sales of other real estate owned	15	(1)	3	2	12	15
Sales of other assets(excluding securities)	(67)	0	4	10	(81)	(5)
Other noninterest income	16,995	135	1,222	2,262	13,377	26,745
Gains/losses on securities	**890**	**6**	**30**	**58**	**795**	**1,718**
Less: Noninterest expense	**66,159**	**997**	**5,025**	**7,805**	**52,331**	**113,396**
Salaries and employee benefits	27,374	488	2,146	2,815	21,925	49,564
Of premises and fixed assets	7,792	121	588	781	6,303	14,287
Other noninterest expense	29,072	383	2,249	4,008	22,431	47,206
Less: Taxes on income before extraord. items	**14,209**	**95**	**596**	**1,712**	**11,807**	**22,431**
Income/loss from extraord. items, net of taxes	**77**	**0**	**(4)**	**0**	**81**	**39**
Memoranda:						
Net operating income	27,126	269	1,495	3,342	22,021	44,102
Income before taxes and extraordinary items	41,926	369	2,113	5,095	34,350	67,698
Income net of taxes before extraordinary items	27,717	274	1,517	3,383	22,543	45,267
Cash dividends declared	21,571	157	746	1,252	19,416	33,901
Net loan and lease losses	15,980	44	297	1,075	14,565	21,636
Charge-offs to loan and lease reserve	18,568	62	385	1,318	16,803	25,375
Less: Recoveries credited to loan & lease resv.	2,587	18	88	243	2,238	3,739

*Includes mortgage indebtedness

Quarterly net loan and lease losses of national banks by asset size
Second quarter 2002

(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Net charge-offs to loan and lease reserve	**$7,648**	**$25**	**$157**	**$468**	**$6,998**	**$10,561**
Loans secured by real estate	**430**	**4**	**16**	**31**	**378**	**650**
1–4 family residential mortgages	203	2	7	11	183	299
Home equity loans	74	0	1	4	69	89
Multifamily residential mortgages	9	0	0	1	8	12
Commercial RE loans	82	1	7	11	63	163
Construction RE loans	33	0	2	3	29	55
Farmland loans	3	0	1	1	2	6
RE loans from foreign offices	0	0	0	0	0	0
Commercial and industrial loans	**2,904**	**10**	**44**	**132**	**2,718**	**4,184**
Loans to individuals	**3,799**	**9**	**89**	**286**	**3,415**	**5,013**
Credit cards	2,838	2	60	212	2,564	3,722
Installment loans and other plans	961	7	29	74	851	1,291
All other loans and leases	**514**	**1**	**8**	**18**	**486**	**713**
Charge-offs to loan and lease reserve	**8,984**	**34**	**202**	**591**	**8,158**	**12,494**
Loans secured by real estate	**515**	**5**	**22**	**41**	**446**	**810**
1–4 family residential mortgages	230	2	9	14	205	349
Home equity loans	85	0	1	5	79	105
Multifamily residential mortgages	10	0	1	1	9	16
Commercial RE loans	108	2	9	15	82	223
Construction RE loans	44	0	2	5	37	72
Farmland loans	5	0	1	1	2	10
RE loans from foreign offices	32	0	0	1	31	34
Commercial and industrial loans	**3,355**	**13**	**55**	**163**	**3,123**	**4,791**
Loans to individuals	**4,501**	**13**	**114**	**362**	**4,013**	**6,031**
Credit cards	3,228	2	70	254	2,902	4,282
Installment loans and other plans	1,274	10	44	108	1,111	1,749
All other loans and leases	**613**	**3**	**11**	**24**	**576**	**861**
Recoveries credited to loan and lease reserve	**1,337**	**10**	**44**	**123**	**1,160**	**1,933**
Loans secured by real estate	**85**	**1**	**6**	**10**	**68**	**160**
1–4 family residential mortgages	27	1	2	2	22	50
Home equity loans	11	(0)	0	1	10	16
Multifamily residential mortgages	1	0	0	0	1	4
Commercial RE loans	26	0	2	3	20	60
Construction RE loans	11	0	0	2	8	17
Farmland loans	1	0	0	1	0	4
RE loans from foreign offices	7	0	0	0	7	8
Commercial and industrial loans	**451**	**3**	**11**	**32**	**405**	**607**
Loans to individuals	**702**	**4**	**25**	**76**	**597**	**1,018**
Credit cards	390	0	10	42	338	560
Installment loans and other plans	312	4	15	34	259	458
All other loans and leases	**100**	**2**	**3**	**5**	**89**	**148**

Year-to-date net loan and lease losses of national banks by asset size
Through June 30, 2002

(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
Number of institutions reporting	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Net charge-offs to loan and lease reserve	**15,980**	**44**	**297**	**1,075**	**14,565**	**21,636**
Loans secured by real estate	**936**	**8**	**39**	**90**	**800**	**1,342**
1–4 family residential mortgages	424	3	16	28	377	582
Home equity loans	145	0	1	9	135	173
Multifamily residential mortgages	12	0	1	1	10	19
Commercial RE loans	212	4	18	31	159	367
Construction RE loans	75	1	2	19	53	121
Farmland loans	7	0	1	1	5	14
RE loans from foreign offices	61	0	0	1	60	66
Commercial and industrial loans	**5,237**	**15**	**68**	**238**	**4,915**	**7,717**
Loans to individuals	**8,907**	**17**	**177**	**720**	**7,993**	**11,332**
Credit cards	6,836	3	114	553	6,166	8,554
Installment loans and other plans	2,071	14	63	167	1,827	2,778
All other loans and leases	**900**	**3**	**13**	**28**	**857**	**1,245**
Charge-offs to loan and lease reserve	**18,568**	**62**	**385**	**1,318**	**16,803**	**25,375**
Loans secured by real estate	**1,097**	**10**	**48**	**110**	**929**	**1,622**
1–4 family residential mortgages	491	4	20	34	433	690
Home equity loans	163	0	1	11	150	199
Multifamily residential mortgages	14	0	1	1	12	25
Commercial RE loans	253	4	22	37	191	460
Construction RE loans	93	1	3	23	65	149
Farmland loans	9	0	2	2	6	21
RE loans from foreign offices	73	0	0	1	72	80
Commercial and industrial loans	**6,081**	**21**	**92**	**297**	**5,671**	**8,865**
Loans to individuals	**10,309**	**25**	**225**	**873**	**9,185**	**13,368**
Credit cards	7,591	4	131	636	6,820	9,648
Installment loans and other plans	2,717	21	94	237	2,365	3,720
All other loans and leases	**1,081**	**6**	**20**	**38**	**1,018**	**1,519**
Recoveries credited to loan and lease reserve	**2,587**	**18**	**88**	**243**	**2,238**	**3,739**
Loans secured by real estate	**160**	**2**	**10**	**20**	**129**	**281**
1–4 family residential mortgages	67	1	4	6	56	108
Home equity loans	18	0	0	2	15	26
Multifamily residential mortgages	3	0	0	0	2	6
Commercial RE loans	41	1	3	5	32	92
Construction RE loans	18	0	1	5	12	28
Farmland loans	2	0	0	1	1	7
RE loans from foreign offices	12	0	0	0	12	13
Commercial and industrial loans	**844**	**5**	**24**	**60**	**755**	**1,148**
Loans to individuals	**1,402**	**8**	**48**	**153**	**1,192**	**2,036**
Credit cards	755	1	17	84	654	1,094
Installment loans and other plans	647	7	31	70	538	942
All other loans and leases	**181**	**3**	**6**	**10**	**162**	**274**

Number of national banks by state and asset size
June 30, 2002

	All national banks	National banks: Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	Memoranda: All commercial banks
All institutions	**2,104**	**987**	**944**	**131**	**42**	**7,966**
Alabama	22	13	8	1	0	153
Alaska	3	1	0	2	0	6
Arizona	16	6	5	3	2	40
Arkansas	41	12	28	1	0	170
California	81	34	37	7	3	288
Colorado	52	26	22	3	1	175
Connecticut	8	1	7	0	0	25
Delaware	14	2	7	2	3	31
District of Columbia	4	2	2	0	0	4
Florida	72	24	40	8	0	259
Georgia	62	31	28	3	0	324
Hawaii	1	0	1	0	0	7
Idaho	1	0	1	0	0	17
Illinois	177	73	92	8	4	686
Indiana	32	8	16	6	2	154
Iowa	49	28	19	2	0	414
Kansas	104	73	28	3	0	368
Kentucky	51	23	25	3	0	227
Louisiana	16	6	8	1	1	142
Maine	6	1	4	0	1	15
Maryland	11	3	8	0	0	72
Massachusetts	13	5	7	1	0	41
Michigan	27	10	16	0	1	161
Minnesota	123	79	39	3	2	472
Mississippi	20	8	10	2	0	98
Missouri	46	24	18	3	1	350
Montana	16	13	2	1	0	80
Nebraska	77	54	21	2	0	273
Nevada	8	1	3	4	0	35
New Hampshire	5	2	2	0	1	14
New Jersey	24	2	15	7	0	82
New Mexico	15	6	6	3	0	52
New York	57	10	39	7	1	137
North Carolina	7	0	5	0	2	72
North Dakota	15	6	6	3	0	104
Ohio	87	36	37	7	7	201
Oklahoma	94	55	35	4	0	276
Oregon	3	0	2	1	0	32
Pennsylvania	80	21	49	7	3	177
Rhode Island	4	2	0	1	1	7
South Carolina	25	13	11	1	0	77
South Dakota	19	8	8	2	1	93
Tennessee	28	6	19	0	3	190
Texas	335	202	123	9	1	675
Utah	7	2	3	1	1	56
Vermont	8	2	6	0	0	15
Virginia	34	5	26	3	0	128
Washington	15	11	4	0	0	79
West Virginia	21	9	10	2	0	70
Wisconsin	48	19	26	3	0	279
Wyoming	20	9	10	1	0	45
U.S. territories	0	0	0	0	0	18

Total assets of national banks by state and asset size
June 30, 2002

(Dollar figures in millions)

		National banks				Memoranda:
	All national banks	Less than $100 million	$100 million to $1 billion	$1 billion to $10 billion	Greater than $10 billion	All commercial banks
All institutions	**$3,739,495**	**$52,273**	**$250,321**	**$413,938**	**$3,022,963**	**$6,749,662**
Alabama	3,953	815	1,921	1,216	0	191,856
Alaska	5,302	60	0	5,242	0	6,369
Arizona	41,280	170	1,853	5,584	33,673	43,803
Arkansas	8,488	732	6,746	1,010	0	30,635
California	225,929	1,796	12,480	17,431	194,222	376,187
Colorado	30,535	1,272	5,076	6,117	18,071	51,376
Connecticut	1,614	91	1,524	0	0	3,649
Delaware	98,585	68	1,518	4,484	92,516	140,322
District of Columbia	463	95	368	0	0	463
Florida	28,824	1,689	10,091	17,045	0	66,963
Georgia	18,734	1,698	5,558	11,478	0	169,825
Hawaii	356	0	356	0	0	22,887
Idaho	258	0	258	0	0	3,021
Illinois	323,114	3,912	22,887	20,521	275,794	462,730
Indiana	72,326	445	6,718	19,314	45,849	110,961
Iowa	14,992	1,510	4,943	8,538	0	46,444
Kansas	16,127	3,670	7,812	4,645	0	37,226
Kentucky	22,806	1,498	5,054	16,255	0	54,707
Louisiana	25,045	329	1,569	6,925	16,222	42,662
Maine	23,316	39	2,036	0	21,241	25,395
Maryland	2,530	169	2,361	0	0	48,655
Massachusetts	3,402	261	1,691	1,449	0	121,324
Michigan	47,254	437	4,554	0	42,263	145,152
Minnesota	84,212	4,138	8,941	5,286	65,847	107,538
Mississippi	10,392	449	2,208	7,736	0	36,347
Missouri	26,330	1,345	4,733	9,953	10,300	70,242
Montana	2,623	570	511	1,543	0	12,996
Nebraska	16,203	2,496	4,921	8,785	0	30,689
Nevada	25,492	43	952	24,496	0	39,424
New Hampshire	16,316	63	397	0	15,857	18,805
New Jersey	34,655	120	4,762	29,773	0	77,172
New Mexico	10,847	373	2,032	8,442	0	15,373
New York	517,875	655	12,120	18,027	487,074	1,432,805
North Carolina	865,292	0	1,531	0	863,761	968,673
North Dakota	11,791	282	1,758	9,751	0	18,158
Ohio	437,548	1,875	10,785	18,459	406,428	520,581
Oklahoma	26,376	2,856	7,350	16,170	0	44,903
Oregon	9,768	0	467	9,301	0	18,140
Pennsylvania	129,355	1,254	15,576	14,615	97,909	189,853
Rhode Island	184,130	24	0	6,086	178,020	194,966
South Carolina	6,037	766	2,905	2,367	0	27,409
South Dakota	57,768	247	2,793	12,778	41,950	66,666
Tennessee	79,086	453	6,599	0	72,033	101,965
Texas	88,281	10,478	30,906	23,522	23,374	146,512
Utah	31,143	67	802	9,716	20,558	126,909
Vermont	1,335	106	1,229	0	0	5,678
Virginia	17,706	243	7,139	10,324	0	76,822
Washington	1,927	592	1,335	0	0	22,952
West Virginia	6,707	505	2,093	4,109	0	18,712
Wisconsin	20,651	1,137	6,362	13,153	0	84,836
Wyoming	4,415	382	1,739	2,294	0	6,843
U.S. territories	0	0	0	0	0	65,085

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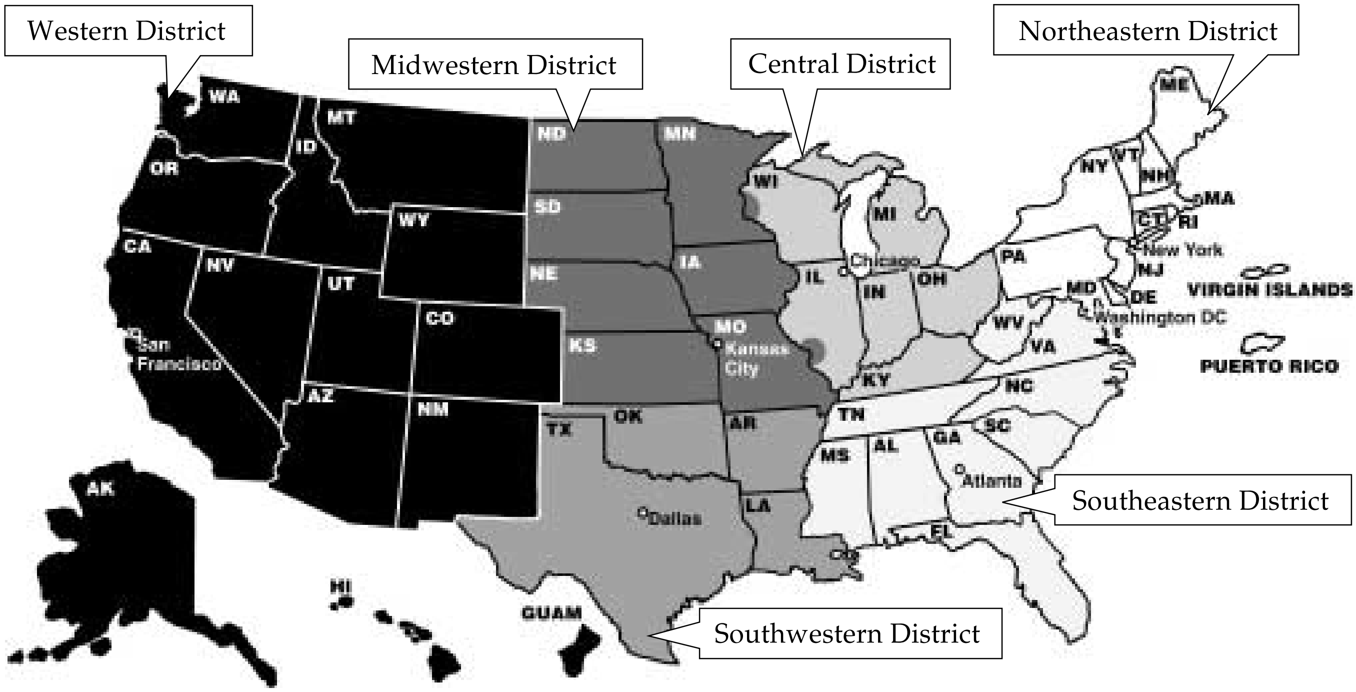

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