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TESTIMONY OF JOHN D. HAWKE, JR.
COMPTROLLER OF THE CURRENCY
Before the
COMMITTEE ON BANKING AND FINANCIAL SERVICES
of the
U.S. HOUSE OF REPRESENTATIVES
April 13, 1999

Statement required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Mr. Chairman and members of the Committee, thank you for the opportunity to appear before you today to report on the progress national banks are making to address the problems associated with the century date change and to discuss pending Year 2000 legislation.

For the past two years, the Office of the Comptroller of the Currency (OCC), together with its Federal Financial Institutions Examination Council (FFIEC) counterparts, has been aggressively engaged in a comprehensive program to address the challenges presented by the coming Year 2000 date change. Let me say at the outset of my statement that the vast majority of national banks and their service providers have made excellent progress toward completing their testing and implementing Year 2000 compliant systems.

However, in our previous reports to Congress, we also noted that Year 2000 preparedness is a dynamic process and that the ratings assigned to individual banks at one stage of the process could change, particularly as that process moves into the testing phase. Indeed, since our most recent quarterly report to Congress, a number of national banks have experienced some delay in meeting some of the milestone dates set out in the FFIEC's guidance, and we anticipate that a small number of national banks may not be able to meet the June 30, 1999 target. The testing process has proven to be more complex, time consuming and costly than many banks anticipated. I want to make it clear that most problems encountered during the testing phase have not proven to be serious, and for the most part they have been quickly solved. It is also important to remember that while the June 30, 1999 target is an important one, the FFIEC chose this date to ensure that there would still be sufficient time remaining in the year to deal with problems coming out of the testing phase. For any banks or service providers that are unable to meet FFIEC Year 2000 milestone dates, we stand well-prepared to take any and all necessary steps to deal with their deficiencies.

In my responses to the questions raised in your invitation letter, I have attempted to give you an accurate picture of the OCC's comprehensive approach to the challenges presented by Year 2000. Together with our FFIEC counterparts, we have:

- developed and disseminated detailed policy guidance to our supervised institutions;
- trained and deployed our examiners to conduct three or more onsite examinations of each institution;
- set up systems to track and monitor progress;
- established and implemented vigorous enforcement programs to deal with deficiencies;
- coordinated with other government agencies as well as private enterprises, domestically and internationally, to share valuable Year 2000-related information;
- conducted numerous outreach programs to educate banks and the public; and
- helped to organize and participated in a series of interagency contingency planning groups to plan for the orderly resolution of problems or issues that may arise either systemically or with individual banks.

This approach to the Year 2000 problem has positioned us well to anticipate and deal with problems. Our examination and supervisory processes provide us with extensive information on the preparedness of each national bank. We assign and update ratings quarterly based on the results of our on-site examinations and off-site reviews. In assigning ratings, a

bank's compliance with the FFIEC interim milestone dates is a key, but not the sole, factor that examiners consider. Last year we also implemented a Quality Assurance process to evaluate the overall quality of our Year 2000 supervisory efforts. This program, staffed by experienced OCC personnel not otherwise responsible for Year 2000 supervisory issues, has provided valuable input to overall management of our Year 2000 effort and identified areas where we can further strengthen our Year 2000 supervisory program.

We have organized the information we collect into a comprehensive database that serves as a valuable management tool for the OCC. Through application of various queries, we use this database to provide information on the preparedness levels of individual banks as well as the system at large and to check the accuracy of our ratings. Because our examinations and reviews seldom coincide with quarter-ends, there is a timing difference between when ratings are assigned and the quarter-end based FFIEC performance targets. To deal with this timing difference, we also compile and maintain a datasheet on each national bank that tracks the bank's progress in meeting various milestones. We use these datasheets to aggressively follow up on those banks that appear to be slipping from the established FFIEC target dates and to decide whether enhanced supervisory or enforcement action is warranted. In cases where a datasheet indicates that a bank has not met a milestone, yet is rated "satisfactory," an exception report is prepared for immediate follow-up by the supervisory office.

Our experience to date has been that a vast majority of those banks have achieved full compliance with FFIEC interim guidelines by the time we review them again. If the bank has not subsequently met the deadline, typically we downgrade the bank's rating. Exceptions to this policy are rare and require senior level approval. With respect to the final June 30, 1999 FFIEC target, we have instructed examiners that if a national bank has not successfully met this target, the bank should be rated less than satisfactory. Exceptions to this policy will be limited.

In sum, given the large number and complexity of systems involved, as well as a host of external considerations, many of them beyond the control of individual institutions, it would be unrealistic to expect or demand a zero-defect Year 2000 outcome. But it is reasonable to expect that we do everything practical to minimize disruption and to anticipate and deal effectively with problems that occur. That is what our program is designed to achieve.

Against this backdrop, Mr. Chairman, I will now address specifically the questions raised in your invitation letter. For ease of reference, I have repeated each of your questions, followed by our response.

Industry Year 2000 Readiness

- Q1. In addition to the percentage of “satisfactory” ratings, please provide a report on the number of institutions which met FFIEC standards for remediation and testing, including, to the maximum extent possible, preliminary findings on the number of institutions which met the December 31, 1998 and March 31, 1999 dates for “substantial” completion of testing internally and with outside service providers (note: please clarify what “substantial” means).**

Ratings Summary

The FFIEC agencies are now conducting Phase II of their Year 2000 workprogram, which focuses primarily on Year 2000 validation (testing) and implementation phases and contingency plans. At the OCC, we are well underway in conducting the second round of Phase II examinations and expect to complete them by July 1999. In cases where we uncovered testing problems, most have been corrected within a short period of time. In general though, testing is taking longer and costing more than institutions expected last year.

Table I shows aggregate ratings information for national bank and Federal branch examinations completed through March 31, 1999 compared with the results from the fourth quarter of 1998. The Year 2000 ratings of all size classes of national banks and Federal branches have slipped some from the fourth quarter, with the largest banks showing the most difference. This decline in the ratings of large banks was not unanticipated, given the complexity of large bank operations and the immense scope of their remediation and testing activities. However, the OCC is closely and continuously monitoring their progress through resident examination teams, whose job it is to see that these banks are taking aggressive corrective action. For smaller banks, we are assessing their progress at least quarterly and more frequently when banks fall behind schedule.

Table 1
Preliminary Year 2000 Summary Evaluations
National Bank and Federal Branches
By Asset Size
4Q98 vs. 1Q99

<i>Evaluation</i>	<i><\$100MM 4Q98 / 1Q99</i>	<i>\$100MM to \$500MM 4Q98 / 1Q99</i>	<i>\$500MM to \$1B 4Q98 / 1Q99</i>	<i>Over \$1B 4Q98 / 1Q99</i>	<i>Overall Percent 4Q98 / 1Q99</i>
<i>Satisfactory</i>	98% / 97%	98% / 97%	98% / 98%	92% / 88%	97% / 96%
<i>Needs Improvement</i>	2% / 2%	2% / 3%	1% / 2%	8% / 12%	3% / 4%
<i>Unsatisfactory</i>	<1% / 1%	<1% / < 1%	1% / 0%	0% / 0%	<1% / < 1%

Source: OCC Year 2000 Database

The OCC and the other FFIEC agencies also examine hundreds of service providers and software vendors that play an important role in processing data and developing software for banks. The ratings for service providers and software vendors have not changed significantly since the fourth quarter of 1998. Table 2 provides a summary of preliminary first quarter Year 2000 evaluations of OCC-supervised service providers and software companies compared with results from the fourth quarter of 1998. We will continue to gather information during examinations to assess the exposure of banks to service providers and software vendors with less than "satisfactory" ratings. We also are assessing the capacity of service providers and software vendors rated "satisfactory" to provide services to an institution that is using a non-compliant provider.

Table 2
Preliminary Year 2000 Summary Evaluations
Service Providers and Software Vendors
4Q98 vs. 1Q99¹

<i>Summary Evaluation</i>	<i>OCC Supervised MDPS 4Q98 / 1Q99</i>	<i>OCC Supervised SARs 4Q98 / 1Q99</i>	<i>OCC Supervised IDCs 4Q98 / 1Q99</i>	<i>OCC Supervised Institutions serving Non-Affiliated Institutions 4Q98 / 1Q99</i>	<i>Total 4Q98 / 1Q99</i>
<i>Satisfactory</i>	5 / 5	4 / 4	33 / 30	75 / 71	117 / 110
<i>Needs Improvement</i>	0 / 0	0 / 0	1 / 1	1 / 2	2 / 3
<i>Unsatisfactory</i>	0 / 0	0 / 0	0 / 0	0 / 0	0 / 0
<i>Total</i>	5 / 5	4 / 4	34 / 31	76 / 73	119 / 113

Source: OCC Year 2000 Database

Institutions Meeting Interim FFIEC Dates

Your letter asked that we report on the number of institutions that met the FFIEC dates for "substantial" completion (December 31, 1998 for internal testing, and March 31, 1999 for external testing.) You also requested that we clarify what "substantially complete" means. Up to now, neither the OCC nor the FFIEC has defined that term. However, with the approach of the final June 30, 1999 deadline, we have instructed our examiners that "substantially

¹ Under the Multi-regional Data Processing Services (MDPS) and Shared Application and Software Review (SASR) programs, the federal banking agencies jointly examine twelve large non-bank data processing service companies and sixteen turnkey software vendors. Lead examination responsibilities are rotated among the FFIEC member agencies. The OCC is the agency in charge for supervising 5 MDPS and 4 SASR companies. Examiners from at least two of the member agencies typically participate on examinations. Additionally, the examination responsibilities of approximately 250 smaller regional data processing companies (designated as Independent Data Centers - IDCs) are assigned to specific member agencies. The OCC is responsible for examining thirty-one IDCs.

complete” means that a bank has completed all FFIEC-required testing and implementation within two weeks of that deadline.

Our database reflects when internal or external testing of *all* mission-critical systems is complete, rather than just substantially complete. Approximately 75 percent of national banks had fully completed their testing of internally developed mission critical systems by December 31, 1998. By the end of the first quarter, the number of institutions that had completed testing of *all* internal mission critical systems had risen to 95 percent. Again, those that have not are being subjected to more intense supervision.

Regarding testing with outside service providers, our preliminary information indicates that approximately 75 percent of national banks were complete as of the March 31, 1999 target date. We will verify the actual completion dates during our second quarter supervisory activities.

Q2. Report on the number of institutions which are currently in non-compliance with at least one FFIEC date and what actions have been taken to ensure those institutions improve compliance with FFIEC standards.

Non-compliance with Interim FFIEC Dates

As of March 31, 1999, only 58 banks that missed the year-end 1998 interim target for *internal* mission-critical testing were still in non-compliance. However, we believe that approximately 25 percent of the national banks missed the March 31, 1999 target for completing testing with *outside* service providers. Of those, we expect that the vast majority will come into compliance within the next few weeks, and we are monitoring those banks closely.

Based upon current examination results, we project that relatively few banks will miss the June 30, 1999 target for completing testing and substantially completing the implementation of mission-critical systems. Given the extended time needed to finish testing at some banks and the possibility of unanticipated problems during implementation, that number may grow. It is important to keep in mind that the aggressive testing targets established by the FFIEC contemplated that some institutions would encounter some difficulties and delays and provided a six-month cushion to enable full implementation before the century date change.

Institutions have missed interim target dates for a variety of reasons. These reasons range from scheduling conflicts with their software or service providers to unanticipated staffing problems and unplanned extra testing requirements. Although we are concerned about these exceptions and we are closely monitoring them, most testing problems have not required lengthy repair periods. Most banks remediated deficiencies uncovered during testing quickly because the problems they encountered were not substantive or complex.

Enforcement

National banks that miss interim FFIEC targets are subject to rigorous OCC oversight. The OCC uses a variety of enforcement tools to ensure that Year 2000 laggards promptly resolve their problems. The form and severity of the OCC's action are determined by the following:

- an institution's Year 2000 rating;
- an institution's progress in complying with any previously issued supervisory directive or other informal or formal enforcement action;
- the cooperation, responsiveness, and capability of the institution's management and board of directors; and
- the time remaining prior to the Year 2000.

To address Year 2000 deficiencies, the OCC has issued or entered into 353 Supervisory Directives, nine Commitment Letters, nine Memoranda of Understanding, eight Formal Agreements, two Consent Orders, and one Safety & Soundness Order. We have also initiated

the Safety & Soundness Order process against 53 banks.² Overall, our enforcement actions have been successful in prompting banks to comply with FFIEC and OCC Year 2000 policy, as evidenced by the large number of banks that have subsequently corrected their problems, been upgraded, and had their enforcement action terminated.

Resolution Alternatives

The OCC also is working with the other FFIEC agencies in a number of contingency planning efforts including the development of methods of resolving banks whose viability might be threatened by Year 2000 problems. These efforts include analyzing legal and supervisory options that would be appropriate for such banks. The OCC and the other federal banking agencies view a resolution involving a receivership as an option that should be considered only as a last resort, and we expect to see few if any failures caused by Year 2000 problems. To ensure that the agencies are prepared to resolve any such banks in an orderly manner, however, we are working to identify issues and options for handling those situations.

² The following Year 2000 enforcement actions are currently outstanding: 18 Supervisory Directives, four Commitment Letters, four Memoranda of Understanding, four Formal Agreements, one Consent Order, and one Safety & Soundness Order. In addition, 31 institutions are operating under approved Safety & Soundness plans.

Q3. Report on the OCC's methodology for ensuring that "satisfactory" ratings and the exam data on which they are based are accurate and consistent with FFIEC standards.

The effectiveness of the OCC's Year 2000 supervisory efforts depends on the accuracy of our ratings system. Earlier last year, the OCC incorporated several management control processes into our Year 2000 supervisory approach to ensure that ratings are assigned uniformly and consistently with FFIEC and OCC policy. This oversight includes field level review of all ratings prior to issuance of examination reports, as well as computer-based analyses that flag banks for which we need to verify their assigned rating.

Our field examiners remain our primary control mechanism in the ratings process. Field examiners have the best understanding of the issues each bank faces. They are in the best position to evaluate bank management's ability to effect corrective action. Before an assigned rating for an institution is finalized, the examiner-in-charge reviews the findings with the Assistant Deputy Comptroller for accuracy and consistency with policy. If the institution is rated less than "satisfactory," the District or Washington Supervision Review Committee conducts additional review of the rating and prescribes enforcement follow-up.

The OCC has two mechanisms to improve the accuracy of our Year 2000 ratings and the integrity of our database. The first mechanism is an OCC database that tracks bank ratings and identifies potential ratings inconsistencies. The second is our formal quality assurance function, which we use to assess the quality and consistency of examinations of banks and service providers.

Our Year 2000 database contains the answers our examiners provide each quarter to specific questions on each national bank's Year 2000 project plan and compliance with FFIEC guidance. This database serves as a Year 2000 management reporting and monitoring tool for the OCC. We have been constantly revising and expanding this database since its inception to address emerging issues and needs. The database enables us to make *ad hoc* inquiries and filter information to best focus our supervisory activities. For example, we use a number of key questions targeted by the Gartner Group and supplemented by OCC experience to create filters that help us to determine if there are any apparent inconsistencies between the database responses and the institution's Year 2000 rating.

Our quality assurance process evaluates the overall quality of our Year 2000 supervision for all sizes and types of institutions. Since the quality assurance process began in October 1998, the OCC has conducted five reviews: two community bank reviews, two large bank reviews and one mid-size/credit card bank review. Specifically, the quality assurance reviews focus on the accuracy of our Year 2000 ratings, consistency of work papers, appropriateness of follow-up, and the overall quality of our communications. This program, conducted by experienced personnel who are independent of the Year 2000 examination process, helps us make our Year 2000 supervisory process more effective.

Q4. Please provide any rebuttal the OCC wishes to make to recent reports on a Weiss Ratings, Inc., survey suggesting that about a third of banks and thrifts responding had missed a Year 2000 deadline.

In recent months, private ratings firms' reports have reflected a broad range of conclusions about the banking industry's Year 2000 preparedness. One rating agency, using an extensive survey methodology, found that the banking industry is well ahead of all other industries in the United States with regard to addressing the Year 2000 issue. Another, using a short and limited survey, assigned lower Year 2000 performance ratings than the FFIEC to institutions that had not *fully completed* renovation and testing of *all* internal mission-critical systems by December 31, 1998.

We believe that this spectrum of conclusions is inevitable, given the dynamic and evolving nature of banks' Year 2000 remediation efforts and the rather limited information that some private rating firms must rely on to make their conclusions. While we recognize that in some instances private rating firms can provide a useful source of information to customers, in other cases, their conclusions may be misleading and unfair to the banks involved. That is why we believe that banks themselves are in the best position to inform customers about their Year 2000 progress. As I note in my response to question six, we stress the importance of banks having customer awareness programs.

Q5. Report on the OCC's policy on whether financial institutions which do not meet the upcoming June 30, 1999 FFIEC regulatory deadline for completing all mission-critical testing will be rated by examiners as "satisfactory," and whether all institutions should be prepared, as a part of their public communications plan, to assure bank customers in writing that they are in compliance with the FFIEC June 30, 1999 deadline.

Generally, national banks that do not comply within the June 30, 1999 target date will be rated less than satisfactory. Exceptions may be granted when completion and implementation are expected within two weeks of that date. Exceptions may also be granted where a bank with many "mission critical" systems has achieved implementation on all but an insignificant number of those systems, core bank functions will be sustained, and full implementation of Year 2000 remedies is anticipated soon thereafter. A satisfactory rating can also be assigned to a bank that plans extra testing, provided the required testing outlined in FFIEC guidance was complete by June 30, 1999.

You also asked whether institutions should be prepared, as part of their public communications plans, to assure bank customers in writing that they are in compliance with the FFIEC June 30, 1999 deadline. I am aware that views vary on this point and that there are strong arguments on both sides of the issue. Those favoring this approach feel strongly that bank customers can only benefit from such disclosures. Those on the other side of the issue are concerned about the potential for overreaction to the very same disclosures. I believe this issue would benefit from additional discussion before arriving at a final policy and that the FFIEC agencies should ultimately reach and follow a clear and consistent policy in this regard. I will work closely with my FFIEC counterparts to resolve this important issue.

Q6. Provide an update on Year 2000 contingency planning at financial institutions, including examples of “best practices” being used by financial institutions to meet - or effectively mitigate - increased customer demand for cash in December 1999 and January 2000, and to communicate Year 2000 contingency plans to bank customers.

Our supervision has identified a number of best practices used by national banks to meet or mitigate increasing customer demand for cash. These best practices generally fall into two categories: customer awareness programs and contingency funding plans.

Customer Awareness Programs

Educating bank customers about the Year 2000 problem is critical to minimizing unnecessary public alarm, which could cause serious problems for financial institutions and their customers. Both the FFIEC agencies and the banks have a role to play in ensuring the public that the banking industry is aggressively addressing Year 2000-related issues.

Our research indicates that customers want to hear more from their own banks about the banks' Year 2000 efforts. We are encouraging bankers to take a more active role in communicating with their customers. We believe that banks can most effectively mitigate customer concerns and excessive demands for cash by adopting an aggressive communications program that includes the following five elements:

- **Effective disclosure.** A bank should keep its customers up-to-date on its efforts to meet the century date change. Customers want to be informed as to the bank's progress, whether the news is good or bad.
- **Employee training.** Bank staff at all levels is a valuable communication asset. A bank that does not provide sufficient Year 2000 training risks delivering an inconsistent or misleading message to customers.
- **Consistent messages in multiple media.** Effective customer awareness programs have a core set of messages that are repeated in a variety of ways. Reliance on one delivery mechanism - like brochures or call centers - may not be sufficient.
- **Cooperation with other banks, community leaders, and leading commercial firms.** Banks have effectively addressed public concerns through joint cooperative efforts with other public and community business leaders. Cooperative efforts leverage resources and provide an opportunity to present a unified message to the public. Some banks are joining with community leaders to host a series of town meetings on Year 2000 issues.
- **Work with local media.** The media have significant influence on public attitudes, including the ability to mitigate or sensationalize Year 2000 issues. Bankers working with local media outlets can provide balanced information on the century date change.

Planning for Contingency Funding

The FFIEC issued specific guidance regarding liquidity issues to help banks address the potential increased demand for cash or other funding associated with the century date change.³ A key feature of that guidance is the development of contingency funding plans that include scenarios that respond to short- or long-term liquidity problems. When establishing its Year 2000 contingency funding plan, a bank should consider the following elements:

- **Borrowing from reliable sources.** One of the primary roles of the Federal Reserve is to act as the lender of last resort through the discount window and to lend to depository institutions in appropriate circumstances when market funding sources are not reasonably available. Depository institutions that plan to use the discount window as a contingent liquidity source should complete the appropriate documents and make arrangements to pledge collateral as early as possible in 1999 in order to facilitate processing.
- **Access to supplies of cash.** As part of the contingency funding planning process for the century date change, financial institutions should estimate the cash demands of their customers and determine whether they need to arrange for additional cash reserves. A financial institution also should determine how quickly it can obtain additional amounts of cash should its reserves be reduced unexpectedly. It may be necessary, for example, for institutions to increase cash reserves before the century date change.
- **Banks' cash distribution network.** A financial institution may wish to evaluate the potential for disruptions in its cash distribution systems and develop plans to meet customer needs throughout its geographical service area. When a financial institution uses a third party to service its cash disbursement requirements (*e.g.*, ATMs, armored car services), it should review the third party provider's plan to ensure that providers of these services and facilities can provide sufficient cash to meet customer needs in late 1999 and early 2000.
- **Security risks.** A financial institution may need to review its insurance coverage and security processes if it plans to hold additional cash reserves. Further, the bank may need to consider the security risks of its customers leaving the premises with large amounts of cash.

³ See the FFIEC's December 11, 1998 Questions and Answers Concerning Year 2000 Contingency Planning.

- Q7. State the OCC's recommendations to federal agencies (e.g. Social Security Administration) and private sector entities (e.g. pension funds) as to whether they should, on a one time basis, move up to December 1999 any monthly payment ordinarily due in January 2000, whether such payments should be made by paper check rather than electronic funds transfer (EFT), what the income tax implications are for such a contingency plan, and how the OCC or others can effectively publicize such recommendations to all those involved in such contingency planning.**

This matter is under review by the President's Council on Year 2000, and I understand that the Council will issue a recommendation shortly.

Q8. Provide an assessment of the effectiveness of financial institution procedures for evaluating Year 2000-related risk from material borrowers and the OCC's exam procedures for assessing the level of that risk for individual institutions.

In March 1998 the FFIEC issued guidance that outlines the agencies' expectations regarding how insured financial institutions manage their Year 2000 customer credit risk⁴. This guidance required financial institutions to establish by June 30, 1998 and to implement by September 30, 1998 a risk control process that:

- identifies material customers;
- assesses the preparedness of material customers;
- evaluates the resulting Year 2000 risk to the institution; and
- develops appropriate risk controls.

Specific procedures to evaluate banks' compliance with this guidance were included in the Phase II procedures. Examinations conducted under these procedures indicate that as of the end of last year, 97 percent of affected national banks had met this target. We are pursuing the other three percent through our supervisory and enforcement processes.

The OCC also assesses Year 2000-related credit risk during the course of its Asset Quality examinations, which assess both the quantity of risk and the quality of risk management. Beginning in the second quarter of 1999, the OCC's quarterly Year 2000 monitoring program will include specific questions about the level of Year 2000 customer risk and how banks have modified their underwriting practices to manage that risk. We are aware that some banks have attempted to alter loan covenants to require a showing of Year 2000 preparedness, but have met with mixed success due to their lack of leverage with borrowers in the currently competitive lending environment.

⁴ See the FFIEC's March 11, 1998 Guidance Concerning the Year 2000 Impact on Customers.

Q9. Report any material change in Year 2000 readiness and contingency planning in the international banking and financial sector since the OCC last testified before the committee on September 17, 1998.

Before I comment on Year 2000 readiness and contingency planning in the international banking and financial services sector, I would like to first make the point that direct international exposure of national banks overall is limited. Only a small number of the largest national banks engage in international transactions directly with foreign banks, private sector enterprises or foreign governments, and only a small number of those banks have significant exposure in countries that are less well prepared to address Year 2000 problems.

I can report that the global financial services sector, including most central banks, large global banks, financial services firms, and clearing and settlement organizations, has made progress in testing and implementing Year 2000 compliant systems. Most countries are now engaged in testing programs that involve both internal and external testing with domestic and global business partners and payment agencies. While progress has been most rapid among the world's major industrialized countries, some smaller countries are also making good progress. Also, more countries have begun active disclosure programs to inform world markets of the readiness of their financial sector for Year 2000.

The greatest concern internationally is whether there are adequate plans and resources to handle the Year 2000 challenge in certain countries of Latin America, Asia, and Eastern Europe. U.S. and global banking supervisors, international organizations such as the Bank for International Settlements (BIS), and private industry groups are providing smaller countries technical assistance to advance their systems testing and remediation efforts.

The following issues will require ongoing attention from the international community over the next few months:

- **Improved information sharing and disclosure.** Financial institutions and regulators should continue to develop clear and proactive communication strategies to ensure that global confidence in their readiness is maintained through this difficult period.
- **Contingency planning.** Bank regulators, such as the members of the FFIEC and BIS, are discussing the need to coordinate contingency planning activities and develop bi-lateral and multi-lateral communications programs, particularly around the period leading up to the changeover day and immediately after.
- **Coordination of bank holidays.** Discussion continues regarding the need to add new holidays to allow additional time for Year 2000 preparations. We are not in favor of additional bank holidays either before or after the century date change, as this would make the global calendar more complex and further complicate global testing plans.

- **Testing.** Testing schedules in those countries that had a late start on addressing the Year 2000 problem are becoming congested. Additional coordination and tailoring of test schedules may be necessary to handle the backlog.
- **Liquidity.** Banks and regulators are closely monitoring the behavior of bank customers and investors to gauge their reactions to the century date change. Changes in perception of global risk could lead to changes in investor behavior, including a sudden flight to quality and changes in liquidity holdings, which could impact world markets.
- **Infrastructure.** Although the overall quality of information on the Year 2000 readiness of power companies, telecommunications providers, and maritime transportation companies, especially in certain emerging market economies, varies significantly, the quality of the information continues to improve.

Pending Year 2000-Related Legislation

Q1. Comment on legislation pending in Congress (H.J. Res. 14) which would move the federal holiday observance of New Year's Day 2000 (which falls on a Saturday), from Friday, December 31, 1999 to Monday, January 3, 2000.

H. J. Res. 14 would move the federal holiday observance of New Year's Day 2000 (which falls on a Saturday) from Friday, December 31, 1999 to Monday, January 3, 2000. We do not believe such a change would be desirable for three reasons. First, if states followed the federal lead and moved the business holiday from Friday to Monday, this would create processing backlogs and increased volumes at the start of the New Year when computer systems may be most vulnerable to Year 2000 errors and malfunctions. Second, the change in the federal holiday date could be perceived as indicating a lack of congressional confidence in the banking industry and this may unnecessarily increase public concern. Third, conforming state action (moving the business holiday) could also create a testing problem for some banks because they would need to add the December 31, 1999 date to test scripts even though most have already completed their internal testing.

Q2. Comment on the potential impact of pending Year 2000 liability legislation (e.g. H.R. 775) on financial institutions, federal Year 2000 supervision of such institutions, or the ability of financial institutions to determine the Year 2000 compliance of borrowers or other critical external parties, such as providers of telecommunications and power services; please submit, if appropriate, any recommended amendment language to H.R. 775

Liability reform legislation, even in the limited context of Year 2000, is complicated, and presents both significant uncertainties and significant governmental issues. For example, the substantive limits involving contractual obligations and tort liability in the proposed legislation may raise potential constitutional issues and basic questions of federalism. However, there are in H.R. 775 several provisions that do not present these types of concerns and may diminish the risk of needless litigation and encourage parties to resolve disputes in an expeditious way. The proposed legislation establishes a required pre-filing notification period of 90 days to encourage resolution of potential Year 2000 disputes without litigation. Specifically, a potential plaintiff would be required to give written notice to the defendant identifying Year 2000 concerns and providing the potential defendant with an opportunity to "cure" the Year 2000 problem. The proposed legislation also has provisions encouraging alternative dispute resolution, such as mediation. These are worthy of serious consideration. Finally, the proposed requirement of proportionality of damages merits further study. While the issue of damages is complex and has historically been addressed by state law, further exploration of some limited foreclosure of pure "joint and several" liability in Year 2000 actions might be warranted.

You invited the OCC to suggest amendments on H.R. 775. The OCC is concerned that H.R. 775 may hinder the OCC's ability to take effective supervisory and enforcement actions regarding Year 2000 problem banks. Accordingly, we suggest two amendments. First, we strongly request a clarification that agency enforcement actions are not affected or covered by the general provisions in Titles I through V of the legislation. "Government entities" are expressly included within the scope of "persons" subject to H.R. 775 and the definition of "Year 2000 action" is sufficiently broad that it might arguably apply to government enforcement actions. This potential ambiguity should be eliminated by amending "Year 2000 action" to expressly exclude actions brought by a Federal, State, or other public entity, agency, or authority acting in a regulatory, supervisory, or enforcement capacity. A similar express exclusion is found in the definition of "covered action" in Section 3 of the Year 2000 Information and Readiness Disclosure Act, P.L. 105-271 and in S. 461, the Year 2000 Fairness and Responsibility Act.

Second, we strongly recommend that Section 605 of H.R. 775 be revised to make clear that banking enforcement actions are not affected by that section. Section 605 would suspend penalties for Year 2000 failures by "small business concerns." It is arguable that small financial institutions might come within the definition of "small business concerns." See 13 C.F.R. Part 121. We are opposed to legislation that would limit the ability of the federal bank regulators to take enforcement actions involving Year 2000 concerns. Such legislation might hinder necessary and timely supervisory actions to achieve Year 2000 readiness.

Q3. Comment on whether references to bona fide error in current banking consumer law would be clarified to include, in the definition of computer error, explicit reference to Year 2000-related errors and, if so, please provide suggested legislative language.

In our view, computer malfunctions and programming errors due to Year 2000 problems appear to be covered by the statutory provisions dealing with "bona fide errors." However, a legislative clarification could be helpful to avoid unnecessary and protracted litigation. Any clarification on this point should not affect the existing standard that institutions maintain procedures reasonably adapted to avoid bona fide errors.