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Comptroller of the Currency  
Administrator of National Banks

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*Quarterly  
Journal*

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# Quarterly Journal □



Office of the Comptroller of the Currency  
Administrator of National Banks

**John C. Dugan**  
*Comptroller of the Currency*

Volume 24, Number 4

December 2005  
(Third quarter data)

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securities, the usual 25 percent prudential limit is not intended to apply under the specific facts and circumstances represented, and retention of the subordinated interest is permissible under 12 USC 24(Seventh). The conclusions are subject to various safety and soundness requirements. The appropriate risk-based capital treatment is the risk-based capital charge for the underlying HELOCs.

**1036**, 8/10/2005, Letter states that a remote check scanning terminal at a customer's location, which permits the customer to deposit checks electronically, is not a branch.

*September* [Interpretations and Actions]

**1037**, 8/9/2005, Letter concludes that trust company may use cash-settled derivatives linked to S&P 500 Index to hedge the market risk associated with the fees it charges customers as part of its investment advisory activities, provided the trust company establishes to the satisfaction of its supervisory office, an appropriate risk management and compliance process.

**1038**, 8/16/2005, A national bank, under contract with the General Services Administration, provides purchasing, travel, and fleet charge cards to government agencies and employees as a payment tool for official government purchases and travel expenses. This letter responds to a request from the bank for an opinion the appropriate capital treatment for unused portions of lines of credit (unused lines) on cards issued to federal employees. Liability for all charges and fees incurred on government credit cards rests solely with the cardholder; the government bears no secondary liability. In the letter, we conclude that the OCC will use its reservation of authority in 12 CFR 3.4 to assign a zero percent conversion factor to the unused lines. This reflects our conclusion that a zero percent conversion factor more appropriately reflects the credit risk to the bank associated with the lines.

**1039**, 9/13/2005, Letter concludes that the bank may engage in customer-drive, perfectly matched, cash-settled derivative transactions provided the bank's examiner-in-charge is satisfied that the bank has adequate risk management and measurement systems and controls to conduct the activities on a safe and sound basis.

**1040**, 9/15/2005, Letter states that the bank, with the approval of its examiner-in-charge, may engage in customer-driven, physically settled emissions derivative transactions and may enter into physical transactions in emission allowances to hedge its risk exposures to the emissions derivative transactions.

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# *Quarterly Journal*

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December 2005

Comptroller \_\_\_\_\_ John C. Dugan

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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 four 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.



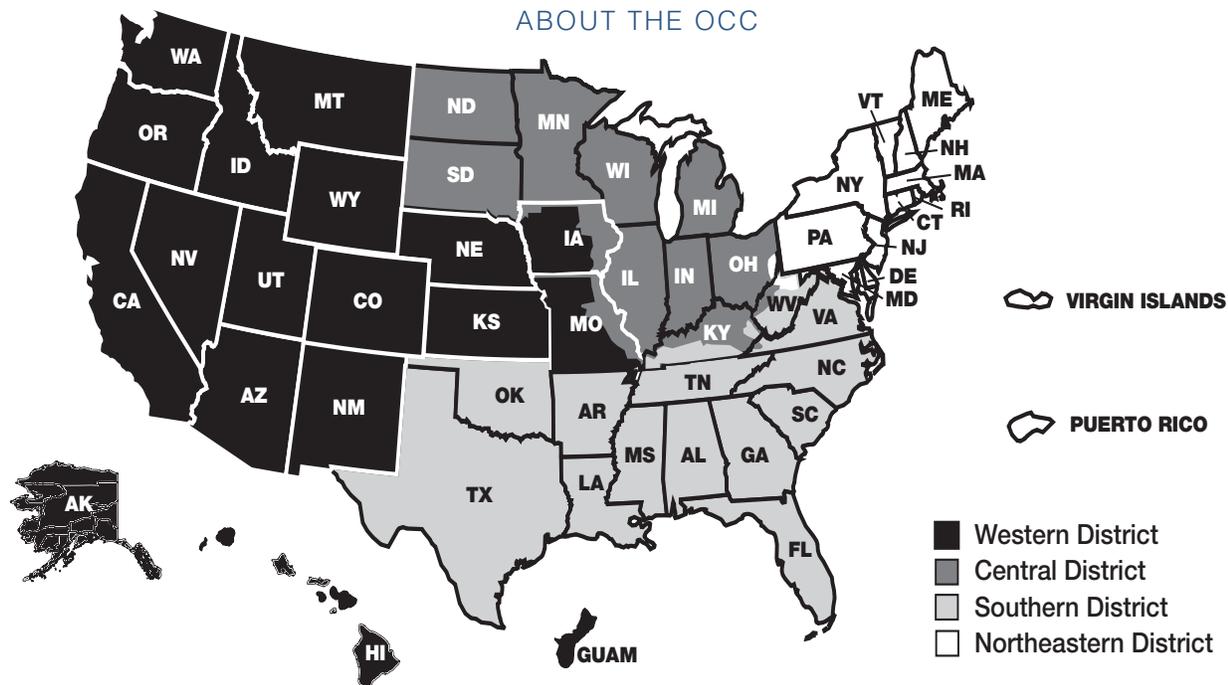
## **The Comptroller**

John C. Dugan was sworn in as the 29th Comptroller of the Currency on August 4, 2005. Prior to his appointment as Comptroller, Mr. Dugan was a partner at the law firm of Covington & Burling, where he chaired the firm's Financial Institutions Group. He specialized in banking and financial institution regulation. He also served as outside counsel to the ABA Securities Association. He served at the Department of the Treasury from 1989 to 1993 and was appointed assistant secretary for domestic finance in 1992. While at Treasury, Mr. Dugan had extensive responsibility for policy initiatives involving banks and financial institutions, including the savings and loan cleanup, Glass-Steagall and banking reform, and regulation of government-sponsored enterprises. In 1991, he oversaw a comprehensive study of the banking industry that formed the basis for the financial modernization legislation proposed by the administration of the first President Bush. From 1985 to 1989, Mr. Dugan was minority counsel and minority general counsel for the U.S. Senate Committee on Banking, Housing, and Urban Affairs. There he advised the committee as it debated the Competitive Equality Banking Act of 1987, the Proxmire Financial Modernization Act of 1988, and the Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

Among his professional and volunteer activities before becoming Comptroller, he served as a director of Minbanc, a charitable organization whose mission is to enhance professional and educational opportunities for minorities in the banking industry. He was also a member of the American Bar Association's committee on banking law, the Federal Bar Association's section of financial institutions and the economy, and the District of Columbia Bar Association's section of corporations, finance, and securities laws. A graduate of the University of Michigan in 1977 with an A.B. in English literature, Mr. Dugan also earned his J.D. from Harvard Law School in 1981.

The *Quarterly Journal* is the journal of record for significant actions and policies of the OCC. It is published four times a year, based on data released in March, June, September, and December. The *Quarterly Journal* is first released on the Web at [www.occ.treas.gov/qj/qj.htm](http://www.occ.treas.gov/qj/qj.htm), and then, by subscription, on the CD-ROM *Quarterly Journal Library*, a cumulative collection starting with volume 17. The *Quarterly Journal* includes the briefing on the condition and performance of commercial banks, statistical tables on the performance of FDIC-insured banks and OCC data on bank corporate structure, policy statements, decisions on banking structure, appeals to the ombudsman, links to selected speeches and congressional testimony and interpretive letters, summaries of enforcement actions, and other information of interest in the administration of national banks. Please send your comments and suggestions to Rebecca Miller, senior writer-editor, by fax to (202) 874-5263 or by e-mail to [quarterlyjournal@occ.treas.gov](mailto:quarterlyjournal@occ.treas.gov). Subscriptions to the *Quarterly Journal Library* CD-ROM are available for \$50 a year by writing to Publications—QJ, OCC, Attn: Accounts Receivable, MS 4-8, 250 E St., SW, Washington, DC 20219.

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(revised July 2005)

\*Note: The *Quarterly Journal Library* starts with Volume 17, not 16 as stated previously.

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*Quarterly  
Journal*

CONDITION AND PERFORMANCE □  
OF COMMERCIAL BANKS □

# CONDITION AND PERFORMANCE OF COMMERCIAL BANKS

Net income increased at national banks in the third quarter of 2005, on the strength of a sharp gain in noninterest income. Provisioning expenses rose for the first time in 13 quarters, holding down the expansion in earnings.

Earnings remained high, particularly at national banks. Return on equity (ROE) stood at 15.2 percent, adjusted for the effects of recent mergers. This is near the historical peak, though slightly off from the level of a year ago. ROE at state-chartered banks, at 13.1 percent, also remained near its historical peak.

Table 1 provides some detail on changes in the major income and expense items for national banks. Net interest income grew by 1 percent year-over-year, as continued weakness in net interest margins nearly offset growth in the loan book. Net interest margins at national banks have now fallen for 12 of the last 13 quarters. On the other hand, the residential lending book experienced a fourteenth straight quarter of double-digit percentage increases.

**Table 1—Noninterest income up sharply; provision rises**

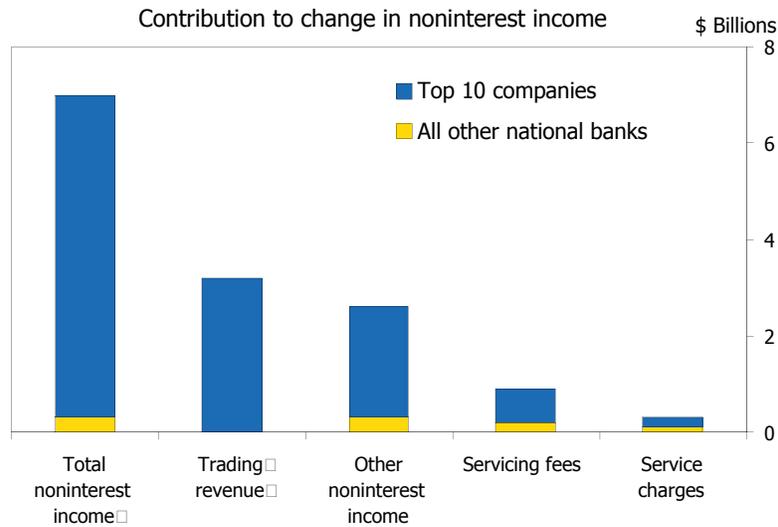
National banks	Major income components (Change, \$ millions)			
	2003Q3-04Q3	% change	2004Q3-05Q3	% change
<b>Revenues</b>				
Net interest income	3,426	8.8%	551	1.3%
Real gains/losses sec	661	n.m.	-1,045	n.m.
Noninterest income	-972	-3.0%	7,290	23.0%
<b>Expenses</b>				
Provisioning	-269	-5.2%	1,461	29.5%
Noninterest expense	3,713	9.2%	2,874	6.5%
Net income	428	2.4%	1,221	6.8%

Source: Integrated Banking Information System (OCC)

Data are merger adjusted and held constant for banks operating as of September 30, 2005.

In the third quarter, the major contributor to growth in net income was noninterest income; within this category, trading income did particularly well, with servicing fees and service charges making smaller contributions. In contrast to many other categories of noninterest income, however, trading income tends to be volatile, as it depends on swings in trading volume in securities markets. Moreover, nearly all of the growth in trading income occurred at large banks, as Figure 1 indicates. As a result, it may be difficult for large institutions to maintain their earnings performance if such gains do not recur.

**Figure 1—Volatile component accounts for large share on noninterest income growth**



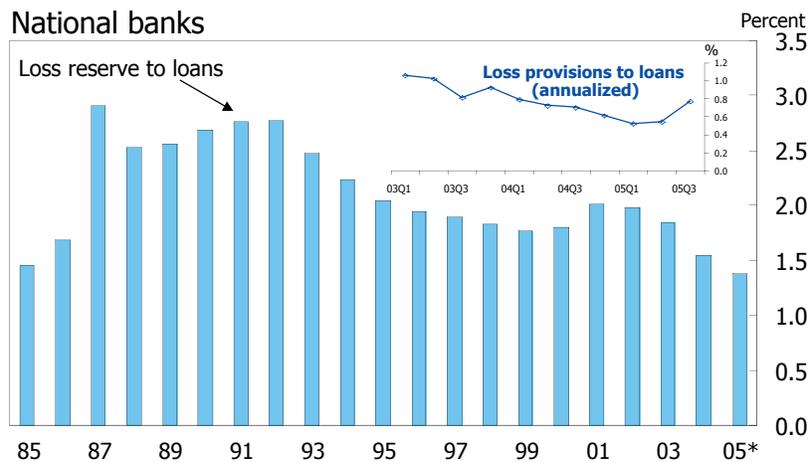
Source: Integrated Banking Information System (OCC)

Data are merger adjusted and held constant for banks operating as of September 30, 2005. Quarterly change 2004Q3-2005Q3.

Loan loss provisions rose during the third quarter, snapping a string of 12 consecutive quarterly declines (where the change is measured year-over-year). This reversed a six-quarter drop in loss provisions to loans. It was not enough, however, to halt the decline of loan loss reserves to loans (Figure 2).

The key factor behind the lower provisioning expenses has been loan performance, and loan quality remained very strong. Noncurrent loans in the aggregate now stand at an all-time low (data series begins in 1984). Commercial real estate loans and construction loans have also reached all-time lows. In all other major loan categories except credit cards, noncurrents now stand below their 20-year medians.

**Figure 2—Reserves continue to shrink relative to loans**



Source: Integrated Banking Information System (OCC) □

\*2005 data as of September 30, 2005. All other data as of year-end. □

**Key indicators, FDIC-insured national banks**  
**Annual 2001--2004, year-to-date through September 30, 2005, third quarter 2004, and third quarter 2005**  
(Dollar figures in millions)

	2001	2002	2003	2004	Preliminary 2005YTD	2004Q3	Preliminary 2005Q3
Number of institutions reporting	2,138	2,077	1,999	1,907	1,846	1,936	1,846
Total employees (FTEs)	966,545	993,469	1,000,493	1,143,384	1,170,569	1,066,167	1,170,569
<b>Selected income data (\$)</b>							
Net income	\$44,072	\$56,435	\$62,994	\$67,550	\$56,799	\$17,782	\$19,318
Net interest income	125,344	141,324	143,148	159,212	127,666	40,143	43,058
Provision for loan losses	28,921	32,606	24,005	18,638	14,987	5,093	6,412
Noninterest income	99,922	109,473	116,158	127,280	111,750	28,884	39,084
Noninterest expense	131,704	136,793	144,938	170,832	140,535	39,086	47,046
Net operating income	42,842	54,292	60,624	65,269	56,339	16,894	19,221
Cash dividends declared	27,783	41,757	45,049	33,034	33,086	9,474	13,336
Net charge-offs	25,107	31,372	26,968	21,904	16,009	4,980	6,200
<b>Selected condition data (\$)</b>							
Total assets	3,634,967	3,908,117	4,292,229	5,602,044	5,946,140	4,846,508	5,946,140
Total loans and leases	2,269,240	2,445,180	2,630,591	3,166,736	3,375,428	2,949,222	3,375,428
Reserve for losses	45,537	48,333	48,623	48,964	46,640	48,187	46,640
Securities	576,550	653,702	753,642	908,054	937,653	799,516	937,653
Other real estate owned	1,799	2,075	1,941	1,529	1,626	1,622	1,626
Noncurrent loans and leases	34,261	38,164	34,876	29,604	27,621	28,558	27,621
Total deposits	2,384,414	2,565,771	2,786,714	3,581,425	3,760,487	3,119,953	3,760,487
Domestic deposits	2,001,243	2,168,876	2,322,009	2,848,726	3,012,881	2,554,456	3,012,881
Equity capital	340,582	371,329	390,492	557,841	585,626	505,719	585,626
Off-balance-sheet derivatives	20,549,785	25,953,772	31,554,693	86,319,461	96,992,909	39,677,915	96,992,909
<b>Performance ratios (annualized %)</b>							
Return on equity	13.81	15.78	16.47	13.83	13.11	14.99	13.22
Return on assets	1.25	1.50	1.53	1.27	1.31	1.49	1.31
Net interest income to assets	3.55	3.75	3.47	3.00	2.94	3.36	2.93
Loss provision to assets	0.82	0.87	0.58	0.35	0.34	0.43	0.44
Net operating income to assets	1.21	1.44	1.47	1.23	1.30	1.42	1.31
Noninterest income to assets	2.83	2.91	2.82	2.40	2.57	2.42	2.66
Noninterest expense to assets	3.74	3.63	3.51	3.22	3.23	3.27	3.20
Loss provision to loans and leases	1.28	1.38	0.95	0.62	0.61	0.70	0.77
Net charge-offs to loans and leases	1.11	1.33	1.07	0.73	0.65	0.69	0.74
Loss provision to net charge-offs	115.19	103.93	89.01	85.09	93.61	102.27	103.42
<b>Performance ratios (%)</b>							
Percent of institutions unprofitable	7.48	6.93	5.60	5.35	4.82	5.79	5.47
Percent of institutions with earnings gains	56.83	71.21	55.93	62.77	62.30	62.29	61.92
Nonint. income to net operating revenue	44.36	43.65	44.80	44.43	46.68	41.84	47.58
Nonint. expense to net operating revenue	58.47	54.54	55.89	59.63	58.70	56.62	57.27
<b>Condition ratios (%)</b>							
Nonperforming assets to assets	1.01	1.06	0.89	0.57	0.50	0.63	0.50
Noncurrent loans to loans	1.51	1.56	1.33	0.93	0.82	0.97	0.82
Loss reserve to noncurrent loans	132.91	126.65	139.42	165.39	168.86	168.73	168.86
Loss reserve to loans	2.01	1.98	1.85	1.55	1.38	1.63	1.38
Equity capital to assets	9.37	9.50	9.10	9.96	9.85	10.43	9.85
Leverage ratio	7.81	7.88	7.70	7.30	7.35	7.50	7.35
Risk-based capital ratio	12.59	12.66	12.65	12.25	12.02	12.37	12.02
Net loans and leases to assets	61.18	61.33	60.15	55.65	55.98	59.86	55.98
Securities to assets	15.86	16.73	17.56	16.21	15.77	16.50	15.77
Appreciation in securities (% of par)	0.47	2.12	0.88	0.55	-0.55	0.71	-0.55
Residential mortgage assets to assets	22.55	24.72	24.44	23.52	23.67	24.08	23.67
Total deposits to assets	65.60	65.65	64.92	63.93	63.24	64.38	63.24
Core deposits to assets	48.08	48.74	48.03	43.83	42.99	46.02	42.99
Volatile liabilities to assets	31.24	30.31	30.57	33.90	35.68	32.35	35.68

**Loan performance, FDIC-insured national banks**  
**Annual 2001--2004, year-to-date through September 30, 2005, third quarter 2004, and third quarter 2005**  
(Dollar figures in millions)

	2001	2002	2003	2004	Preliminary 2005YTD	2004Q3	Preliminary 2005Q3
<b>Percent of loans past due 30-89 days</b>							
Total loans and leases	1.38	1.14	1.02	0.87	0.87	0.87	0.87
Loans secured by real estate (RE)	1.42	1.07	0.91	0.75	0.76	0.77	0.76
1- to 4-family residential mortgages	1.84	1.45	1.30	1.05	1.01	1.11	1.01
Home equity loans	0.79	0.61	0.45	0.39	0.46	0.37	0.46
Multifamily residential mortgages	0.82	0.42	0.54	0.39	0.42	0.48	0.42
Commercial RE loans	0.85	0.58	0.47	0.44	0.50	0.44	0.50
Construction RE loans	1.28	0.91	0.66	0.61	0.58	0.63	0.58
Commercial and industrial loans	0.94	0.76	0.63	0.56	0.59	0.54	0.59
Loans to individuals	2.38	2.15	2.08	1.84	1.83	1.87	1.83
Credit cards	2.52	2.57	2.48	2.21	2.31	2.24	2.31
Installment loans and other plans	2.62	2.07	1.95	1.67	1.60	1.71	1.60
All other loans and leases	0.84	0.55	0.34	0.31	0.33	0.23	0.33
<b>Percent of loans noncurrent</b>							
Total loans and leases	1.51	1.56	1.33	0.93	0.82	0.97	0.82
Loans secured by real estate (RE)	1.05	0.97	0.95	0.68	0.74	0.73	0.74
1- to 4-family residential mortgages	1.06	1.02	1.14	0.86	0.99	0.94	0.99
Home equity loans	0.38	0.32	0.24	0.18	0.21	0.16	0.21
Multifamily residential mortgages	0.54	0.48	0.45	0.42	0.42	0.33	0.42
Commercial RE loans	1.02	1.05	0.97	0.71	0.67	0.79	0.67
Construction RE loans	1.15	1.03	0.71	0.45	0.43	0.54	0.43
Commercial and industrial loans	2.44	3.00	2.19	1.22	0.86	1.35	0.86
Loans to individuals	1.49	1.60	1.78	1.66	1.35	1.62	1.35
Credit cards	2.05	2.16	2.24	2.03	1.91	1.92	1.91
Installment loans and other plans	1.24	1.30	1.55	1.46	0.99	1.50	0.99
All other loans and leases	1.19	1.11	0.74	0.39	0.29	0.39	0.29
<b>Percent of loans charged-off, net</b>							
Total loans and leases	1.11	1.33	1.07	0.73	0.65	0.69	0.74
Loans secured by real estate (RE)	0.26	0.19	0.21	0.08	0.06	0.08	0.06
1- to 4-family residential mortgages	0.32	0.17	0.24	0.08	0.06	0.08	0.06
Home equity loans	0.35	0.23	0.23	0.10	0.09	0.10	0.09
Multifamily residential mortgages	0.04	0.11	0.03	0.04	0.05	0.03	0.04
Commercial RE loans	0.16	0.17	0.13	0.05	0.05	0.07	0.05
Construction RE loans	0.15	0.19	0.14	0.04	0.02	0.04	0.02
Commercial and industrial loans	1.50	1.80	1.35	0.43	0.15	0.32	0.11
Loans to individuals	3.13	4.02	3.45	3.14	3.07	3.07	3.57
Credit cards	5.06	6.58	5.48	5.14	4.62	4.81	4.62
Installment loans and other plans	1.66	1.91	1.81	1.51	1.74	1.50	2.70
All other loans and leases	0.58	0.83	0.58	0.15	0.17	0.10	0.38
<b>Loans outstanding (\$)</b>							
Total loans and leases	\$2,269,240	\$2,445,180	\$2,630,591	\$3,166,736	\$3,375,428	\$2,949,222	\$3,375,428
Loans secured by real estate (RE)	976,090	1,139,259	1,254,981	1,572,071	1,725,495	1,452,951	1,725,495
1- to 4-family residential mortgages	472,678	573,667	605,100	745,212	816,966	672,764	816,966
Home equity loans	102,129	141,056	192,703	294,919	326,737	266,115	326,737
Multifamily residential mortgages	30,075	33,968	35,652	39,942	44,256	39,051	44,256
Commercial RE loans	236,489	253,427	269,936	301,691	320,858	295,196	320,858
Construction RE loans	91,436	95,360	104,218	128,631	157,226	122,593	157,226
Farmland loans	12,615	13,225	13,614	14,678	15,569	14,719	15,569
RE loans from foreign offices	30,668	28,556	33,758	46,998	43,883	42,512	43,883
Commercial and industrial loans	597,304	546,053	500,005	580,788	649,128	534,392	649,128
Loans to individuals	389,940	450,515	527,968	615,506	610,208	565,035	610,208
Credit cards+A27	166,628	209,892	250,870	300,097	275,685	277,566	275,685
Other revolving credit plans	29,258	33,243	32,883	34,258	34,956	33,421	34,956
Installment loans	194,054	207,381	244,215	281,151	299,567	254,048	299,567
All other loans and leases	307,851	311,803	349,521	400,595	392,529	398,881	392,529
Less: Unearned income	1,944	2,449	1,884	2,224	1,931	2,038	1,931

**Key indicators, FDIC-insured national banks by asset size**  
**Third quarter 2004 and third quarter 2005**  
(Dollar figures in millions)

	Less than \$100M		\$100M to \$1B		\$1B to \$10B		Greater than \$10B	
	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3
Number of institutions reporting	795	711	966	961	127	127	48	47
Total employees (FTEs)	18,393	16,011	90,014	88,655	86,128	83,739	871,632	982,164
<b>Selected income data (\$)</b>								
Net income	\$121	\$109	\$875	\$893	\$1,299	\$1,301	\$15,487	\$17,015
Net interest income	423	390	2,531	2,539	3,031	3,007	34,158	37,121
Provision for loan losses	24	16	163	142	210	212	4,695	6,042
Noninterest income	164	144	1,213	1,325	2,186	2,312	25,321	35,304
Noninterest expense	410	375	2,397	2,507	3,081	3,180	33,198	40,983
Net operating income	119	110	869	892	1,291	1,292	14,615	16,927
Cash dividends declared	55	58	501	534	559	1,168	8,359	11,575
Net charge-offs	18	10	112	92	162	175	4,688	5,923
<b>Selected condition data (\$)</b>								
Total assets	44,124	39,795	267,795	269,469	365,322	354,377	4,169,267	5,282,499
Total loans and leases	26,377	23,724	171,957	174,240	224,425	225,392	2,526,463	2,952,072
Reserve for losses	380	335	2,378	2,226	2,997	2,785	42,432	41,294
Securities	11,427	10,665	65,393	61,146	88,332	72,851	634,364	792,991
Other real estate owned	74	53	254	235	192	123	1,101	1,215
Noncurrent loans and leases	298	250	1,353	1,241	1,507	1,357	25,401	24,772
Total deposits	36,658	33,051	215,901	217,523	244,952	244,145	2,622,443	3,265,769
Domestic deposits	36,636	33,036	215,479	217,275	242,356	241,103	2,059,986	2,521,467
Equity capital	5,245	4,643	27,414	28,269	40,197	38,140	432,863	514,574
Off-balance-sheet derivatives	18	21	2,535	4,164	19,340	17,426	40,077,653	97,719,244
<b>Performance ratios (annualized %)</b>								
Return on equity	9.47	9.40	13.05	12.75	13.43	13.67	15.34	13.24
Return on assets	1.11	1.11	1.32	1.34	1.44	1.49	1.51	1.30
Net interest income to assets	3.87	3.95	3.82	3.82	3.35	3.45	3.33	2.84
Loss provision to assets	0.22	0.16	0.25	0.21	0.23	0.24	0.46	0.46
Net operating income to assets	1.09	1.12	1.31	1.34	1.43	1.48	1.42	1.29
Noninterest income to assets	1.50	1.45	1.83	1.99	2.42	2.65	2.47	2.70
Noninterest expense to assets	3.75	3.80	3.62	3.77	3.41	3.65	3.23	3.14
Loss provision to loans and leases	0.38	0.28	0.39	0.33	0.38	0.38	0.76	0.83
Net charge-offs to loans and leases	0.28	0.18	0.26	0.21	0.29	0.31	0.76	0.81
Loss provision to net charge-offs	136.46	156.01	145.97	154.47	129.55	121.64	100.15	102.00
<b>Performance ratios (%)</b>								
Percent of institutions unprofitable	10.44	9.42	2.28	3.02	3.15	2.36	6.25	4.26
Percent of institutions with earnings gains	57.99	57.10	65.22	63.68	69.29	75.59	56.25	61.70
Nonint. income to net operating revenue	27.87	26.92	32.39	34.29	41.90	43.46	42.57	48.75
Nonint. expense to net operating revenue	69.78	70.30	64.04	64.88	59.06	59.79	55.81	56.59
<b>Condition ratios (%)</b>								
Nonperforming assets to assets	0.85	0.76	0.60	0.55	0.47	0.42	0.65	0.50
Noncurrent loans to loans	1.13	1.05	0.79	0.71	0.67	0.60	1.01	0.84
Loss reserve to noncurrent loans	127.80	133.92	175.79	179.33	198.90	205.24	167.05	166.70
Loss reserve to loans	1.44	1.41	1.38	1.28	1.34	1.24	1.68	1.40
Equity capital to assets	11.89	11.67	10.24	10.49	11.00	10.76	10.38	9.74
Leverage ratio	11.59	11.69	9.49	9.65	9.22	9.00	7.16	7.08
Risk-based capital ratio	18.87	19.12	14.71	14.67	15.18	13.37	11.96	11.77
Net loans and leases to assets	58.92	58.78	63.32	63.83	60.61	62.82	59.58	55.10
Securities to assets	25.90	26.80	24.42	22.69	24.18	20.56	15.22	15.01
Appreciation in securities (% of par)	0.51	-0.89	0.76	-0.67	1.04	-0.71	0.66	-0.52
Residential mortgage assets to assets	20.68	20.61	23.13	21.84	26.86	24.49	23.93	23.73
Total deposits to assets	83.08	83.05	80.62	80.72	67.05	68.89	62.90	61.82
Core deposits to assets	70.57	70.11	67.64	66.31	57.16	56.30	43.40	40.71
Volatile liabilities to assets	14.95	15.73	17.74	19.01	23.35	26.53	34.26	37.30

**Loan performance, FDIC-insured national banks by asset size**  
**Third quarter 2004 and third quarter 2005**  
(Dollar figures in millions)

	Less than \$100M		\$100M to \$1B		\$1B to \$10B		Greater than \$10B	
	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3
<b>Percent of loans past due 30-89 days</b>								
Total loans and leases	1.24	1.23	0.85	0.82	0.61	0.76	0.89	0.88
Loans secured by real estate (RE)	1.13	1.13	0.72	0.71	0.47	0.52	0.80	0.78
1- to 4-family residential mortgages	1.60	1.61	1.04	1.05	0.61	0.66	1.15	1.03
Home equity loans	0.53	0.48	0.33	0.38	0.23	0.29	0.38	0.47
Multifamily residential mortgages	0.18	0.85	0.55	0.42	0.26	0.32	0.52	0.44
Commercial RE loans	0.91	0.88	0.56	0.52	0.35	0.50	0.43	0.48
Construction RE loans	1.08	0.88	0.70	0.78	0.58	0.48	0.62	0.57
Commercial and industrial loans	1.49	1.39	0.95	1.02	0.86	1.40	0.48	0.50
Loans to individuals	2.25	2.27	1.80	1.60	1.31	1.11	1.89	1.86
Credit cards	2.01	1.91	3.33	2.88	2.99	1.85	2.22	2.31
Installment loans and other plans	2.28	2.33	1.52	1.48	1.14	1.03	1.75	1.63
All other loans and leases	0.51	0.64	0.54	0.54	0.37	0.54	0.22	0.32
<b>Percent of loans noncurrent</b>								
Total loans and leases	1.13	1.05	0.79	0.71	0.67	0.60	1.01	0.84
Loans secured by real estate (RE)	0.97	0.95	0.69	0.68	0.58	0.54	0.75	0.76
1- to 4-family residential mortgages	0.98	0.92	0.66	0.70	0.51	0.55	0.99	1.04
Home equity loans	0.27	0.30	0.14	0.18	0.15	0.18	0.17	0.21
Multifamily residential mortgages	0.60	1.00	0.51	0.49	0.29	0.24	0.31	0.44
Commercial RE loans	1.11	1.17	0.78	0.74	0.82	0.74	0.78	0.63
Construction RE loans	0.72	0.58	0.69	0.63	0.43	0.37	0.53	0.41
Commercial and industrial loans	1.97	1.68	1.19	1.00	1.05	0.87	1.38	0.85
Loans to individuals	0.87	0.82	0.82	0.58	0.64	0.50	1.68	1.40
Credit cards	1.20	1.15	2.62	1.73	2.52	1.37	1.91	1.92
Installment loans and other plans	0.87	0.83	0.46	0.45	0.38	0.35	1.64	1.06
All other loans and leases	1.06	0.98	0.73	0.56	0.45	0.47	0.37	0.27
<b>Percent of loans charged-off, net</b>								
Total loans and leases	0.28	0.18	0.26	0.21	0.29	0.31	0.76	0.81
Loans secured by real estate (RE)	0.09	0.05	0.06	0.06	0.05	0.08	0.08	0.06
1- to 4-family residential mortgages	0.07	0.04	0.07	0.08	0.07	0.08	0.08	0.05
Home equity loans	0.10	0.04	0.05	0.02	0.03	0.09	0.10	0.09
Multifamily residential mortgages	0.00	0.17	0.00	0.16	0.07	0.12	0.02	0.00
Commercial RE loans	0.12	0.07	0.05	0.04	0.02	0.10	0.08	0.04
Construction RE loans	0.03	0.05	0.07	0.04	0.10	0.04	0.02	0.01
Commercial and industrial loans	0.65	0.51	0.44	0.30	0.69	0.63	0.28	0.06
Loans to individuals	0.86	0.59	1.58	1.24	1.23	1.13	3.20	3.73
Credit cards	2.86	1.91	6.57	5.88	4.03	2.59	4.80	4.64
Installment loans and other plans	0.82	0.55	0.54	0.62	0.85	0.85	1.60	2.90
All other loans and leases	0.22	0.02	0.15	0.49	0.22	0.58	0.10	0.38
<b>Loans outstanding (\$)</b>								
Total loans and leases	\$26,377	\$23,724	\$171,957	\$174,240	\$224,425	\$225,392	\$2,526,463	\$2,952,072
Loans secured by real estate (RE)	16,334	14,761	119,386	124,044	143,027	148,042	1,174,204	1,438,648
1- to 4-family residential mortgages	6,424	5,913	38,814	38,623	52,253	48,789	575,274	723,641
Home equity loans	546	471	7,346	6,920	11,601	11,836	246,622	307,510
Multifamily residential mortgages	412	356	4,155	4,105	5,777	7,265	28,707	32,530
Commercial RE loans	5,110	4,626	47,750	48,875	50,143	49,553	192,194	217,803
Construction RE loans	1,828	1,538	15,502	19,377	20,761	27,098	84,503	109,212
Farmland loans	2,015	1,856	5,817	6,141	1,891	2,612	4,996	4,959
RE loans from foreign offices	0	0	2	2	601	890	41,908	42,992
Commercial and industrial loans	4,157	3,688	27,251	26,887	45,573	47,003	457,412	571,549
Loans to individuals	2,854	2,471	15,959	13,951	18,628	21,027	527,594	572,759
Credit cards+A27	57	58	2,786	1,624	2,410	3,424	272,312	270,578
Other revolving credit plans	39	54	336	414	1,192	1,117	31,855	33,371
Installment loans	2,758	2,359	12,837	11,913	15,026	16,485	223,427	268,810
All other loans and leases	3,053	2,823	9,527	9,519	17,321	9,461	368,980	370,725
Less: Unearned income	22	19	167	162	123	141	1,726	1,609

**Key indicators, FDIC-insured national banks by region**

**Third quarter 2005**

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Number of institutions reporting	207	215	356	382	542	144	1,846
Total employees (FTEs)	318,682	265,633	300,321	163,514	79,022	43,397	1,170,569
<b>Selected income data (\$)</b>							
Net income	\$4,577	\$5,567	\$4,557	\$2,568	\$610	\$1,438	\$19,318
Net interest income	10,568	11,090	9,950	5,521	2,138	3,791	43,058
Provision for loan losses	2,966	284	939	590	339	1,294	6,412
Noninterest income	11,888	7,038	11,232	5,546	1,104	2,276	39,084
Noninterest expense	12,921	9,698	13,317	6,517	2,083	2,510	47,046
Net operating income	4,520	5,534	4,526	2,583	610	1,449	19,221
Cash dividends declared	2,904	3,361	1,822	1,691	357	3,201	13,336
Net charge-offs	3,121	441	790	681	87	1,079	6,200
<b>Selected condition data (\$)</b>							
Total assets	1,379,844	1,707,013	1,809,684	545,936	241,660	262,003	5,946,140
Total loans and leases	760,801	921,383	942,341	404,226	151,767	194,912	3,375,428
Reserve for losses	13,487	8,508	11,887	5,440	1,951	5,367	46,640
Securities	244,555	362,923	192,776	55,308	50,159	31,933	937,653
Other real estate owned	142	546	505	179	210	43	1,626
Noncurrent loans and leases	7,644	3,437	8,653	4,630	1,172	2,085	27,621
Total deposits	901,276	1,120,327	1,034,617	379,299	187,229	137,740	3,760,487
Domestic deposits	506,560	982,572	850,935	355,961	184,025	132,829	3,012,881
Equity capital	146,130	163,661	164,122	59,602	22,514	29,598	585,626
Off-balance-sheet derivatives	23,071,790	24,726,754	48,194,793	891,475	62,638	45,460	96,992,909
<b>Performance ratios (annualized %)</b>							
Return on equity	12.54	13.61	11.18	17.34	10.90	18.87	13.22
Return on assets	1.33	1.32	1.02	1.91	1.02	2.22	1.31
Net interest income to assets	3.07	2.63	2.23	4.11	3.59	5.86	2.93
Loss provision to assets	0.86	0.07	0.21	0.44	0.57	2.00	0.44
Net operating income to assets	1.31	1.31	1.02	1.92	1.03	2.24	1.31
Noninterest income to assets	3.46	1.67	2.52	4.13	1.86	3.52	2.66
Noninterest expense to assets	3.76	2.30	2.99	4.85	3.50	3.88	3.20
Loss provision to loans and leases	1.55	0.13	0.41	0.59	0.91	2.68	0.77
Net charge-offs to loans and leases	1.63	0.20	0.34	0.68	0.23	2.23	0.74
Loss provision to net charge-offs	95.04	64.40	118.86	86.65	387.71	119.86	103.42
<b>Performance ratios (%)</b>							
Percent of institutions unprofitable	5.80	8.37	4.78	3.40	4.98	9.72	5.47
Percent of institutions with earnings gains	60.39	70.23	55.34	58.38	64.02	69.44	61.92
Nonint. income to net operating revenue	52.94	38.82	53.02	50.11	34.06	37.52	47.58
Nonint. expense to net operating revenue	57.54	53.50	62.87	58.89	64.24	41.37	57.27
<b>Condition ratios (%)</b>							
Nonperforming assets to assets	0.56	0.24	0.52	0.89	0.57	0.82	0.50
Noncurrent loans to loans	1.00	0.37	0.92	1.15	0.77	1.07	0.82
Loss reserve to noncurrent loans	176.45	247.52	137.38	117.50	166.43	257.45	168.86
Loss reserve to loans	1.77	0.92	1.26	1.35	1.29	2.75	1.38
Equity capital to assets	10.59	9.59	9.07	10.92	9.32	11.30	9.85
Leverage ratio	7.97	6.67	6.71	8.48	8.30	9.54	7.35
Risk-based capital ratio	13.98	10.91	11.22	12.48	12.75	12.94	12.02
Net loans and leases to assets	54.16	53.48	51.42	73.05	61.99	72.34	55.98
Securities to assets	17.72	21.26	10.65	10.13	20.76	12.19	15.77
Appreciation in securities (% of par)	-0.11	-1.03	-0.44	0.88	-1.05	-0.72	-0.55
Residential mortgage assets to assets	14.82	36.18	18.48	26.39	24.14	18.57	23.67
Total deposits to assets	65.32	65.63	57.17	69.48	77.48	52.57	63.24
Core deposits to assets	29.01	51.21	39.44	56.34	59.34	44.71	42.99
Volatile liabilities to assets	46.36	31.22	37.14	21.03	26.84	37.05	35.68

**Loan performance, FDIC-insured national banks by region**  
**Third quarter 2005**  
(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
<b>Percent of loans past due 30-89 days</b>							
Total loans and leases	1.08	0.57	0.82	0.94	1.10	1.39	0.87
Loans secured by real estate (RE)	0.84	0.60	0.89	0.73	0.85	0.76	0.76
1- to 4-family residential mortgages	1.02	0.80	1.27	0.99	1.10	1.32	1.01
Home equity loans	0.39	0.47	0.45	0.52	0.52	0.14	0.46
Multifamily residential mortgages	0.12	0.34	0.55	0.14	1.12	0.61	0.42
Commercial RE loans	0.48	0.32	0.70	0.43	0.75	0.36	0.50
Construction RE loans	0.44	0.27	0.85	0.68	0.79	0.47	0.58
Commercial and industrial loans	0.69	0.38	0.47	0.72	1.39	0.86	0.59
Loans to individuals	1.99	1.44	1.21	2.20	2.16	2.36	1.83
Credit cards	2.23	0.99	1.71	2.96	2.02	2.45	2.31
Installment loans and other plans	2.11	1.54	1.08	1.42	2.26	2.14	1.60
All other loans and leases	0.20	0.12	0.64	0.28	1.26	0.29	0.33
<b>Percent of loans noncurrent</b>							
Total loans and leases	1.00	0.37	0.92	1.15	0.77	1.07	0.82
Loans secured by real estate (RE)	0.69	0.30	1.03	1.33	0.74	0.41	0.74
1- to 4-family residential mortgages	0.51	0.30	1.64	2.28	1.15	0.45	0.99
Home equity loans	0.13	0.16	0.24	0.29	0.19	0.04	0.21
Multifamily residential mortgages	0.34	0.37	0.49	0.72	0.36	0.11	0.42
Commercial RE loans	0.70	0.47	0.96	0.67	0.70	0.47	0.67
Construction RE loans	0.54	0.26	0.60	0.36	0.53	0.36	0.43
Commercial and industrial loans	0.92	0.56	1.12	0.63	1.02	0.65	0.86
Loans to individuals	1.77	0.76	0.62	1.38	0.42	2.00	1.35
Credit cards	1.92	0.70	1.39	2.15	1.17	2.08	1.91
Installment loans and other plans	1.96	0.81	0.35	0.53	0.39	1.78	0.99
All other loans and leases	0.16	0.23	0.41	0.39	0.66	0.34	0.29
<b>Percent of loans charged-off, net</b>							
Total loans and leases	1.63	0.20	0.34	0.68	0.23	2.23	0.74
Loans secured by real estate (RE)	0.04	0.03	0.11	0.05	0.06	0.03	0.06
1- to 4-family residential mortgages	0.04	0.02	0.13	0.03	0.08	0.06	0.06
Home equity loans	0.03	0.06	0.12	0.14	0.13	0.01	0.09
Multifamily residential mortgages	0.00	0.00	0.05	0.13	0.17	0.00	0.04
Commercial RE loans	0.01	0.06	0.10	-0.02	0.02	0.01	0.05
Construction RE loans	-0.05	0.04	0.01	0.04	0.02	0.01	0.02
Commercial and industrial loans	-0.13	0.09	0.07	0.48	0.42	0.76	0.11
Loans to individuals	5.22	0.65	1.59	3.09	0.95	5.36	3.57
Credit cards	4.13	2.56	3.75	4.85	3.37	5.99	4.62
Installment loans and other plans	6.52	0.62	0.78	0.93	0.80	0.97	2.70
All other loans and leases	-0.04	0.90	0.31	0.44	0.46	0.12	0.38
<b>Loans outstanding (\$)</b>							
Total loans and leases	\$760,801	\$921,383	\$942,341	\$404,226	\$151,767	\$194,912	\$3,375,428
Loans secured by real estate (RE)	243,055	578,754	488,932	238,552	97,918	78,285	1,725,495
1- to 4-family residential mortgages	114,040	311,542	216,389	112,593	30,436	31,968	816,966
Home equity loans	28,853	101,708	121,858	59,182	9,533	5,603	326,737
Multifamily residential mortgages	6,795	11,632	15,399	4,436	2,221	3,771	44,256
Commercial RE loans	42,386	98,689	84,607	38,888	31,452	24,836	320,858
Construction RE loans	11,996	49,070	44,921	18,750	21,569	10,920	157,226
Farmland loans	793	1,900	4,279	4,703	2,707	1,187	15,569
RE loans from foreign offices	38,192	4,213	1,479	0	0	0	43,883
Commercial and industrial loans	160,167	161,870	203,967	59,966	33,264	29,893	649,128
Loans to individuals	243,177	70,776	137,223	68,556	13,512	76,965	610,208
Credit cards	132,546	958	37,221	36,897	749	67,313	275,685
Other revolving credit plans	20,887	4,036	5,017	2,587	549	1,881	34,956
Installment loans	89,743	65,782	94,985	29,072	12,214	7,771	299,567
All other loans and leases	115,770	110,280	112,281	37,176	7,160	9,862	392,529
Less: Unearned income	1,368	297	62	24	87	93	1,931

**Key indicators, FDIC-insured commercial banks**  
**Annual 2001--2004, year-to-date through September 30, 2005, third quarter 2004, and third quarter 2005**  
(Dollar figures in millions)

	2001	2002	2003	2004	Preliminary 2005YTD	2004Q3	Preliminary 2005Q3
Number of institutions reporting	8,080	7,888	7,770	7,631	7,541	7,660	7,541
Total employees (FTEs)	1,701,721	1,745,614	1,759,517	1,814,999	1,856,293	1,806,846	1,856,293
<b>Selected income data (\$)</b>							
Net income	\$73,730	\$89,670	\$102,463	\$104,174	\$87,218	\$27,725	\$29,776
Net interest income	214,654	236,602	239,986	249,602	201,481	65,326	68,568
Provision for loan losses	43,337	48,187	34,832	26,097	19,551	6,712	8,159
Noninterest income	158,034	172,350	186,528	183,909	153,428	45,831	53,692
Noninterest expense	223,223	233,560	245,989	257,525	207,009	65,555	69,996
Net operating income	70,902	85,373	98,216	101,590	86,691	26,709	29,772
Cash dividends declared	54,228	67,536	77,838	55,686	49,277	14,413	19,097
Net charge-offs	36,474	44,529	37,928	29,107	20,176	6,766	7,702
<b>Selected condition data (\$)</b>							
Total assets	6,552,336	7,076,676	7,601,172	8,413,850	8,903,605	8,244,957	8,903,605
Total loans and leases	3,884,328	4,156,070	4,428,827	4,904,482	5,265,929	4,815,220	5,265,929
Reserve for losses	72,273	76,994	77,146	73,502	70,981	75,200	70,981
Securities	1,172,540	1,334,826	1,456,307	1,551,273	1,584,036	1,494,868	1,584,036
Other real estate owned	3,569	4,165	4,218	3,373	3,327	3,659	3,327
Noncurrent loans and leases	54,581	60,548	52,949	42,077	39,652	43,919	39,652
Total deposits	4,377,558	4,689,852	5,035,056	5,593,169	5,917,027	5,406,587	5,917,027
Domestic deposits	3,748,042	4,031,815	4,293,884	4,727,277	5,014,276	4,586,727	5,014,276
Equity capital	593,621	647,340	691,900	850,335	899,409	821,627	899,409
Off-balance-sheet derivatives	45,325,982	56,208,857	71,098,970	87,872,811	98,783,602	84,205,235	98,783,602
<b>Performance ratios (annualized %)</b>							
Return on equity	13.08	14.46	15.31	13.74	13.19	14.17	13.29
Return on assets	1.15	1.33	1.40	1.30	1.34	1.36	1.35
Net interest income to assets	3.35	3.50	3.27	3.12	3.10	3.21	3.11
Loss provision to assets	0.68	0.71	0.47	0.33	0.30	0.33	0.37
Net operating income to assets	1.11	1.26	1.34	1.27	1.33	1.31	1.35
Noninterest income to assets	2.46	2.55	2.54	2.30	2.36	2.25	2.44
Noninterest expense to assets	3.48	3.46	3.35	3.22	3.18	3.22	3.18
Loss provision to loans and leases	1.12	1.21	0.82	0.56	0.51	0.57	0.63
Net charge-offs to loans and leases	0.95	1.12	0.89	0.63	0.53	0.57	0.59
Loss provision to net charge-offs	118.82	108.21	91.84	89.66	96.90	99.21	105.93
<b>Performance ratios (%)</b>							
Percent of institutions unprofitable	8.13	6.64	6.01	5.87	5.83	5.61	5.68
Percent of institutions with earnings gains	56.27	72.68	59.19	64.85	64.79	62.95	62.23
Nonint. income to net operating revenue	42.40	42.14	43.73	42.42	43.23	41.23	43.92
Nonint. expense to net operating revenue	59.90	57.11	57.67	59.40	58.33	58.97	57.25
<b>Condition ratios (%)</b>							
Nonperforming assets to assets	0.92	0.94	0.77	0.55	0.49	0.59	0.49
Noncurrent loans to loans	1.41	1.46	1.20	0.86	0.75	0.91	0.75
Loss reserve to noncurrent loans	132.41	127.16	145.70	174.68	179.01	171.23	179.01
Loss reserve to loans	1.86	1.85	1.74	1.50	1.35	1.56	1.35
Equity capital to assets	9.06	9.15	9.10	10.11	10.10	9.97	10.10
Leverage ratio	7.78	7.82	7.85	7.82	7.93	7.80	7.93
Risk-based capital ratio	12.70	12.76	12.75	12.61	12.43	12.62	12.43
Net loans and leases to assets	58.18	57.64	57.25	57.42	58.35	57.49	58.35
Securities to assets	17.89	18.86	19.16	18.44	17.79	18.13	17.79
Appreciation in securities (% of par)	0.82	2.22	0.84	0.43	-0.58	0.57	-0.58
Residential mortgage assets to assets	21.64	23.29	23.28	23.33	23.70	23.00	23.70
Total deposits to assets	66.81	66.27	66.24	66.48	66.46	65.57	66.46
Core deposits to assets	48.72	48.68	48.63	47.56	46.71	47.38	46.71
Volatile liabilities to assets	31.45	31.41	30.95	31.67	33.13	32.18	33.13

**Loan performance, FDIC-insured commercial banks**  
**Annual 2001--2004, year-to-date through September 30, 2005, third quarter 2004, and third quarter 2005**  
(Dollar figures in millions)

	2001	2002	2003	2004	Preliminary 2005YTD	2004Q3	Preliminary 2005Q3
<b>Percent of loans past due 30-89 days</b>							
Total loans and leases	1.37	1.17	1.02	0.86	0.83	0.86	0.83
Loans secured by real estate (RE)	1.32	1.08	0.90	0.73	0.72	0.73	0.72
1- to 4-family residential mortgages	1.69	1.49	1.29	1.05	0.99	1.05	0.99
Home equity loans	0.79	0.59	0.45	0.37	0.44	0.37	0.44
Multifamily residential mortgages	0.73	0.46	0.48	0.36	0.41	0.41	0.41
Commercial RE loans	0.90	0.68	0.56	0.49	0.52	0.52	0.52
Construction RE loans	1.23	0.89	0.69	0.58	0.58	0.58	0.58
Commercial and industrial loans	1.01	0.89	0.72	0.64	0.63	0.64	0.63
Loans to individuals	2.46	2.22	2.08	1.82	1.75	1.83	1.75
Credit cards	2.70	2.72	2.53	2.24	2.22	2.28	2.22
Installment loans and other plans	2.54	2.08	1.93	1.62	1.56	1.63	1.56
All other loans and leases	0.84	0.58	0.48	0.38	0.35	0.35	0.35
<b>Percent of loans noncurrent</b>							
Total loans and leases	1.41	1.46	1.20	0.86	0.75	0.91	0.75
Loans secured by real estate (RE)	0.96	0.89	0.86	0.65	0.66	0.69	0.66
1- to 4-family residential mortgages	0.97	0.93	1.00	0.82	0.91	0.86	0.91
Home equity loans	0.37	0.30	0.24	0.18	0.21	0.17	0.21
Multifamily residential mortgages	0.46	0.38	0.38	0.35	0.35	0.31	0.35
Commercial RE loans	0.96	0.94	0.90	0.69	0.63	0.77	0.63
Construction RE loans	1.06	0.98	0.70	0.44	0.39	0.51	0.39
Commercial and industrial loans	2.41	2.93	2.10	1.17	0.88	1.43	0.88
Loans to individuals	1.43	1.51	1.53	1.46	1.20	1.39	1.20
Credit cards	2.12	2.24	2.22	2.00	1.86	1.92	1.86
Installment loans and other plans	1.12	1.14	1.14	1.12	0.82	1.09	0.82
All other loans and leases	0.97	1.01	0.66	0.40	0.31	0.41	0.31
<b>Percent of loans charged-off, net</b>							
Total loans and leases	0.95	1.12	0.89	0.63	0.53	0.57	0.59
Loans secured by real estate (RE)	0.19	0.15	0.17	0.08	0.06	0.08	0.06
1- to 4-family residential mortgages	0.22	0.14	0.19	0.08	0.06	0.08	0.06
Home equity loans	0.27	0.19	0.20	0.10	0.10	0.10	0.10
Multifamily residential mortgages	0.04	0.08	0.03	0.04	0.04	0.06	0.06
Commercial RE loans	0.13	0.15	0.13	0.07	0.05	0.07	0.06
Construction RE loans	0.14	0.17	0.14	0.05	0.03	0.05	0.03
Commercial and industrial loans	1.43	1.76	1.26	0.50	0.22	0.41	0.20
Loans to individuals	2.73	3.34	3.04	2.81	2.68	2.64	3.04
Credit cards	5.12	6.38	5.57	5.01	4.48	4.72	4.47
Installment loans and other plans	1.29	1.46	1.45	1.28	1.39	1.22	2.05
All other loans and leases	0.54	0.77	0.53	0.21	0.19	0.14	0.38
<b>Loans outstanding (\$)</b>							
Total loans and leases	\$3,884,328	\$4,156,070	\$4,428,827	\$4,904,482	\$5,265,929	\$4,815,220	\$5,265,929
Loans secured by real estate (RE)	1,800,224	2,068,149	2,272,837	2,624,849	2,921,130	2,545,414	2,921,130
1- to 4-family residential mortgages	810,779	945,706	994,151	1,083,211	1,206,844	1,066,001	1,206,844
Home equity loans	154,191	214,722	284,511	398,896	436,965	375,178	436,965
Multifamily residential mortgages	64,131	71,934	79,678	87,913	96,376	85,379	96,376
Commercial RE loans	505,882	555,990	602,724	667,093	721,563	651,518	721,563
Construction RE loans	193,014	207,451	231,514	290,051	363,521	273,818	363,521
Farmland loans	35,533	38,066	40,699	44,620	47,240	43,957	47,240
RE loans from foreign offices	36,695	34,280	39,559	53,066	48,622	49,565	48,622
Commercial and industrial loans	981,133	910,810	869,490	908,453	988,202	889,573	988,202
Loans to individuals	629,405	703,659	770,479	838,736	831,363	806,335	831,363
Credit cards	232,448	275,877	315,996	371,421	338,934	339,962	338,934
Other revolving credit plans	34,202	38,209	37,556	39,158	40,324	38,368	40,324
Installment loans	362,755	389,573	416,927	428,156	452,105	428,005	452,105
All other loans and leases	476,689	476,854	518,890	535,652	528,111	576,946	528,111
Less: Unearned income	3,123	3,401	2,870	3,208	3,020	3,048	3,020

**Key indicators, FDIC-insured commercial banks by asset size**  
**Third quarter 2004 and third quarter 2005**  
(Dollar figures in millions)

	Less than \$100M		\$100M to \$1B		\$1B to \$10B		Greater than \$10B	
	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3
Number of institutions reporting	3,754	3,523	3,459	3,552	360	380	87	86
Total employees (FTEs)	73,302	67,612	295,643	298,324	232,175	234,690	1,205,726	1,255,667
<b>Selected income data (\$)</b>								
Net income	\$526	\$491	\$2,991	\$3,354	\$3,563	\$3,534	\$20,645	\$22,397
Net interest income	1,885	1,814	8,956	9,649	8,516	8,992	45,969	48,113
Provision for loan losses	108	87	580	538	639	596	5,384	6,938
Noninterest income	487	466	3,216	3,355	5,080	4,926	37,048	44,945
Noninterest expense	1,606	1,564	7,543	7,958	7,805	8,038	48,601	52,436
Net operating income	520	495	2,971	3,328	3,527	3,515	19,691	22,433
Cash dividends declared	220	239	1,216	1,439	1,441	2,709	11,536	14,710
Net charge-offs	77	48	387	328	557	472	5,745	6,855
<b>Selected condition data (\$)</b>								
Total assets	194,589	184,186	928,181	982,498	971,679	1,022,592	6,150,507	6,714,330
Total loans and leases	120,957	115,937	622,480	671,389	618,073	669,454	3,453,710	3,809,150
Reserve for losses	1,760	1,645	8,649	8,784	9,039	8,643	55,752	51,909
Securities	48,305	43,858	207,269	200,946	233,749	222,731	1,005,544	1,116,501
Other real estate owned	303	239	1,129	998	566	436	1,661	1,653
Noncurrent loans and leases	1,266	1,067	4,822	4,496	4,605	4,044	33,226	30,044
Total deposits	161,852	152,238	749,445	796,172	668,394	719,681	3,826,896	4,248,936
Domestic deposits	161,830	152,224	748,144	794,447	658,342	709,926	3,018,411	3,357,679
Equity capital	22,757	22,000	93,309	99,412	106,162	109,442	599,398	668,554
Off-balance-sheet derivatives	95	124	6,123	9,467	62,977	73,479	84,781,655	99,501,000
<b>Performance ratios (annualized %)</b>								
Return on equity	9.46	8.99	13.18	13.67	13.93	12.99	14.56	13.42
Return on assets	1.09	1.08	1.31	1.38	1.49	1.40	1.36	1.35
Net interest income to assets	3.91	3.99	3.91	3.98	3.55	3.57	3.03	2.89
Loss provision to assets	0.23	0.19	0.25	0.22	0.27	0.24	0.35	0.42
Net operating income to assets	1.08	1.09	1.30	1.37	1.47	1.39	1.30	1.35
Noninterest income to assets	1.01	1.02	1.40	1.38	2.12	1.95	2.44	2.70
Noninterest expense to assets	3.33	3.44	3.29	3.28	3.26	3.19	3.20	3.15
Loss provision to loans and leases	0.37	0.31	0.38	0.33	0.42	0.36	0.63	0.74
Net charge-offs to loans and leases	0.26	0.17	0.25	0.20	0.37	0.29	0.67	0.73
Loss provision to net charge-offs	141.07	182.35	150.14	163.82	114.68	126.31	93.73	101.22
<b>Performance ratios (%)</b>								
Percent of institutions unprofitable	9.24	9.62	1.99	2.17	2.78	2.63	4.60	2.33
Percent of institutions with earnings gains	58.55	54.61	66.78	68.41	72.50	73.95	60.92	67.44
Nonint. income to net operating revenue	20.54	20.42	26.42	25.80	37.36	35.39	44.63	48.30
Nonint. expense to net operating revenue	67.72	68.60	61.97	61.20	57.41	57.75	58.54	56.35
<b>Condition ratios (%)</b>								
Nonperforming assets to assets	0.81	0.71	0.64	0.56	0.54	0.44	0.58	0.48
Noncurrent loans to loans	1.05	0.92	0.77	0.67	0.75	0.60	0.96	0.79
Loss reserve to noncurrent loans	139.03	154.09	179.38	195.36	196.27	213.71	167.80	172.78
Loss reserve to loans	1.46	1.42	1.39	1.31	1.46	1.29	1.61	1.36
Equity capital to assets	11.70	11.94	10.05	10.12	10.93	10.70	9.75	9.96
Leverage ratio	11.41	11.94	9.48	9.68	9.44	9.37	7.16	7.34
Risk-based capital ratio	17.98	18.45	14.15	14.02	14.41	13.37	11.98	11.92
Net loans and leases to assets	61.26	62.05	66.13	67.44	62.68	64.62	55.25	55.96
Securities to assets	24.82	23.81	22.33	20.45	24.06	21.78	16.35	16.63
Appreciation in securities (% of par)	0.62	-0.76	0.81	-0.55	0.70	-0.76	0.48	-0.55
Residential mortgage assets to assets	20.55	19.78	22.02	20.54	25.83	23.82	22.77	24.25
Total deposits to assets	83.18	82.65	80.74	81.04	68.79	70.38	62.22	63.28
Core deposits to assets	70.53	69.15	67.12	65.38	56.25	54.97	42.27	42.11
Volatile liabilities to assets	14.98	16.04	18.26	20.19	25.12	27.99	35.95	36.27

**Loan performance, FDIC-insured commercial banks by asset size**  
**Third quarter 2004 and third quarter 2005**  
(Dollar figures in millions)

	Less than \$100M		\$100M to \$1B		\$1B to \$10B		Greater than \$10B	
	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3	2004Q3	2005Q3
<b>Percent of loans past due 30-89 days</b>								
Total loans and leases	1.25	1.25	0.86	0.84	0.74	0.71	0.86	0.83
Loans secured by real estate (RE)	1.13	1.17	0.72	0.73	0.54	0.53	0.77	0.74
1- to 4-family residential mortgages	1.70	1.69	1.14	1.13	0.78	0.71	1.06	0.99
Home equity loans	0.52	0.56	0.38	0.42	0.34	0.39	0.37	0.45
Multifamily residential mortgages	0.41	0.60	0.47	0.56	0.28	0.29	0.45	0.41
Commercial RE loans	0.87	0.98	0.58	0.58	0.42	0.47	0.50	0.48
Construction RE loans	0.82	0.92	0.55	0.62	0.51	0.55	0.61	0.56
Commercial and industrial loans	1.52	1.36	1.02	1.01	0.92	1.06	0.51	0.49
Loans to individuals	2.38	2.40	1.94	1.86	1.91	1.41	1.80	1.76
Credit cards	2.52	1.99	4.62	3.85	3.10	1.45	2.20	2.23
Installment loans and other plans	2.41	2.45	1.65	1.72	1.59	1.47	1.61	1.52
All other loans and leases	0.55	0.60	0.52	0.51	0.48	0.46	0.33	0.33
<b>Percent of loans noncurrent</b>								
Total loans and leases	1.05	0.92	0.77	0.67	0.75	0.60	0.96	0.79
Loans secured by real estate (RE)	0.92	0.81	0.68	0.60	0.65	0.53	0.70	0.70
1- to 4-family residential mortgages	0.99	0.93	0.72	0.69	0.70	0.66	0.90	0.97
Home equity loans	0.21	0.23	0.19	0.22	0.19	0.21	0.17	0.21
Multifamily residential mortgages	0.46	0.76	0.53	0.41	0.20	0.20	0.29	0.39
Commercial RE loans	0.97	0.86	0.76	0.65	0.80	0.62	0.75	0.60
Construction RE loans	0.68	0.47	0.54	0.43	0.49	0.37	0.49	0.38
Commercial and industrial loans	1.65	1.47	1.17	1.03	1.12	0.93	1.51	0.83
Loans to individuals	0.97	0.90	0.83	0.73	0.80	0.53	1.49	1.30
Credit cards	1.53	1.28	3.07	2.16	1.91	1.12	1.90	1.89
Installment loans and other plans	0.97	0.91	0.56	0.60	0.43	0.36	1.25	0.90
All other loans and leases	0.99	0.79	0.76	0.56	0.61	0.53	0.35	0.26
<b>Percent of loans charged-off, net</b>								
Total loans and leases	0.26	0.17	0.25	0.20	0.37	0.29	0.67	0.73
Loans secured by real estate (RE)	0.08	0.04	0.06	0.06	0.09	0.08	0.08	0.06
1- to 4-family residential mortgages	0.09	0.05	0.08	0.08	0.09	0.07	0.08	0.06
Home equity loans	0.07	0.04	0.05	0.05	0.14	0.10	0.10	0.10
Multifamily residential mortgages	0.05	0.07	0.07	0.05	0.04	0.06	0.07	0.07
Commercial RE loans	0.09	0.05	0.07	0.05	0.09	0.10	0.06	0.04
Construction RE loans	0.08	0.03	0.04	0.04	0.08	0.04	0.04	0.02
Commercial and industrial loans	0.60	0.37	0.52	0.37	0.64	0.53	0.35	0.11
Loans to individuals	0.86	0.72	1.41	1.29	1.80	1.24	2.84	3.35
Credit cards	3.13	2.30	6.96	6.01	4.20	2.69	4.70	4.53
Installment loans and other plans	0.83	0.70	0.71	0.80	0.96	0.77	1.32	2.37
All other loans and leases	0.23	0.11	0.24	0.25	0.24	0.42	0.13	0.39
<b>Loans outstanding (\$)</b>								
Total loans and leases	\$120,957	\$115,937	\$622,480	\$671,389	\$618,073	\$669,454	\$3,453,710	\$3,809,150
Loans secured by real estate (RE)	75,490	72,901	446,037	492,800	407,377	452,934	1,616,511	1,902,495
1- to 4-family residential mortgages	29,233	27,593	132,681	137,039	129,242	128,084	774,844	914,128
Home equity loans	2,621	2,497	26,149	26,398	32,744	35,166	313,664	372,904
Multifamily residential mortgages	1,694	1,617	16,438	17,620	21,606	26,192	45,641	50,947
Commercial RE loans	23,258	22,503	180,847	195,763	153,848	169,811	293,565	333,486
Construction RE loans	8,407	8,725	69,815	94,257	62,988	85,123	132,607	175,416
Farmland loans	10,276	9,966	20,074	21,693	5,970	7,600	7,637	7,980
RE loans from foreign offices	0	0	33	29	978	958	48,554	47,634
Commercial and industrial loans	19,019	18,283	97,975	102,143	114,157	123,459	658,422	744,318
Loans to individuals	12,178	11,027	49,141	45,492	59,803	62,005	685,213	712,839
Credit cards	189	190	5,611	4,225	15,658	14,524	318,504	319,994
Other revolving credit plans	162	206	1,438	1,514	2,598	2,376	34,170	36,229
Installment loans	11,827	10,631	42,092	39,753	41,547	45,105	332,539	356,616
All other loans and leases	14,348	13,791	29,898	31,410	37,251	31,642	495,450	451,268
Less: Unearned income	77	66	571	599	515	585	1,886	1,770

**Key indicators, FDIC-insured commercial banks by region**

**Third quarter 2005**

(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
Number of institutions reporting	585	1,075	1,552	1,967	1,682	680	7,541
Total employees (FTEs)	466,461	460,444	423,473	221,107	165,672	119,136	1,856,293
<b>Selected income data (\$)</b>							
Net income	\$6,898	\$8,301	\$6,334	\$3,253	\$1,372	\$3,619	\$29,776
Net interest income	15,914	17,634	14,296	7,393	4,564	8,766	68,568
Provision for loan losses	3,407	791	1,117	693	540	1,611	8,159
Noninterest income	16,932	11,508	13,217	6,031	1,907	4,097	53,692
Noninterest expense	19,286	16,098	16,967	7,887	4,094	5,664	69,996
Net operating income	6,947	8,280	6,300	3,269	1,372	3,603	29,772
Cash dividends declared	4,513	4,939	2,733	2,032	702	4,178	19,097
Net charge-offs	3,598	882	978	752	186	1,306	7,702
<b>Selected condition data (\$)</b>							
Total assets	2,149,659	2,470,081	2,342,568	739,545	491,704	710,048	8,903,605
Total loans and leases	1,151,080	1,452,618	1,305,278	542,773	308,966	505,213	5,265,929
Reserve for losses	18,886	15,021	16,254	7,366	4,095	9,359	70,981
Securities	482,531	495,926	291,961	92,762	111,449	109,406	1,584,036
Other real estate owned	286	990	912	391	567	181	3,327
Noncurrent loans and leases	10,537	6,285	11,311	5,607	2,364	3,548	39,652
Total deposits	1,422,175	1,668,385	1,431,320	531,500	390,293	473,353	5,917,027
Domestic deposits	929,754	1,507,898	1,218,314	508,162	386,857	463,291	5,014,276
Equity capital	228,027	245,117	214,430	79,489	47,706	84,641	899,409
Off-balance-sheet derivatives	24,366,032	24,945,621	48,354,754	894,962	64,995	157,238	98,783,602
<b>Performance ratios (annualized %)</b>							
Return on equity	12.12	13.58	11.90	16.48	11.59	17.08	13.29
Return on assets	1.29	1.36	1.10	1.78	1.13	2.06	1.35
Net interest income to assets	2.97	2.89	2.47	4.05	3.77	5.00	3.11
Loss provision to assets	0.64	0.13	0.19	0.38	0.45	0.92	0.37
Net operating income to assets	1.30	1.36	1.09	1.79	1.13	2.06	1.35
Noninterest income to assets	3.16	1.88	2.29	3.31	1.57	2.34	2.44
Noninterest expense to assets	3.60	2.63	2.94	4.33	3.38	3.23	3.18
Loss provision to loans and leases	1.19	0.22	0.35	0.52	0.71	1.30	0.63
Net charge-offs to loans and leases	1.25	0.25	0.30	0.56	0.24	1.05	0.59
Loss provision to net charge-offs	94.67	89.73	114.19	92.24	290.10	123.34	105.93
<b>Performance ratios (%)</b>							
Percent of institutions unprofitable	7.69	8.28	4.57	2.85	5.83	10.15	5.68
Percent of institutions with earnings gains	60.85	73.77	58.57	55.36	61.30	75.74	62.23
Nonint. income to net operating revenue	51.55	39.49	48.04	44.93	29.46	31.85	43.92
Nonint. expense to net operating revenue	58.72	55.24	61.67	58.76	63.27	44.03	57.25
<b>Condition ratios (%)</b>							
Nonperforming assets to assets	0.50	0.30	0.53	0.81	0.60	0.53	0.49
Noncurrent loans to loans	0.92	0.43	0.87	1.03	0.77	0.70	0.75
Loss reserve to noncurrent loans	179.24	239.01	143.70	131.38	173.22	263.74	179.01
Loss reserve to loans	1.64	1.03	1.25	1.36	1.33	1.85	1.35
Equity capital to assets	10.61	9.92	9.15	10.75	9.70	11.92	10.10
Leverage ratio	8.17	7.22	7.24	8.84	8.76	10.43	7.93
Risk-based capital ratio	14.01	11.36	11.53	12.81	13.42	13.57	12.43
Net loans and leases to assets	52.67	58.20	55.03	72.40	62.00	69.83	58.35
Securities to assets	22.45	20.08	12.46	12.54	22.67	15.41	17.79
Appreciation in securities (% of par)	-0.44	-0.86	-0.55	0.25	-0.78	-0.53	-0.58
Residential mortgage assets to assets	19.89	33.00	19.18	23.99	23.92	17.31	23.70
Total deposits to assets	66.16	67.54	61.10	71.87	79.38	66.66	66.46
Core deposits to assets	33.37	52.42	43.51	58.87	62.39	54.26	46.71
Volatile liabilities to assets	44.41	29.23	34.37	20.35	23.98	28.04	33.13

**Loan performance, FDIC-insured commercial banks by region**  
**Third quarter 2005**  
(Dollar figures in millions)

	Northeast	Southeast	Central	Midwest	Southwest	West	All institutions
<b>Percent of loans past due 30-89 days</b>							
Total loans and leases	0.98	0.62	0.79	0.93	1.13	0.86	0.83
Loans secured by real estate (RE)	0.76	0.60	0.84	0.76	0.95	0.47	0.72
1- to 4-family residential mortgages	0.96	0.84	1.20	1.04	1.27	0.82	0.99
Home equity loans	0.36	0.43	0.45	0.54	0.55	0.21	0.44
Multifamily residential mortgages	0.17	0.39	0.58	0.41	1.18	0.21	0.41
Commercial RE loans	0.52	0.39	0.67	0.53	0.80	0.32	0.52
Construction RE loans	0.56	0.36	0.77	0.75	0.89	0.45	0.58
Commercial and industrial loans	0.68	0.47	0.52	0.79	1.33	0.72	0.63
Loans to individuals	1.94	1.53	1.21	2.16	2.22	1.88	1.75
Credit cards	2.18	2.18	1.71	2.95	1.82	2.21	2.22
Installment loans and other plans	1.98	1.52	1.10	1.49	2.31	1.28	1.56
All other loans and leases	0.25	0.17	0.60	0.35	0.94	0.28	0.35
<b>Percent of loans noncurrent</b>							
Total loans and leases	0.92	0.43	0.87	1.03	0.77	0.70	0.75
Loans secured by real estate (RE)	0.66	0.37	0.94	1.13	0.71	0.34	0.66
1- to 4-family residential mortgages	0.62	0.41	1.48	2.00	0.95	0.37	0.91
Home equity loans	0.15	0.16	0.26	0.30	0.20	0.10	0.21
Multifamily residential mortgages	0.18	0.44	0.50	0.56	0.47	0.07	0.35
Commercial RE loans	0.65	0.47	0.88	0.68	0.73	0.40	0.63
Construction RE loans	0.59	0.26	0.55	0.39	0.47	0.27	0.39
Commercial and industrial loans	0.98	0.59	1.06	0.77	1.05	0.83	0.88
Loans to individuals	1.65	0.81	0.59	1.33	0.57	1.41	1.20
Credit cards	1.95	1.44	1.38	2.17	1.02	1.87	1.86
Installment loans and other plans	1.55	0.76	0.36	0.55	0.57	0.47	0.82
All other loans and leases	0.18	0.23	0.42	0.42	0.76	0.37	0.31
<b>Percent of loans charged-off, net</b>							
Total loans and leases	1.25	0.25	0.30	0.56	0.24	1.05	0.59
Loans secured by real estate (RE)	0.03	0.05	0.11	0.06	0.08	0.02	0.06
1- to 4-family residential mortgages	0.03	0.04	0.13	0.03	0.12	0.04	0.06
Home equity loans	0.03	0.07	0.13	0.15	0.12	0.02	0.10
Multifamily residential mortgages	-0.01	0.18	0.03	0.11	0.10	0.00	0.06
Commercial RE loans	0.02	0.06	0.13	0.02	0.07	0.01	0.06
Construction RE loans	0.00	0.04	0.01	0.06	0.04	0.03	0.03
Commercial and industrial loans	0.00	0.20	0.12	0.44	0.47	0.53	0.20
Loans to individuals	4.72	1.09	1.45	2.90	0.91	3.64	3.04
Credit cards	4.26	4.05	3.75	4.87	3.08	5.08	4.47
Installment loans and other plans	5.22	0.63	0.74	0.87	0.80	0.58	2.05
All other loans and leases	0.05	0.86	0.31	0.31	0.41	0.39	0.38
<b>Loans outstanding (\$)</b>							
Total loans and leases	\$1,151,080	\$1,452,618	\$1,305,278	\$542,773	\$308,966	\$505,213	\$5,265,929
Loans secured by real estate (RE)	462,015	947,226	716,258	327,753	207,721	260,157	2,921,130
1- to 4-family residential mortgages	209,535	437,551	286,317	136,633	64,029	72,779	1,206,844
Home equity loans	48,587	146,074	149,100	63,483	12,942	16,779	436,965
Multifamily residential mortgages	18,592	21,161	26,133	7,341	4,890	18,258	96,376
Commercial RE loans	110,526	201,275	161,994	71,099	73,539	103,129	721,563
Construction RE loans	33,295	128,109	80,130	33,659	44,240	44,089	363,521
Farmland loans	1,999	6,080	11,074	15,537	8,081	4,469	47,240
RE loans from foreign offices	39,481	6,977	1,511	0	0	653	48,622
Commercial and industrial loans	226,086	238,294	288,920	84,270	58,565	92,067	988,202
Loans to individuals	302,499	132,017	163,806	77,864	27,380	127,796	831,363
Credit cards	157,744	16,445	38,251	38,590	1,323	86,581	338,934
Other revolving credit plans	22,020	6,179	5,750	2,777	789	2,809	40,324
Installment loans	122,735	109,393	119,805	36,497	25,268	38,407	452,105
All other loans and leases	162,040	135,596	136,442	52,942	15,356	25,735	528,111
Less: Unearned income	1,560	516	148	55	200	541	3,020

## 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**—the 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- to 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.

*Quarterly  
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SPECIAL STUDIES

# SPECIAL STUDIES □

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## What's Your Risk with the Growing Use of ACH Payments?

by Karen Furst, Policy Analyst, and Daniel E. Nolle, Senior Financial Economist, OCC Policy Analysis Division\*

### Introduction

The financial services community and the business press have given increased attention to the significant shift in the balance between paper-based and electronic retail payments. Declining paper-check usage, growing reliance on credit cards, and the rapid expansion of debit cards are all well-known aspects of the rise of electronic payments. Less focus has been placed on automated clearing house (ACH) transactions, but the growth in the use of this form of electronic payment and, more significantly, changes both in the nature of such payments and in the participants who make up the ACH system, warrant scrutiny.

Historically, ACH payments have been preauthorized arrangements between payors and payees, commonly in a sustained and systematically recurring manner (for example, automatic deposit of payroll and the pre-authorized monthly payment of an insurance premium). More recently, new applications have emerged—known collectively as “electronic checks” or “e-checks”—most of which, unlike traditional ACH payments, are not pre-authorized, and some of which are also characterized by the lack of an established relationship between the payor and the payee. Related to the transformation of the ACH network from one used primarily for recurring payments to a more general-purpose payments network is the role that third parties play in processing many of these new “e-check” payments. Frequently, these third-party processors stand between the bank and the merchant originating the payment, which can complicate customer due diligence by banks.

With this in mind, the aim of this paper is to describe the changing ACH landscape, and to consider the degree to which this growth and change have heightened one risk issue in particular: the susceptibility of ACH payments to fraud. This paper is organized as follows. The first section outlines the basic nature of an ACH transaction and describes recent trends in ACH usage. Section II examines basic economic incentives for the growth of ACH transactions. Section III describes significant changes in the nature of ACH payments, focusing in particular on e-checks. Section IV explains how—with the emergence of new ACH applications and the proliferation of third-party processors—the ACH system has become more susceptible to fraud. Section V outlines recent industry and government responses to the growing susceptibility to fraud, and section VI concludes.

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\* The views expressed in this paper are those of the authors and do not necessarily reflect those of the Office of the Comptroller of the Currency or the Department of the Treasury. A previous version of this article appeared as *Policy Analysis Paper #6*, Office of the Comptroller of the Currency (October 2005). The authors wish to thank David Nebhut, Mark Levonian, and William Lang for helpful comments, and Rebecca Miller for editorial assistance.

## I. ACH Basics and Growth Trends

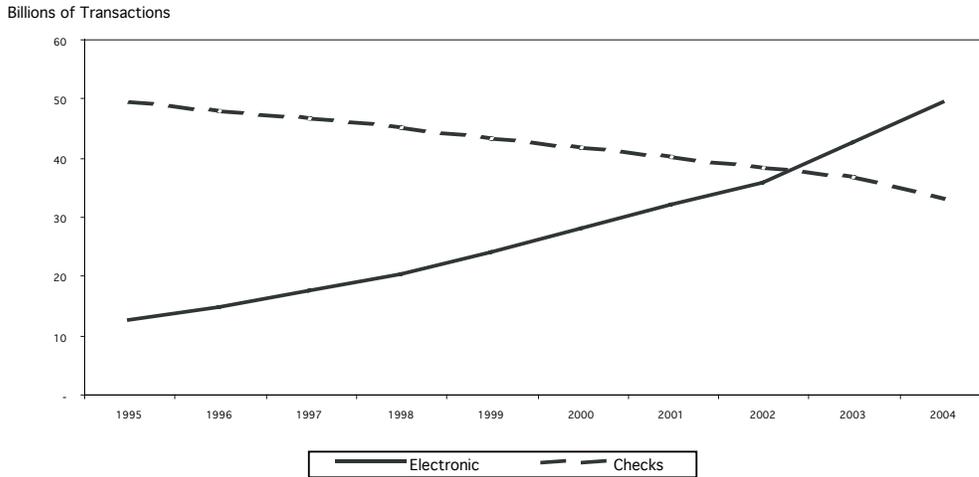
The ACH system is a funds transfer system typically used for retail payments and was originally developed in the 1970s to provide an alternative to paper checks.<sup>1</sup> It is a batch-processing, “store-and-forward” electronic system; that is, transactions received by a bank are stored and processed at a later time, rather than being processed individually. The five participants involved in an ACH transaction are the payor, the payee, the payor’s bank, the payee’s bank, and the provider of the ACH service between the two banks. ACH transactions can be either credits or debits. A credit transaction is initiated by the payor: for example, direct deposit of payroll is originated by the employer through the employer’s bank, which transfers money to the employee’s bank account. A debit transaction is originated by the payee: for example, a mortgage payment is originated by the lender through the lender’s bank, which initiates the payment transferring funds from the customer’s bank account. Increasingly, a sixth set of participants, third-party processors, has become a significant presence in the ACH system. Third-party processors handle aspects of the origination of ACH payments and, as such, insert themselves into the payment process between a payor and the payor’s bank (for ACH credit transactions), or between the payee and the payee’s bank (for ACH debit transactions).

Broadly speaking, ACH transactions, along with credit card and debit card transactions, comprise retail “electronic payments.” In the United States, retail payments historically had been dominated by paper checks, but very recently the volume of electronic payments surpassed payments by check, as illustrated in Figure 1. Prior to 1995, electronic payments grew steadily, but so did check usage, albeit at a declining rate. However, since 1995, electronic payments have displaced check usage to an extent large enough to result in an absolute decline in the number of checks.

Increased use of ACH payments contributed to the overall growth of electronic payments (and, by extension, the decline in check usage), but, as Figure 2 illustrates, the substantial and steady growth of ACH payments was exceeded by the growth rate of credit card usage and, especially since 1999, the surge in debit card use. Nevertheless, in dollar-value terms, ACH transactions dwarf card transactions and have increased substantially both absolutely and, as Figure 3 illustrates, relative to all electronic and check retail transactions.

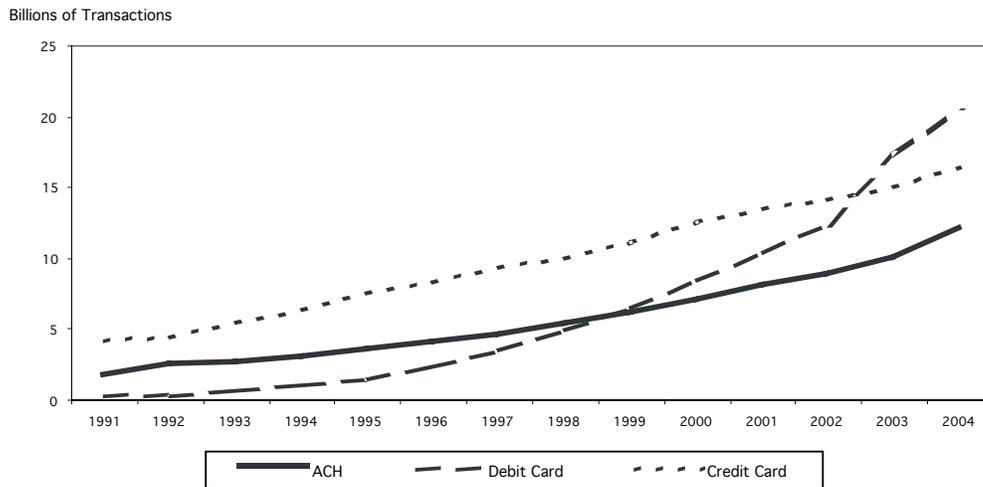
<sup>1</sup> Analysts and practitioners divide payments into “wholesale” and “retail” payments. Wholesale payments consist of large-value electronic funds transfers such as wire transfers (Fedwire and CHIPS) used for time-critical payments, and interbank settlement. Retail payments include the majority of domestic payments made by consumers, businesses, and governments. The major components of retail payments in the United States include cash, checks, credit cards, debit cards, and ACH transactions. Unlike the other forms of retail payments, reliable records for the number and value of cash payments are not compiled, and hence exact data on cash usage is impossible to obtain. In this paper the term “payments” covers noncash retail payments only.

**Figure 1. Electronic Payments Overtake Checks**

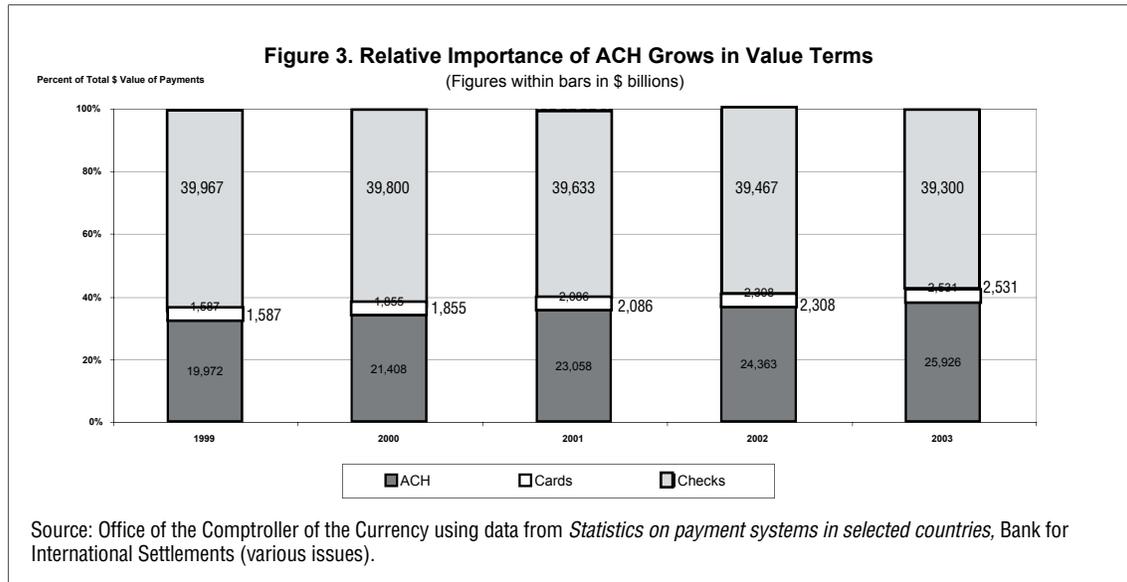


Source: Office of the Comptroller of the Currency using data from *Statistics on payment systems in selected countries*, Bank for International Settlements (various issues); *The Nilson Report* (various issues); and *ATM & Debit News* (various issues). Check volume for 2004 is an estimate.

**Figure 2. Growth in Electronic Payments**



Source: Office of the Comptroller of the Currency using information from *The Nilson Report* (various issues); *ATM & Debit News* (various issues); and NACHA.



## II. ACH Benefits for Banks, Businesses, Government, and Consumers

Growth in the use of ACH transactions can be explained by two basic factors. The first is the significant benefits depository institutions (“banks”), businesses, government, and consumers derive from this form of payment. This section describes the nature of these advantages. The second impetus for growth in ACH transactions is the emergence of new ACH applications, a subject discussed in the next section of the paper.

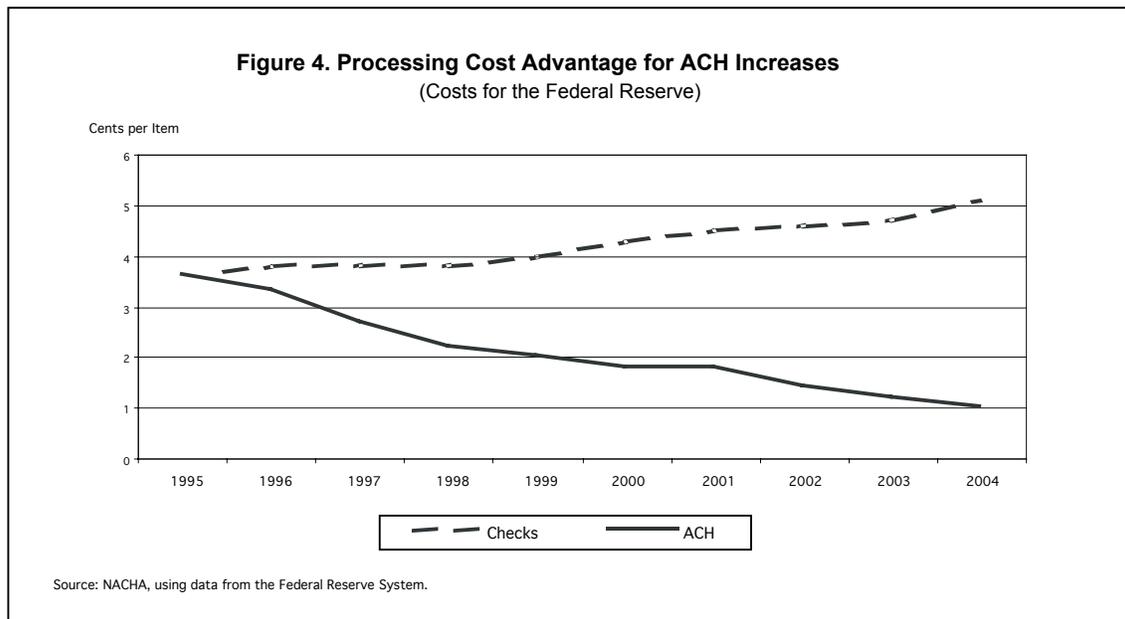
### II.A. ACH Benefits for Banks

The Federal Reserve is a major processor of payments by check and by ACH, and payments processing costs facing the Federal Reserve can be considered at least broadly illustrative of underlying payments-processing costs for financial institutions.<sup>2</sup> Figure 4 illustrates the widening pro-

<sup>2</sup> Check and ACH payments are also processed by private clearinghouses and “on us” (i.e., within a bank which is the same for the payor and the payee). In 2003, the latest year for which comprehensive data is available, the Federal Reserve processed 44 percent of all checks and 66 percent of all ACH transactions. See the Committee on Payment and Settlement Systems (2005, Table 7, p. 159). In order that private sector payment processors not be faced with an “unfair” competitive disadvantage compared to the Federal Reserve, the Monetary Control Act of 1980 requires the Federal Reserve to price its payments processing services such that it is able to cover the costs of providing these services.

There is some debate in the payments industry over Federal Reserve System ACH pricing policy. For example, in a December 2002 whitepaper, The Electronic Payments Network (EPN), the only remaining private sector ACH

cessing cost advantage for ACH transactions versus checks for the Fed. In 1995, per transaction processing costs for each type of payment were equal, at 3.5 cents per item. Over the next decade, processing costs for paper checks rose to 5.1 cents per item. Meanwhile, technological improvements, deregulation of the communications industry, and increasing economies of scale in ACH transactions processing resulted in a greater than two-thirds decline in per item processing costs, to just under 1 cent, making it one-fifth as costly to process an ACH payment versus a payment by paper check.<sup>3</sup>



operator, questioned whether the main goal of the Federal Reserve's pricing policy was ACH processing costs recovery, or preservation of market share, especially in light of the Federal Reserve's rapid ACH price reductions in 2001 and 2002. The EPN whitepaper noted that the Reserve Banks did not expect to recover the full costs for all priced services (and, indeed, the Federal Reserve has not recovered 100 percent of the cost of priced services since 2000). EPN also notes that a few months after the first two Fed ACH price reductions, the American Clearing House announced that it could no longer compete in the new price environment. Early in 2005, the Board of Governors requested comments on possible changes to the private-sector adjustment factor (i.e., the method used to compute a target return-on-equity). Periodically, the Board reviews its methodology for calculating this factor in order to determine if, in light of changing business and regulatory conditions and practices, the methodology is still appropriate.

<sup>3</sup> Federal Reserve System, *Annual Report* (various issues). The existence of large-scale economies in the processing of electronic payments is well established. Bauer and Ferrier (1996) estimated scale economies in the Federal Reserve's ACH processing such that a 10 percent increase in ACH volume was associated with only a 4.8 percent increase in processing expenses.

Payment-processing cost changes have been passed along to banks. In recent congressional testimony, a Federal Reserve payment system official noted that “Over the past decade, the reductions in the processing costs for ACH have allowed Reserve Banks to cut approximately in half the fees they charge depository institutions for providing ACH services. Over the same period, the Reserve Banks have increased the price of their more labor-intensive paper check service approximately 50 percent.”<sup>4</sup> As a consequence, one large bank estimated that it cost about \$0.08 to \$0.10 to process a check, compared to \$0.02 to \$0.04 to process an ACH payment.<sup>5</sup>

## II.B. ACH Benefits for Business and Government

Cost advantages also accrue to businesses and government from using ACH payments. First, there is a long-standing awareness in the business and government communities of the benefits of ACH direct deposit of payroll. The National Automated Clearing House Association (NACHA), an industry group of ACH network participants, estimates that a typical large company switching from the cutting and distribution of paper paychecks to ACH direct deposit of payroll might realize per transaction savings of \$0.187. With a payroll of, for example, 100,000 transactions per month, annual cost savings would amount to \$224,400. Even a small business with, say, 500 payroll transactions per month, could cut costs by \$0.352 per payroll transaction, saving perhaps a few thousand dollars per year by switching to ACH direct deposit of payroll.<sup>6</sup>

A second advantage businesses have increasingly pursued is the use of ACH transactions for customers’ bill payments. As an example, BellSouth Corp reports ACH as the least expensive form of electronic payment for bills. It costs the utility around \$2.00 when a customer pays a phone bill with a credit card, and \$0.50 to \$0.60 for PIN debit, compared to only \$0.10 to \$0.15 for an ACH payment.<sup>7</sup>

A third, relatively recent source of ACH benefits is in check conversion at a lockbox using the ACH system.<sup>8</sup> Illustrative of the magnitude of savings in this respect are credit card issuers’ check conversion savings. In particular, credit card issuers have reported that checks converted to ACH transactions at a lockbox resulted in operational cost savings of \$0.057 per consumer check con-

<sup>4</sup> Testimony of Louise L. Roseman, Director, Division of Reserve Bank Operations and Payment System on *Recent developments in the payments system*, before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, (April 20, 2005).

<sup>5</sup> Schneider, Ivan, “JPMC Prepares for Check Conversion Growth,” *Bank Systems & Technology* (May 11, 2004).

<sup>6</sup> There is a difference in the per item savings between the hypothetical large and small companies because the NACHA estimates include some differences in account services and significant differences in the pricing structure for banking services for the two businesses.

<sup>7</sup> Kuykendall, Lavonne, “Chase Offers Payments Consulting to Billers,” *American Banker*, June 3, 2005.

<sup>8</sup> Such an ACH transaction is called an “accounts receivable conversion” or “ARC” transaction. See Box 1 for a detailed description of ARC transactions.

verted. Based on this per item savings, credit card issuers collectively saved an estimated \$99.6 million in 2004.<sup>9</sup> Additionally, converting a check to an ACH transaction can reduce card issuers' losses, owing to the shorter return time frames for ACH items compared to checks.<sup>10</sup>

Governmental entities disperse millions of payments annually, and ACH transactions convey significant advantages. For example, in its 2004 Annual Report, the Federal Reserve reported figures for check and ACH processing costs for services provided to the federal government: \$24.25 million to process 234 million government checks at 10.4 cents apiece, and \$5.35 million to process 940 million government ACH payments at 0.57 cents per item. Hence, for the federal government, paying by check was almost 20 times more costly than paying by ACH.<sup>11</sup>

### II.C. ACH Benefits for Consumers

Consumers have also found substantial savings of time and effort, as well as added security, by choosing direct deposit of paychecks compared to receiving a paper paycheck. The popularity of this form of ACH payment is reflected in the fact that 75 percent of Social Security recipients sign up for direct deposit when they register for benefits.<sup>12</sup>

Consumers' familiarity with direct payroll deposit likely increases their penchant for adopting other forms of ACH payments. For example, using sample results from two surveys, Klee and Hayachi (2003) constructed a model to predict the probability that a user of direct deposit would use direct bill payment.<sup>13</sup> They found that the use of direct deposit by a person represents a 21 to 24-percentage point increase in the predicted likelihood of that person adopting direct bill payment. In a related vein, Klee and Hayachi found that consumers who use new technology products (e.g., the Internet) are more likely to use electronic forms of payment than those who do not. Others have observed the emergence of a strong correlation between growth in the adoption of

<sup>9</sup> Nelson, Bill, "Inside the Numbers—How Costs/Benefits Impact the Growth of ACH Payments," *Electronic Payments Journal*, Volume 3, Issue 7 (November/December 2004) estimates that the credit card industry accounted for 78 percent of the 2.24 billion commercial ARC and WEB originations. ARC and WEB are ACH transactions used as substitutes for check payments; they are described in detail in Box 1.

<sup>10</sup> Converting checks to ACH has a greater impact on the processing of returned deposited checks than on the forward collection of checks. This is because, for example, the largest banks (the banks most likely to be handling lockbox processing for a credit card issuer) receive funds on the majority of checks deposited (90 percent of local checks and 63 percent of non-local checks) within one business day. However, the average time for the return of deposited checks is often longer than the return time for ACH items. See the ABA *Deposit Account Survey Report* (2004) for information on average check processing and return cycle times.

<sup>11</sup> *91st Annual Report*, Board of Governors of the Federal Reserve System (2004), pp. 125-126.

<sup>12</sup> Jackson, Ben, "Treasury to Tout Direct Deposit of Social Security," *American Banker*, August 2, 2005.

<sup>13</sup> Hayashi, Fumiko, and Elizabeth Klee, "Technology Adoption and Consumer Payments: Evidence from Survey Data," *Review of Network Economics*, Vol. 2, Issue 2 (June 2003).

broadband (high-speed) Internet connectivity and growth in online banking, and some expect the growth of broadband access and online banking to propel online bill payment.<sup>14</sup>

As of December 2004, there were approximately 36 million U.S. households using online banking—more than a fivefold increase from the 7 million online banking households in December of 1998.<sup>15</sup> Although growth in the number of net new households adopting online banking slowed to 9 percent in 2004, the increase in Internet banking customers at one large bank was considerably higher.<sup>16</sup> Bank of America has the largest online banking customer base with a reported 13.8 million active online banking customers—an increase of 38 percent for the 16 months ending in August 2004.<sup>17</sup> During the same time period, the number of Bank of America customers using online bill payment increased by 68 percent. Consistent with the broadband-online banking correlation noted above, Bank of America found that more than 60 percent of its customers used high-speed Internet connections for online banking. The rapid growth in the adoption of online bill payment at Bank of America and other banks may, in part, account for the recent increase in the rate of growth for “customer initiated entries” (CIE), a type of ACH credit transaction. Based on second quarter 2005 volume, CIE entries will increase an estimated 40 percent for all of 2005, compared to an increase of 14 percent in 2004.

### III. The Changing Nature of ACH Transactions: New Applications

In addition to strong growth for traditional ACH transactions such as those for recurring consumer payments, a new set of ACH debit transactions, termed by some as “electronic checks” or “e-checks,” have spurred overall ACH growth. (See Box 1.) E-checks differ in important respects from preauthorized and recurring ACH payments.<sup>18</sup> With traditional, recurring ACH transactions, after an initial set of payment instructions is successfully processed, payments are repeated using the same routing and account number details, thus limiting the likelihood of errors.<sup>19</sup>

<sup>14</sup> On the first point see “Big Broadband Buy-In Feeds On-Line Banking,” *Bank Technology News*, Vol.18, No.7, page 17, (July 2005), and McGrath, James C., “Will Online Bill Payment Spell the Demise of Paper Checks?” *Payment Cards Center Discussion Paper*; Federal Reserve Bank of Philadelphia (July 2005). McGrath also comments on the second point.

<sup>15</sup> *Online Banking Report*, Number 114 (January 17, 2005).

<sup>16</sup> *Ibid.*

<sup>17</sup> Press release (August 16, 2005) “Bank of America wins awards for best consumer Internet bank and best information security initiatives,” and Press release (April 21, 2004) “Growth propels Bank of America to 10 million subscriber milestone.”

<sup>18</sup> It is important to distinguish e-checks from “check electronification.” Check electronification refers to a process to speed up check processing, most commonly by “check truncation,” which essentially means to stop, or hold, the paper, and subsequently process electronically the information contained on the check.

<sup>19</sup> If there is a change in the bank’s routing number, or in the consumer’s account number, the bank will send a “notification of change” ACH entry.

E-checks are a recent advance in ACH payments. Point-of-purchase (POP) transactions came into use in September 2000, while the other three applications began in 2001 or 2002. Adoption of e-checks grew rapidly however, and e-checks now account for over 40 percent of all ACH debits, compared to 6 percent in 2001. Figure 5 shows the changing composition, both absolute and relative, of the four components of e-checks over the recent past. Accounts-receivable-conversion (ARC) transactions, which did not exist until 2002, had by the end of 2004 become the dominant form of e-checks, with 941.7 million transactions accounting for 47 percent of all e-checks.<sup>20</sup> Internet-initiated (WEB) usage also grew steeply over this period, from 54 million transactions in 2001, to 715 million in 2004. Telephone-initiated (TEL) transactions, though less in total volume than either ARC or WEB, nevertheless grew from 6.3 million to 187.7 million, a 30-fold increase over the four-year period. Even POP almost tripled between 2001 and 2004, from 64.2 million to 162.3 million transactions (although POP was the only e-check application to experience single digit growth in 2004).<sup>21</sup> Of note, although ARC has come to dominate e-check payments, most industry observers believe that its dominance will be transitory because as the decline in check-writing gains further momentum, conversion of checks via ARC will taper off correspondingly.<sup>22</sup>

#### **Box 1. Descriptions of ACH “E-Checks”**

*A point-of-purchase (standard entry class code “POP”) entry is created for an in-person purchase of goods or services when, for example, a merchant receiving a paper check from a consumer uses it as a source document to electronically enter its routing number, account number, serial number, and dollar amount of the transaction into a point-of-sale terminal or other electronic system to generate a debit entry to the consumer’s demand deposit account. The merchant obtains a written authorization from the consumer, and the paper check is voided and returned to the consumer at the point-of-purchase. POP payments are “nonrecurring” or “single-entry” (one-time) in the sense that even if, for example, a consumer’s grocery store always uses this method when the consumer presents a check to pay for weekly grocery purchases, each transaction must be authorized anew by the consumer at the point-of-sale. POP is an example of “check conversion.”*

<sup>20</sup> The figures used here are for network volume and exclude on-us items. Including on-us items, 2004 ARC volume was 1.3 billion. A few originators could account for a large portion of ARC transactions, which may help to explain ARC’s rapid growth. For example, if a single credit card issuer such as Citibank adopted ARC and converted around 60 percent of all monthly payments received for active accounts, this one “adopter” of ARC could generate over one third of all ARC transactions originated in 2004. Citibank has more active accounts than other card issuers, but a handful of large credit card issuers could account for most of the ARC transactions. Credit card issuers account for around 78 percent of ARC and WEB transactions.

<sup>21</sup> These figures exclude on-us transactions.

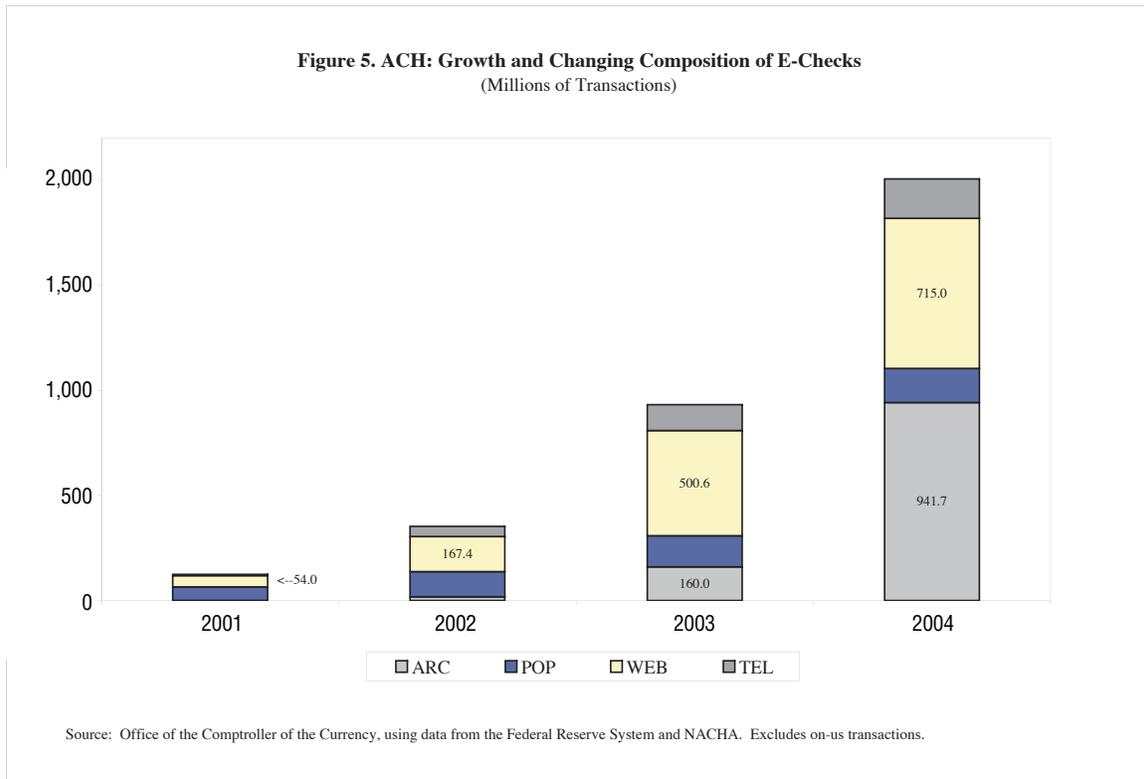
<sup>22</sup> Some payments research firms expect ARC to top out at about 3.5 or 4 billion transactions around 2007 or 2008, and decline substantially thereafter. Others expect ARC to level off and decline slowly as fewer paper checks are used to pay bills. See *American Banker* (July 1, 2005), and Hoffman, Karen Epper, “Payment’s Mass Conversion,” *Banking Strategies*, Volume LXXXI, Number II, (March/April 2005).

*An accounts-receivable-conversion (“ARC”)* entry also uses the consumer’s check as a source document, but not at the point-of-sale. Rather, the routing number, account number, check serial number, and dollar amount of the transaction are captured using a scanning device and converted to an electronic ACH entry after a biller receives the consumer’s check in the mail, or at a lockbox location for payment of goods and services. ARC transactions can be “recurring” in the everyday sense of the word, in that a consumer’s monthly paper check payment to a credit card company may routinely be processed as an ARC transaction. However, such payments are not recurring and pre-authorized in the same sense as would be the case if a consumer arranged for his credit card company to automatically debit his bank account in order to pay the bill every month.

*A telephone-initiated (“TEL”)* entry is created when a consumer gives authorization via the telephone for her account to be debited electronically by the party she wishes to pay. This type of entry may only be originated when there is either an existing relationship between the consumer and the payee or, if there is no pre-existing relationship, only when the consumer has initiated the telephone call. TEL transactions are single-entry; that is, a separate oral authorization must be obtained for each debit.

*An Internet-initiated (“WEB”)* entry is created when a consumer authorizes a merchant or other payee, via the Internet, to debit the consumer’s account. In contrast to other forms of e-checks, WEB payments can be used for pre-authorized transactions, as for example when a consumer “signs” with an electronic signature via the Internet an agreement for recurring automatic debits to his account for repayment of a loan. However, many WEB transactions are single-entry. These single-entry WEB transactions may be with a merchant or other originator new to the consumer, or the consumer may have an established relationship with an originator, as for example when a consumer authorizes the payment of his credit card bill online at the credit card issuer’s Web site.

**Figure 5. ACH: Growth and Changing Composition of E-Checks**  
(Millions of Transactions)



#### IV. ACH Transactions: Susceptibility to Fraud

The growing use of new ACH applications is a clear indication that ACH network participants are finding increasing value in them. Nevertheless, some of these new applications have increased the susceptibility of the ACH system to fraudulent transactions. This section deals first with certain characteristics of ACH e-checks that may raise their susceptibility to fraudulent use. No ACH payments, including e-checks, are subject to real-time authorization of “good funds.” Until recently, that potential vulnerability was of limited concern because ACH payor and payee generally enjoyed an ongoing payment relationship. However, with the emergence of e-checks, the lack of a recurring payment relationship between the payor and payee, coupled in some cases with the lack of a physical “source” document, have raised fraud vulnerability.

The second part of this section points out that there are also long-standing characteristics of the ACH system that make it vulnerable to fraud. These include weak fraud detection and prevention mechanisms, weaknesses in the incentive structure for return items, and weak system governance mechanisms. In general, when ACH transactions are pre-authorized and recurring between a consumer and an originator who are known to each other, these ACH system vulnerabilities present a low risk of fraud; but, as the last part of this section explains, the addition of new ACH applications has attracted new participants, creating new opportunities for fraudsters. These fraudsters

have exploited some of the new ACH applications for which an established customer-originator relationship is not necessarily a requirement.

Ahead of a more detailed discussion of the ACH system's susceptibility to fraud, it is important to bear in mind that banks experience relatively fewer ACH fraud losses versus check fraud losses, a point Table 1 helps to illustrate. Smaller size banks in particular are less likely to have experienced ACH fraud losses compared to check fraud losses. However, large banks, which are more intensely involved in ACH transactions than small banks, also experience lower ACH fraud loss than check fraud loss. In this respect, ACH transactions have had a relatively good track record.

**Table 1. Bank Fraud Losses: Checks vs. ACH  
(2003)**

	Bank Size Groups (in assets)			
	Under \$500 million	\$500 million to \$4.99 billion	\$5 billion to \$49.99 billion	\$50 billion or more
Percent of Banks with Fraud Losses:				
Check-related	72	97	100	100
ACH-related	23	40	61	72
Median Dollar Value of Fraud Loss:				
Check-related	\$5,042	\$51,353	\$977,508	\$8,716,014
ACH-related	\$250	\$3,543	not available	not available

Source: ABA Deposit Account Fraud Survey Report (2004).

#### **IV.A. Susceptibility to Fraud: New ACH Applications**

Fraudulent (i.e., “unauthorized”) payments within the ACH system have always been costly to deal with as “return” items, but because of ongoing payment relationships that characterize traditional ACH transactions, incidence of fraud was historically very low.<sup>23</sup> Most e-checks, on the other hand, do not involve preauthorization for a series of recurring payments. In addition, some e-checks are “spontaneous” in nature—that is, there is no pre-existing payment relationship between consumer and payee.<sup>24</sup> Because consumer and payee may have little or no knowledge of

<sup>23</sup> A “return” item is returned to the originating bank because the originating bank warrants that all transactions it originates into the network are authorized. If a debit is returned as “unauthorized” this means that a consumer has notified his bank (the payor’s bank) that the transaction was not authorized. Another reason for return items is error (i.e., incorrect information). Two primary sources of incorrect information are 1) the consumer gives inaccurate information during the enrollment process, or 2) the information related to the consumer or the consumer’s account at the payor’s bank changes, such as when a once-valid routing number changes after a bank merger, or a once-valid account number changes because a consumer closes an account but opens another account at the same bank.

<sup>24</sup> The four e-check transactions (ARC, POP, TEL, and WEB—described in Box 1) are consumer applications (i.e., they are meant to be used to originate debit entries to a consumer’s account).

each other's veracity, the probability of payment fraud is higher, and therefore the risk of costly return items is higher. However, the different types of e-checks differ in their relative vulnerability to fraud.

In general (and in the absence of counterfeit checks), ARC and POP payments, e-check applications that use a paper check as a source document, are less vulnerable to fraud than TEL and WEB payments, which are conducted remotely and do not use a paper check as a source document. Although numerous variables affect riskiness, ARC, which is currently the least risky ACH debit application, is likely to remain a low-risk application because of the way it is used (i.e., to pay recurring bills such as loan payments and utility bills). Under current conditions, the unauthorized payments rate for POP transactions is similar to that for traditional preauthorized debits (i.e., PPD payments).<sup>25</sup> However, the risks associated with POP mirror the risks associated with accepting paper checks in a retail environment.<sup>26</sup> As more "good" payments migrate away from checks to electronic payment instruments such as credit and debit cards, and as fraudsters continue to concentrate on payment instruments that do not provide real-time transaction authorization—such as checks—the rate of check fraud is likely to increase. In tandem with this development, there could be an increase in the proportion of fraudulent checks presented at the point-of-sale that are then converted to ACH transactions. WEB transactions, executed via the Internet, are subject to that medium's fraud vulnerabilities, but NACHA requirements for WEB transactions, and the fact that the majority of WEB transactions are being used for bill payment transactions between a consumer and an originator who are known to each other tend to reduce the risk profile of this e-check application.<sup>27</sup> Because TEL shares the weaknesses of WEB but lacks the features that tend to mitigate fraud vulnerability, it is likely to remain a higher risk ACH application.

#### **IV.B. Susceptibility to Fraud: ACH System Characteristics**

*Fraud Detection and Prevention Mechanisms.* Vulnerabilities in ACH fraud detection and prevention mechanisms can best be understood in comparison with contrasting features of credit and/or

<sup>25</sup> NACHA data for 2004 show that the unauthorized return rate for POP was 0.05 percent, slightly lower than the 0.07 percent rate for PPD.

<sup>26</sup> Note that the allocation of liability among the parties to a transaction is different between checks and ACH payments, because different laws and regulations cover these two forms of payment. This in turn may change the degree of risk assumed by the payee and/or the payee's bank in an ACH transaction compared to a check transaction.

<sup>27</sup> The NACHA Rules impose heightened security requirements for WEB transactions and direct originating banks to establish procedures to monitor the creditworthiness of originators of WEB transactions on an on-going basis, thus requiring banks to investigate merchants and to have an understanding of their business and financial condition.

debit card systems.<sup>28</sup> First, unlike in the case of credit card transactions, the ACH system has no system-wide method to link a payor's name, address, and deposit account number. Second, the ACH system has no mechanism for real-time authorization of transactions, as is the case with, for example, credit cards. Third, the ACH system lacks the kind of measures credit card systems have for fraud detection.<sup>29</sup> In particular, credit card issuers have long incorporated procedures for “vertical” fraud detection—identifying a pattern of seemingly anomalous transactions for a particular account. In addition, and more importantly from a systemic perspective, card systems employ procedures for “horizontal” fraud detection. Such measures can identify cases when, for example, there is a large volume of payments for the identical amount across the system, as might occur if criminals were attempting large-scale fraudulent debit transactions after stealing customer account numbers from a merchant. The absence of these measures makes it easier for fraudsters to exploit the ACH system and to avoid detection.

*Incentive Structure for Return Items.* Maintaining the traditionally low incidence of return items associated with the ACH network is important in order to maintain confidence in the system. In addition, return items place a relatively high burden on some system participants. First, on a per-item basis, ACH returns are costly. Based on a survey of banks, NACHA estimated that the cost to the payor's bank for handling an ACH return is between \$12 and \$17 per item.<sup>30</sup> Second, procedures for dealing with return items greatly disadvantage banks receiving unauthorized or fraudulent ACH debits to consumer accounts.<sup>31</sup> In particular, the payor's bank earns no direct fee or income to offset the receipt of consumer ACH debits, and it has to bear the cost of the return process, including the cost of obtaining a written statement from its account holder victimized by

<sup>28</sup> It is of course important to keep in mind that per item costs for processing credit and debit card transactions are considerably higher than for ACH transactions in part because of these differences. Credit card networks provide services that are valued by merchants, including card authorization, verification, and payment guarantees. Among other things, these services reduce the risk of fraud and facilitate risk management. For an analysis and empirical evaluation of the benefits to merchants provided by credit and debit card networks, and the related network investments, see Guerin-Calvert, Margaret, and Janusz A. Ordover, “Merchant Benefits and Public Policy Towards Interchange: An Economic Assessment,” presented at Federal Reserve Bank of New York conference on *Antitrust Activity in Card-Based Payment Systems: Causes and Consequences* (September 2005).

<sup>29</sup> Although no ACH network-wide solutions currently exist, payments industry participants are aware of these problems and some partial solutions exist. For example, using the data in debit bureau files, providers of databases used for opening bank accounts and for check verification and guarantee services can help validate some ACH transactions. Merchants are most likely to use this type of service when converting checks to ACH payments at the point of sale (i.e., POP). Section V further discusses industry responses.

<sup>30</sup> “Network Return Entry Fees Questions and Answers,” *Electronic Payments Journal*, Volume 3, Issue 7 (November/December 2004). As the article points out, this cost does not include potential indirect costs such as closed accounts and reputation damage.

<sup>31</sup> Note that NACHA Rules require the payor's bank to accept all ACH entries it receives.

the unauthorized transaction.<sup>32</sup> Under such circumstances, the continued growth of both traditional and new ACH payments is likely to increase the return-item processing costs for some banks.

In addition to the high per-incident costs for return items, growth in return items is likely to exacerbate potentially unsafe and unsound incentives embedded in the ACH returns system. In particular, fee income from return items can become an important source of non-interest income for an originating bank. Even if an ACH transaction originator (i.e., the payee) has an unusually high level of returns, from a fee perspective the bank for whom that originator is a client has a disincentive to deny or even limit ACH origination services, because the bank earns a fee from the originator on both the initial presentment of the (faulty) debit entry, as well as the return. Additionally, and unlike in the case of check-processing, a bank originating ACH debit transactions is not constrained by the necessity of having to maintain demand deposit accounts with every originator. Under these circumstances, some banks may not scrutinize returns at the originator level, increasing the likelihood that they will continue to process transactions for acquired merchants with high return rates operating through one or more third-party processors.

*ACH System Governance Mechanisms.* Vulnerabilities in the ACH system's fraud detection and prevention mechanisms, and incentives in the return-items pricing structure that may (unintentionally) reward some originating banks for practicing inadequate due diligence on questionable originators could be counter-balanced by an effective governance system. A key element to such a system is the existence of a central authority with power to effectively monitor and, if necessary, expel participants whose actions undermine the ACH system's integrity.<sup>33</sup> In the Visa and American Express card systems for example, Visa and American Express function both as system operators and as governing bodies for their respective networks. This arrangement enhances their ability to monitor system participants. In addition, the major credit card and debit card systems have the ability to ban merchants who have excessive charge-backs.<sup>34</sup> For most merchants, the

<sup>32</sup> In an effort to address problems with the current price structure, NACHA and its board of directors proposed a network return entry fee ("NREF") to provide an incentive to originating banks to prevent unauthorized payments from entering the ACH network, and to compensate the payor's bank for the costs associated with processing ACH items returned as unauthorized. The NREF would shift the financial responsibility from the payor's bank to the payee's bank (i.e., the originating bank). Though a majority of NACHA members voted for the May 2005 ballot initiative, the proposed change did not achieve the necessary two-thirds vote to become effective. On September 29, 2005, NACHA's voting membership approved an amendment to the section of the rules related to telephone-initiated (TEL) entries that may make it easier for a payor bank to recover damages from an originating bank for breach of warranty. The new subsection specifically addresses an originating bank's liability for breach of warranty, and includes an indemnification from costs and losses that are a direct or indirect result of the originating bank's failure to comply with the rules.

<sup>33</sup> While this type of central authority can facilitate risk management, it does not eliminate risk. Recent security breaches at several major merchants (e.g., B.J.'s Wholesale Club, DSW Shoe Warehouse, etc.) and the processor CardSystems have led some industry observers to question how many processors and merchants are not complying with the payment card industry's data security protocol.

<sup>34</sup> Generally, before a merchant account is shut down, penalties are imposed and, depending on the severity of the chargeback levels, a correction plan may be agreed to between the merchant, the acquiring bank, and the card association. Card networks, like the ACH system, are faced with an increase in the number and types of merchants participating in their networks. Representatives from Visa and MasterCard met in September of 2005 to discuss requiring more rigorous security audits to address these changes.

threat of being expelled from participation in the card networks appears to serve as an effective deterrent. By contrast, for the ACH system, NACHA is primarily a rules-setting body without the same operational control and ability to monitor members' compliance, or to expel members who consistently participate in the origination of a high rate of return items.

#### **IV.C. Susceptibility to Fraud: New System Participants**

As pointed out, the level of ACH fraud traditionally has been relatively low, especially in comparison to check fraud rates, even in the presence of the vulnerabilities just discussed. However, with the proliferation of new participants in the ACH system, especially in combination with the increase in the volume of ACH payments, industry observers have begun to worry about the rising number of unauthorized returns and opportunities for fraudulent exploitation of system vulnerabilities.<sup>35</sup>

Technological advancements have reduced scale and information-processing barriers to entry into the payments system for third-party service providers, including third-party processors.<sup>36</sup> As a result, the number and relative importance of third-party processors has increased along with the growth of the ACH network. A third-party processor is an entity that acts in an intermediary, ACH-transaction-processing capacity between an originator and an originating bank.<sup>37</sup> For example, a third-party processor could be a traditional data-processing service bureau, or an independent sales organization that specializes in acquiring merchants engaged in high-risk transactions (e.g., mail order and telephone merchants).

In the course of providing services to ACH originators, these third-party processors become both customers of originating banks and intermediaries between banks and originators. It is possible that such "layering" between a bank and an originator might diminish or eliminate the due diligence a bank would otherwise perform were it to have a direct customer relationship with the originator. When third-party processors contract with independent sales organizations or other third-party processors, there may be two or more layers between banks and originators. Problems tend to arise when neither the third-party processor nor the originating bank performs due diligence on the companies for whom they are originating payments.<sup>38</sup> This becomes increasingly

<sup>35</sup> See for example *News from FedACH*, Vol. 1, No. 1, Retail Payments Office, Federal Reserve Bank of Atlanta (Q4 2003), and Vol. 1, No. 5 (Q4 2004).

<sup>36</sup> We use the term "third-party processor" for a subset of third-party service providers referred to in the NACHA Rules as "third-party senders." The fraud risk issues raised in this paper are related to this subset of third-party processors. Other third parties perform tasks outsourced to them by originating or receiving banks and/or have direct access to an ACH operator. Risk issues related to such third-party service providers are beyond the scope of this paper.

<sup>37</sup> For ACH debits, an originator is the payee, i.e., the entity to whom funds are paid.

<sup>38</sup> Fox, Jeannette, "NACHA on mitigating risk in the ACH network," *Fedfocus: News from the Federal Reserve Banks*, Volume 3, Issue 2, Federal Reserve Financial Services (April 2005); and *News from FedACH*, Vol. 1, No. 1, Retail Payments Office, Federal Reserve Bank of Atlanta (Q4 2003).

important as new third-party processors specializing in lower volume, but higher margin transactions, enter the ACH network; such participants are more likely to violate the rules of the ACH network (i.e., the NACHA Rules) or generate illegal transactions. Without adequate monitoring at the originator level, layering makes it easier for illicit originators to operate undetected.

An originating bank is responsible for all the entries it submits into the ACH network regardless of the extent to which one or more third-party processors may have been involved. Third-party processors are, in general, not subject to the same level of regulation and supervision as banks; under similar circumstances, payment card networks have devised procedures to help identify the third parties involved in the system, promoting a measure of industry-imposed governance over the operations of third-party participants.<sup>39</sup> The ACH network lacks a comparable system-wide identification process. As the ranks of nonbank third-party participants in the ACH system swell, especially in response to opportunities arising from new payment applications, the lack of such industry-imposed governance procedures increases the risk of fraud.

Given these circumstances, ACH industry observers have expressed concerns about fraud, especially for two of the newer ACH transaction types, TEL and WEB.<sup>40</sup> There is evidence to justify

**Table 2. Unauthorized TEL and WEB Returns**  
(percent of total transactions, by type of ACH payment)

	2002	2003	2004
TEL	0.86 %	0.19 %	0.21 %
WEB	0.68 %	0.47 %	0.08 %
Prearranged payment (PPD)	0.10 %	0.09 %	0.07 %

Source: NACHA.

TEL: Telephone-initiated transactions.

WEB: Internet-initiated transactions.

PPD: Prearranged payment and deposit transactions.

<sup>39</sup> For example, in addition to bank sponsorship, third parties must also be registered with Visa. Although registration is required, John Shaughnessy, Visa USA's senior vice president, Fraud Prevention, recently noted that they are "seeing a lot of unregistered agents in the system." Forward Financial Bank Card Conference, Memphis, Tennessee (September 2005).

<sup>40</sup> See in particular the interview with Richard Oliver, senior vice president, Retail Payments Office of the Federal Reserve Bank of Atlanta, in *News from Fed ACH*, Vol. 1, No. 5, Retail Payments Office, Federal Reserve Bank of Atlanta (December 2004).

these concerns, as Table 2 illustrates. In particular, Table 2 shows that in 2002 nearly 1 percent of TEL transactions, and significantly more than half a percent of WEB transactions were “unauthorized”—i.e., cases where a consumer’s account was debited but the consumer asserts that he did not authorize the transaction. Those rates were substantially higher than traditional pre-authorized ACH debits. Indeed, though both unauthorized transactions rates for TEL and WEB declined after 2002, unauthorized TEL transactions rates were still three times the rate for traditional preauthorized, (or prearranged payment and deposit [“PPD”]), debits. As explained in the next section, industry efforts to avert fraudulent ACH efforts have played a role in the decline in unauthorized payments rates for TEL and WEB. Nevertheless, fraudsters still appear to be taking advantage of TEL transactions.

## **V. Susceptibility to Fraud: Industry and Government Responses**

Amid a growing recognition that new ACH users and uses have heightened fraud vulnerabilities, industry participants and government authorities have introduced measures to combat rising fraud rates. Industry and government responses have focused primarily on measures to stop “bad actors” from entering the system to begin with, and on measures to monitor ACH activities in order to make it more difficult for illicit parties to continue processing ACH payments if they nevertheless manage to enter the system. The common theme for most recent industry and government measures is better due diligence by participants with respect to their direct customers, as well as the “customers of their customers.” In effect, these measures counteract existing vulnerabilities in the system’s fraud detection and prevention mechanisms. Indirectly, they also address system governance issues by encouraging each participant to take more individual responsibility for policing bad actors.

### **V.A. Industry Responses**

As Table 2 illustrated, there is a significantly higher unauthorized transactions rate for TEL than for other types of ACH debits, and as a consequence recent industry (and government) responses have focused on this form of ACH payment in particular. Industry participants have observed that the return problem is a result of several factors, most notably banks originating payments without performing adequate due diligence on companies for whom they originate payments, and telemarketers skirting the NACHA Rules or engaging in deceptive or in some cases illegal practices.

NACHA has observed a strong correlation between high unauthorized return rates and originators (i.e., merchants) who are violating the NACHA Operating Rules, and who are engaged in fraudulent or deceptive marketing practices. In order to help identify potential fraud within the ACH network, NACHA receives data from the two ACH operators: the Federal Reserve and the EPN (Electronics Payment Network, the ACH business of the Clearing House Payments Company) on the volume of return entries sent back to originating banks. NACHA uses this data to identify originating banks with unusually high returns volume, and alerts the originating bank if it believes that bank should review an originator’s activity and compliance with the NACHA Rules. Because

merchants involved in fraudulent or deceptive practices typically experience higher than average rates of unauthorized returns, NACHA has adopted a rule requiring originating banks to provide it with information about the merchant, the nature of the merchant's business, and the merchant's explanation for the excessive unauthorized TEL return rates above 2.5 percent. The monitoring of excessive returns by NACHA and EPN has led to a significant reduction in the rate of unauthorized returns. As shown previously in Table 2, the rate of unauthorized TEL returns in 2004 (0.21 percent) was less than one-fourth the rate of returns in 2002 (0.86 percent).

NACHA has also implemented rule changes and worked with industry participants to improve the quality of WEB transactions. Partly as a consequence, the 2004 rate for unauthorized WEB returns was one-eighth the 2002 rate.<sup>41</sup> More generally, payees are using bank debit less often than in prior years as a method of payment for transactions associated with telemarketing fraud. Twenty-six percent of fraudulent telemarketing transactions in 2004 were funded with bank debit, down from 37 percent in 2003.<sup>42</sup>

The two ACH operators are also responding to changes in the ACH network. In response to the growing threat of fraud, several years ago EPN developed EPNWatch(r), a service that offers reports to originating banks when unauthorized payments exceed established thresholds. The reports are designed to alert originating banks to customers with excessive unauthorized returns. The Federal Reserve is pilot-testing a similar service for originating banks, and plans to offer reports as a priced service (in the form of a per-originator fee) starting early in 2006. In addition to its reporting service for originating banks, EPN has announced that it is in the process of developing a report for receiving banks to help them identify fraudulent payments before they are settled.<sup>43</sup>

## V.B. Government Responses

Governmental agencies have also responded to fraudulent ACH activities stemming from changes in payments applications and the nature of industry participants. In particular, federal and state government actions have targeted deceptive and fraudulent telemarketing activities in part by taking action against third-party processors and banks that have facilitated such activities by providing access to the ACH system.

<sup>41</sup> As mentioned in the previous section, the current lower return rates for WEB are also likely due to how the majority of WEB transactions are being used—for bill payment transactions between a consumer and an originator who are known to each other. A three-day random sampling of WEB transactions revealed that 80 percent of these transactions are being used for bill payments, 19 percent for funds transfers, and only 1 percent for spontaneous purchases. Presentation given by Jane Larimer of NACHA at the FFIEC Payments System Risk Conference, May 10–13, 2005.

<sup>42</sup> “Bank debit” is comprised of demand drafts—paper checks that are produced without a payor signature but which are presumed to have been authorized by the payor—as well as ACH. Information on the use of debits is from the National Consumers League's National Fraud Information Center report, *Telemarketing Scams: January–December 2004*.

<sup>43</sup> Wade, Will, “Fed, EPN Develop Tools to Detect, Report ACH Fraud,” *American Banker*, April 15, 2005.

An example at the federal level is the complaint filed in January 2004 by the Federal Trade Commission (FTC) charging a third-party ACH processor, First American Payment Processing, Inc. (“First American”) with violating the Telemarketing Sales Rule (TSR).<sup>44</sup> Specifically, the FTC alleged that First American processed ACH payments for telemarketers who they knew or should have known were deceptively selling advance-fee credit cards and engaging in other deceptive or abusive telemarketing practices.<sup>45</sup> Additionally, the FTC alleged that First American engaged in an unfair practice by systematically breaching its contractual promise to banks to adhere to the NACHA Rules governing the ACH network. The NACHA Rules specifically prohibit the processing of ACH transactions on behalf of merchants engaged in “cold-call” outbound telemarketing.<sup>46</sup> The final order issued by the FTC prohibits First American from processing payments if it has information indicating that the business practices of a merchant violate the TSR, NACHA Rules, or the FTC Act.<sup>47</sup> Such information would include when unauthorized return rates exceed the 2.5 percent threshold for return entry monitoring under NACHA Rules, or when there are significant numbers of consumer complaints in any given month regarding unauthorized charges. In addition, the order requires First American to investigate the business practices of each of the companies for which it processes transactions.

At the state level, a number of actions have similarly targeted third-party processors that were providing ACH payment services to businesses involved in fraudulent telemarketing schemes.<sup>48</sup> In addition, and very recently, state government officials have underlined banks’ responsibilities in thwarting fraudulent ACH activities. For example, in July 2005, the Iowa Attorney General’s office entered into an agreement with a community bank in South Dakota that was used by third-party processors to gain access to the ACH network.<sup>49</sup> In the Iowa Attorney General’s view, the

<sup>44</sup> See FTC Press Release, February 11, 2004, “FTC Sues Electronic Payment Processor for Facilitating Fraudulent Telemarketing Schemes.” In this case the FTC took action against a third-party processor that aided telemarketers engaged in illegal practices. Under the TSR, a company can be held liable not only if its own activities are in violation of the TSR, but also if it provides substantial assistance or facilitates a violation of the rule.

<sup>45</sup> The TSR defines an advance-fee loan as an abusive telemarketing practice “requesting or receiving payment of any fee or consideration in advance of obtaining a loan or other extension of credit when the seller or telemarketer has guaranteed or represented a high likelihood of success in obtaining or arranging a loan or other extension of credit.” See 16 CFR 310.3(a)(4).

<sup>46</sup> Telemarketing also includes calls generated from advertisements or other solicitations to purchase products or services (i.e., in-bound calls).

<sup>47</sup> Section 5 of the Federal Trade Commission Act (FTC Act), 15 USC 45(a)(1), prohibits “unfair or deceptive acts or practices in or affecting commerce,” a model followed by most states. For additional information, see OCC Advisory Letter 2002-3.

<sup>48</sup> See, for example, Iowa Attorney General press release (February 15, 2005), “Electracash, Inc. Agrees to Stop Processing Withdrawals for Telemarketing Scams.”

<sup>49</sup> The Iowa Attorney General worked with the offices of the Minnesota and South Dakota attorneys general. These attorneys general initially contacted the bank in 2002 in the course of investigating the complaints of telemarketing fraud victims. See Iowa Attorney General press release (July 6, 2005), “First Premier Bank Agrees to Deny Automatic Withdrawal Services to Telemarketing Scams.”

law requires banks not to assist any telemarketer that the bank knows or should have known is engaged in fraudulent conduct.<sup>50</sup> This approach enables the Attorney General's office to combat telemarketing fraud by looking at the businesses providing support to telemarketing schemes, not just the telemarketers directly engaged in fraudulent activity.

Very recent action by the state of Vermont provides additional definition to the scope of ACH system participants' anti-fraud responsibilities. A new law in Vermont, which became effective on July 1, 2005, and which is reported to be the first of its kind in the country, prohibits telemarketers from using the ACH network to transfer funds from a consumer's bank account in connection with any outbound telemarketing, unless the consumer has purchased something from that telemarketer in the past year, or currently has a written agreement with the telemarketer.<sup>51</sup> Additionally, third-party processors will be held liable for processing ACH debits or demand drafts for telemarketers that would be illegal if the telemarketers themselves initiated the debit. In the event the telemarketer is "out of reach" (e.g., in another country) or has disappeared, the third-party processor will be responsible for compensating victims of the telemarketer. The Vermont law also addresses the telemarketer's bank, which is deemed to be aiding and abetting a fraudulent telemarketer when the bank knows, or consciously avoids knowing that, the telemarketer is engaging in an unfair or deceptive act or practice.

Finally, amid changes in payment applications and participants, the bank regulatory agencies have heightened their attention to ACH risk issues. The March 2004 Federal Financial Institutions Examinations Council handbook on retail payment systems specifically cautions banks offering TEL origination services on behalf of their customers to adopt appropriate risk management practices, and warns them that they are exposing themselves to substantial risk if they originate payments for merchants engaged in fraudulent or deceptive business practices.<sup>52</sup> In the same vein, in its December 2004 "Automated Clearing House" bulletin, the OCC encourages banks to focus adequate due diligence efforts on ACH payments originators that are not direct customers of the bank, but are rather customers of third-party processors with which the bank deals.<sup>53</sup> The guidance instructs banks to have controls in place to restrict or refuse ACH services to potential originators engaged in questionable or deceptive business practices.

<sup>50</sup> Most of the telemarketers involved in the advance-fee credit card scams in the Iowa case processed payments through an intermediary third party, and many of the fraudulent telemarketers used the same third-party processor. □

<sup>51</sup> See press release, Office of the Vermont Attorney General (April 5, 2005), "Telemarketing Bill Signed into Law." □

<sup>52</sup> FFIEC *IT Handbook*, "Retail Payment Systems," March 2004. □

<sup>53</sup> Office of the Comptroller of the Currency, "Automated Clearing House: NACHA Rule Changes," OCC Bulletin □ 2004-58, December 20, 2004. □

Additionally, the *Comptroller's Handbook* booklet on merchant processing informs banks of the need for a formal merchant underwriting and approval policy. This policy should designate the types of merchants with which the bank is willing to do business and the types of merchants with which the bank should refuse to do business (i.e., “prohibited merchants”).<sup>54</sup> The booklet also outlines some of the essential elements of an underwriting policy, such as a background check on merchants to verify the validity of the business.

## VI. Summary and Conclusions

This paper began by describing overall trends in ACH payments, and factors underlying the growing demand for ACH payments by banks, businesses, government, and consumers. Its focus then turned to the emergence and rapid, recent growth of new ACH payment applications that, unlike traditional ACH debits, do not rely on established customer–originator relationships. Some of these new ACH debit payments in particular have drawn more third-party processors into the ACH system, as well as new merchants eager to use (i.e., originate) the new ACH debits. Most new participants are of course drawn by the opportunities for greater (legitimate) economic benefits, but certain characteristics of the ACH system, especially in tandem with some of the new ACH debit applications, have presented opportunities for fraudsters.

Three long-standing characteristics of the ACH system make it somewhat vulnerable to fraud, although historically fraud rates have been quite low. These vulnerabilities include weak fraud detection and prevention mechanisms, weaknesses in the incentive structure for return items, and weak system governance. Recently, entrance of a new set of ACH system participants—third-party service providers—have increased the complexity of the ACH system by adding one or more layers of participants between originating banks and the entities for whom those banks ultimately are originating ACH payments. This layering heightens the challenge for banks to perform adequate due diligence on originators (i.e., performing adequate “merchant underwriting”)—especially those originators who are not direct customers of the bank. Such due diligence is increasingly important because of the opportunities for unscrupulous merchants to engage in deceptive and fraudulent practices, subsequently generating fraudulent payments. Telemarketing has proven to be an especially attractive avenue for such merchants to originate fraudulent debits.

In response to heightened fraud vulnerabilities, industry and government authorities have introduced measures designed to prevent “bad actors” from entering the system, and to make it more difficult for those who do slip through the cracks to continue to exploit the ACH network. The common theme is better due diligence by participants with respect to their direct customers, as well as the “customers of their customers,” measures aimed specifically at counteracting existing vulnerabilities in the system’s fraud detection and prevention mechanisms.

<sup>54</sup> “Merchant Processing,” booklet, *Comptroller's Handbook* (December 2001).

## SPECIAL STUDIES □

As the ACH system continues to adapt to the changing needs of its users, banks in particular will be subject to increased risk management challenges, including the misuse and fraud that has followed an increase in the volume and changes in the production of ACH payments. Bank supervisors need to ensure that banks choosing to be in the business of originating ACH entries understand the new challenges and have an adequate risk management program and board and management oversight.

## Payment Option Mortgages: Analyzing Scenarios for Future Risks

by Richard Nisenson, Senior Financial Economist, OCC Global Banking and Financial Analysis Department\*

*Executive Summary:* Initially designed as an innovative financial management tool for sophisticated borrowers, payment option adjustable rate mortgages (PO ARMs) are increasingly being marketed and chosen for their ability to lower a borrower's initial monthly payment. However, by delaying principal repayment and deferring the payment of interest due, payment option borrowers could face significantly higher monthly payments in the future. This paper demonstrates how the impact of the potential payment shock associated with payment option mortgages depends on the type of payment made each period and the uncertain future paths of interest rates and other economic conditions. After discussing the key features of these loans and the behavior of key economic factors over the last 23 years, the payment stream of an example payment option mortgage is analyzed under three alternative economic scenarios.

Rather than just focusing on the potential dollar change in monthly payments, this paper also analyzes changes in the debt-service-to-income ratio and the loan-to-value ratio. These ratios measure the borrower's payment capacity and financial leverage, respectively, and are key predictive indicators of loan performance over time. Although the payment shock may be large in terms of dollars or percentage change—even if interest rates are stable, the borrower's payment capacity need not necessarily be stressed if the loan is underwritten and structured conservatively. Rising interest rates will stress borrower payment capacity, but a significant interest rate shock that is accompanied by rising income and home values leads to a more moderate stretching of payment capacity. Over the last 23 years, periods of rising interest rates were relatively short-lived and were accompanied at the national level by rising incomes and home values. While a decline in home values during a period of rising interest rates would significantly stress payment capacity and increase leverage, past comovements in these variables indicate a period of falling home values at the national level is more likely to be accompanied by falling interest rates. A decline in home values accompanied by a decline in interest rates leads to countervailing changes in payment capacity and leverage.

The scenarios discussed in this paper demonstrate the complexity of payment option adjustable rate mortgages and the wide variation in the potential payment shocks associated with these mortgages. Lenders need to factor the additional complexity and risk from PO ARMs into their underwriting and qualifying standards, disclosure policies, management information systems, and their risk management process. Borrowers need to fully understand that making the monthly minimum or interest only payment only temporarily defers the repayment of principal and interest, and thus they could face a significant payment shock in the future, depending on uncertain economic conditions.

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## Introduction

A prolonged period of rapidly rising home prices has spurred consumer demand for residential mortgage products that lower monthly mortgage payments. One such product, the payment option (PO) mortgage, gives borrowers the option to choose among four types of monthly payments, including a minimum payment that may be less than the interest due. If the monthly minimum is made and is less than the interest due, the amount of deferred interest is added to the outstanding loan balance, which is known as negative amortization (neg am). This potential for neg am from making the minimum monthly payment (MMP) combined with the fact that these are adjustable rate mortgages (ARMs), means PO borrowers could face significantly higher monthly payments in the future. The impact of this potential payment shock depends on the payment type borrowers make each period and the future paths of interest rates and other economic conditions.

Payment option mortgages were initially designed as an innovative financial management tool for sophisticated borrowers. The different monthly mortgage payment options provide greater flexibility for borrowers who do not receive all of their income in smooth monthly salary payments or who suffer temporary cashflow problems. Additionally, the interest only and neg am options allow borrowers to manage the amount of their net worth held in untapped home equity. Payment option mortgages are increasingly being marketed and chosen for their ability to lower the initial monthly payment compared to a fully amortizing mortgage. Depending on underwriting and qualification standards, a marginal or stretched borrower could potentially use a PO ARM to purchase a more expensive home than with a traditional mortgage because of the option to make lower payments over an initial period. Financial analysts and regulators have raised concern that both borrowers and mortgage lenders may be overly focused on the initial lower payment associated with PO ARMs, and not fully accounting for the risk that payments could rise significantly in the future-potentially even as home values fall.

## Focus and Organization of Analysis

This paper focuses on analyzing the payment stream implications for PO ARMs of the borrower's choice of payment type and changes in future economic conditions. It differs from analyses conducted previously in two respects. First, rather than highlighting the potential dollar change in monthly payments, this paper extends the analysis to look at changes in the debt-service-to-income ratio and the loan-to-value ratio. These ratios are used in the initial qualification and underwriting decision as measures of the borrower's payment capacity and financial leverage, respectively. They are key predictive indicators of loan performance over time and will also influence the borrower's ability to refinance into another type of mortgage in the future. Second, rather than just focusing on changes in interest rates, this paper also includes the potential impact of changes in income and home prices. Payment capacity and financial leverage are affected by these economic factors as well as by interest rate changes.

The paper begins with a discussion of the key features of payment option adjustable rate mortgages and we introduce an example loan to demonstrate those features. In the second section,

historical trends in three key economic variables—interest rates, income and home prices—are examined. The potential risks associated with payment option ARMs from future changes in economic conditions are demonstrated in the third section. The impacts of three different economic scenarios on the example loan introduced previously are analyzed. The paper concludes with a discussion of major implications for lenders and borrowers in considering the use of payment option ARMs in light of the uncertainty of future economic conditions.

## Key Features of Payment Option ARMs

Payment Option ARMs provide borrowers the flexibility to choose among four payment options and the potential to increase their loan balance each month. The monthly payment options include:

1. 30-year amortizing payment of principal and interest (P&I);
2. 15-year amortizing payment of P&I;
3. Interest only payment (IO); or
4. Minimum monthly payment (MMP).

The MMP sets the floor amount that must be made by borrowers each month. The other payment options are available only if they exceed the minimum monthly payment. The initial MMP is calculated to amortize the loan at a rate referred to as the teaser rate, which is lower than the fully indexed rate (the current value of the particular interest rate index tied to the loan plus a fixed margin). The other three payments, and the actual interest due each month, are calculated using the fully indexed rate. The minimum monthly payment resets annually at a level sufficient to amortize the outstanding balance at the prevailing fully indexed interest rate, but its annual increase is capped. Typically the MMP can rise no more than 7.5 percent. Whether that cap is binding in the early years of the loan depends on the payment option the borrower chooses and changes in the interest rate index.

The amount of deferred interest from making a MMP that is less than the interest due that month is added back to the loan balance. This is referred to as negative amortization (neg am), and the next month's interest due reflects that increase in the loan balance. To ensure the principal repayment built into the MMP is large enough to pay off the loan over the remaining term, the MMP is allowed to recast to the fully indexed interest rate every five years, with no cap on the increase. Additionally, the minimum payment will recast earlier than every fifth year if the loan's neg am cap is reached, which generally is set between 10 to 25 percent of the original loan amount. As a marketing inducement, some lenders accrue interest on their PO ARMs at the teaser rate rather than the fully indexed rate for the first one to six months of the loan. This means the MMP will be greater than the interest due and the loan will not negatively amortize over that short initial period.

In addition to the special features associated with the minimum monthly payment option, the timing and caps on the interest rate reset is different for PO ARMs than for other types of ARMs. For PO ARMs the interest rate, and hence the interest due and P&I payments, adjusts monthly rather than annually as for traditional one-year ARMs. Moreover, the only cap on the monthly rate reset for PO ARMs is the lifetime maximum interest rate, which is generally set in the neighborhood of 10 to 12 percent. Other types of ARMs generally have caps on both the annual and lifetime change in the interest rate.

### A Payment Option ARM Example Loan

To demonstrate these features, consider the example loan shown in Table 1. First we focus on the conditions of the loan at origination. This example approximates the terms available on a PO mortgage that were prevalent in mid 2004, which is both when these mortgages began to quickly grow in popularity and the current rising rate cycle began. Given the interest rate index and margin, the fully indexed rate is 4.25 percent, compared to a teaser rate of 1 percent. On a \$400,000 loan the borrower can lower his monthly payment by over \$500 by making the IO payment rather than the 30-year P&I payment.<sup>1</sup> The monthly payment can be lowered by another \$130 if the MMP is made, with the loan balance rising by that amount.

**Table 1: Payment option ARM example loan**

<b>Initial terms of loan</b>	
Loan amount	\$400,000
Interest rate index	1.50%
Margin	2.75%
Fully-indexed rate	4.25%
Teaser rate	1.00%
Minimum payment reset cap	7.50%
Negative amortization cap	10%
Home value	\$500,000
Origination LTV	80%
Annual borrower income	\$95,000
<b>Initial payment if interest due at fully indexed rate</b>	
30-year principal & interest (P&I)	\$1,968
Debt-service-to-income (DTI) ratio	25%
Interest only payment	\$1,417
DTI ratio	18%
Minimum monthly payment (MMP)	\$1,287
DTI ratio	16%
Negative amortization from MMP	\$130
<b>Payment if interest due at teaser rate</b>	
Interest only	\$333
30-yr P&I = MMP	\$1,287
Negative amortization from MMP	-\$953

<sup>1</sup> The 15-year principal and interest payment would be \$3,009. In order to focus on the difference between the minimum payment option and the standard 30-year amortizing payment, the 15-year amortizing payment is not discussed in the rest of this paper.

The initial potential amount of neg am by making the MMP is determined by the difference between fully indexed and teaser rates, which is 325 basis points in our example. If the gap was 500 basis points, implying a fully indexed rate of 6 percent, the neg am by making the monthly minimum payment would climb from \$333 to \$713.<sup>2</sup> Lenders can thus slow down the potential speed at which borrowers could negatively amortize on their loans by increasing the teaser rate. Lenders can also accomplish this if interest is accrued at the teaser rate for a short period of time. When this is done, the interest due decreases considerably for that period, the IO payment is not available because it is less than the minimum payment, and the MMP and 30-year P&I payment are equivalent and reduce the loan balance by almost \$950 (the amount of neg am is negative).

### **Underwriting and Qualification Issues**

Two primary issues with regards to lenders' underwriting and qualification decisions arise from how PO ARMs are structured. Lenders base these decisions on the borrower's payment capacity and financial leverage, which are traditionally measured primarily by the debt-service-to-income (DTI) ratio and the loan-to-value (LTV) ratio, respectively.

The first issue for the lender is which payment type to consider when determining the borrower's capacity to handle the payment out of current income. For our example loan in Table 1, the DTI ranges from 25 percent based on the 30-year P&I payment to 16 percent for the monthly minimum payment.<sup>3</sup> If the lender used the minimum-monthly-payment-based DTI in the qualification process, and had a DTI limit of 25 percent, this suggests the borrower has the capacity to maintain a loan substantially over the \$400,000 calculated using the traditional P&I-payment-based DTI.

The second issue facing the lender is whether to consider the neg am potential of PO ARMs when setting initial limits on the amount the borrower leverages his or her home. Traditional LTV calculations and limits are based on the initial loan amount. But as previously noted, the neg am feature of PO ARMs allows borrowers to increase the amount they leverage their homes. In our example, if the borrower accumulates neg am on the loan up to the 10 percent cap, the LTV would increase to 88 percent (assuming a constant home value). However, the borrower may not have initially qualified for a loan with an LTV over 80 percent.

### **Comparison of PO ARMs with Home Equity Loans**

With the capability to accumulate negative amortization, PO ARMs can serve the same basic function as home equity loans, but some differences are also worth noting. Both products can be used to receive additional principal and increase how much borrowers are leveraging their home.

<sup>2</sup> The interest due rises to  $[0.06 \times (\$400,000/12)]$  which equals \$2,000, compared to the minimum payment, which remains at \$1,287.

<sup>3</sup> Lenders usually consider both the front-end DTI ratio—monthly housing expenses relative to pre-tax income—and back-end ratio, which adds other monthly consumer debt payments (such as on auto or home equity loans) to the numerator. For simplicity, this paper only considers the front-end ratio and does not include taxes and insurance.

For example, accumulating 10 percent neg am is equivalent to taking out a \$40,000 home equity loan on a \$500,000 home (for an LTV of 8 percent) that has a first mortgage with an 80 percent LTV. Rather than increasing outstanding principal over time by deferring interest to decrease monthly payments, the home equity borrower can receive additional principal all at once. With a home equity loan, however, the borrower may pay additional transaction costs for the second loan and may pay a higher interest rate because it is a second lien.

### Payment Stream of Example Loan under Stable Economic Conditions

We now return to our example loan to analyze how the mechanics of PO ARMs affect how required payments evolve over time, even if interest rates and other economic conditions are stable. Even though the fully indexed rate is unchanged, the monthly minimum payment on PO ARMs rise on a yearly basis, subject to the annual reset cap until the payment recasts after the fifth year. Assuming the borrower chooses to make the minimum payment each month and that interest due is calculated using the teaser rate for the first month, the payments for selected months for our example loan are shown in Table 2. Note that while the loan begins to negatively amortize once interest due is calculated at the fully indexed rate starting in month two, it takes until after the ninth month before the loan balance rises above the initial amount.

When the first annual reset occurs in month 13, the MMP rises in order to amortize the higher outstanding balance over the remaining 29 years of the loan, but the increase is constrained by the reset cap to 7.5 percent. Although higher, the month 13 MMP is still less than the interest due that month, so the loan continues to negatively amortize. It isn't until the next annual reset in the 25th month that the loan balance peaks and the MMP rises to be greater than the interest due and principal reduction begins to occur. However, the speed of principal repayment is not fast enough

**Table 2: Payment option ARM example: □  
Minimum monthly payments if interest rate stable □**

<b>Payment Activity</b>	<b>Month</b>	<b>Beginning Balance (\$)</b>	<b>Interest Due (\$)</b>	<b>Minimum Monthly Payment (\$)</b>
Teaser-rate interest due	1	400,000	333	1,287
Fully indexed interest due	2	399,047	1,413	1,287
Fully indexed interest due	10	400,073	1,417	1,287
Annual MMP reset	13	400,466	1,418	1,383
Annual MMP reset	25	400,897	1,420	1,487
Annual MMP reset	37	400,078	1,417	1,598
Annual MMP reset	49	397,859	1,409	1,718
5-year recast (4.25% rate)	61	394,077	1,396	2,135

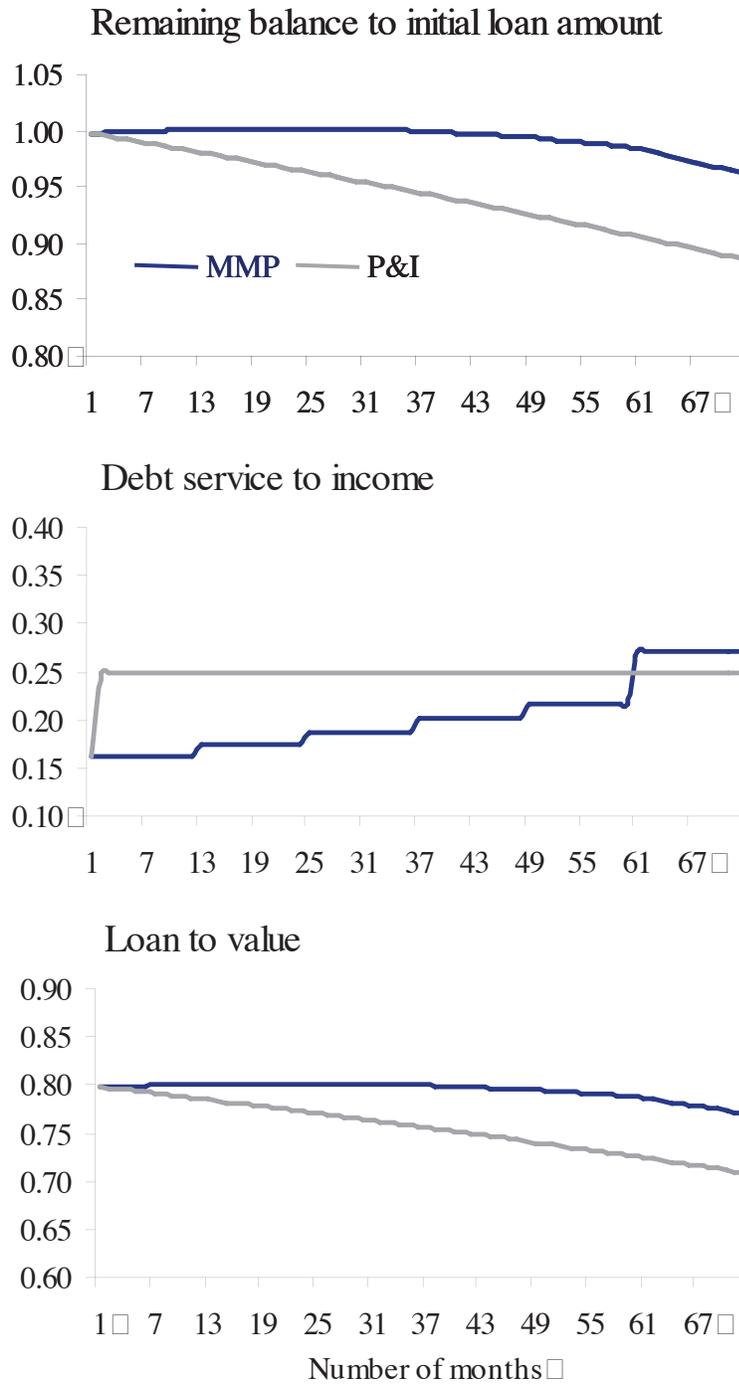
Notes: See Table 1 for the initial conditions associated with this loan.

to ensure the loan is paid off over the remaining term of the loan. To ensure the principal repayment built into the MMP is large enough to pay off the loan over the remaining term, the MMP is allowed to recast to the fully indexed interest rate every five years. In this example, the MMP rises by more than \$400 or nearly 25 percent in the 61st month.

The relatively small amount of neg am that occurs in this example results from the narrow gap between the teaser rate and initial fully indexed rate. Consider the alternative case discussed above where the fully indexed rate is 6 percent and the teaser rate is 1 percent. Because of the 500 basis point gap, the MMP would be less than interest due after each of the annual resets prior to year five, and the neg am would climb to 8.5 percent of the initial loan amount in the 60th month. When the loan recasts to the fully indexed rate in the 61st month, the MMP would rise over \$1,000 or 63 percent in order to amortize the outstanding balance at the fully indexed rate over the remaining 25 years of the loan.

The payment shock when the MMP recasts after five years appears dramatic in dollars or percentage point change, but it's the borrower capacity to handle those payments that really matters. In the middle panel of Figure 1, the DTI ratio in our example for a borrower who consistently makes the 30-year P&I payment is compared to that of a borrower who consistently makes the MMP. Because interest rates and income (along with home prices) are assumed to be stable, the only change in the P&I-payment-based DTI occurs in the second month when interest due begins to be calculated at the fully indexed rate. The MMP-based DTI steps up each year, rising from 16 percent at origination to 22 percent in year four, and then rising to 27 percent when the loan recasts after five years. Thus the payment shock at the five-year recast from making the MMP throughout the life of the PO ARM need not necessarily stress the borrower's payment capacity.

**Figure 1: Payment option ARM example:  
Key ratios if interest rates stable**



Notes: See Table 1 for the initial conditions associated with this loan. In addition to interest rates, income and home prices also held stable in this example.

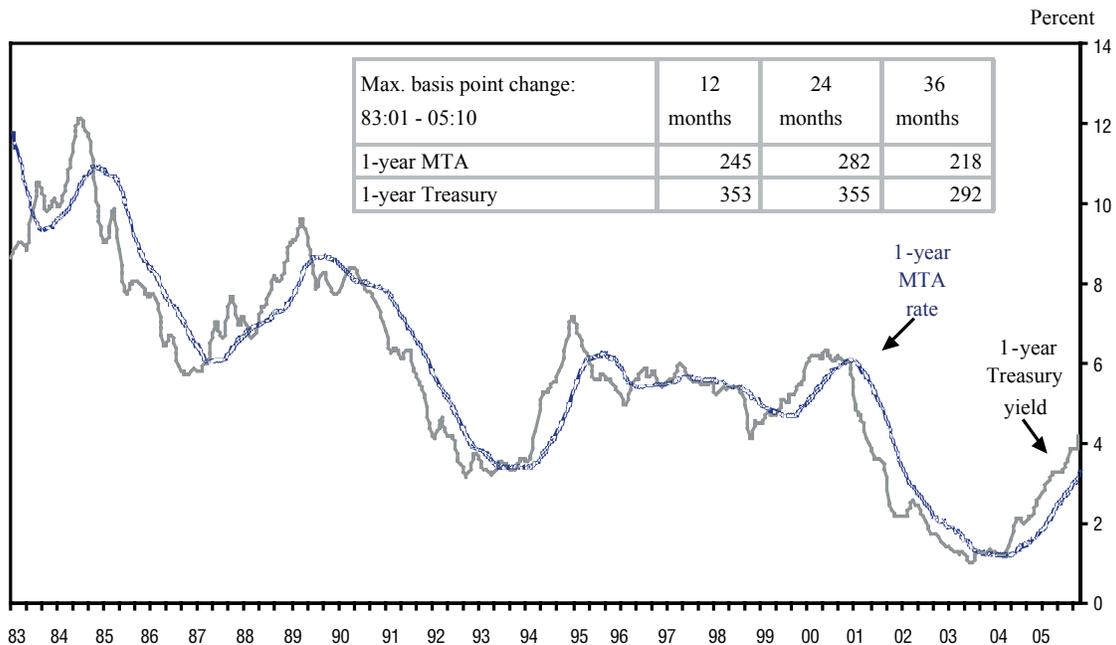
## Historical Trends in Key Economic Variables

Before studying the impact of changing economic conditions on our example payment option mortgage, this section looks at the behavior of three key economic drivers—interest rates, income, and home prices—over the last 23 years.

### Interest Rate Behavior

Similar to other ARMs, PO mortgages are indexed to short-term rather than longer-term interest rates, to which fixed rate mortgages are tied. The most common index for POs is the Monthly Treasury Average, or MTA, which is the 12-month average of the monthly average yields on one-year constant maturity Treasury securities. The use of a 12-month average rather than just the current one-year Treasury rate—as is used for many one-year or hybrid ARMs—slows and dampens changes in the fully indexed rate applied to PO mortgages. This partially offsets the potential for sudden and quick changes that arise from PO mortgages not having annual caps on movements in the fully indexed rate like other ARMs. This is demonstrated in Figure 2, which shows the monthly levels of the one-year Treasury and MTA rates since 1983.

**Figure 2: Use of MTA index slows and dampens interest rate changes**



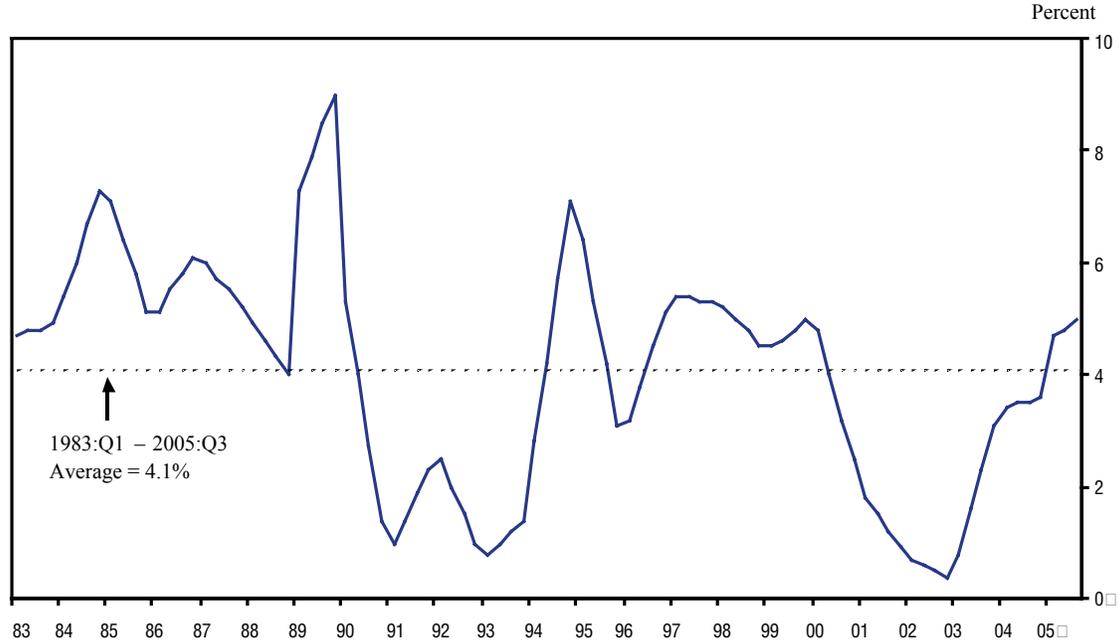
Source: Federal Reserve Board from Haver Analytics. Notes: The Monthly Treasury Average, or MTA, is the 12-month average of the monthly average yields on one-year constant maturity Treasury securities.

Figure 2 also shows that rate shocks have been short-lived over the last 23 years. The largest 12-month change in the MTA since 1983 was 245 basis points (in early 1995), over 100 basis points less than the largest change in the one-year Treasury rate. The largest 24-month change in the MTA was less than 40 basis points higher than the 12-month change. A rate stress outside these historical ranges would likely necessitate a significant change in the economic environment, such as a return to the high and volatile inflation levels of the 1970s and early 1980s.

### Income Behavior

While the potential payment shock PO mortgage borrowers may face are driven by changes in interest rates, the capacity to manage those payments is driven by changes in household income. Over the last 22 years, median income growth has averaged 4.1 percent, as shown in Figure 3. Failure to account for income growth can lead to underestimating the ability of borrowers to withstand payment shocks. In the previous section, we demonstrated that even if interest rates were stable, the DTI ratio for making the minimum monthly payments on our example loan would rise from 16 percent to 27 percent when the loan recasts after five years. Factoring in 4 percent income growth on average over five years, the DTI would rise to only 22 percent when the MMP recasts in the 61st month.

**Figure 3: Median income growth has rebounded and is now back above long-run average**



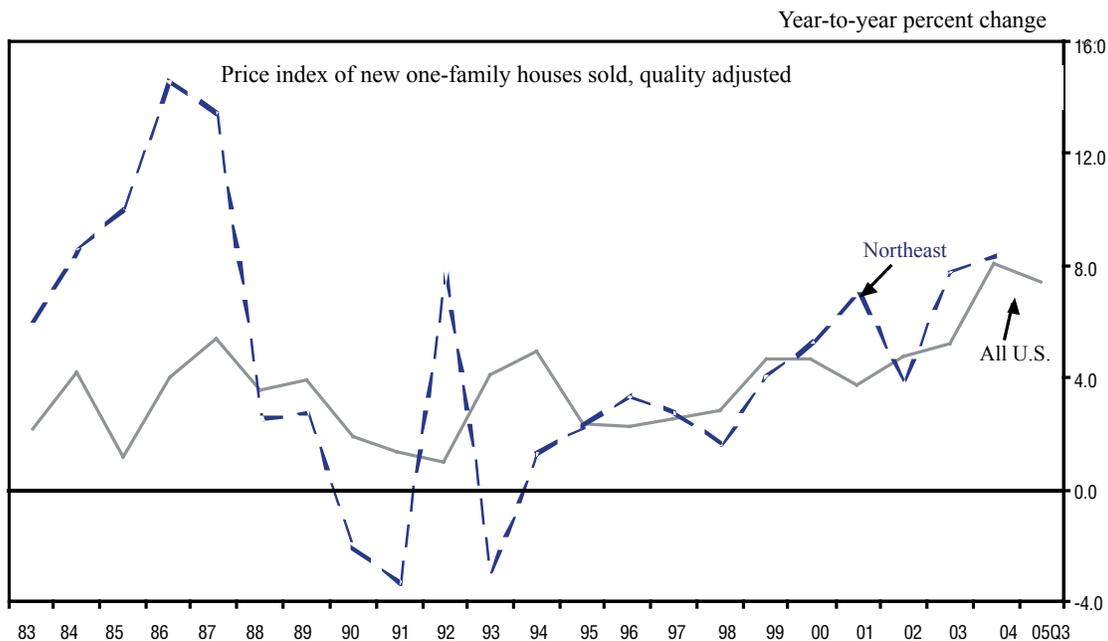
Source: National Association of Realtors from Haver Analytics.

Another important reason to include income growth in the analysis of a borrower's capacity to withstand interest rate shocks is that income and interest rate movements are positively correlated. For the United States as whole, rising interest rates have usually been accompanied by faster income growth.<sup>4</sup> For example, the nearly 200 basis point rise in the MTA over the last 16 months that has pushed it above 3 percent has been offset to some extent by acceleration in income growth, which is once again back above its long-run average. The largest one-year movement in the MTA occurred in the first quarter of 1995 and was accompanied by income growth of more than twice its long-run average.

### Home Prices Behavior

The final key economic driver to examine is movement in home values. If home prices were to fall, the concern is that borrowers who accumulated a lot of neg am by consistently making the minimum payment could find themselves owing more on the loan than their house is currently worth, which creates an incentive for borrowers to default on the loan. Mortgage defaults would

**Figure 4: Home prices more volatile and have fallen at regional or local level**



Source: Census Bureau from Haver Analytics. Notes: 2005 data for "All U.S." is through the third quarter, regional data are reported annually.

<sup>4</sup> The correlation coefficient between median the one-year Treasury rate and income growth series shown in Figures 2 and 3 over the last 23 years is 0.67.

rise even further if the drop in home prices occurred at the same time that their mortgage payments rose, either due to the loan recasting to fully amortize the outstanding balance or interest rates rising.

Nominal home prices have not declined year over year on a national basis since the Great Depression. However, at the regional or local level home values are much more volatile and have declined in the past, as shown in Figure 4. Many cities in the Northeast experienced falling home prices in the early 1990s from a deep regional recession set off by problems in the defense, technology, and commercial real estate industries. Because they were driven by downturns in the regional economy, declines in local home prices have occurred as income growth slowed or fell in response to job loss.

Since interest rates generally rise when the national economy is strong, a key issue for whether borrowers could face the double whammy of declining local prices and rising interest rates is how correlated the regional economy is with the national economy. In the 1980s and early 1990s there were a series of severe rolling regional recessions set off by localized shocks. From the agricultural heartland, to the oil patch, to defense and tech-driven New England and California, the downturns were deep enough to drive down local home prices regardless of national conditions and movements in interest rates. Over the last 15 years, regional economies have become more diversified and move much more in synch with the national economy. In this type of economic environment, it is much less likely that a region could experience declining home prices in a period of rising interest rates. This type of movement would need to be driven by a national economic downturn with rising interest rates, which while not out of the question, would necessitate a significant change in the future economic environment from the last 15 years.

## **Mortgage Payments under Three Alternative Economic Scenarios**

To study the impact of different economic conditions and payment choices on PO ARM borrowers, the payment streams of our example loan for three alternative economic scenarios are analyzed:

- Scenario 1: Rising interest rates, with incomes and home values stable
- Scenario 2: Rising rates, incomes, and home values
- Scenario 3: Rising interest rates followed by declining home values and a modest rate cut

The starting point is once again the set of initial conditions of our example loan summarized in Table 1 above, which reflects the borrowing environment in mid 20004 when PO mortgages began to grow rapidly and interest rates began to rise. Underwriting and qualification standards are assumed to be conservative: a 25 percent DTI based on the fully indexed P&I payment and an 80 percent LTV at origination. Also assume that the neg am cap is also conservatively set at 10 percent of the initial balance. The assumed path for interest rates, income, and home prices

over the first year of the scenarios are layered on to match developments over the last year. The assumptions for years two through five are layered on, based on the behavior of interest rates over the last 23 years and the expectation that housing markets will slow markedly.

**Payment Stream of Example Loan under Alternative Scenario 1**

A significant interest rate shock with no countervailing growth in income or home prices creates significant accumulation of negative amortization and stretching of payment capacity for borrowers who consistently make only the minimum monthly payment. Scenario 1 is outlined in the bottom panel of Table 3, where the fully indexed rate increases by 150 basis points for two years. The interest due and P&I and minimum payments at each annual reset and the five-year recast are shown in the top right-hand table. The impacts of consistently making the P&I payment versus MMP on the outstanding balance, the debt-service-to-income ratio, and the loan-to-value ratio for Scenario 1 are depicted in Figure 5. While this loan accumulated very little neg am if rates were stable, a 300 basis point increase would see a relatively quick accumulation of neg am. The 10 percent neg am cap would be hit in the 51st month and the LTV rises to 88 percent. When the MMP recasts the next month, the DTI would rise to 40 percent, compared to 27 percent in a stable rate environment as was shown in Figure 1. The significant increase in leveraging and deterioration in payment capacity increases the likelihood of default for this borrower.

**Table 3: Payment option ARM example for Scenario 1: Minimum monthly payments with rising interest rate, stable income, and stable home values**

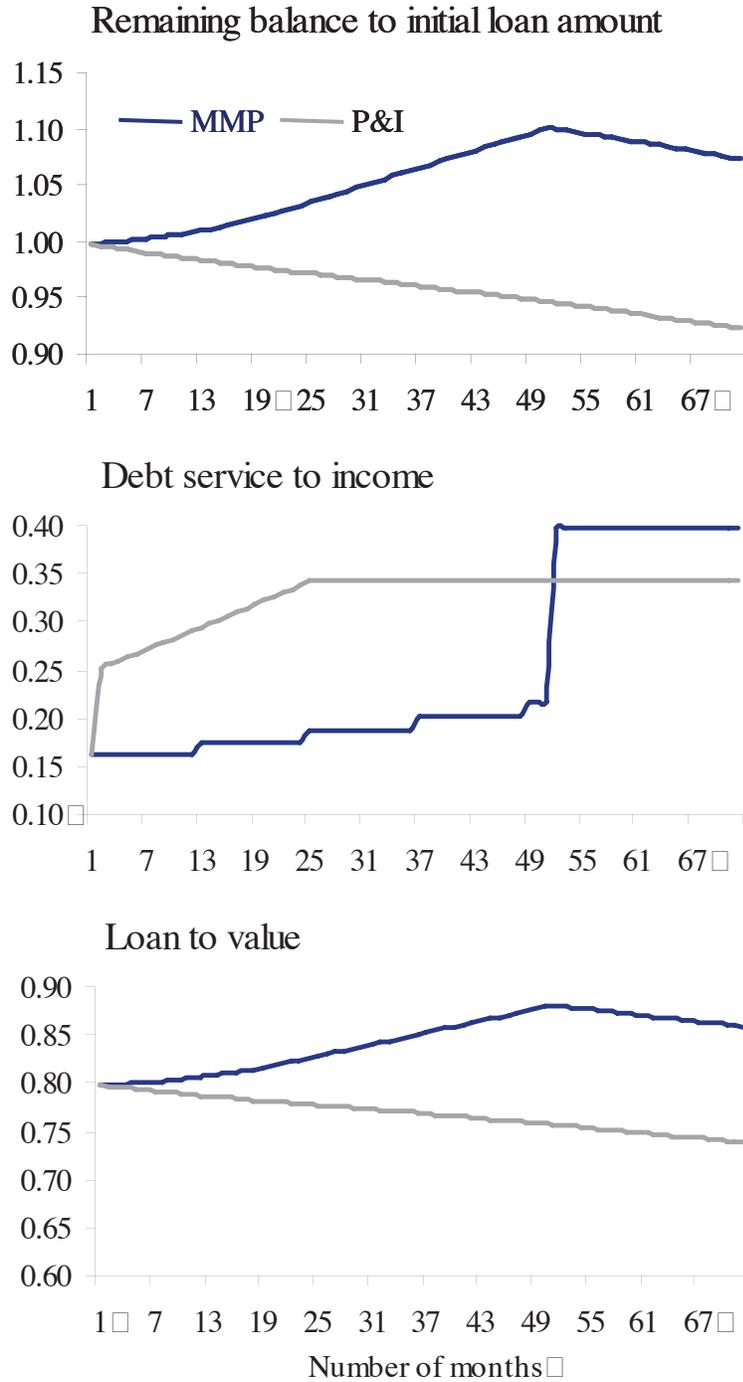
Payment Activity	Month	Beginning Balance (\$)	Interest Due (\$)	Minimum Monthly Payment (\$)
Annual MMP reset	13	403,256	1,932	1,383
Annual MMP reset	25	412,879	2,494	1,487
Annual MMP reset	37	425,381	2,570	1,598
Annual MMP reset	49	437,438	2,643	1,718
Recast at neg am cap	52	440,228	2,660	3,149

**Assumed path of key drivers □**

Year	Home price growth	Interest rate basis point change	Income growth
1	0%	150	0%
2	0%	150	0%
3	0%	0	0%
4	0%	0	0%
5	0%	0	0%
5+	0%	0	0%

Notes: See Table 1 for the initial conditions associated with this loan. In the lower panel, the highlighted cells show the new assumptions about the key drivers introduced in Scenario 1. In the upper panel, the highlighted cells show the resulting changes in payment stream and the month when the loan recasts.

**Figure 5: Payment option ARM example for Scenario 1: Key ratios with rising interest rate, stable income, and stable home values**



Notes: See Table 1 for the initial conditions associated with this loan. See Table 3 for the assumed changes in interest rates, income, and home prices.

**Payment Stream of Example Loan under Alternative Scenario 2**

A significant interest rate shock that is accompanied by rising income and home values leads to a more moderate stretching of payment capacity. Table 4 and Figure 6 demonstrate the impact even modest income growth of 3 percent per year (recall that 23 year average growth in median income is over 4 percent). This scenario also assumes that home prices appreciate rapidly in the first year (as has occurred over the last year) and then they slow quickly the following year (as is expected to occur over the next year).

The neg am cap is still hit in the 51st month (same change in interest rate as in previous scenario), but at recast the DTI rises to 35 percent rather than 40 percent. Also, the robust house price growth of the first year provides a buffer to absorb the neg am of making the minimum payment, so that the LTV of the loan is still below the origination level of 80 percent at recast. Thus the impact on payment capacity and leverage, and hence the likelihood of loan repayment, can be significantly overestimated by not considering the normal historical relationship that rising interest rates are usually accompanied by faster income growth and home appreciation.

**Table 4: Payment option ARM example for Scenario 2: □  
Minimum monthly payments with rising interest rate, income, and home values □**

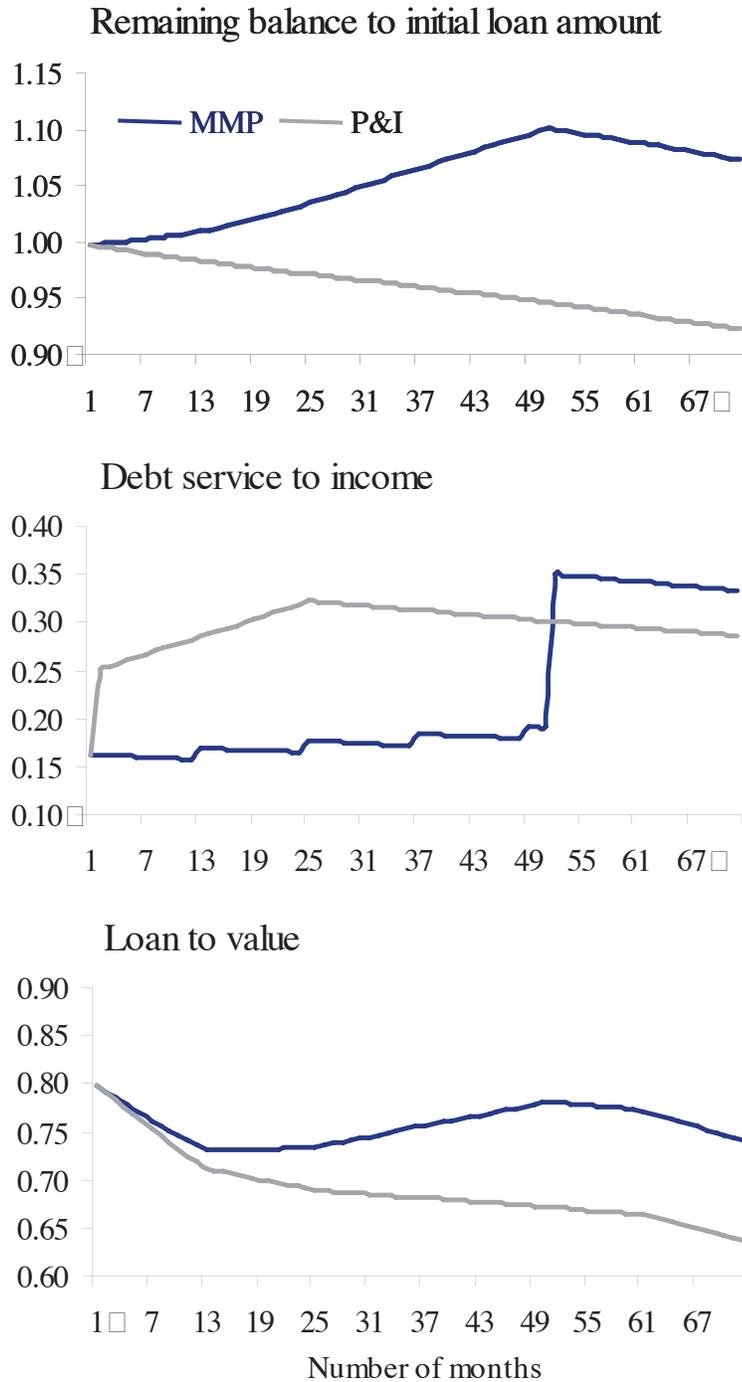
Payment Activity	Month	Beginning Balance (\$)	Interest Due (\$)	Minimum Monthly Payment (\$)
Annual MMP reset	13	403,256	1,932	1,383
Annual MMP reset	25	412,879	2,494	1,487
Annual MMP reset	37	425,381	2,570	1,598
Annual MMP reset	49	437,438	2,643	1,718
Recast at neg am cap	52	440,228	2,660	3,149

**Assumed path of key drivers □**

Year	Home price growth	Interest rate basis point change	Income growth
1	10%	150	3%
2	2%	150	3%
3	0%	0	3%
4	0%	0	3%
5	0%	0	3%
5+	3%	0	3%

Notes: See Table 1 for the initial conditions associated with this loan. In the lower panel, the highlighted cells show the new assumptions about the key drivers introduced in Scenario 2.

**Figure 6: Payment option ARM example for Scenario 2: Key ratios with rising interest rate, income, and home value**



Notes: See Table 1 for the initial conditions associated with this loan. See Table 4 for the assumed changes in interest rates, income, and home prices.

**Payment Stream of Example Loan under Alternative Scenario 3**

Declining home prices in a period of moderately falling interest rates leads to countervailing movements in payment capacity and leverage. This is demonstrated in Table 5 and Figure 7, which starts with the prior scenario and then assumes that in year four a 10 percent decline in home values is accompanied by a 50 basis point drop in interest rates. Neg am accumulates more slowly in this scenario because of the drop in interest rates, with the 10 percent cap being hit in the 53rd rather than the 51st month. The smaller jump in payments also dampens the rise in the DTI when the loan recasts: it peaks at 33 percent rather than 35 percent in the previous example. The drop in home prices pushes the LTV ratio above 80 percent, but the net increase is lessened by the robust appreciation of the first year. Thus a period of declining home prices with rising interest rates would see borrowers experience less payment stress but increased leverage. The net impact on credit quality would depend on the relative movements in home prices and interest rates.

**Table 5: Payment option ARM example for Scenario 3: Minimum monthly payments with rising interest rate, followed by declining home values and a modest rate cut**

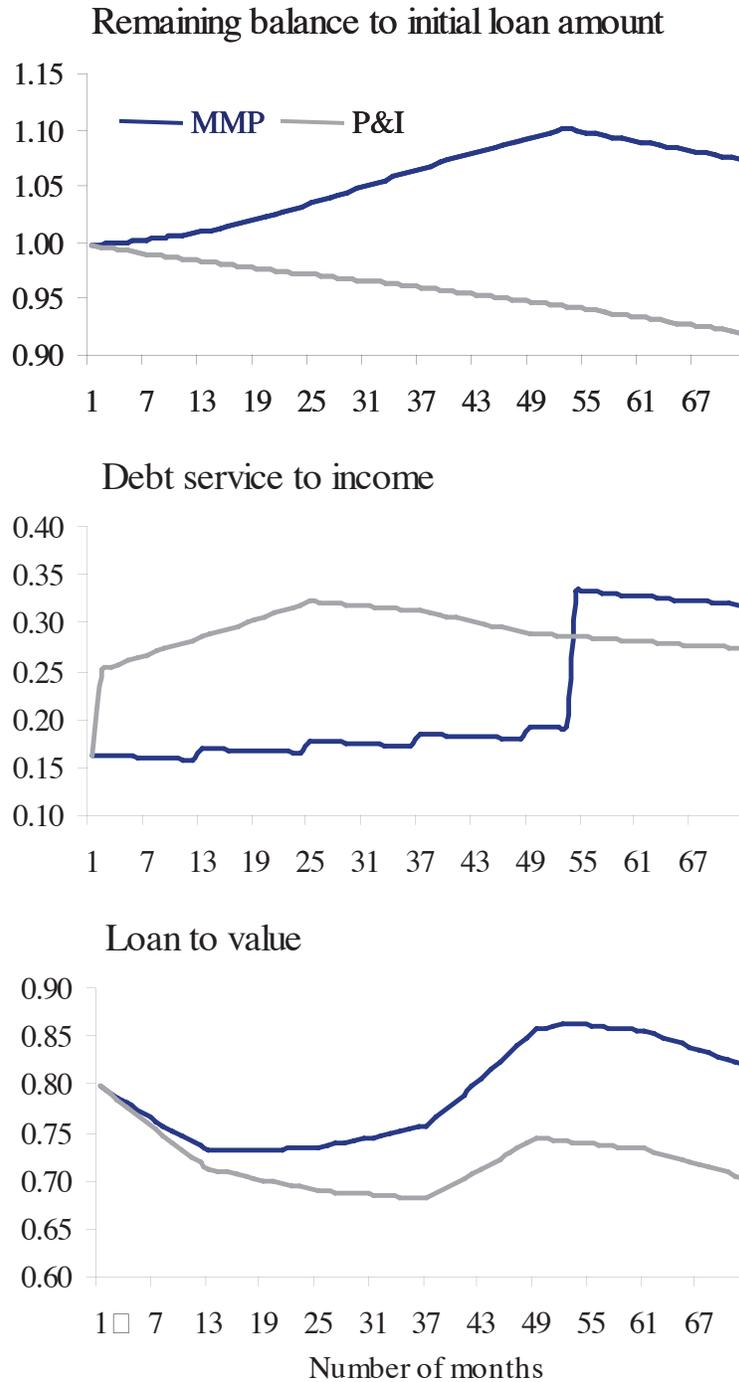
Payment Activity	Month	Beginning Balance (\$)	Interest Due (\$)	Minimum Monthly Payment (\$)
Annual MMP reset	13	403,256	1,932	1,383
Annual MMP reset	25	412,879	2,494	1,487
Annual MMP reset	37	425,381	2,570	1,598
Annual MMP reset	49	436,426	2,455	1,718
Recast at neg am cap	54	440,152	2,476	3,015

**Assumed path of key drivers** □

Year	Home price growth	Interest rate basis point change	Income growth
1	10%	150	3%
2	2%	150	3%
3	0%	0	3%
4	-10%	-50	3%
5	0%	0	3%
5+	3%	0	3%

Notes: See Table 1 for the initial conditions associated with this loan. In the lower panel, the highlighted cells show the new assumptions about the key drivers introduced in Scenario 3. In the upper panel, the highlighted cells show the resulting changes in payment stream and the month when the loan recasts.

**Figure 7: Payment option ARM example for Scenario 3: Minimum monthly payments with rising interest rate, followed by declining home values and a modest rate cut**



Notes: See Table 1 for the initial conditions associated with this loan. See Table 5 for the assumed changes in interest rates, income, and home prices.

## Conclusions

The scenarios discussed in this paper demonstrate the complexity of payment option adjustable rate mortgages and the wide variation in the potential payment shocks associated with these mortgages. The impact of the payment shock depends on how often the borrower does not make the full P&I payment and the uncertain path of future economic conditions such as interest rates, income, and home prices.

Lenders need to factor the additional complexity and risk from PO ARMs into their underwriting and qualifying standards, disclosure policies, management information systems, and their risk management process. For example, lenders can adjust a number of underwriting and qualification standards or initial loan conditions to lessen the potential impact of changing economic conditions on borrowers ability to repay, such as:

- Underwriting the loan to the fully indexed P&I debt to income rate provides some cushion against the potential payment shock at the five-year recast;
- Resetting the initial LTV requirement, the gap between the teaser rate and fully indexed rate, and the neg am cap as economic conditions change to manage the potential impact of negative amortization over time; and
- Using an interest rate index based on a moving average slows and dampens the transmission of interest rate shocks into payment changes.

Borrowers need to fully understand that making the monthly minimum or interest only payment only temporarily defers the repayment of principal and interest, and thus they could face a significant payment shock in the future. Assessing the impact of the future payment shock is conditional on an expectation of future economic conditions such as interest rates, income, and home prices. It is critical that borrowers consider more than just the most recent past in forming their expectations of future economic conditions. This is particularly important since the U.S. housing market is coming off an exceptional five-year period of low interest rates and rapidly appreciating home values.

# Quarterly Journal

RECENT LICENSING □  
DECISIONS □

# RECENT LICENSING DECISIONS □

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## **Cases Published during July, August, and September 2005**

### **CRA Decision**

On July 12, 2005, the OCC approved the application to merge First Bank of San Luis Obispo, San Luis Obispo, CA, into Pacific Capital Bank, National Association, Santa Barbara, CA (PCB), under the charter of PCB and the title Pacific Capital Bank, National Association. The OCC received nearly identical comments from nine commenters who expressed concerns related to Refund Anticipation Loans (RALs) offered by Santa Barbara Bank and Trust, a branch of PCB. As part of the OCC's ongoing supervision of PCB within the past year, the OCC reviewed the bank's RAL program and found no violations of law, but did recommend that the bank improve its processes for oversight of third-party tax preparers. PCB committed to address this issue and the OCC will continue to monitor PCB's commitment. The commenters also requested that the OCC conduct a public hearing. After careful consideration, the OCC decided not to conduct a hearing on this merger application. [Corporate Decision No. 2005-11]

### **Conversion**

On June 9, 2005, the OCC conditionally approved the application of Brown Brothers Harriman Trust Company, LLC, to convert to a national banking association to be called Brown Brothers Harriman National Trust Co. In the review of this application, the OCC determined that state banks and trust companies organized as limited liability companies may convert into national banking associations under section 12 USC 35. The bank would continue to operate in a similar manner electing, under 12 CFR .2000(b), to follow New York limited liability company law for its internal governance to the extent not inconsistent with applicable federal banking statutes and regulations or bank safety and soundness. This conditional approval was subject to several conditions including the execution of a Capital Assurances and Liquidity Maintenance Agreement between the Bank and its parent Brown Brothers Harriman & Co. [Conditional Approval No. 696]

### **Change in Bank Control**

On June 10, 2005, the OCC did not disapprove a Change in Bank Control Notice submitted by Computershare Limited, Victoria, Australia, and EQAC Inc., Chicago, IL, to acquire control of

EquiServe Trust Company, National Association, Canton, MA. The OCC's decision was based, in part, on agreements made in connection with this filing between Computershare Limited and the OCC effective June 10, 2005, and EquiServe Trust Company, N.A. and the OCC effective June 23, 2005. These agreements help ensure that the bank will be operated in a safe and sound manner and both agreements may be enforced under 12 USC 1818. [Corporate Decision No. 2005-06]

## **Capital**

On June 20, 2005, the OCC approved the application by The Ephrata National Bank, Ephrata, PA, to reduce its permanent capital by purchasing a limited amount of its own common stock to be held as treasury stock to be reissued in the future under the bank's Dividend Reinvestment and Stock Purchase Plan. The OCC found that repurchasing bank stock to facilitate a bank's shareholder dividend reinvestment plan is a "legitimate corporate purpose" under 12 CFR 7.2020. [Corporate Decision No. 2005-07]

## **Comments to Other Agencies**

On April 7, 2005, the OCC provided comments to the Federal Reserve Board on the application by Republic Bancorp, Inc. to become a bank holding company through the acquisition of National Family Bank, Munden, KS. In connection with this application, the directors of Republic Bancorp, Inc. and the OCC entered into an agreement, and the National Family Bank and the OCC entered into an agreement, both effective June 14, 2005. These agreements help ensure the bank will be operated in a safe and sound manner and both agreements may be enforced under 12 USC 1818. [Corporate Decision No. 2005-08]

On June 15, 2005, the OCC provided comments to the Federal Reserve Bank of Kansas City on the Notice of Change in Bank Control by certain controlling shareholders to acquire indirect control of American National Bank of Rock Springs, Rock Springs, WY. In connection with this filing, the controlling shareholders and the OCC entered into an agreement effective June 15, 2005, and the American National Bank of Rock Springs and the OCC entered into an agreement effective June 28, 2005. These agreements help ensure the bank will be operated in a safe and sound manner and both agreements may be enforced under 12 USC 1818. [Corporate Decision No. 2005-08]

# *Quarterly Journal*

SPEECHES AND □  
CONGRESSIONAL TESTIMONY □

# SPEECHES AND CONGRESSIONAL TESTIMONY

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7/14/2005, Acting Comptroller Williams Discusses History and Characteristics of National Banks and the Bank Supervisory Process in Light of Current Issues [<http://www.occ.treas.gov/ftp/release/2005-68a.pdf>]

9/26/2005, Comptroller Dugan Tells Bankers that Long Fight to Shed Outdated Laws Promoted Innovation and Broad Range of New Consumer Products and Services [<http://www.occ.treas.gov/ftp/release/2005-95a.pdf>]

*Quarterly  
Journal*

INTERPRETATIONS □

# INTERPRETATIONS □

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## *July* [Interpretations and Actions]

**1033**, 6/14/2005, Letter confirms that the bank, with approval of its examiner-in-charge, may engage in customer-driven equity index derivatives transactions and may use baskets of securities to hedge its risk exposures to the index swaps where the baskets do not exactly match the underlying index, but are designed to replicate the sector and industry weightings and general risks of the index.

**1034**, 4/1/2005, Letter states that the bank may construct a new office complex on existing bank premises and lease unused space as excess bank premises.

## *August* [Interpretations and Actions]

**1035**, 7/21/2005, Letter concludes that in the bank's securitization of its own home equity lines of credit (HELOCs), the bank may hold the securitized HELOC notes as Type V securities, the usual 25 percent prudential limit is not intended to apply under the specific facts and circumstances represented, and retention of the subordinated interest is permissible under 12 USC 24(Seventh). The conclusions are subject to various safety and soundness requirements. The appropriate risk-based capital treatment is the risk-based capital charge for the underlying HELOCs.

**1036**, 8/10/2005, Letter states that a remote check scanning terminal at a customer's location, which permits the customer to deposit checks electronically, is not a branch.

## *September* [Interpretations and Actions]

**1037**, 8/9/2005, Letter concludes that trust company may use cash-settled derivatives linked to S&P 500 Index to hedge the market risk associated with the fees it charges customers as part of its investment advisory activities, provided the trust company establishes to the satisfaction of its supervisory office, an appropriate risk management and compliance process.

**1038**, 8/16/2005, A national bank, under contract with the General Services Administration, provides purchasing, travel, and fleet charge cards to government agencies and employees as a payment tool for official government purchases and travel expenses. This letter responds to a request from the bank for an opinion the appropriate capital treatment for unused portions of lines of credit (unused lines) on cards issued to federal employees. Liability for all charges and fees incurred on government credit cards rests solely with the cardholder; the government bears no secondary liability. In the letter, we conclude that the OCC will use its reservation of author-

ity in 12 CFR 3.4 to assign a zero percent conversion factor to the unused lines. This reflects our conclusion that a zero percent conversion factor more appropriately reflects the credit risk to the bank associated with the lines.

**1039**, 9/13/2005, Letter concludes that the bank may engage in customer-driven, perfectly matched, cash-settled derivative transactions provided the bank's examiner-in-charge is satisfied that the bank has adequate risk management and measurement systems and controls to conduct the activities on a safe and sound basis.

**1040**, 9/15/2005, Letter states that the bank, with the approval of its examiner-in-charge, may engage in customer-driven, physically settled emissions derivative transactions and may enter into physical transactions in emission allowances to hedge its risk exposures to the emissions derivative transactions.

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MERGERS □

# MERGERS—JULY 1 TO SEPTEMBER 30, 2005

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Affiliated merger—thrift (merger consummated involving affiliated national bank <input type="checkbox"/> and savings and loan association).....	76 <input type="checkbox"/>

## MERGERS □

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 July 1 to September 30, 2005, by state**

Title and location (charter number)	Total assets
<b>California</b>	
Landmark National Bank, Solana Beach (024296)	68,198,000
and Legacy Bank, National Association, San Diego (La Jolla), California (024361)	35,472,000
merged on July 15, 2005, under the title of <b>Landmark National Bank, Solana Beach</b> (024296)	129,241,000
Community National Bank, Escondido (018686)	707,568,000
and Rancho Bernardo Community Bank, San Diego, California	113,778,000
merged on August 19, 2005, under the title of <b>Community National Bank, Escondido</b> (018686)	850,256,000
Pacific Western National Bank, Santa Monica (017423)	1,584,359,000
and First American Bank, Rosemead, California	244,750,000
merged on August 12, 2005, under the title of <b>Pacific Western National Bank, Santa Monica</b> (017423)	1,867,786,000
<b>Colorado</b>	
AMG Guaranty Trust, National Association, Greenwood Village (024182)	7,125,000
and Old Dominion Trust Company, Norfolk, Virginia	1,717,000
merged on March 1, 2004, under the title of <b>AMG Guaranty Trust, National Association, Greenwood Village</b> (024182)	8,365,000
<b>Georgia</b>	
Omni National Bank, Fayetteville (016560)	316,855,000
and Omni Interim, National Association, Dalton, Georgia (024608)	45,088,000
merged on July 1, 2005, under the title of <b>Omni National Bank, Atlanta</b> (016560)	370,738,000
<b>Illinois</b>	
Citizens First National Bank, Princeton (002413)	655,524,000
and Farmers State Bank Of Somonauk, Somonauk, Illinois	210,162,000
merged on July 31, 2005, under the title of <b>Citizens First National Bank, Princeton</b> (002413)	881,284,000
<b>Nebraska</b>	
The Security National Bank, Laurel (013182)	94,671,000
and The Coleridge National Bank, Coleridge, Nebraska (010023)	31,664,000
merged on July 23, 2005, under the title of <b>Security National Bank, Laurel</b> (013182)	126,335,000
<b>Tennessee</b>	
First Tennessee Bank National Association, Memphis (000336)	29,513,702,000
and First National Bank West Metro, Dallas, Georgia (024261)	130,743,000
merged on August 26, 2005, under the title of <b>First Tennessee Bank National Association, Memphis</b> (000336)	29,664,310,000
<b>Texas</b>	
First Victoria National Bank, Victoria (010360)	855,194,000
and Planters & Merchants State Bank, Hearne, Texas	187,383,000
merged on August 31, 2005, under the title of <b>First Victoria National Bank, Victoria</b> (010360)	1,041,184,000

MERGERS □

**Affiliated mergers (mergers consummated involving two or more affiliated operating banks), from July 1 to September 30, 2005, by state**

Title and location (charter number)	Total assets
<b>Iowa</b>	
The First National Bank of Waverly, Waverly (003105)	154,758,000
and The First National Bank of Cedar Falls, Cedar Falls, Iowa (023640)	52,368,000
merged on August 19, 2005, under the title of <b>First National Bank, Waverly</b> (003105)	205,627,000
<b>Kentucky</b>	
First Southern National Bank, Lancaster (001493)	377,000,000
and The Citizens National Bank of Russellville, Russellville, Kentucky (006546)	167,000,000
and Citizens State Bank of Ballard County, Wickliffe, Kentucky	57,000,000
and First Bank and Trust Co. of Princeton, Kentucky, Princeton, Kentucky	85,000,000
merged on July 1, 2005, under the title of <b>First Southern National Bank, Lancaster</b> (001493)	686,000,000
<b>Minnesota</b>	
The First National Bank of Deerwood, Deerwood (009703)	150,405,000
and Northland Community Bank, Northome, Minnesota	52,792,000
merged on July 14, 2005, under the title of <b>The First National Bank of Deerwood, Deerwood</b> (009703)	203,424,000
<b>Nebraska</b>	
First National Bank, Sidney (018339)	139,063,000
and First National Bank, Torrington, Torrington, Wyoming (014506)	161,702,000
merged on September 12, 2005, under the title of <b>First National Bank, Sidney</b> (018339)	300,765,000
<b>New Jersey</b>	
Monmouth Community Bank, National Association, Long Branch (024240)	276,517,000
and Allaire Community Bank, Sea Girt, New Jersey	197,319,000
merged on August 22, 2005, under the title of <b>Central Jersey Bank, National Association, Long Branch</b> (024240)	473,836,000
<b>Ohio</b>	
KeyBank National Association, Cleveland (014761)	77,374,961,000
and EverTrust Asset Management, Seattle, Washington	372,000
merged on August 1, 2005, under the title of <b>KeyBank National Association, Cleveland</b> (014761)	78,246,717,000
First Financial Bank, National Association, Hamilton (000056)	1,962,777,000
and Community First Bank & Trust, Celina, Ohio	928,845,000
and Sand Ridge Bank, Highland, Indiana	872,891,000
merged on August 19, 2005, under the title of <b>First Financial Bank, National Association, Hamilton</b> (000056)	3,764,513,000
<b>Pennsylvania</b>	
Commerce Bank, National Association, Cherry Hill (017094)	14,305,670,000
and Commerce Bank/Pennsylvania, National Association, Philadelphia, Pennsylvania (018273)	6,446,659,000
merged on July 29, 2005, under the title of <b>Commerce Bank, National Association, Philadelphia</b> (017094)	22,032,151,000
<b>South Dakota</b>	
Citibank USA, National Association, Sioux Falls (024281)	5,635,306,000
and Associates Capital Bank, Inc., Salt Lake City, Utah	172,363,000
merged on September 15, 2005, under the title of <b>Citibank USA, National Association, Sioux Falls</b> (024281)	5,957,669,000
<b>Tennessee</b>	
First Tennessee Bank National Association, Memphis (000336)	29,664,310,000
and United Bank and Trust Company, Saint Petersburg, Florida	1,000
merged on July 22, 2005, under the title of <b>First Tennessee Bank National Association, Memphis</b> (000336)	29,670,810,000
FSGBank, National Association, Chattanooga (024425)	795,021,000
and Jackson Bank & Trust, Gainesboro, Tennessee	170,645,000
merged on August 31, 2005, under the title of <b>FSGBank, National Association, Chattanooga</b> (024425)	983,774,000

MERGERS □

**Affiliated mergers (mergers consummated involving two or more affiliated operating banks), from July 1 to September 30, 2005 (continued)**

Title and location (charter number)	Total assets
<b>Texas</b>	
The First National Bank of Seymour, Seymour (004263)	29,495,000
and First State Bank of Matador, Matador, Texas	12,206,000
merged on July 22, 2005, under the title of <b>The First National Bank of Seymour, Seymour</b> (004263)	41,690,000
Inter National Bank, McAllen (018480)	953,320,000
and City National Bank, Weslaco, Texas (016883)	68,139,000
merged on August 19, 2005, under the title of <b>Inter National Bank, McAllen</b> (018480)	1,015,659,000
<b>Wisconsin</b>	
Associated Bank, National Association, Green Bay (023695)	18,097,424,000
and Associated Bank Minnesota National Association, Minneapolis, Minnesota (023582)	1,896,951,000
and Associated Bank Chicago, Chicago, Illinois	769,803,000
merged on July 15, 2005, under the title of <b>Associated Bank, National Association, Green Bay</b> (023695)	20,906,853,000

## MERGERS

### **Affiliated merger—thrift (merger consummated involving affiliated national banks and savings and loan associations), from July 1 through September 30, 2005**

<b>Title and location (charter number)</b>	<b>Total assets</b>
<b>Illinois</b>	
The First National Bank of Danville, Danville (000113)	181,314,000
and American Savings Bank of Danville, Danville, Illinois	51,474,000
merged on August 26, 2005, under the title of <b>The First National Bank of Danville, Danville</b> (000113)	230,288,000

*Quarterly  
Journal*

FINANCIAL PERFORMANCE □  
OF NATIONAL BANKS □

# FINANCIAL PERFORMANCE OF NATIONAL BANKS

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FINANCIAL PERFORMANCE OF NATIONAL BANKS

**Assets, liabilities, and capital accounts of national banks**  
**September 30, 2004 and September 30, 2005**  
(Dollar figures in millions)

	September 30, 2004	September 30, 2005	Change September 30, 2004- September 30, 2005 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
<b>Number of institutions</b>	<b>1,936</b>	<b>1,846</b>	<b>(90)</b>	<b>(4.65)</b>
<b>Total assets</b>	<b>\$4,846,508</b>	<b>\$5,946,140</b>	<b>\$1,099,632</b>	<b>22.69</b>
<b>Cash and balances due from depositories</b>	<b>214,527</b>	<b>247,675</b>	<b>33,148</b>	<b>15.45</b>
Noninterest-bearing balances, currency and coin	141,744	170,716	28,973	20.44
Interest bearing balances	72,784	76,959	4,175	5.74
<b>Securities</b>	<b>799,516</b>	<b>937,653</b>	<b>138,137</b>	<b>17.28</b>
Held-to-maturity securities, amortized cost	31,991	37,267	5,276	16.49
Available-for-sale securities, fair value	767,525	900,386	132,861	17.31
<b>Federal funds sold and securities purchased</b>	<b>190,430</b>	<b>355,747</b>	<b>165,318</b>	<b>86.81</b>
<b>Net loans and leases</b>	<b>2,901,035</b>	<b>3,328,788</b>	<b>427,753</b>	<b>14.74</b>
Total loans and leases	2,949,222	3,375,428	426,207	14.45
Loans and leases, gross	2,951,259	3,377,360	426,100	14.44
Less: Unearned income	2,038	1,931	(106)	(5.22)
Less: Reserve for losses	48,187	46,640	(1,546)	(3.21)
<b>Assets held in trading account</b>	<b>240,388</b>	<b>489,337</b>	<b>248,949</b>	<b>103.56</b>
<b>Other real estate owned</b>	<b>1,622</b>	<b>1,626</b>	<b>4</b>	<b>0.26</b>
<b>Intangible assets</b>	<b>204,734</b>	<b>229,500</b>	<b>24,767</b>	<b>12.10</b>
<b>All other assets</b>	<b>294,257</b>	<b>355,814</b>	<b>61,557</b>	<b>20.92</b>
<b>Total liabilities and equity capital</b>	<b>4,846,508</b>	<b>5,946,140</b>	<b>1,099,632</b>	<b>22.69</b>
Deposits in domestic offices	2,554,456	3,012,881	458,425	17.95
Deposits in foreign offices	565,497	747,606	182,109	32.20
<b>Total deposits</b>	<b>3,119,953</b>	<b>3,760,487</b>	<b>640,534</b>	<b>20.53</b>
Noninterest-bearing deposits	590,455	809,937	219,482	37.17
Interest-bearing deposits	2,529,498	2,950,550	421,053	16.65
<b>Federal funds purchased and securities sold</b>	<b>327,303</b>	<b>489,517</b>	<b>162,214</b>	<b>49.56</b>
<b>Other borrowed money</b>	<b>543,124</b>	<b>551,997</b>	<b>8,873</b>	<b>1.63</b>
<b>Trading liabilities less revaluation losses</b>	<b>35,136</b>	<b>123,942</b>	<b>88,806</b>	<b>252.75</b>
<b>Subordinated notes and debentures</b>	<b>72,922</b>	<b>96,852</b>	<b>23,930</b>	<b>32.82</b>
<b>All other liabilities</b>	<b>242,351</b>	<b>337,718</b>	<b>95,367</b>	<b>39.35</b>
Trading liabilities revaluation losses	90,094	136,495	46,400	51.50
Other	152,257	201,224	48,967	32.16
<b>Total equity capital</b>	<b>505,719</b>	<b>585,626</b>	<b>79,908</b>	<b>15.80</b>
Perpetual preferred stock	2,515	3,353	838	33.30
Common stock	11,936	14,362	2,426	20.32
Surplus	324,192	360,313	36,120	11.14
Retained earnings and other comprehensive income	165,956	197,406	31,450	18.95
Other equity capital components	(62)	(152)	(90)	NM

NM indicates calculated percent change is not meaningful.

FINANCIAL PERFORMANCE OF NATIONAL BANKS

Quarterly income and expenses of national banks  
Third quarter 2004 and third quarter 2005  
(Dollar figures in millions)

	Third quarter 2004	Third quarter 2005	Change Third quarter, 2004- third quarter, 2005 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
<b>Number of institutions</b>	<b>1,936</b>	<b>1,846</b>	<b>(90)</b>	<b>(4.65)</b>
<b>Net income</b>	<b>\$17,782</b>	<b>\$19,318</b>	<b>\$1,536</b>	<b>8.64</b>
<b>Net interest income</b>	<b>40,143</b>	<b>43,058</b>	<b>2,914</b>	<b>7.26</b>
Total interest income	55,271	72,819	17,548	31.75
On loans	42,973	54,422	11,449	26.64
From lease financing receivables	1,278	1,291	12	0.95
On balances due from depositories	331	812	482	145.64
On securities	8,567	10,417	1,850	21.59
From assets held in trading account	1,124	3,099	1,975	175.64
On federal funds sold and securities repurchased	639	2,352	1,713	268.13
Less: Interest expense	15,128	29,762	14,634	96.73
On deposits	9,539	18,112	8,573	89.87
Of federal funds purchased and securities sold	1,476	4,022	2,546	172.53
On demand notes and other borrowed money*	3,326	6,209	2,882	86.66
On subordinated notes and debentures	787	1,419	632	80.31
<b>Less: Provision for losses</b>	<b>5,093</b>	<b>6,412</b>	<b>1,319</b>	<b>25.91</b>
<b>Noninterest income</b>	<b>28,884</b>	<b>39,084</b>	<b>10,201</b>	<b>35.32</b>
From fiduciary activities	2,283	3,204	922	40.37
Service charges on deposits	5,689	6,252	563	9.90
Trading revenue	936	4,400	3,464	NM
From interest rate exposures	(193)	2,136	2,329	NM
From foreign exchange exposures	875	997	122	13.98
From equity security and index exposures	136	802	666	NM
From commodity and other exposures	(15)	508	523	NM
Investment banking brokerage fees	1,318	1,964	646	49.05
Venture capital revenue	58	274	216	NM
Net servicing fees	2,658	3,573	915	34.43
Net securitization income	4,811	4,832	22	0.46
Insurance commissions and fees	683	613	(70)	(10.25)
Insurance and reinsurance underwriting income	144	88	(56)	(38.92)
Income from other insurance activities	540	526	(14)	(2.62)
Net gains on asset sales	1,290	1,014	(276)	(21.40)
Sales of loans and leases	1,058	609	(449)	(42.45)
Sales of other real estate owned	21	20	(1)	(6.97)
Sales of other assets(excluding securities)	211	386	175	82.77
Other noninterest income	9,270	12,957	3,687	39.77
<b>Gains/losses on securities</b>	<b>1,163</b>	<b>124</b>	<b>(1,039)</b>	<b>(89.32)</b>
<b>Less: Noninterest expense</b>	<b>39,086</b>	<b>47,046</b>	<b>7,959</b>	<b>20.36</b>
Salaries and employee benefits	16,516	20,769	4,253	25.75
Of premises and fixed assets	4,658	5,993	1,336	28.68
Goodwill impairment losses	1	5	4	446.36
Amortization expense and impairment losses	1,571	1,498	(73)	(4.65)
Other noninterest expense	16,341	18,781	2,440	14.93
<b>Less: Taxes on income before extraordinary items</b>	<b>8,234</b>	<b>9,480</b>	<b>1,246</b>	<b>15.13</b>
<b>Income/loss from extraordinary items, net of income taxes</b>	<b>5</b>	<b>(11)</b>	<b>(16)</b>	<b>NM</b>
<b>Memoranda:</b>				
Net operating income	16,894	19,221	2,328	13.78
Income before taxes and extraordinary items	26,011	28,808	2,797	10.75
Income net of taxes before extraordinary items	17,777	19,328	1,552	8.73
Cash dividends declared	9,474	13,336	3,861	40.76
Net charge-offs to loan and lease reserve	4,980	6,200	1,220	24.50
Charge-offs to loan and lease reserve	6,652	8,140	1,488	22.37
Less: Recoveries credited to loan and lease reserve	1,672	1,940	268	16.02

\* Includes mortgage indebtedness

NM indicates calculated percent change is not meaningful.

FINANCIAL PERFORMANCE OF NATIONAL BANKS

Year-to-date income and expenses of national banks  
Through September 30, 2004, and through September 30, 2005  
(Dollar figures in millions)

	September 30, 2004	September 30, 2005	Change September 30, 2004- September 30, 2005 fully consolidated	
	Consolidated foreign and domestic	Consolidated foreign and domestic	Amount	Percent
<b>Number of institutions</b>	<b>1,936</b>	<b>1,846</b>	<b>(90)</b>	<b>(4.65)</b>
<b>Net income</b>	<b>\$48,894</b>	<b>\$56,799</b>	<b>\$7,905</b>	<b>16.17</b>
<b>Net interest income</b>	<b>111,008</b>	<b>127,666</b>	<b>16,659</b>	<b>15.01</b>
Total interest income	149,750	205,788	56,038	37.42
On loans	116,022	152,547	36,524	31.48
From lease financing receivables	3,573	4,050	477	13.35
On balances due from depositories	944	2,289	1,345	142.39
On securities	23,385	30,738	7,353	31.44
From assets held in trading account	3,198	9,206	6,008	187.84
On federal funds sold and securities repurchased	1,650	5,695	4,045	245.16
Less: Interest expense	38,742	78,122	39,379	101.64
On deposits	24,751	47,292	22,541	91.07
Of federal funds purchased and securities sold	3,578	9,751	6,174	172.55
On demand notes and other borrowed money*	8,298	17,046	8,748	105.41
On subordinated notes and debentures	2,115	4,033	1,918	90.65
<b>Less: Provision for losses</b>	<b>14,722</b>	<b>14,987</b>	<b>265</b>	<b>1.80</b>
<b>Noninterest income</b>	<b>82,331</b>	<b>111,750</b>	<b>29,419</b>	<b>35.73</b>
From fiduciary activities	6,531	9,528	2,997	45.89
Service charges on deposits	15,199	17,735	2,537	16.69
Trading revenue	4,049	10,412	6,363	157.16
From interest rate exposures	460	4,057	3,597	781.87
From foreign exchange exposures	2,507	3,721	1,214	48.42
From equity security and index exposures	662	1,739	1,077	162.63
From commodity and other exposures	416	886	470	112.81
Investment banking brokerage fees	3,575	6,069	2,494	69.76
Venture capital revenue	100	530	430	427.87
Net servicing fees	9,115	9,438	323	3.54
Net securitization income	11,801	14,205	2,405	20.38
Insurance commissions and fees	1,821	1,887	66	3.63
Insurance and reinsurance underwriting income	396	390	(6)	(1.54)
Income from other insurance activities	1,425	1,497	72	5.07
Net gains on asset sales	4,776	3,823	(953)	(19.95)
Sales of loans and leases	3,159	2,914	(245)	(7.75)
Sales of other real estate owned	74	67	(7)	(9.21)
Sales of other assets(excluding securities)	1,543	842	(701)	(45.45)
Other noninterest income	25,365	38,123	12,758	50.30
<b>Gains/losses on securities</b>	<b>2,806</b>	<b>693</b>	<b>(2,113)</b>	<b>(75.31)</b>
<b>Less: Noninterest expense</b>	<b>108,945</b>	<b>140,535</b>	<b>31,589</b>	<b>29.00</b>
Salaries and employee benefits	45,681	61,080	15,398	33.71
Of premises and fixed assets	12,707	17,898	5,191	40.85
Goodwill impairment losses	11	13	3	26.87
Amortization expense and impairment losses	3,677	4,586	909	24.72
Other noninterest expense	46,870	56,958	10,088	21.52
<b>Less: Taxes on income before extraordinary items</b>	<b>23,581</b>	<b>27,771</b>	<b>4,190</b>	<b>17.77</b>
<b>Income/loss from extraordinary items, net of income taxes</b>	<b>(3)</b>	<b>(18)</b>	<b>(15)</b>	<b>NM</b>
<b>Memoranda:</b>				
Net operating income	46,903	56,339	9,436	20.12
Income before taxes and extraordinary items	72,478	84,588	12,110	16.71
Income net of taxes before extraordinary items	48,897	56,817	7,920	16.20
Cash dividends declared	22,700	33,086	10,386	45.75
Net charge-offs to loan and lease reserve	15,518	16,009	491	3.16
Charge-offs to loan and lease reserve	19,977	21,491	1,514	7.58
Less: Recoveries credited to loan and lease reserve	4,459	5,481	1,023	22.94

\* Includes mortgage indebtedness

NM indicates calculated percent change is not meaningful.

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

**Assets of national banks by asset size**  
**September 30, 2005**  
 (Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
<b>Total assets</b>	<b>\$5,946,140</b>	<b>\$39,795</b>	<b>\$269,469</b>	<b>\$354,377</b>	<b>\$5,282,499</b>	<b>\$8,903,605</b>
<b>Cash and balances due from</b>	<b>247,675</b>	<b>2,292</b>	<b>11,348</b>	<b>15,914</b>	<b>218,121</b>	<b>384,706</b>
<b>Securities</b>	<b>937,653</b>	<b>10,665</b>	<b>61,146</b>	<b>72,851</b>	<b>792,991</b>	<b>1,584,036</b>
<b>Federal funds sold and securities purchased</b>	<b>355,747</b>	<b>1,586</b>	<b>8,912</b>	<b>17,158</b>	<b>328,092</b>	<b>423,101</b>
<b>Net loans and leases</b>	<b>3,328,788</b>	<b>23,390</b>	<b>172,014</b>	<b>222,607</b>	<b>2,910,778</b>	<b>5,194,948</b>
Total loans and leases	3,375,428	23,724	174,240	225,392	2,952,072	5,265,929
Loans and leases, gross	3,377,360	23,743	174,402	225,534	2,953,681	5,268,949
Less: Unearned income	1,931	19	162	141	1,609	3,020
Less: Reserve for losses	46,640	335	2,226	2,785	41,294	70,981
<b>Assets held in trading account</b>	<b>489,337</b>	<b>0</b>	<b>128</b>	<b>395</b>	<b>488,814</b>	<b>520,405</b>
<b>Other real estate owned</b>	<b>1,626</b>	<b>53</b>	<b>235</b>	<b>123</b>	<b>1,215</b>	<b>3,327</b>
<b>Intangible assets</b>	<b>229,500</b>	<b>102</b>	<b>3,408</b>	<b>9,242</b>	<b>216,748</b>	<b>291,808</b>
<b>All other assets</b>	<b>355,814</b>	<b>1,707</b>	<b>12,280</b>	<b>16,088</b>	<b>325,740</b>	<b>501,276</b>
<b>Gross loans and leases by type:</b>						
<b>Loans secured by real estate</b>	<b>1,725,495</b>	<b>14,761</b>	<b>124,044</b>	<b>148,042</b>	<b>1,438,648</b>	<b>2,921,130</b>
1- to 4-family residential mortgages	816,966	5,913	38,623	48,789	723,641	1,206,844
Home equity loans	326,737	471	6,920	11,836	307,510	436,965
Multifamily residential mortgages	44,256	356	4,105	7,265	32,530	96,376
Commercial RE loans	320,858	4,626	48,875	49,553	217,803	721,563
Construction RE loans	157,226	1,538	19,377	27,098	109,212	363,521
Farmland loans	15,569	1,856	6,141	2,612	4,959	47,240
RE loans from foreign offices	43,883	0	2	890	42,992	48,622
<b>Commercial and industrial loans</b>	<b>649,128</b>	<b>3,688</b>	<b>26,887</b>	<b>47,003</b>	<b>571,549</b>	<b>988,202</b>
<b>Loans to individuals</b>	<b>610,208</b>	<b>2,471</b>	<b>13,951</b>	<b>21,027</b>	<b>572,759</b>	<b>831,363</b>
Credit cards	275,685	58	1,624	3,424	270,578	338,934
Other revolving credit plans	34,956	54	414	1,117	33,371	40,324
Installment loans	299,567	2,359	11,913	16,485	268,810	452,105
<b>All other loans and leases</b>	<b>392,529</b>	<b>2,823</b>	<b>9,519</b>	<b>9,461</b>	<b>370,725</b>	<b>528,111</b>
<b>Securities by type:</b>						
<b>U.S. Treasury securities</b>	<b>34,477</b>	<b>404</b>	<b>1,644</b>	<b>2,737</b>	<b>29,693</b>	<b>58,391</b>
<b>Mortgage-backed securities</b>	<b>590,451</b>	<b>2,289</b>	<b>20,238</b>	<b>38,000</b>	<b>529,923</b>	<b>902,879</b>
Pass-through securities	449,603	1,813	14,484	19,657	413,649	604,702
Collateralized mortgage obligations	140,848	477	5,754	18,343	116,274	298,177
<b>Other securities</b>	<b>273,833</b>	<b>7,970</b>	<b>38,960</b>	<b>31,285</b>	<b>195,617</b>	<b>545,968</b>
Other U.S. government securities	88,552	5,913	24,175	18,738	39,726	271,279
State and local government securities	58,656	1,783	12,329	8,065	36,479	119,268
Other debt securities	120,566	173	1,799	3,918	114,676	141,501
Equity securities	6,059	101	657	564	4,737	13,920
<b>Memoranda:</b>						
Agricultural production loans	20,554	2,423	5,794	2,298	10,039	50,523
Pledged securities	507,828	4,378	31,341	39,460	432,648	847,749
Book value of securities	942,802	10,754	61,534	73,371	797,143	1,592,963
Available-for-sale securities	905,535	9,175	54,047	66,013	776,299	1,463,690
Held-to-maturity securities	37,267	1,578	7,487	7,358	20,844	129,273
Market value of securities	937,616	10,657	61,123	72,853	792,982	1,583,653
Available-for-sale securities	900,386	9,087	53,659	65,493	772,147	1,454,762
Held-to-maturity securities	37,231	1,570	7,464	7,361	20,835	128,891

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

### Past-due and nonaccrual loans and leases of national banks by asset size September 30, 2005 (Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
<b>Loans and leases past due 30-89 days</b>	<b>\$29,328</b>	<b>\$293</b>	<b>\$1,434</b>	<b>\$1,709</b>	<b>\$25,892</b>	<b>\$43,622</b>
<b>Loans secured by real estate</b>	<b>13,049</b>	<b>168</b>	<b>886</b>	<b>768</b>	<b>11,227</b>	<b>20,939</b>
1- to 4-family residential mortgages	8,271	95	407	320	7,448	11,947
Home equity loans	1,504	2	26	35	1,440	1,926
Multifamily residential mortgages	186	3	17	23	143	393
Commercial RE loans	1,594	41	255	250	1,049	3,735
Construction RE loans	914	13	151	129	620	2,113
Farmland loans	85	13	29	11	32	252
RE loans from foreign offices	495	0	0	0	495	573
<b>Commercial and industrial loans</b>	<b>3,822</b>	<b>51</b>	<b>273</b>	<b>658</b>	<b>2,840</b>	<b>6,258</b>
<b>Loans to individuals</b>	<b>11,148</b>	<b>56</b>	<b>223</b>	<b>233</b>	<b>10,636</b>	<b>14,558</b>
Credit cards	6,358	1	47	63	6,247	7,522
Installment loans and other plans	4,790	55	176	169	4,389	7,036
<b>All other loans and leases</b>	<b>1,309</b>	<b>18</b>	<b>52</b>	<b>51</b>	<b>1,189</b>	<b>1,866</b>
<b>Loans and leases past due 90+ days</b>	<b>12,513</b>	<b>68</b>	<b>274</b>	<b>257</b>	<b>11,915</b>	<b>15,855</b>
<b>Loans secured by real estate</b>	<b>5,050</b>	<b>37</b>	<b>167</b>	<b>106</b>	<b>4,741</b>	<b>6,664</b>
1- to 4-family residential mortgages	4,526	22	75	45	4,383	5,478
Home equity loans	140	0	3	3	133	223
Multifamily residential mortgages	24	1	4	4	15	53
Commercial RE loans	158	6	52	18	82	480
Construction RE loans	135	3	25	33	73	294
Farmland loans	23	5	8	1	9	85
RE loans from foreign offices	45	0	0	0	45	51
<b>Commercial and industrial loans</b>	<b>544</b>	<b>12</b>	<b>43</b>	<b>93</b>	<b>395</b>	<b>1,053</b>
<b>Loans to individuals</b>	<b>6,774</b>	<b>9</b>	<b>51</b>	<b>49</b>	<b>6,665</b>	<b>7,904</b>
Credit cards	4,807	1	27	26	4,753	5,559
Installment loans and other plans	1,966	9	24	22	1,911	2,345
<b>All other loans and leases</b>	<b>146</b>	<b>10</b>	<b>13</b>	<b>9</b>	<b>114</b>	<b>234</b>
<b>Nonaccrual loans and leases</b>	<b>15,046</b>	<b>182</b>	<b>967</b>	<b>1,100</b>	<b>12,797</b>	<b>23,709</b>
<b>Loans secured by real estate</b>	<b>7,638</b>	<b>103</b>	<b>671</b>	<b>695</b>	<b>6,168</b>	<b>12,666</b>
1- to 4-family residential mortgages	3,588	32	194	222	3,140	5,465
Home equity loans	549	1	9	18	521	696
Multifamily residential mortgages	162	3	16	14	129	282
Commercial RE loans	2,005	48	311	351	1,295	4,041
Construction RE loans	548	6	97	68	377	1,133
Farmland loans	143	13	44	23	64	335
RE loans from foreign offices	642	0	0	0	642	715
<b>Commercial and industrial loans</b>	<b>5,035</b>	<b>50</b>	<b>225</b>	<b>314</b>	<b>4,446</b>	<b>7,633</b>
<b>Loans to individuals</b>	<b>1,459</b>	<b>11</b>	<b>30</b>	<b>56</b>	<b>1,361</b>	<b>2,107</b>
Credit cards	458	0	1	21	436	756
Installment loans and other plans	1,001	11	29	35	925	1,350
<b>All other loans and leases</b>	<b>976</b>	<b>17</b>	<b>40</b>	<b>36</b>	<b>882</b>	<b>1,390</b>

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

### Liabilities of national banks by asset size September 30, 2005 (Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	1,846	711	961	127	47	7,541
<b>Total liabilities and equity capital</b>	<b>5,946,140</b>	<b>39,795</b>	<b>269,469</b>	<b>354,377</b>	<b>5,282,499</b>	<b>8,903,605</b>
Deposits in domestic offices	3,012,881	33,036	217,275	241,103	2,521,467	5,014,276
Deposits in foreign offices	747,606	14	248	3,042	744,302	902,751
<b>Total deposits</b>	<b>3,760,487</b>	<b>33,051</b>	<b>217,523</b>	<b>244,145</b>	<b>3,265,769</b>	<b>5,917,027</b>
Noninterest bearing	809,937	6,162	38,378	44,386	721,011	1,175,370
Interest bearing	2,950,550	26,888	179,144	199,759	2,544,759	4,741,657
<b>Federal funds purchased and securities sold</b>	<b>489,517</b>	<b>538</b>	<b>7,057</b>	<b>29,032</b>	<b>452,890</b>	<b>669,648</b>
<b>Other borrowed funds</b>	<b>551,997</b>	<b>1,286</b>	<b>13,900</b>	<b>35,183</b>	<b>501,628</b>	<b>769,332</b>
<b>Trading liabilities less revaluation losses</b>	<b>123,942</b>	<b>0</b>	<b>0</b>	<b>1</b>	<b>123,941</b>	<b>124,180</b>
<b>Subordinated notes and debentures</b>	<b>96,852</b>	<b>0</b>	<b>203</b>	<b>1,163</b>	<b>95,485</b>	<b>116,911</b>
<b>All other liabilities</b>	<b>337,718</b>	<b>276</b>	<b>2,518</b>	<b>6,713</b>	<b>328,211</b>	<b>407,099</b>
<b>Equity capital</b>	<b>585,626</b>	<b>4,643</b>	<b>28,269</b>	<b>38,140</b>	<b>514,574</b>	<b>899,409</b>
<b>Total deposits by depositor:</b>						
Individuals and corporations	3,021,512	19,909	150,445	195,910	2,655,248	4,737,974
U.S., state, and local governments	131,994	3,006	16,844	15,625	96,519	247,949
Depositories in the U.S.	65,362	483	3,770	2,950	58,158	94,254
Foreign banks and governments	208,312	1	302	393	207,616	227,416
<b>Domestic deposits by depositor:</b>						
Individuals and corporations	2,493,001	19,897	150,362	193,012	2,129,731	4,076,460
U.S., state, and local governments	131,994	3,006	16,844	15,625	96,519	247,949
Depositories in the U.S.	36,930	483	3,770	2,950	29,727	60,150
Foreign banks and governments	18,103	1	136	250	17,716	20,790
<b>Foreign deposits by depositor:</b>						
Individuals and corporations	528510.405	12	82	2,899	525,518	661,514
Depositories in the U.S.	28431.863	0	0	0	28,432	34,104
Foreign banks and governments	190,209	0	165	144	189,900	206,626
<b>Deposits in domestic offices by type:</b>						
<b>Transaction deposits</b>	<b>395,720</b>	<b>10,949</b>	<b>52,386</b>	<b>33,406</b>	<b>298,979</b>	<b>713,174</b>
Demand deposits	305,133	6,005	31,271	24,783	243,073	520,307
<b>Savings deposits</b>	<b>1,795,601</b>	<b>7,694</b>	<b>73,865</b>	<b>126,750</b>	<b>1,587,292</b>	<b>2,710,318</b>
Money market deposit accounts	1318563.914	3,982	41,977	93,304	1,179,301	1,971,407
Other savings deposits	477037.174	3,712	31,889	33,445	407,991	738,911
<b>Time deposits</b>	<b>821,560</b>	<b>14,393</b>	<b>91,024</b>	<b>80,947</b>	<b>635,196</b>	<b>1,590,507</b>
Small time deposits	365,094	9,255	52,435	39,375	264,029	735,180
Large time deposits	456,466	5,138	38,588	41,572	371,167	855,327

FINANCIAL PERFORMANCE OF NATIONAL BANKS

Off-balance-sheet items of national banks by asset size  
September 30, 2005  
(Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
<b>Unused commitments</b>	<b>\$4,694,156</b>	<b>\$56,620</b>	<b>\$141,396</b>	<b>\$685,981</b>	<b>\$3,810,158</b>	<b>\$6,004,966</b>
Home equity lines	350,235	342	5,803	11,810	332,280	457,922
Credit card lines	2,874,490	53,127	105,250	618,917	2,097,196	3,442,354
Commercial RE, construction and land	164,002	917	11,447	22,159	129,479	306,165
All other unused commitments	1,305,430	2,235	18,897	33,096	1,251,203	1,798,525
<b>Letters of credit:</b>						
<b>Standby letters of credit</b>	<b>266,848</b>	<b>111</b>	<b>1,877</b>	<b>4,854</b>	<b>260,005</b>	<b>352,445</b>
Financial letters of credit	223,440	64	1,198	3,483	218,695	300,124
Performance letters of credit	43,407	47	679	1,370	41,311	52,322
<b>Commercial letters of credit</b>	<b>25,216</b>	<b>15</b>	<b>230</b>	<b>604</b>	<b>24,368</b>	<b>29,618</b>
<b>Securities lent</b>	<b>532,026</b>	<b>24</b>	<b>20</b>	<b>986</b>	<b>530,996</b>	<b>1,353,805</b>
<b>Spot foreign exchange contracts</b>	<b>747,946</b>	<b>0</b>	<b>2</b>	<b>77</b>	<b>747,867</b>	<b>800,468</b>
<b>Credit derivatives (notional value)</b>						
Reporting bank is the guarantor	2,368,089	0	0	0	2,368,089	2,369,460
Reporting bank is the beneficiary	2,710,758	0	40	0	2,710,718	2,724,212
<b>Derivative contracts (notional value)</b>	<b>96,992,909</b>	<b>21</b>	<b>4,161</b>	<b>17,349</b>	<b>96,971,378</b>	<b>98,783,602</b>
Futures and forward contracts	11,254,597	4	1,307	3,780	11,249,506	11,926,969
Interest rate contracts	6,902,613	4	1,295	2,285	6,899,029	6,999,076
Foreign exchange contracts	4,174,470	0	10	1,495	4,172,966	4,746,726
All other futures and forwards	177,513	0	1	0	177,512	181,167
Option contracts	19,173,783	12	1,506	3,039	19,169,226	19,636,311
Interest rate contracts	15,728,391	10	1,457	2,385	15,724,540	16,147,897
Foreign exchange contracts	2,047,743	0	1	642	2,047,099	2,075,213
All other options	1,397,649	2	48	12	1,397,587	1,413,201
Swaps	61,485,681	5	1,309	10,529	61,473,838	62,126,649
Interest rate contracts	59,147,355	5	1,293	10,496	59,135,561	59,737,703
Foreign exchange contracts	2,059,788	0	0	0	2,059,788	2,101,945
All other swaps	278,539	0	16	33	278,489	287,001
<b>Memoranda: Derivatives by purpose</b>						
Contracts held for trading	89,660,962	0	64	5,291	89,655,607	91,135,353
Contracts not held for trading	2,253,099	21	4,057	12,058	2,236,963	2,554,577
<b>Memoranda: Derivatives by position</b>						
Held for trading--positive fair value	1,320,278	0	1	15	1,320,262	1,336,099
Held for trading--negative fair value	1,298,263	0	1	10	1,298,252	1,315,079
Not for trading--positive fair value	12,859	1	16	32	12,810	15,004
Not for trading--negative fair value	12,399	0	24	104	12,271	14,859

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

 Quarterly income and expenses of national banks by asset size  
 Third quarter, 2005  
 (Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
<b>Net income</b>	<b>\$19,318</b>	<b>\$109</b>	<b>\$893</b>	<b>\$1,301</b>	<b>\$17,015</b>	<b>\$29,776</b>
<b>Net interest income</b>	<b>43,058</b>	<b>390</b>	<b>2,539</b>	<b>3,007</b>	<b>37,121</b>	<b>68,568</b>
Total interest income	72,819	554	3,762	4,723	63,781	112,736
On loans	54,422	430	3,044	3,745	47,204	85,433
From lease financing receivables	1,291	2	15	46	1,228	1,810
On balances due from depositories	812	6	21	39	746	1,253
On securities	10,417	98	589	724	9,006	16,980
From assets held in trading account	3,099	0	1	8	3,090	3,332
On fed. funds sold & securities repurchased	2,352	15	72	130	2,135	2,889
Less: Interest expense	29,762	164	1,223	1,716	26,659	44,168
On deposits	18,112	147	1,027	1,114	15,825	28,570
Of federal funds purchased & securities sold	4,022	4	50	229	3,740	5,557
On demand notes & other borrowed money*	6,209	13	143	357	5,696	8,308
On subordinated notes and debentures	1,419	0	3	16	1,399	1,677
<b>Less: Provision for losses</b>	<b>6,412</b>	<b>16</b>	<b>142</b>	<b>212</b>	<b>6,042</b>	<b>8,159</b>
<b>Noninterest income</b>	<b>39,084</b>	<b>144</b>	<b>1,325</b>	<b>2,312</b>	<b>35,304</b>	<b>53,692</b>
From fiduciary activities	3,204	12	179	466	2,547	6,035
Service charges on deposits	6,252	45	330	314	5,564	8,932
Trading revenue	4,400	0	1	9	4,390	4,820
From interest rate exposures	2,136	0	1	5	2,130	1,651
From foreign exchange exposures	997	0	0	(3)	1,000	1,454
From equity security and index exposures	802	0	0	0	802	1,244
From commodity and other exposures	508	0	0	(0)	508	507
Investment banking brokerage fees	1,964	1	19	41	1,904	2,388
Venture capital revenue	274	0	(0)	(0)	274	275
Net servicing fees	3,573	31	106	127	3,310	4,398
Net securitization income	4,832	0	101	26	4,705	5,916
Insurance commissions and fees	613	10	20	30	554	1,071
Insurance and reinsurance underwriting income	88	0	0	3	85	113
Income from other insurance activities	526	10	20	27	469	958
Net gains on asset sales	1,014	4	89	544	378	1,902
Sales of loans and leases	609	4	84	542	(21)	1,371
Sales of other real estate owned	20	(0)	(0)	1	20	28
Sales of other assets(excluding securities)	386	0	5	1	379	504
Other noninterest income	12,957	40	480	758	11,678	17,959
<b>Gains/losses on securities</b>	<b>124</b>	<b>(2)</b>	<b>1</b>	<b>11</b>	<b>114</b>	<b>104</b>
<b>Less: Noninterest expense</b>	<b>47,046</b>	<b>375</b>	<b>2,507</b>	<b>3,180</b>	<b>40,983</b>	<b>69,996</b>
Salaries and employee benefits	20,769	194	1,197	1,373	18,005	31,384
Of premises and fixed assets	5,993	48	301	321	5,323	8,793
Goodwill impairment losses	5	0	5	0	0	6
Amortization expense and impairment losses	1,498	1	29	100	1,368	1,750
Other noninterest expense	18,781	132	976	1,387	16,287	28,064
<b>Less: Taxes on income before extraord. items</b>	<b>9,480</b>	<b>32</b>	<b>324</b>	<b>639</b>	<b>8,485</b>	<b>14,343</b>
<b>Income/loss from extraord. items, net of taxes</b>	<b>(18)</b>	<b>1</b>	<b>0</b>	<b>2</b>	<b>(21)</b>	<b>(85)</b>
<b>Memoranda:</b>						
Net operating income	19,221	110	892	1,292	16,927	29,772
Income before taxes and extraordinary items	28,808	141	1,216	1,938	25,513	44,209
Income net of taxes before extraordinary items	19,328	109	893	1,298	17,028	29,866
Cash dividends declared	13,336	58	534	1,168	11,575	19,097
Net loan and lease losses	6,200	10	92	175	5,923	7,702
Charge-offs to loan and lease reserve	8,140	16	128	238	7,758	10,237
Less: Recoveries credited to loan & lease resv.	1,940	6	36	63	1,834	2,535

\* Includes mortgage indebtedness

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

 Year-to-date income and expenses of national banks by asset size  
 Through September 30, 2005  
 (Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
<b>Net income</b>	<b>\$56,799</b>	<b>\$325</b>	<b>\$2,594</b>	<b>\$3,877</b>	<b>\$50,004</b>	<b>\$87,218</b>
<b>Net interest income</b>	<b>127,666</b>	<b>1,134</b>	<b>7,358</b>	<b>8,759</b>	<b>110,415</b>	<b>201,481</b>
Total interest income	205,788	1,571	10,595	13,229	180,393	317,425
On loans	152,547	1,211	8,511	10,469	132,355	238,097
From lease financing receivables	4,050	5	41	135	3,869	5,597
On balances due from depositories	2,289	17	56	96	2,120	3,623
On securities	30,738	290	1,744	2,071	26,633	49,847
From assets held in trading account	9,206	0	8	24	9,175	10,199
On fed. funds sold & securities repurchased	5,695	40	178	343	5,134	7,093
Less: Interest expense	78,122	437	3,237	4,469	69,978	115,944
On deposits	47,292	393	2,701	2,824	41,374	74,314
Of federal funds purchased & securities sold	9,751	9	124	611	9,007	13,839
On demand notes & other borrowed money*	17,046	34	403	990	15,619	23,036
On subordinated notes and debentures	4,033	0	10	45	3,979	4,754
<b>Less: Provision for losses</b>	<b>14,987</b>	<b>46</b>	<b>411</b>	<b>556</b>	<b>13,975</b>	<b>19,551</b>
<b>Noninterest income</b>	<b>111,750</b>	<b>416</b>	<b>3,787</b>	<b>6,711</b>	<b>100,837</b>	<b>153,428</b>
From fiduciary activities	9,528	36	523	1,366	7,603	17,850
Service charges on deposits	17,735	128	940	884	15,783	25,303
Trading revenue	10,412	(0)	3	30	10,379	11,238
From interest rate exposures	4,057	0	4	16	4,037	3,623
From foreign exchange exposures	3,721	0	0	4	3,717	4,437
From equity security and index exposures	1,739	0	0	0	1,739	2,264
From commodity and other exposures	886	0	0	0	886	885
Investment banking brokerage fees	6,069	3	58	118	5,891	7,410
Venture capital revenue	530	0	(1)	4	527	527
Net servicing fees	9,438	91	297	365	8,685	11,530
Net securitization income	14,205	0	313	73	13,820	17,418
Insurance commissions and fees	1,887	29	61	88	1,710	3,280
Insurance and reinsurance underwriting income	390	0	1	8	381	545
Income from other insurance activities	1,497	29	60	79	1,329	2,735
Net gains on asset sales	3,823	12	226	1,642	1,944	6,231
Sales of loans and leases	2,914	10	207	1,597	1,099	4,989
Sales of other real estate owned	67	(0)	3	16	48	124
Sales of other assets(excluding securities)	842	2	16	28	796	1,118
Other noninterest income	38,123	118	1,367	2,142	34,495	52,642
<b>Gains/losses on securities</b>	<b>693</b>	<b>(2)</b>	<b>12</b>	<b>16</b>	<b>667</b>	<b>880</b>
<b>Less: Noninterest expense</b>	<b>140,535</b>	<b>1,086</b>	<b>7,244</b>	<b>9,156</b>	<b>123,048</b>	<b>207,009</b>
Salaries and employee benefits	61,080	563	3,483	3,985	53,048	92,047
Of premises and fixed assets	17,898	137	873	921	15,967	26,138
Goodwill impairment losses	13	2	11	0	0	16
Amortization expense and impairment losses	4,586	3	79	307	4,196	5,317
Other noninterest expense	56,958	380	2,798	3,942	49,838	83,490
<b>Less: Taxes on income before extraord. items</b>	<b>27,771</b>	<b>93</b>	<b>908</b>	<b>1,900</b>	<b>24,871</b>	<b>41,926</b>
<b>Income/loss from extraord. items, net of taxes</b>	<b>(18)</b>	<b>1</b>	<b>0</b>	<b>2</b>	<b>(21)</b>	<b>(85)</b>
<b>Memoranda:</b>						
Net operating income	56,339	326	2,586	3,864	49,563	86,691
Income before taxes and extraordinary items	84,588	417	3,501	5,774	74,895	129,229
Income net of taxes before extraordinary items	56,817	324	2,594	3,874	50,025	87,303
Cash dividends declared	33,086	211	1,495	2,779	28,601	49,277
Net loan and lease losses	16,009	30	280	512	15,188	20,176
Charge-offs to loan and lease reserve	21,491	48	388	719	20,336	27,356
Less: Recoveries credited to loan & lease resv.	5,481	19	108	207	5,148	7,180

\* Includes mortgage indebtedness

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

### Quarterly net loan and lease losses of national banks by asset size Third quarter, 2005 (Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
<b>Net charge-offs to loan and lease reserve</b>	<b>\$6,200</b>	<b>\$10</b>	<b>\$92</b>	<b>\$175</b>	<b>\$5,923</b>	<b>\$7,702</b>
<b>Loans secured by real estate</b>	<b>252</b>	<b>2</b>	<b>18</b>	<b>29</b>	<b>203</b>	<b>459</b>
1- to 4-family residential mortgages	112	1	8	10	93	188
Home equity loans	76	0	0	3	72	107
Multifamily residential mortgages	4	0	2	2	0	14
Commercial RE loans	38	1	5	12	20	107
Construction RE loans	7	0	2	2	3	26
Farmland loans	3	0	1	(0)	2	4
RE loans from foreign offices	13	0	0	0	13	13
<b>Commercial and industrial loans</b>	<b>181</b>	<b>5</b>	<b>20</b>	<b>74</b>	<b>82</b>	<b>485</b>
<b>Loans to individuals</b>	<b>5,392</b>	<b>4</b>	<b>43</b>	<b>58</b>	<b>5,288</b>	<b>6,261</b>
Credit cards	3,178	0	24	21	3,133	3,782
Installment loans and other plans	2,214	3	19	36	2,155	2,479
<b>All other loans and leases</b>	<b>374</b>	<b>0</b>	<b>11</b>	<b>13</b>	<b>349</b>	<b>498</b>
<b>Charge-offs to loan and lease reserve</b>	<b>8,140</b>	<b>16</b>	<b>128</b>	<b>238</b>	<b>7,758</b>	<b>10,237</b>
<b>Loans secured by real estate</b>	<b>378</b>	<b>3</b>	<b>23</b>	<b>38</b>	<b>314</b>	<b>639</b>
1- to 4-family residential mortgages	165	1	10	16	138	261
Home equity loans	99	0	1	4	94	138
Multifamily residential mortgages	4	0	2	2	0	16
Commercial RE loans	63	1	8	14	40	151
Construction RE loans	16	0	2	3	11	38
Farmland loans	4	0	1	0	3	7
RE loans from foreign offices	27	0	0	0	27	27
<b>Commercial and industrial loans</b>	<b>750</b>	<b>7</b>	<b>31</b>	<b>95</b>	<b>617</b>	<b>1,193</b>
<b>Loans to individuals</b>	<b>6,500</b>	<b>6</b>	<b>57</b>	<b>84</b>	<b>6,353</b>	<b>7,732</b>
Credit cards	3,978	0	28	33	3,917	4,795
Installment loans and other plans	2,522	6	29	51	2,436	2,938
<b>All other loans and leases</b>	<b>512</b>	<b>1</b>	<b>17</b>	<b>20</b>	<b>474</b>	<b>673</b>
<b>Recoveries credited to loan and lease reserve</b>	<b>1,940</b>	<b>6</b>	<b>36</b>	<b>63</b>	<b>1,834</b>	<b>2,535</b>
<b>Loans secured by real estate</b>	<b>126</b>	<b>1</b>	<b>6</b>	<b>9</b>	<b>110</b>	<b>180</b>
1- to 4-family residential mortgages	53	0	2	5	45	73
Home equity loans	23	(0)	0	1	22	31
Multifamily residential mortgages	0	0	0	0	0	2
Commercial RE loans	26	0	3	2	21	45
Construction RE loans	9	0	0	0	8	12
Farmland loans	1	0	0	0	1	3
RE loans from foreign offices	14	0	0	0	14	14
<b>Commercial and industrial loans</b>	<b>569</b>	<b>2</b>	<b>11</b>	<b>21</b>	<b>535</b>	<b>708</b>
<b>Loans to individuals</b>	<b>1,107</b>	<b>2</b>	<b>15</b>	<b>26</b>	<b>1,065</b>	<b>1,472</b>
Credit cards	800	0	4	11	784	1,013
Installment loans and other plans	308	2	11	15	280	459
<b>All other loans and leases</b>	<b>138</b>	<b>1</b>	<b>5</b>	<b>7</b>	<b>125</b>	<b>176</b>

FINANCIAL PERFORMANCE OF NATIONAL BANKS

Year-to-date net loan and lease losses of national banks by asset size  
Through September 30, 2005  
(Dollar figures in millions)

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>Number of institutions reporting</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
<b>Net charge-offs to loan and lease reserve</b>	<b>16,009</b>	<b>30</b>	<b>280</b>	<b>512</b>	<b>15,188</b>	<b>20,176</b>
<b>Loans secured by real estate</b>	<b>754</b>	<b>5</b>	<b>54</b>	<b>74</b>	<b>620</b>	<b>1,269</b>
1- to 4-family residential mortgages	340	2	18	24	296	539
Home equity loans	218	0	2	6	209	301
Multifamily residential mortgages	15	1	4	3	6	28
Commercial RE loans	108	1	20	35	52	280
Construction RE loans	21	1	4	6	10	63
Farmland loans	12	(0)	6	1	5	17
RE loans from foreign offices	41	0	0	0	41	40
<b>Commercial and industrial loans</b>	<b>723</b>	<b>13</b>	<b>65</b>	<b>193</b>	<b>452</b>	<b>1,554</b>
<b>Loans to individuals</b>	<b>14,025</b>	<b>11</b>	<b>131</b>	<b>216</b>	<b>13,667</b>	<b>16,610</b>
Credit cards	9,754	1	83	76	9,594	11,612
Installment loans and other plans	4,270	10	48	140	4,072	4,998
<b>All other loans and leases</b>	<b>508</b>	<b>1</b>	<b>29</b>	<b>29</b>	<b>449</b>	<b>743</b>
<b>Charge-offs to loan and lease reserve</b>	<b>21,491</b>	<b>48</b>	<b>388</b>	<b>719</b>	<b>20,336</b>	<b>27,356</b>
<b>Loans secured by real estate</b>	<b>1,119</b>	<b>8</b>	<b>73</b>	<b>98</b>	<b>940</b>	<b>1,816</b>
1- to 4-family residential mortgages	498	3	25	34	435	760
Home equity loans	279	0	3	8	268	383
Multifamily residential mortgages	18	1	4	4	8	34
Commercial RE loans	187	2	27	44	114	427
Construction RE loans	52	1	6	7	38	112
Farmland loans	15	0	7	1	7	29
RE loans from foreign offices	70	0	0	0	70	71
<b>Commercial and industrial loans</b>	<b>2,277</b>	<b>19</b>	<b>96</b>	<b>251</b>	<b>1,910</b>	<b>3,516</b>
<b>Loans to individuals</b>	<b>17,123</b>	<b>18</b>	<b>176</b>	<b>322</b>	<b>16,607</b>	<b>20,701</b>
Credit cards	11,855	1	97	128	11,628	14,256
Installment loans and other plans	5,268	17	79	194	4,978	6,446
<b>All other loans and leases</b>	<b>972</b>	<b>3</b>	<b>43</b>	<b>47</b>	<b>880</b>	<b>1,322</b>
<b>Recoveries credited to loan and lease reserve</b>	<b>5,481</b>	<b>19</b>	<b>108</b>	<b>207</b>	<b>5,148</b>	<b>7,180</b>
<b>Loans secured by real estate</b>	<b>365</b>	<b>3</b>	<b>18</b>	<b>24</b>	<b>320</b>	<b>547</b>
1- to 4-family residential mortgages	158	1	7	11	138	221
Home equity loans	62	0	0	3	59	82
Multifamily residential mortgages	3	0	0	0	2	6
Commercial RE loans	79	1	8	9	62	147
Construction RE loans	32	0	2	1	28	48
Farmland loans	4	1	1	0	2	12
RE loans from foreign offices	29	0	0	0	29	32
<b>Commercial and industrial loans</b>	<b>1,554</b>	<b>6</b>	<b>31</b>	<b>59</b>	<b>1,458</b>	<b>1,963</b>
<b>Loans to individuals</b>	<b>3,098</b>	<b>8</b>	<b>45</b>	<b>106</b>	<b>2,940</b>	<b>4,091</b>
Credit cards	2,100	1	14	52	2,034	2,643
Installment loans and other plans	998	7	31	54	906	1,448
<b>All other loans and leases</b>	<b>464</b>	<b>2</b>	<b>13</b>	<b>18</b>	<b>430</b>	<b>579</b>

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

### Number of national banks by state and asset size September 30, 2005

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>All institutions</b>	<b>1,846</b>	<b>711</b>	<b>961</b>	<b>127</b>	<b>47</b>	<b>7,541</b>
Alabama	23	12	10	0	1	149
Alaska	2	1	0	1	0	5
Arizona	15	3	7	4	1	48
Arkansas	39	9	28	2	0	156
California	71	15	41	13	2	267
Colorado	43	17	23	3	0	164
Connecticut	10	1	7	1	1	24
Delaware	8	0	3	2	3	27
District of Columbia	4	1	3	0	0	6
Florida	61	5	50	6	0	259
Georgia	51	10	40	1	0	329
Hawaii	1	0	1	0	0	5
Idaho	1	0	1	0	0	14
Illinois	146	58	81	4	3	615
Indiana	31	6	17	7	1	134
Iowa	44	18	25	1	0	392
Kansas	93	61	28	4	0	354
Kentucky	41	16	24	0	1	204
Louisiana	14	3	9	1	1	136
Maine	3	0	1	1	1	15
Maryland	10	1	8	1	0	65
Massachusetts	11	2	8	1	0	37
Michigan	22	8	13	0	1	156
Minnesota	105	59	43	2	1	447
Mississippi	19	5	12	2	0	93
Missouri	44	20	20	3	1	341
Montana	14	11	3	0	0	79
Nebraska	66	43	21	2	0	250
Nevada	7	1	1	4	1	36
New Hampshire	4	1	1	1	1	13
New Jersey	20	0	13	5	2	72
New Mexico	14	4	7	3	0	48
New York	56	12	33	9	2	134
North Carolina	4	0	2	0	2	74
North Dakota	13	6	5	2	0	96
Ohio	78	30	36	5	7	177
Oklahoma	81	40	39	1	1	268
Oregon	3	1	1	1	0	38
Pennsylvania	70	15	43	8	4	159
Rhode Island	3	2	0	0	1	7
South Carolina	23	5	16	2	0	74
South Dakota	17	6	8	1	2	87
Tennessee	27	6	18	2	1	184
Texas	305	156	130	18	1	633
Utah	6	2	2	0	2	63
Vermont	8	2	6	0	0	14
Virginia	38	7	29	1	1	124
Washington	11	7	4	0	0	81
West Virginia	15	8	6	1	0	66
Wisconsin	38	11	25	1	1	266
Wyoming	13	4	9	0	0	40
U.S. territories	0	0	0	0	0	16

## FINANCIAL PERFORMANCE OF NATIONAL BANKS

**Total assets of national banks by state and asset size** □  
**September 30, 2005** □  
(Dollar figures in millions) □

	All national banks	National banks				Memoranda: All commercial banks
		Less than \$100 million	\$100 million to \$1 billion	\$1 billion to \$10 billion	Greater than \$10 billion	
<b>All institutions</b>	<b>\$5,946,140</b>	<b>\$39,795</b>	<b>\$269,469</b>	<b>\$354,377</b>	<b>\$5,282,499</b>	<b>\$8,903,605</b>
Alabama	24,343	901	2,352	0	21,090	214,032
Alaska	2,295	64	0	2,231	0	3,691
Arizona	71,382	138	3,008	8,490	59,745	76,414
Arkansas	10,645	496	7,641	2,507	0	41,642
California	113,772	923	10,403	37,622	64,825	304,849
Colorado	11,892	818	6,215	4,860	0	40,320
Connecticut	23,822	99	2,576	3,539	17,607	25,563
Delaware	287,068	0	766	8,135	278,168	334,927
District of Columbia	691	92	599	0	0	836
Florida	32,887	372	13,397	19,118	0	93,209
Georgia	15,788	439	9,117	6,233	0	257,806
Hawaii	436	0	436	0	0	27,520
Idaho	320	0	320	0	0	4,950
Illinois	177,230	3,286	22,287	19,656	132,001	327,848
Indiana	54,396	364	6,914	18,608	28,510	87,231
Iowa	9,849	1,096	6,965	1,788	0	47,262
Kansas	18,687	3,325	9,010	6,352	0	46,542
Kentucky	17,821	1,083	5,077	0	11,660	51,336
Louisiana	35,194	145	2,489	9,419	23,141	58,844
Maine	33,857	0	963	1,143	31,750	37,580
Maryland	3,102	29	1,751	1,322	0	40,809
Massachusetts	10,271	115	1,981	8,176	0	164,611
Michigan	44,529	415	3,145	0	40,969	193,842
Minnesota	28,468	3,053	9,324	3,238	12,852	60,990
Mississippi	12,805	304	3,241	9,260	0	44,556
Missouri	30,509	1,214	6,300	10,423	12,572	89,493
Montana	1,583	665	918	0	0	15,307
Nebraska	15,133	2,060	4,868	8,206	0	32,285
Nevada	27,108	53	106	10,608	16,340	56,121
New Hampshire	15,047	59	236	1,654	13,098	17,544
New Jersey	43,319	0	4,246	15,705	23,367	85,864
New Mexico	6,915	254	1,750	4,911	0	13,363
New York	754,031	851	11,425	21,580	720,175	1,062,384
North Carolina	1,536,984	0	1,692	0	1,535,292	1,678,425
North Dakota	7,459	305	1,846	5,308	0	15,610
Ohio	1,484,744	1,716	11,735	13,170	1,458,123	1,576,104
Oklahoma	26,951	2,221	9,463	2,031	13,235	50,798
Oregon	7,519	17	235	7,266	0	22,881
Pennsylvania	194,018	958	13,822	21,221	158,017	241,557
Rhode Island	12,958	70	0	0	12,888	29,562
South Carolina	9,689	319	4,270	5,100	0	40,337
South Dakota	435,831	217	3,222	6,945	425,447	447,363
Tennessee	46,173	506	6,267	2,636	36,764	76,847
Texas	91,084	8,393	32,604	39,752	10,334	165,334
Utah	33,498	103	402	0	32,993	154,323
Vermont	1,660	124	1,535	0	0	6,771
Virginia	82,810	387	9,420	1,976	71,027	166,356
Washington	1,975	398	1,577	0	0	37,260
West Virginia	4,512	517	1,471	2,524	0	19,916
Wisconsin	30,964	651	8,141	1,666	20,506	106,208
Wyoming	2,115	176	1,939	0	0	5,618
U.S. territories	0	0	0	0	0	102,766

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