Audit Report

OIG-06-017

Audit of the Office of the Comptroller of the Currency's Fiscal Years 2005 and 2004 Financial Statements

December 15, 2005

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

December 15, 2005

MEMORANDUM FOR JOHN C. DUGAN
COMPTROLLER OF THE CURRENCY

FROM: William H. Pugh, William H. Pugh
Deputy Assistant Inspector General
for Financial Management and Information
Technology Audits

SUBJECT: Audit of the Office of the Comptroller of the Currency's Fiscal Years 2005 and 2004 Financial Statements

I am pleased to transmit the attached audited Office of the Comptroller of the Currency (OCC) financial statements for fiscal years 2005 and 2004. We contracted with the independent certified public accounting firm Gardiner Kamya & Associates, PC (GKA) to audit the financial statements of OCC as of September 30, 2005 and 2004 and for the years then ended. The contract required that the audit be performed in accordance with generally accepted government auditing standards; applicable provisions of Office of Management and Budget Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements;* and the *GAO/PCIE Financial Audit Manual*.

The following reports, prepared by GKA, are incorporated in the attachment:

- Independent Auditors' Report on Financial Statements;
- Independent Auditors' Report on Internal Control over Financial Reporting; and
- Independent Auditors' Report on Compliance with Laws and Regulations.

In its audit, GKA found:

- that the financial statements were fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America,
- no matters involving internal control over financial reporting and its operation that are considered material weaknesses, and
- no instances of reportable noncompliance with laws and regulations tested.

GKA also issued a management letter dated October 27, 2005 discussing other matters that were identified during the audit but were not required to be included in the auditors' reports.

In connection with the contract, we reviewed GKA's reports and related documentation and inquired of its representatives. Our review, as differentiated from an audit in accordance with generally accepted government auditing standards, was not intended to enable us to express, and we do not express, an opinion on the financial statements or conclusions about the effectiveness of internal control or compliance with laws and regulations. GKA is responsible for the attached auditors' reports dated October 27, 2005 and the conclusions expressed in the reports. However, our review disclosed no instances where GKA did not comply, in all material respects, with generally accepted government auditing standards.

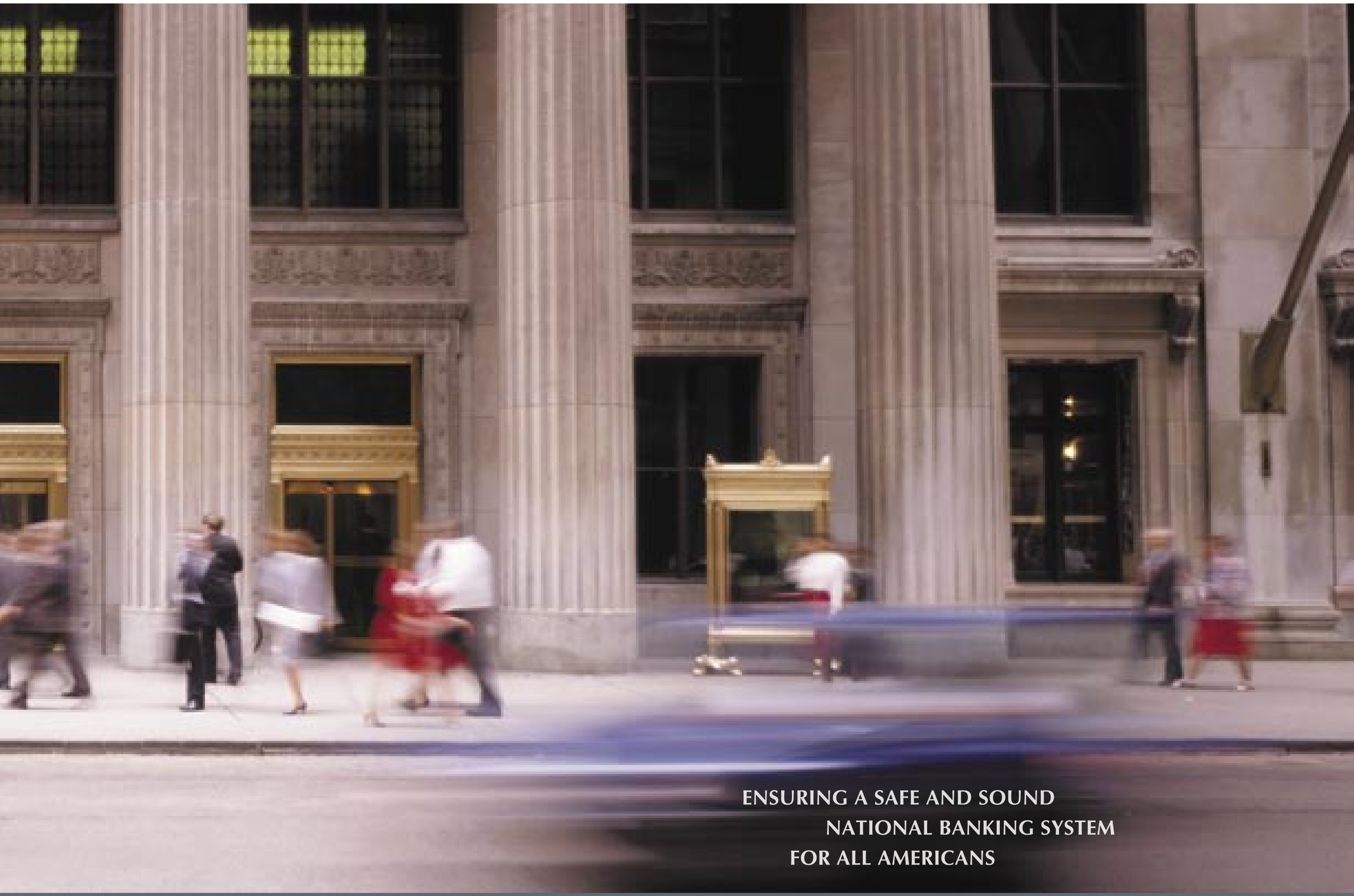
Should you have any questions, please contact me at (202) 927-5400, or a member of your staff may contact Mike Fitzgerald, Director, Financial Audits at (202) 927-5789.

Attachment

Comptroller of the Currency
Administrator of National Banks
US Department of the Treasury

Annual Report

Fiscal Year 2005



ENSURING A SAFE AND SOUND
NATIONAL BANKING SYSTEM
FOR ALL AMERICANS

OCC Vision

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

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Spurred by reports from OCC examiners about rising credit risk — typical for this phase of the credit cycle — we took a number of steps to identify potential areas of weakness and to strengthen our supervisory oversight of areas that presented elevated safety and soundness concerns.

Comptroller's Viewpoint

I was sworn in as the 29th Comptroller of the Currency on August 4, 2005, and assumed leadership of a proud organization with a long tradition of excellence in bank supervision. I look forward to building on the initiatives that were carried out by my distinguished predecessors during fiscal year (FY) 2005.

The safety and soundness of the national banking system must always be a fundamental priority of the OCC. In FY 2005, national banks compiled record earnings and posted other measures of strength. Capital grew to historic highs. This is especially good news in light of the challenges facing the banking system as it enters the later phases of the credit cycle — a time that customarily brings increased competition and pressure on loan volume and earnings.

As Comptroller, I am committed to maintaining a strong supervisory presence in our approximately 1,900 national banks. That is down slightly from last year's numbers. National bank assets, however, stand at nearly $6 trillion — a significant increase over FY 2004. Those statistical changes underscore both the long-term structural consolidation of the banking industry and its overall growth — two secular trends that continued in FY 2005.

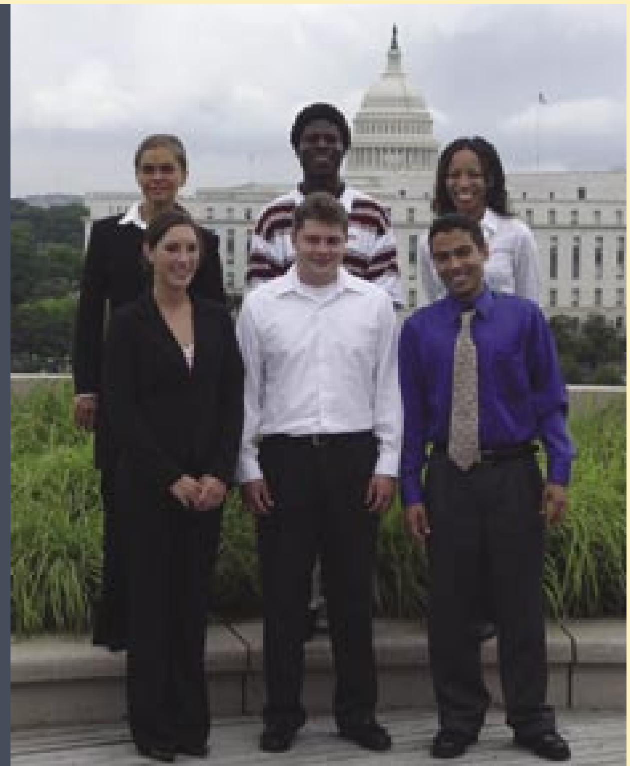
Regulatory capital issues were front-and-center in FY 2005. The OCC has been committed to strengthening the international capital framework to make it more risk sensitive through the Basel II effort. The April release of the Basel Committee's fourth Quantitative Impact Statement — QIS-4 — raised new concerns about the Basel II framework, and as FY 2005 came to close, the OCC and the other U.S. banking agencies announced a revised implementation plan that will enable us to address these concerns.

Spurred by reports from OCC examiners about rising credit risk — typical for this phase of the credit cycle — we took a number of steps to identify potential areas of weakness and to strengthen our supervisory oversight of areas that presented elevated safety and soundness concerns. Specifically, the OCC issued guidance, or participated in the issuance of guidance, on such products as home equity lending, overdraft protection programs, predatory residential mortgage lending, and more.

The products I've just mentioned illustrate that banking today is a diverse business, an important component of which is serving retail customers. They also demonstrate that a bank's record on compliance and customer service can have serious safety and soundness consequences. Assuring fair access and fair treatment of bank customers are significant OCC responsibilities to which the agency devoted major resources and effort in FY 2005. It will continue to absorb our attention in the coming months.

The OCC's Customer Assistance Group (CAG) is a vital component of the OCC's efforts in this area. In FY 2005, CAG opened 73,519 cases involving consumer complaints, and

We have long recognized that the OCC is only as strong as its people. In FY 2005 we upgraded our efforts to attract and retain a high quality workforce. The agency's demographics require no less; over the next five years, more than 25 percent of current OCC employees will be eligible to retire.



closed cases resulted in the payment of more than $6.3 million in disputed fees and other charges to customers of national banks.

Bank Secrecy Act enforcement provided further evidence of the convergence of compliance and safety and soundness. Several OCC-supervised institutions were subject to enforcement actions arising from violations of the Bank Secrecy Act. In several cases, violations resulted in large monetary and administrative penalties. These actions sent a strong message to banks that heightened regulatory scrutiny of their Bank Secrecy Act and anti-money laundering (BSA/AML) activities are facts of life in the post-9/11 world, and that banks will be expected to establish and maintain BSA/AML systems and controls commensurate with their risk exposure.

While it is vital to our national security that banks and other financial institutions have effective BSA/AML programs in place, it is equally important that we maintain a fair and balanced approach in this area. To that end, we took steps throughout the year both to clarify our BSA/AML goals and to achieve greater consistency in our supervisory guidance to banks and examiners. A major step in that direction came with the issuance, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), of a Bank Secrecy Act/Anti-Money Laundering Examination Manual. The OCC also participated in an ambitious outreach program that included nationwide conference calls and meetings around the country, so that bankers and others could have their BSA/AML questions answered and our supervisory standards explained to them. More than 24,000 people, mostly bankers, participated in this program.

The agency continued to be sensitive to the impact of its actions on the industry it supervises — and alert to opportunities to ease that impact. We have been especially concerned about the burden of regulatory compliance for our community banks — smaller institutions that are least likely to have the specialized resources to deal with rising compliance costs and responsibilities.

With these concerns in mind, we adopted new CRA regulations in FY 2005. A key change was the creation of a new category of Intermediate Small Banks, which will be subject to reduced data collection and reporting requirements. By refining our approach, we were able to provide some regulatory relief for banks, while ensuring that the basic purpose of the law — to meet the needs of communities — continued to be served.

We also are committed to conducting OCC's operations efficiently and with the utmost integrity. The agency is in strong financial health. Continuing efforts to strengthen our financial systems produced an unqualified audit opinion, with no material weaknesses, from our independent auditors, and the achievement of important milestones for prompt payment and collection of obligations.

We have long recognized that the OCC is only as strong as its people. In FY 2005 we upgraded our efforts to attract and retain a high

With that in mind, we continued a recruitment campaign that placed 96 entry-level bank examiners into permanent field office positions.

OCC Offices

quality workforce. The agency's demographics require no less; over the next five years, more than 25 percent of current OCC employees will be eligible to retire.

With that in mind, we continued a recruitment campaign that placed 96 entry-level bank examiners into permanent field office positions. We also hired another 100 new examiners, and began to train them for placement. Our efforts to make the OCC a more attractive employer — both by improving compensation and benefits and by building a more congenial workplace — were recognized when the OCC was named as one of the top 10 places to work among 143 comparable agencies in the federal government in a survey conducted by the Partnership for Public Service and American University's Institute for the Study of Public Policy Implementation.

This recognition is a tribute to the quality of the OCC staff and its commitment to public service — a commitment that I see every day.

The past year offered a dramatic reminder of the banking system's importance to the American people. The devastation of several major hurricanes left millions of Americans in need of emergency financial services to help them obtain the basic necessities of life and begin the rebuilding process. Despite considerable personal hardship, OCC personnel living in the disaster areas worked closely with national banks and other regulators to facilitate the delivery of cash, loans, and other forms of relief to those who needed them most. Their performance in this time of crisis was truly exemplary.

Each of us rests on the shoulders of others. When the 28th Comptroller of the Currency, John D. Hawke, Jr., left office on October 13, 2004, the OCC's chief counsel and first senior deputy, Julie L. Williams, assumed the duties of acting Comptroller for almost 10 months. Thus, most of the activities and accomplishments described above occurred during her tenure. She deserves a large share of the credit for the successes the Office achieved during this period.

John C. Dugan

Comptroller of the Currency

October 27, 2005

This annual report will describe what those activities entailed, highlighting steps the OCC took to combat terrorist financing and money laundering, as well as threats from natural disasters, such as Hurricane Katrina.

2005 Profile

Last year the OCC focused its efforts on maintaining a safe and sound national banking system for all Americans by protecting the deposits of bank customers. This annual report will describe what those activities entailed, highlighting steps the OCC took to combat terrorist financing and money laundering, as well as threats from natural disasters, such as Hurricane Katrina.

Overview

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

As of September 30, 2005, the OCC was responsible for regulating and supervising 1,933 national banks and 51 federal branches of foreign banks in the U.S. Based on the most recent data (June 30, 2005 call reports), national banks held $5.8 trillion in assets or 67 percent of the total assets of all U.S. commercial banks.

The OCC's operations are funded primarily by semiannual assessments levied on national banks (97 percent) and from interest revenue from investments in U.S. Treasury securities and licensing and other fees combined (3 percent). The OCC does not receive congressional appropriations to fund any of its operations.

Structure

As of September 30, 2005, the OCC had 2,802 OCC employees, including 1,895 bank examiners. The OCC has its headquarters in Washington, D.C., a data center in Maryland, and four district offices in Chicago, Dallas, Denver, and New York. The OCC's Office of the Ombudsman is located in Houston. The OCC also has 52 field offices and 25 satellite locations in cities throughout the U.S., resident examiner teams in the 23 largest banking companies supervised, and an examining office in London, England.

The OCC is headed by the Comptroller of the Currency, who is appointed for a five-year term by the President, with the advice and consent of the Senate. An Executive Committee of senior executives of the major business units advises the Comptroller on policy and operational issues. To provide more focused attention on critical issues, senior executives also serve on smaller subcommittees (audit; bank supervision; budget and finance; human capital; regulatory policy, legal and external affairs; and technology and systems) that regularly report to the Comptroller and Executive Committee. From October 2004 to August 2005, Julie L. Williams was the acting Comptroller of the Currency.

Strategic Goals

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

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

Performance Measures

The OCC issues an annual performance budget outlining the performance goals and measures for the year, as mandated by the Government Performance Results Act (GPRA) and its implementing guidance. The OCC performance information presented in this report is reliable and complete, as ascertained through the FY 2005 management control assessment process described in the Systems, Controls, and Legal Compliance section of this report. The OCC's performance on the GPRA goals is incorporated in the program area discussions. Appendix A presents the results achieved on the OCC's GPRA performance measures and other internal measures, workload indicators, and customer service standards. Performance results for the three previous years are also presented, as available.

Program Results

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

- 1,287 strategy certifications completed for examination activities that concluded:
  - 99 percent of national banks were well capitalized.
  - 94 percent of national banks earned strong composite CAMELS[1] ratings of 1 or 2.
  - 94 percent of national banks merited high consumer compliance ratings of 1 or 2.
- 427 Community Reinvestment Act (CRA) examinations completed.
  - 273 bank consultations on community development opportunities were conducted.
  - 100 percent of qualified banks in the new category of "Intermediate Small Bank" under recently amended CRA regulation were offered a consultation.

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

- 607 enforcement actions completed on banks and individuals.
  - 44 percent of problem national banks rehabilitated.
- Approximately 150 substantive inquiries, including formal and informal appeals, processed by the Office of the Ombudsman.
- 67,839 calls fielded by the OCC's customer assistance call center.
  - 72 percent of the 72,203 closed consumer complaints were completed within 60 calendar days of receipt.
- 131 legal opinions issued in response to banks' requests. Significant topics addressed included use of derivatives, electronic banking, and directors' qualifying shares.
  - 86 percent of the 120 legal opinions subject to established processing time frames were issued on time. The remaining 11 opinions dealt with novel or complex issues and were excluded from this requirement.
- 3,332 corporate applications and notices received.
  - 96 percent of the 2,128 decisions issued were within established time frames.
  - 38 percent of all corporate applications and notices were received electronically.
- Examination and licensing activities performed in a quality and professional manner.
  - External ratings on the OCC's examination and licensing functions exceeded goals for service standards.

Other noteworthy program accomplishments in FY 2005 included:

- OCC filed "friend of the court" briefs in six cases that affirmed federal preemption of state law restriction of national bank activities.
- Conducted USA PATRIOT Act (USAPA) examinations in all large banks as well as transaction testing and compliance reviews regarding BSA/AML/USAPA for identified high-risk areas and activities. Completed BSA/AML/USAPA reviews in high-risk mid-size and community banks.
- Published the FFIEC's BSA/AML Examination Manual, which provides bankers and bank examiners with comprehensive guidance and resources about the BSA requirements and the agencies' supervisory expectations in this area. Hosted a series of interagency training and outreach sessions for examiners and bankers to discuss the new manual.
- Completed the annual shared national credit review that covered 6,817 credits with commitments totaling $1.6 trillion in coordination with the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation

(FDIC), and the Office of Thrift Supervision (OTS).

- Placed 96 entry-level bank examiners, hired in June 2004 and January 2005, into permanent field office positions for community bank supervision. Another 100 new examiners began on-the-job training and will be placed into permanent field offices in the first half of 2006.
- Issued four consumer advisories on such subjects as gift cards and Check 21.
- Revised guidance on the national banking system in "A Guide to the National Banking System," a companion publication to the Comptroller's Licensing Manual that is distributed at OCC's outreach meetings and recruitment efforts.
- Issued interagency Credit Risk Management Guidance on Home Equity Lending that describes supervisory expectations for product development and marketing; origination and underwriting; third-party originations; collateral valuation management; account management; portfolio management; operations, servicing, and collections; secondary marketing activities; and portfolio classifications, allowance for loan and lease losses, and regulatory capital.
- Through the FFIEC, issued updated guidance for the industry on effective methods that they can use to authenticate the identity of customers who use Internet-based banking services to help deter account fraud and identity theft.
- Implemented a Collective Bargaining Agreement between the OCC and the National Treasury Employees Union (NTEU) covering employee working conditions, such as processes for job and assignment opportunities, provisions for administering leave, work scheduling and work location, and provisions for remediation.
- Initiated 21 process improvement studies. Completed projects have resulted in cost savings of $700,000, enabled the redirection of staff resources to higher priority needs, minimized the impact of complying with new mandated or existing requirements, and matched internal customer expectations with service delivery.

Financial Management Results

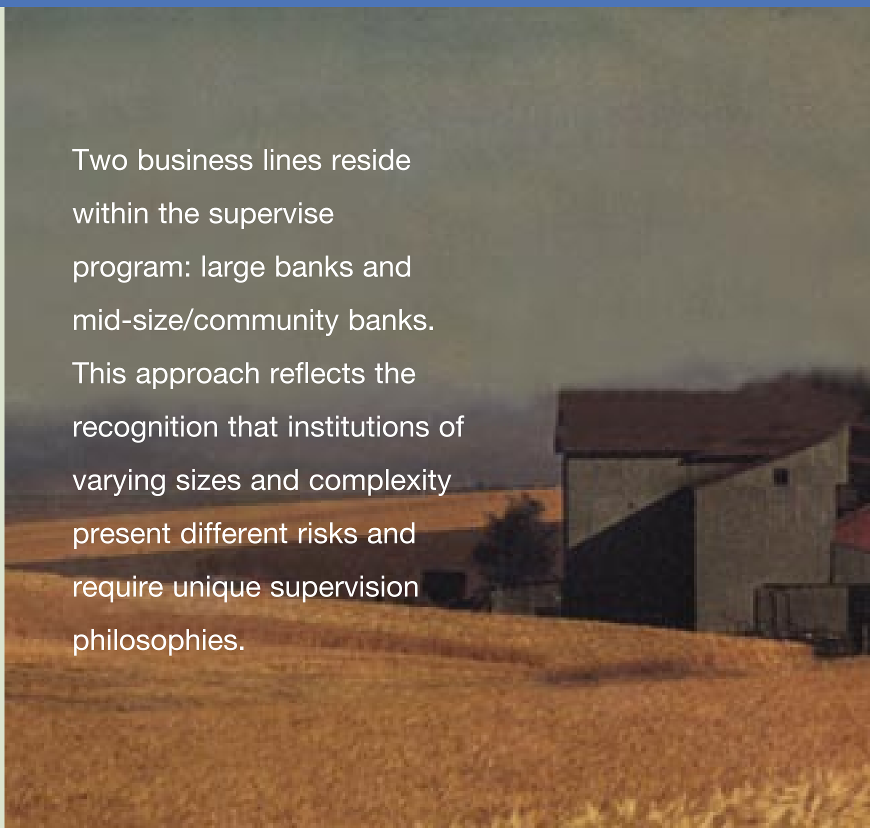
- Received an unqualified audit opinion from its independent auditors on the FY 2005 financial statements with no material weaknesses.
- Published the annual statement of reasonable assurance on the OCC's compliance with the Federal Managers' Financial Integrity Act (FMFIA) and the Federal Financial Management Improvement Act (FFMIA).
- Completed timely and accurate monthly and quarterly financial and performance reporting.

- Completed the documentation for several processes related to financial reporting and established a Senior Assessment Team (SAT) to ensure the requirements of the Office of Management & Budget (OMB) Circular A-123, Appendix A, are implemented effectively and communicated throughout the agency.
- Paid more than 22,400 invoices totaling \$81.3 million with 99.6 percent of payments timely, exceeding the OMB goal of 98 percent for government entities. This was an improvement from 98.7 percent of the 21,300 invoices paid timely in FY 2004. Interest penalties on late payments totaled \$1,198, an 82 percent reduction from the \$6,642 paid in FY 2004.
- Processed 99.5 percent of total vendor disbursements by means of electronic funds transfers (EFT). Additionally, the OCC made 100 percent of travel reimbursement payments through EFT. The OCC's performance in both areas exceeded OMB's goal of minimizing disbursement costs and improving accuracy through the use of EFT.
- Collected fee assessments from national banks totaling \$579.3 million, with 98.8 percent collected within five business days. This was a small improvement over FY 2004 when 98.4 percent of the \$490.3 million in assessments collected were within five business days.

Office of the Comptroller of the Currency

District Locations

Two business lines reside within the supervise program: large banks and mid-size/community banks. This approach reflects the recognition that institutions of varying sizes and complexity present different risks and require unique supervision philosophies.



The supervise program, by far the largest program, constitutes the core for accomplishing the OCC's mission.

Supervise Program

This program encompasses the supervision of national banks and their subsidiaries, federal branches and agencies of foreign banks,[2] national trust companies, bank data software vendors, and data processing service providers. This program also consists of activities to identify, analyze, and respond to emerging systemic risks and trends that could affect an individual national bank or the entire national banking system. The Committee on Bank Supervision establishes and oversees areas of emphasis for the OCC's supervisory activities. The committee is made up of the Chief National Bank Examiner and the senior deputy comptrollers for Large Bank Supervision and Mid-size/Community Bank Supervision. The supervise program supports the OCC's strategic goals of a safe and sound national banking system, fair access to financial services, and fair treatment of bank customers.

The supervise program, by far the largest program, constitutes the core for accomplishing the OCC's mission. In FY 2005, the OCC devoted 2,236 full-time equivalent (FTEs), or 83.4 percent of its total workforce, to the supervise program. The cost of the supervise program was $420.3 million in FY 2005.

Two business lines reside within the supervise program: large banks and mid-size/community banks. This approach reflects the recognition that institutions of varying sizes and complexity present different risks and require unique supervision philosophies.

The OCC's large bank program is responsible for supervising the 23 largest and most complex national banking companies, using teams of dedicated onsite examiners. During FY 2005, areas of supervisory emphasis for the large bank program included BSA/AML/USAPA compliance, corporate governance, credit quality and credit risk management, allowance for loan and lease losses (ALLL) procedures and adequacy, the integrity of banks' financial statements, ensuring adherence to accepted accounting practices, operational vulnerabilities, operational risk measurement and management practices, corporate structured transactions, compliance with anti-tying and covered transaction rules, and the implementation of Basel II at mandatory and opt-in banks.[3]

[2]Federal branches and agencies are branches licensed by the OCC and operated by foreign banking organizations. Federal agencies are offices that engage in the business of banking but do not accept deposits or exercise fiduciary powers.
[3]See the Partnership and Outreach section of this report for more information on activities related to Based II. In August 2003, the OCC, FDIC, FRB, and OTS issued an Advance Notice of Proposed Rulemaking, which explained how the agencies might implement Basel II in the U.S. and proposed criteria for determining whether a bank would be required to adopt the Basel II framework.

There are 26 banking companies in OCC's mid-size bank program and 30 companies in the credit card bank program. During FY 2005, areas of supervisory emphasis for the mid-size and credit card bank programs included BSA/AML/USAPA compliance, early identification and resolution of supervisory issues, the effectiveness of risk management practices and controls, the integrity of banks' financial statements, ensuring adherence to accepted accounting practices, banks' increased reliance on noninterest income, outsourcing and vendor activities, interest rate risk models and controls, investment portfolio practices and holdings, and concentration risk.

The OCC's community bank program generally covers national banks with less than $1 billion in total assets. Banks are assigned to an OCC portfolio manager who oversees the supervisory strategy for each bank. These strategies combine onsite examinations and off-site analysis to monitor bank performance. During FY 2005, areas of supervisory emphasis for the community bank program included BSA/AML/USAPA compliance, early identification and resolution of supervisory issues, banks' risk management practices and controls, banks' expanded use of outsourcing, interest rate risk monitoring and controls, concentration risk, and investment portfolio practices and holdings.

The supervise program is further divided into three subprograms: examining, enforcing, and ensuring fair access and fair treatment.

Examining

The OCC continuously supervises banks in the community bank, large bank, mid-size bank, and credit card bank programs. A supervisory strategy is developed based on each banking institution's risk profile and condition. The strategy includes a variety of supervisory activities, including examinations and off-site analyses, to be completed during a supervisory cycle. Examination activities focus on safety and soundness, consumer compliance, BSA/AML/USAPA, fair lending, asset management, bank information technology, and the CRA. The supervisory cycle conforms to either a 12- or 18-month time frame, depending on the size, complexity, and condition of the bank. All large banks and mid-size banks, and federal branches are on a 12-month supervisory cycle. At the end of each bank's cycle, OCC examiners certify the completion of the supervisory strategy and onsite activities, assign CAMELS ratings, and communicate their findings to the bank.

The OCC completed and certified 1,287 supervisory strategies during FY 2005. Included in this number are strategy certifications for all large, mid-size, and credit card banks; all federal branches and agencies; and more than 57 percent of community banks. In addition to strategy certification activities, the OCC conducted 427 CRA examinations, which are on either an 18- or 36-month cycle.

The supervisory strategy certifications completed during FY 2005 show that national banks continue to operate in a safe and sound manner as evidenced by assigned CAMELS ratings and assessments of capital levels. The results of OCC's supervisory activities indicated that 94 percent of all national banks earned the highest composite CAMELS ratings of 1 or 2, and 99 percent were well capitalized relative to their risks. For the 119 national banks with CAMELS ratings of 3, 4, or 5 on September 30, 2004, 35 had improved their composite CAMELS rating to either 1 or 2 by the end of FY 2005. Another 18 banks were sold, merged, or left the national banking system during the year without loss to the Bank Insurance Fund. The OCC achieved a 44 percent rehabilitation rate, exceeding the target of 40 percent, and an improvement from the 40 percent in FY 2004 and 32 percent in FY 2003. The OCC also exceeded its customer service standard for examination activities as rated by bank officials. The customer service results were based on 665 examination surveys completed by banks for the period July 2004 through June 2005, representing a 43 percent response rate. The survey is based on a five-point scale, in which 1 indicates complete agreement and 5 indicates complete disagreement with the survey statements. The results of the examining performance measures are shown in Table 1.

Table 1: Examining Performance Measures, FY 2005

Performance Measures	Target	Actual [1]
Percentage of national banks that are well capitalized	95%	***99%***
Percentage of national banks with composite CAMELS rating of 1 or 2	90%	***94%***
Rehabilitated problem national banks as a percentage of the problem national banks one year ago (CAMELS 3, 4 or 5)	40%	***44%***
Average survey response that the report of examination clearly communicated examination findings, significant issues, and the corrective actions (including time frames) management needed to take	≤ 1.75	1.28

[1] Performance numbers shown in bold italics are estimates. Some performance data is obtained from quarterly call reports from banks. The September 30, 2005 Reports of Condition and Income ("call reports") are not due until 30 or 45 days after the end of the period. Additionally, examinations concluded late in the fiscal year are not finalized for another 30 to 60 days. As a result, complete fiscal year data is not yet available, so estimates have been reported.

Horizontal Reviews

A horizontal review is an examination tool used to address significant, systemic concerns by examining across a portfolio of banks with similar characteristics. Horizontal reviews offer many benefits, notably the opportunity for exchange of best practices and a mechanism to ensure consistent expectations and supervision practices across all the banks. Typically conducted by experts in the area of focus, horizontal reviews provide an independent assessment. These reviews provide invaluable insights during the supervision process and give a quick assessment of how the banks are complying with laws, regulations, and other regulatory guidance. They allow the OCC to focus on higher-risk banks and make adjustments to supervision strategies and staffing as needed. During FY 2005, Large Bank Supervision restructured its senior management to bring the horizontal, systemic review, and analytic activities under a single deputy comptroller. The goal of this restructuring is to achieve greater consistency in the supervision of the large institutions.

The Mid-size Bank Supervision program conducted the following horizontal reviews in FY 2005:

- Automated Clearing House (ACH) activity
- ALLL methodology
- Appraisal programs and appraisal review programs
- Retail credit risk management

Two of these reviews (ALLL methodology and appraisal programs) were conducted at all of OCC's mid-size banks, while the rest focused on particular banks in the portfolio based on selection criteria.

Large Bank Supervision conducted a review focusing on staff monitoring and supervision processes to ensure each large bank's compliance with OCC guidance for ALLL methodology. The review was performed to determine the completeness and timeliness of Large Bank Supervision's efforts regarding ALLL, as supported by specific documentation provided by each large bank examination team.

Bank Secrecy Act, Anti-Money Laundering, and the USA PATRIOT Act

Money laundering and terrorist financing pose significant risks to the national banking system. The OCC responded to these risks in FY 2005 by conducting in-depth reviews across all lines of business for compliance with the requirements of the BSA/AML/USAPA.

All large banks received examinations, transaction testing, and compliance reviews regarding BSA/AML/USAPA for high-risk areas and activities. Using a risk-focused approach, the OCC completed similar reviews at high-risk mid-size banks and community banks. Concurrent with these reviews, OCC communicated with bank managers to make them aware of OCC expectations amid the heightened supervisory attention to this area.

On the international front, the OCC continued to provide foreign supervisors with technical assistance and training on BSA/AML techniques used in the OCC's supervision process. The OCC trained more than 50 supervisors from several countries at its headquarters; provided the same training to the Latin American regional bank supervisors group; and completed with the World Bank a video of its BSA/AML training courses. The video will be available to bank supervisors worldwide.

OCC Bolsters BSA/AML Compliance Program

The OCC took an array of actions in FY 2005 to improve its BSA/AML compliance program, many of which address findings and recommendations in a final report emanating from an internal review of the agency's BSA/AML supervision. The agency has:

- Enhanced its BSA/AML expertise by creating and filling a new position, director for Bank Secrecy Act and Anti-money Laundering Compliance, to consolidate anti-money laundering activities within the agency; increasing the number of BSA policy staff in its Washington headquarters; establishing BSA/AML as a focal point for the OCC's Examiner Specialized Skills Program; and augmenting staff dedicated to BSA/AML compliance by expanding the contract examiner pool to include BSA skills.
- Conducted 1,123 BSA/AML/USAPA examinations through June 30, 2005.
- Published enforcement policy to provide additional guidance about situations in which formal actions should be taken.
- Worked with the other federal banking agencies and the Financial Crimes Enforcement Network (FinCEN) to develop and issue guidance on providing banking services to money services businesses.
- Issued, jointly with the other federal financial regulators and FinCEN, a new and comprehensive FFIEC BSA/AML Examination Manual that establishes minimum core procedures that will be used at every examination to review and verify that a bank has an adequate BSA/AML compliance program and include mandatory transaction testing in each examination.
- Conducted a teleconference for almost 5,000 participants from national banks to ask questions about BSA and participated in interagency teleconferences and outreach sessions to examiners and bankers on the new BSA/AML Manual.
- Created a money laundering risk assessment system to help examiners identify potentially high-risk bank activities that may warrant increased scrutiny.
- Enhanced internal tracking systems to ensure timely follow-up on BSA/AML compliance deficiencies cited in examination reports.

Continued

OCC Bolsters BSA/AML Compliance Program *continued*

- Worked with FinCEN and other agencies to improve information sharing and data analysis.

The OCC investigates and brings enforcement actions against national banks that fail to meet BSA/AML requirements to implement adequate BSA compliance programs in accordance with OCC regulations, establish procedures to identify and monitor high-risk accounts, and report suspicious transactions. The OCC coordinates with other regulators and law enforcement authorities to ensure compliance with BSA/AML provisions and detect, track, and prevent attempts by terrorists and other criminals to use the national banking system for their activities.

The OCC brought enforcement actions against several banks for inadequate BSA/AML compliance programs. Among other requirements, banks were ordered to develop and implement internal controls, conduct audits, designate BSA compliance officers, and conduct employee training programs.

- The OCC issued two cease-and-desist orders by consent against a federal branch of a foreign bank to preserve asset levels, restrict its wire transfer activities, pay off depositors, and convert to an uninsured agency office with limited banking activities. In addition, the OCC, jointly with FinCEN, assessed a $24 million civil monetary penalty (CMP) against a federal branch for failure to comply with BSA/AML requirements. The agencies took these actions after determining that the branch failed to implement an adequate anti-money laundering program to manage the risks of money laundering and terrorist financing associated with its dollar clearing transactions, and that the branch violated BSA's suspicious activity reporting requirements.
- The OCC issued a cease-and-desist order by consent and assessed a $750,000 CMP against a bank for multiple and continuing violations of BSA and the USAPA, including failure to classify and monitor accounts of senior foreign officials.
- The OCC issued a cease-and-desist order by consent against a federal branch for deficiencies in the branch's internal controls, particularly in BSA/AML compliance. The OCC also issued a prohibition order by consent and assessed a $200,000 CMP against the branch's former general manager.
- The OCC issued a cease-and-desist order by consent that required a bank to shut down one of its lending departments, after the OCC determined that the bank permitted the department to engage in unsafe or unsound banking practices. The OCC also required the bank to address deficiencies in the bank's compliance with BSA and the USAPA; to increase capital levels, in view of increased risks; and to correct problems with the bank's books and records.

The OCC will also implement a Money Laundering Risk (MLR) system in early FY 2006. This system will provide collective information that will formulate the first step in assessing overall BSA/AML quantity of risk for each bank and enhance the OCC's ability to better measure the level of risk, evaluate risks within banks, and assess a bank's relative BSA/AML risk. This effort will not only enhance the quality of risk analysis by providing a more consistent methodology for measuring BSA/AML risks, but will allow for a larger scale of analysis because of the amount of data that will be systematically processed.

Shared National Credit Review

In the spring of 2005, the OCC completed the annual shared national credit review in coordination with the FRB, FDIC, and the OTS. This year's review covered 6,817 credits with commitments totaling $1.6 trillion. Additional information on this program is provided in the Partnership and Outreach section.

National Resource Planning Tool

The National Resource Planning Tool (NRPT) is a centralized and integrated Web-based database that shows resource needs and opportunities throughout the OCC. It facilitates the National Resource Planning Process, which uses an agreed-upon timeline and common data elements for requesting and scheduling resources from the other lines of business. In FY 2005 the large bank, mid-size bank and credit card bank lines of business piloted a uniform national process for requesting examination staff resources. The pilot involved standardizing the processes for staffing and scheduling for better communication and accountability. The pilot resulted in better examination planning and led to the creation of the NRPT.

Entry-Level Bank Examiner Training

In FY 2005, the OCC continued its recruitment program for entry-level bank examiners. Given the number of projected examiner retirements over the next five years, this program is critical for maintaining the OCC's high level of examiner expertise. In this program, newly hired bank examiners join training teams led by experienced examiners who provide on-the-job training examining banks during their first six to eight months with the OCC. During the year, 21 training teams consisting of 96 entry-level bank examiners hired in June 2004 and January 2005 completed their training team assignments and were placed in permanent field office locations in the community bank line of business. In June 2005, 21 new training teams began their on-the-job examiner training, and this group of 100 examiners is expected to join community bank field offices in the first half of FY 2006.

Risk Committees

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

National Bank Appeals
The national bank appeals process resolves individual appeals and inquiries from national banks. The ombudsman, with the consent of the Comptroller, has the discretion to stay any agency decision or action during the resolution of an appealable matter. The Office of the Ombudsman processed more than 150 substantive inquiries, including formal and informal appeals, during FY 2005.

Some of the issues considered by the ombudsman in 2005 include:

- The downgrade in the safety and soundness examination of the bank's composite rating from 2 to 4.
- The OCC's right to retain the full semiannual assessment fee for the period of January 1 through June 30 for a bank that converted to a state chartered commercial bank on January 1.
- The downgrade to a 3 of a bank's overall composite rating and component ratings for asset quality, management, and consumer compliance. The bank's board also appealed the violations of law of the legal lending limit.
- The restoration to a 2 of a 3 composite CAMELSI (capital, asset quality, management, earnings, liquidity, sensitivity to market risk, and information technology) rating assigned at the most recent examination.

An appeal summary is prepared for each formal appeal received in the ombudsman's office.

Enforcing

Enforcement actions ensure that corrective actions are taken to address violations of laws, rules, and regulations, unsafe or unsound banking practices, and non-compliance with policies or procedures by national banks, their insiders, and other affiliated parties. The OCC takes formal as well as informal actions to support prompt detection and mitigation of problems before they affect a bank's viability, and to require resolution of troubled banks in an orderly manner. The OCC's Enforcement and Compliance Division conducts investigations, takes administrative actions, and litigates those actions.

During FY 2005, the OCC took formal and informal enforcement actions against national banks and institution-affiliated parties who engaged in violations of laws and regulations or unsafe or unsound banking practices. The actions included temporary cease-and-desist orders, final cease-and-desist orders, removal or prohibition orders, CMPs, and formal agreements. The OCC's Fast Track Enforcement Program helps ensure that bank insiders and employees who committed criminal acts involving banks, but who are not being criminally prosecuted, are prohibited from working in the banking system. This program resulted in several prohibitions and personal cease-and-desist orders during FY

2005. Table 2 summarizes all enforcement actions completed in FY 2005.

- The OCC issued orders by consent for prohibition and restitution in the amount of $5,550 against a former bank teller for making unauthorized and fraudulent withdrawals from a bank customer's account for his own benefit.
- Following the OCC's issuance of a Notice of Charges, the FRB issued a prohibition order and the OCC issued an order for restitution in the amount of $2,400 against a former bank employee for altering bank records to inflate the amount of deposits into customers' accounts and depositing the surplus into his own account, and for diverting for his own use a cash overage that resulted when he conducted an improper transaction.
- The OCC issued a prohibition order by consent and assessed a $5,000 CMP against a former bank employee who made unauthorized transfers from her relatives' accounts into her business account; made unauthorized loans to, and withdrawals from, accounts of unrelated bank customers; and provided falsified bank documents to another bank to obtain a business loan.
- The OCC assessed a $180,000 CMP by consent against a bank's operating subsidiary for failing to dispose of confidential customer information in a secure fashion, in violation of bank regulations governing the security of customer information.

Table 2: Enforcement Actions, FY 2005

Type of Enforcement Action	FY 2005 Against National Banks	FY 2005 Against Institution-Affiliated Parties
Cease-and-Desist Orders	23	21
Temporary Cease-and-Desist Orders	1	0
Civil Money Penalties	11	52
Civil Money Penalties Amount Assessed	$25,587,700	$6,146,750
Formal Agreements	27	0
Memoranda of Understanding	14	0
Commitment Letters	5	0
Suspension Orders	0	4
Letters of Reprimand	0	15
12 USC 1818 Removal/Prohibition Orders	0	24
12 USC 1829 Prohibitions	0	410
Total Enforcement Actions	81	526

Other Enforcement Actions

The OCC continued to review the compliance of national banks with federal regulations requiring flood insurance for certain properties located in special flood hazard areas that secure loans made by national banks. The OCC assessed CMPs totaling $272,700 against nine banks for violations of flood insurance requirements in FY 2005.

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

The OCC also brought enforcement actions against banks and bank insiders to support prompt detection and mitigation of problems before they affected a bank's viability and against persons or companies who, while serving as agents or independent contractors of national banks, engaged in allegedly reckless acts causing losses to the banks.

Ensuring Fair Access and Fair Treatment

During FY 2005, the OCC's efforts to ensure fair access and fair treatment focused on integrating compliance risk supervision into the on-going supervision activities for national banks.

This subprogram included:

- Conducting risk-based fair lending examinations.
- Conducting outreach to national banks to assist them in meeting their responsibilities under the recently revised CRA and the new Home Mortgage Disclosure Act (HMDA) requirements.
- Researching new opportunities for community development activities by national banks and publishing best practices.
- Meeting with persons and groups that protest banks' corporate applications.
- Facilitating the community and consumer groups' interactions with the OCC, such as helping them inform their constituents about the OCC's customer assistance group (CAG).
- Reviewing or approving individual bank community development activities.

The OCC met two of the three FY 2005 performance targets for ensuring fair access and fair treatment of bank customers as depicted in the following table.

Table 3: Ensuring Fair Access and Fair Treatment Performance Measures, FY 2005

Performance Measures	Target	Actual
Percentage of national banks with consumer compliance rating of 1 or 2	94%	***94%***
Percentage of qualified intermediate small institutions to which the OCC offers to provide consultation on the CRA and community development opportunities	100%	100%
Percentage of consumer complaints closed within 60 calendar days of receipt	80%	72%

Unfair and Deceptive Acts or Practices

On February 2, 2005, OCC issued residential real estate lending standards to assist national banks in their efforts to avoid becoming involved in predatory, abusive, unfair, or deceptive residential mortgage lending practices. The OCC also continues to respond vigorously to abusive, unfair, or deceptive business practices by national banks, thereby promoting fair treatment of bank customers and fair access to financial services for all Americans.

- The OCC issued prohibition and cease-and-desist orders by consent and assessed a $20,000 CMP against a former bank vice president and loan officer for making tax lien loans that violated the Home Ownership Equity Protection Act, the Truth in Lending Act, the Real Estate Settlement Procedures Act, and the Federal Trade Commission Act; and for receiving a large portion of excessive and duplicative fees collected by the bank from customers, including fees for services that were never performed. Earlier the OCC required the bank to make restitution to affected customers and issued a cease-and-desist order by consent against the company that marketed, originated, serviced, and collected the tax lien loans for the purpose of restricting its conduct of business with insured depository institutions.

Actions to Combat Identity Theft

The OCC investigates and brings enforcement actions against individual bank employees as well as against bank service providers who misuse bank customer information to engage in identity theft and other illegal activities.

Consumer Complaints

The CAG (Customer Assistance Group) assists consumers who have questions or complaints about national banks and their operating subsidiaries. The CAG implements a wide range of initiatives each year to further improve the way it conducts its business and responds to its constituents' needs. Through these efforts, CAG strives to make a positive impact on the lives of many consumers, a considerable contribution to the OCC supervisory process, and a significant difference to the nation's banking industry.

The CAG serves three constituents:

- Customers of national banks and their subsidiaries — by providing a venue to resolve complaints;
- OCC bank supervision — by alerting supervisory staff members to emerging problems that may potentially result in the development of policy guidance or enforcement action; and
- National bank management — by providing a comprehensive analysis of complaint volumes and trends.

The CAG is not an advocate for banks or consumers, but remains neutral in answering questions and offering guidance on applicable banking laws, regulations, and practices. The CAG encourages customers to contact their banks first to try to resolve their concerns. If these efforts are unsuccessful, CAG may serve as a liaison between the consumer and the bank. If a CAG specialist is unable to help over the phone, the consumer may be asked to submit a signed, written complaint. The CAG is not always able to resolve complaints of a factual or contractual dispute nature; these more appropriately may be decided by a court of law. Additionally, federal laws and regulations might not govern service issues or complaints related to the bank's internal policies and procedures. The CAG cannot give legal advice or personal opinions about consumer complaints and/or the bank's position in a case, but it can offer informal education to the consumer on banking and the use of credit.

The CAG is staffed with highly trained compliance professionals equipped to deliver responsive customer service. The operation employs state-of-the art call center technology with bilingual call routing (English and Spanish), a Web-based complaint resolution process, and Internet and facsimile access 365 days a year.

During FY 2005, the CAG received 67,839 calls, opened 73,519 cases and closed 72,203 cases. Of the cases closed, 72 percent were completed within 60 calendar days of receipt, falling short of the target of 80 percent and less than the 74 percent achieved in FY 2004. Although the Houston call center was closed for days due to Hurricane Rita, there was still a 1 percent increase in calls from FY 2004. Additionally, the OCC opened 8 percent and closed 6 percent more cases than in FY 2004. The risks and complexity of consumer complaints continue to increase, requiring additional time for analysis and in many instances, additional information from the consumer or the bank. This has lengthened the average response time.

Community Affairs

Revisions to the CRA regulations in 2005 added a new category of banks to include "Intermediate Small Bank," a bank with assets between $250 million and $1 billion. The OCC identified national banks in this category and offered CRA consultative services to each of them. During FY 2005 the

OCC conducted 273 bank consultations. The consultations covered strategies for national banks' responsibilities under CRA, including local and regional investment opportunities, the OCC's investment authority for community development investments, federal low-income housing tax credits, new markets tax credits, individual development accounts, bank-owned community development corporations, and small business administration programs.

The OCC published two *Community Developments Insights* papers on "Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked," and "Individual Development Accounts: An Asset Building Product for Lower Income Consumers." It also published four *Community Developments* newsletters: "The Power of Plastic: How Banks Are Using Technology to Reach the Unbanked," "Growing Markets with Bank-Owned Community Development Corporations," "Investment Intermediaries: Helping Banks Achieve a Double Bottom Line," and "Using the New HMDA Data to Expand Home Mortgage Lending Opportunities."

OCC, Banks, and Other Agencies Team Up to Help Katrina Victims

In the days and hours leading up to Hurricane Katrina's landfall along the Gulf Coast on August 29, 2005, the OCC was already coordinating with other federal agencies, state officials, and national bankers on efforts to weather the storm and begin recovery for what would turn out to be the most costly natural disaster in U.S. history.

After the storm, the OCC joined with other federal and state banking officials and industry trade groups in a coordinated response to the crisis. Of immediate importance was restoring financial services to the people dealing with Katrina's aftermath — ensuring that individuals and businesses had access to cash and that financial institutions could continue to receive and process payments, including Social Security, veterans, and disability payments. As part of these efforts, the OCC and other agencies encouraged banks to consider actions to assist storm victims, including:

- Waiving ATM fees for customers and non-customers.
- Increasing ATM daily cash withdrawal limits.
- Easing restrictions on cashing out-of-state and non-customer checks.
- Waiving overdraft fees resulting from paycheck interruption.
- Waiving early withdrawal penalties on time deposits.
- Waiving availability restrictions on insurance checks.
- Allowing customers to defer or skip some loan payments.

Continued

OCC, Banks, and Other Agencies Team Up to Help Katrina Victims *continued*

- Waiving late fees for credit cards and other loans due to interruption of mail and billing statements, or the customer's inability to access funds.
- Easing credit card limits and credit terms on new loans.
- Delaying delinquency notices to credit bureaus.
- Using non-documentary customer verification methods for customers who could not provide standard identification documents.

In addition, the OCC assisted banks in establishing temporary branches and sharing branch facilities and employees. The OCC also established a special section on its Web site where bankers and consumers could obtain additional Katrina-related information. Beyond addressing these immediate needs, the OCC has remained committed to working with national banks and the industry in addressing longer term concerns and issues. In September 2005, the federal financial regulatory agencies announced the formation of a working group to foster the regulatory agencies' coordination, communication, and financial supervisory responses to the issues facing the industry in Katrina's wake.

The response to Katrina showed the resiliency and strength of the nation's banking system. It showed the pride and professionalism of the federal and state regulators and banking trade groups who recognized the essential role banks play in responding to such crises and rebuilding communities. The response also showed the willingness of competing financial institutions to act in the interests of their communities and customers by sharing space, resources, and support. Lastly it showed the importance of sound disaster recovery planning.

Although hurricanes like Katrina do not come ashore every year, other natural disasters and incidents regularly affect the lives, communities, and businesses they touch. The safety and soundness of America's national banking system requires vigilance for responding to these crises, maintaining plans for disaster recovery and continuity of operations, and reviewing those plans to ensure they protect against foreseeable risks.

Regulate Program

The regulate program establishes regulations, policies, operating guidance, and interpretations of general applicability to national banks. These regulations, policies, and interpretations may set system-wide standards, define acceptable banking practices, provide guidance on risks and responsibilities facing national banks, or prohibit (or restrict) banking practices deemed to be imprudent or unsafe. This program includes the establishment of examination policies, handbooks, and interpretations for examiners. It also includes representing and defending the OCC's regulatory authorities and interpretations in administrative, judicial, and congressional hearings.

The OCC devoted 358 FTEs or 13.4 percent of the OCC workforce, to the regulate program in FY 2005. The cost of the regulate program was $65.9 million. The OCC issued 131 legal opinions. Of the 120 legal opinions subject to the processing time frames, 86 percent were completed on time, meeting the FY 2005 goal.

The OCC issued seven final rules, one interim rule, and two notices of proposed rulemaking. The OCC also issued two notices, pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA), inviting comment on ways to improve current regulations, and two notices seeking comment on substantive guidance that OCC proposed to provide to national banks.

Among the most significant rulemakings completed this year were:

- *Rules, Policies, and Procedures for Corporate Activities; Annual Report on Operating Subsidiaries (12 CFR5) 69 FR 64478 (November 5, 2004).* This final rule revised OCC's rules governing national bank operating subsidiaries. It requires a national bank to file an annual report with the OCC that identifies its operating subsidiaries that do business directly with consumers and are not otherwise "functionally regulated" subsidiaries within the meaning of section 5(c)(5) of the Bank Holding Company Act of 1956, as amended. The annual filing contains the name of each reportable operating subsidiary, its state of incorporation, and a brief description of its activities. The OCC makes this information available to the public on its Internet Web site.
- *Proper Disposal of Consumer Information under the Fair and Accurate Credit Transactions Act of 2003 (12 CFR 30 and 41) 69 FR 77610 (December 28, 2004).* The OCC, together with the FRB, FDIC, and the OTS issued a joint rulemaking to implement section 216 of the Fair and Accurate Credit Transactions Act of 2003. Section 216 requires the banking agencies, the National Credit Union Administration (NCUA), the Securities and Exchange Commission (SEC), and the Federal Trade Commission (FTC) to adopt consistent and comparable regulations, to the extent possible, requiring entities subject to their jurisdictions to dispose of consumer information properly to reduce the risk of identity theft.
- *OCC Guidelines Establishing Standards for Residential Mortgage Lending Practices (12 CFR 30) 70 FR 6329 (February 7, 2005).* OCC issued final guidelines concerning the residential mortgage lending practices of national banks and their operating subsidiaries as a further step to protect against national bank involvement in predatory, abusive, unfair, or deceptive residential mortgage lending practices. The guidelines identify practices that are consistent with sound residential mortgage lending practices and describe terms and practices that may lead to predatory, abusive, unfair, or deceptive lending practices. They also address steps banks should take to mitigate risks associated with their purchase of residential mortgage loans and use of mortgage brokers to originate loans.

- *Interagency Guidance on Response Programs for Unauthorized Access to Customer Information and Customer Notice (12 CFR 30) 70 FR 15736 (March 29, 2005).* The OCC, the FRB, the FDIC, and the OTS issued an interpretation of section 501(b) of the Gramm-Leach-Bliley Act and the Interagency Guidelines Establishing Standards for Safeguarding Customer Information. The interpretation describes the agencies' expectations regarding the response programs, including customer notification procedures, that a financial institution should develop and implement to address the unauthorized access to, or use of, customer information that could result in substantial harm or inconvenience to a customer.

- *Fair Credit Reporting Medical Information Regulations (12 CFR 41) 70 FR 33958 (June 10, 2005).* This interim final rule implements section 411 of the Fair and Accurate Credit Transactions Act of 2003. The interim final rule creates exceptions to the statute's general prohibition on creditors obtaining or using medical information pertaining to a consumer in connection with any determination of the consumer's eligibility, or continued eligibility, for credit for all creditors. The exception permits creditors to obtain or use medical information in connection with credit eligibility determinations when necessary and appropriate for legitimate purposes, consistent with the congressional intent to restrict the use of medical information for inappropriate purposes. The interim final rule also creates limited exceptions to permit affiliates to share medical information with each other without becoming consumer reporting agencies.

- *CRA Regulations (12 CFR 25) 70 FR 44256 (August 2, 2005).* The OCC, together with the FRB and the FDIC, issued a final rule to revise certain provisions of its rules implementing the CRA. This rulemaking addresses the regulatory burden imposed on smaller banks by revising the eligibility requirements for CRA evaluation under the lending, investment, and service tests. The rulemaking adds a new community development test for banks with at least $250 million and less than $1 billion in assets (Intermediate Small Bank). This rulemaking also revises the definition of the term "community development" to include affordable housing and revitalization and stabilization in underserved rural areas and designated disaster areas and revises the regulation to address the impact on a bank's CRA rating of evidence of discrimination or other illegal credit practices.

Legal Opinions

Significant legal opinions issued in FY 2005 included:

- *Directors' Qualifying Shares.* National bank directors may meet the qualifying shares requirement under 12 USC 72 by purchasing trust preferred stock. This offers bank directors a new means of obtaining a financial stake in the bank in addition to purchasing bank stock. Interpretive Letter No. 1020 (February 8, 2005).
- *Equity Derivative Transactions with Affiliates and Subsidiaries.* A bank may enter into equity derivatives transactions with certain of its affiliates and subsidiaries that mirror the affiliates' and subsidiaries' transactions with their customers, and the bank may hedge the risks of those transactions in the same manner as it hedges the risks of its existing derivatives business, provided the OCC has no supervisory objection. Interpretive Letter No. 1018 (February 10, 2005).
- *Agricultural Loans.* A bank may offer agricultural loans with payments that vary based on changes in commodity prices. The proposed activities are permissible as incidental to an existing agricultural lending business. The bank first must satisfy itself concerning possible application of commodity laws to the program and must also establish that the bank has an appropriate risk measurement and management process. Interpretive letter No. 1019 (February 10, 2005).
- *Financial Intermediation Transactions Involving Electricity.* A bank may engage in electricity derivative transactions and hedges, settled in cash and by transitory title transfer, as part of, or incidental to, its existing financial intermediation business in energy-related commodities derivatives, provided the bank has established an appropriate risk measurement and management process for those activities to which the OCC expresses no supervisory objection. Interpretive Letter No. 1025 (April 6, 2005).
- *Branching.* The OCC concluded that a remote check-scanning terminal at a customer's location, which permits the customer to deposit checks electronically, is not a branch. This was the first letter to discuss such terminals. Interpretive Letter No. 1036 (August 10, 2005).
- *Workers' Compensation Self-Insurance.* The OCC issued a legal opinion confirming that it is permissible for national banks to participate in a group to self-insure group members' workers' compensation obligations. This opinion opens the way for community banks to reduce their costs significantly in this area. Interpretive Letter No. 1022 (February 15, 2005).

Supervisory Guidance, Policies, and Examination Handbooks

During FY 2005, the OCC issued supervisory guidance, policies, and examination handbooks on various issues and risks affecting national banks.

- *Clarifications to the OCC's Enforcement Guidelines.* Under 12 CFR 21.21, all national banks must establish and maintain adequate internal controls, independent testing, responsible personnel, and training to comply with the BSA. This guidance clarifies and provides a consistent approach for examiners to use when citing violations and taking enforcement actions with respect to this rule. The OCC also issued an appendix to its Enforcement Action Policy to identify those violations (including BSA) or other supervisory findings that, as a result of a statutory or other legal requirement, require the OCC to take a specific action. (OCC Bulletins 2004-50 and 2004-51).
- *Interim Examination Procedures for Retail Credit.* In recent years, the mix and complexity of products that banks offer and the availability of credit to consumers has expanded. Concurrent with this growth have been changes in the ways that banks manage their retail portfolios. In response to these trends, the OCC issued updated examination procedures that address the various risk management and control functions that banks need to manage more diverse and complex portfolios. The OCC plans to incorporate these procedures in a subsequent update to the Comptroller's Handbook. (OCC Bulletin 2004-59).
- *Guidance on Risk Mitigation and Response to Web-Site Spoofing Incidents.* Web-site spoofing is a method of creating fraudulent Web sites that look similar, if not identical to an actual site, such as that of a bank, with the goal of enticing customers to reveal information that would enable a criminal to use customers' accounts to commit fraud or steal the customers' identities. In response to the growing incidents of Web-site spoofing, the OCC issued guidance to banks on how to respond to such incidents and steps that they can take to mitigate the risks to themselves and their customers from such incidents. (OCC Bulletin 2005-24).
- *Advisory Letter on Electronic Disclosures and Notices.* Increasingly, banks are replacing their paper-based consumer notices or disclosures with electronic disclosures. However, the failure to provide such electronic disclosures in a proper manner can expose a bank to significant compliance, transaction, and reputation risk. This advisory letter provides background and highlights issues that should be considered by national banks that provide electronic consumer disclosures. (OCC AL-2004-11).
- *Additions and Updates to the Comptroller's Handbook series.* The OCC published two updates to the Comptroller's Compliance Handbook.

- “Other Consumer Protection Laws and Regulations” incorporates interagency examination procedures for the Homeowners Protection Act, the Disclosure and Reporting of CRA-Related Agreements, and the Prohibition Against Use of Interstate Branches Primarily for Deposit Production. It replaces the OCC’s 1996 booklet.
- “Home Mortgage Disclosure Act Examination Procedures” incorporates FRB changes to Regulation C, the majority of which relate to additional information requirements lenders must include on their HMDA Loan Application Register and replaces the OCC’s August 1996 booklet.

Consumer Advisories

Consumer Advisories issued in FY 2005 included:

- *Gift Cards: OCC Provides Holiday Tips for Consumers, OCC News Release 2004-108 (December 7, 2004).* The OCC issued this consumer advisory to provide important information to holiday shoppers about the terms and conditions that apply to gift cards. The OCC advised consumers to make sure they have received disclosures on significant terms and conditions of gift cards, including any applicable fees, such as those that apply after the purchase of the card and thereby reduce its value; any expiration date for the card; procedures to follow in the event the card is lost or stolen; the locations at which the gift card can be used; and the procedures to follow in the event there are problems with the card. If these disclosures are not stated on the gift card itself, or its packaging, the OCC recommended that consumers determine if there is a toll-free number or Web site that would provide this information.
- *Check 21: Q’s and A’s, http://www.occ.treas.gov/consumer/check21/htm.* The OCC posted on its public Web site these questions and answers for consumers about the Check Clearing for the 21st Century Act, commonly referred to as the “Check 21 Act.” The questions and answers provide basic information to consumers on various aspects of this new federal law. The document focuses on what consumers most need to know about the Check 21 Act, including the importance of ensuring that there are sufficient funds in the account to cover checks that are written; the possibility that original checks will not be returned; the availability and significance of substitute checks created pursuant to the Check 21 Act; and special procedures to correct errors involving substitute checks.
- *Writing a Check: Understanding Your Rights, OCC News Release 2005-75 (August 2, 2005).* The OCC issued this consumer advisory to provide consumers with important information about their rights when they use checks to make payments. The advisory outlines the

different ways that checks can be processed and the significance for consumers of those differences. For example, the advisory informs consumers that various methods for electronic check processing may mean that funds are taken from consumers' bank accounts more quickly than before. As a result, it is even more important for consumers to ensure that they have enough money in their accounts to cover checks at the time they write them. The advisory also discusses the different laws and regulations governing check transactions, how consumers' rights may vary depending on how a check is processed, and how consumers may resolve problems in connection with their checks.

In addition to these OCC issuances, the OCC participated in and issued supervisory guidance and examination procedures in conjunction with other federal financial regulators. These initiatives are discussed in the Partnership and Outreach section of this report.

Litigation Activities

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

- *Decisions that federal law preempts state law restrictions on the activities of national bank mortgage operating subsidiaries.* Four U.S. district courts in California, Connecticut, Maryland, and Michigan have granted national banks declaratory and injunctive relief in suits challenging states' efforts to license and exercise visitorial powers over the operating subsidiaries of national banks. In each case, the district court held that the National Bank Act and OCC regulations preempt state licensing and enforcement authority over the real estate lending activities of national bank operating subsidiaries. Both the Second and Ninth Circuit Courts of Appeals have affirmed the decisions of the district courts in California and Connecticut. *Wells Fargo Bank, N.A.* v. *Boutris,* — F.3d —, 2005 WL 1924713 (9th Cir. August 12, 2005), *Wachovia Bank, N.A.* v. *Burke,* 414 F.3d 305 (2nd Cir. 2005). The decisions of district courts in Maryland and Michigan are pending appeal before the Fourth and the Sixth Circuit Courts of Appeals, respectively. *Nat'l City Bank of Ind.* v. *Turnbaugh,* 367 F.Supp.2d 805 (D.Md.2005), appeal docketed, No. 05-1647 (4th Cir. June 13, 2005); *Wachovia Bank, N.A.* v. *Watters,* 334 F.Supp.2d 957 (W.D.Mich.2004) appeal docketed, No. 04-2257 (6th Cir. October 14, 2004).
- *Challenge to federal diversity jurisdiction ruling of the Court of Appeals for the Fourth Circuit.* The Supreme Court granted certiorari to review a decision of the Court of Appeals for the Fourth Circuit that held, based upon its interpretation of 28 USC 1348, that a national bank is a citizen of any state in which it maintains a branch office or other physical presence for federal

diversity jurisdictional purposes. *Wachovia Bank, Nat. Ass'n* v. *Schmidt,* 388 F.3d 414 (4th Cir. 2004), *cert. granted,* 73 USLW 3540, 73 USLW 3713, 73 USLW 3718 (U.S. June 13, 2005) (No. 04-1186). The Fourth Circuit Court of Appeals decision created a conflict within the United States courts of appeals when it rejected a contrary interpretation of 28 USC 1348 adopted by the Fifth, Seventh and Ninth Circuits. *See Horton* v. *Bank One, N.A.,* 387 F.3d 426 (5th Cir. 2004).

- *Section 104 of the Gramm-Leach-Bliley Act preempts state law that restricts the sale of insurance by national banks.* A U.S. District Court granted summary judgment to plaintiffs who challenged as preempted state statutory provisions that restrict national bank insurance sales, solicitation, and cross-marketing. The court held that section 104 of the Gramm-Leach-Bliley Act, 15 USC 6701, preempts state laws that restrict the insurance sales activities of national banks. *Massachusetts Banking Ass'n* v. *Bowler,* 2005 WL 61458 (D.Mass. 2005).

- *Highest state court holds that state law authorizes a national bank to charge document preparation fees.* In an unanimous opinion, the Illinois Supreme Court affirmed two decisions of the Illinois Court of Appeals that dismissed complaints in 38 lawsuits, consolidated for appeal, where the plaintiffs alleged that various lenders, including a national bank operating subsidiary, engaged in the unauthorized practice of law by charging a fee for preparing real estate mortgage loan documents. The court concluded that a company engages in the practice of law by preparing loan documents, such as the note and the mortgage. Under Illinois law, however, a party to a transaction is permitted to prepare the documents memorializing that transaction. Thus, the court held that state law permits lenders, including national bank subsidiaries, to charge fees for preparing loan documents. *King.* v. *First Capital Financial Service Corp.,* 828 N.E.2d 1155 (2005).

- *Fair Credit Reporting Act preempts California statute that restricts information sharing among affiliates.* The Ninth Circuit Court of Appeals held that the clause of the Fair Credit Reporting Act preempting state laws regulating the exchange of information among affiliates invalidates the requirements and prohibitions imposed by the California Financial Information Privacy Act (commonly known as SB1) for affiliates sharing information bearing on a consumer's creditworthiness, credit standing, credit capacity, character, or other factor used to establish the consumer's eligibility for credit or insurance. *American Bankers Ass'n* v. *Gould,* 412 F.3d 1081 (9th Cir. 2005).

- *Federal court upholds OCC decision denying a request for suspicious activity reports.* The U.S. District Court for the Northern District of Ohio held that the OCC's decision denying a request for suspicious activity reports (SARs) was reasonable because the BSA's prohibition on the disclosure of a SAR and the OCC's implementing regulation declaring a SAR to be confidential prohibits the disclosure of a SAR to anyone. The court also sustained the constitutionality of the BSA's confidentiality provision and the OCC's implementing regulation. *Wuliger* v. *OCC,* — F.Supp. —, 2005 WL 2217039 (N.D. Ohio).

- *United States Court of Federal Claims rejects banker's Tucker Act claim to recover compensation for a Fifth Amendment taking.* The U.S. Court of Federal Claims ruled that the OCC did not prohibit a former banker from selling shares of stock he owned in a national bank following his suspension from participation in the affairs of the bank and, thus, did not violate his constitutional rights. *Hedrick* v. *United States,* No. 95-684C, slip op. (Fed. Cl. September 29, 2004).

Charter Program

The charter program relates to chartering national banks as well as evaluating the permissibility of structures and activities of those banks and their subsidiaries. The program includes the review and approval of new national bank charters, federal branches and agencies, mergers, conversions, corporate reorganizations, changes in control, operating subsidiaries, branches, relocations, and subordinated debt issues. The charter process incorporates conditions and agreements as needed to support the safe and sound operation of the resulting entities.

In FY 2005, the OCC devoted $15.5 million and 86 FTEs or 3.2 percent of its workforce, to the charter program. The OCC exceeded all of its FY 2005 performance targets and customer service standards for licensing operations. The customer service results were based on 645 licensing surveys completed by banks during the year, for a 37 percent response rate. The survey is based on a five-point scale, in which 1 indicates outstanding and 5 indicates significantly deficient. The OCC follows up with every applicant that rates the overall licensing process 3 or worse. This follow-up helps agency employees understand the applicants' concerns, so that the OCC can make appropriate modifications to its licensing process. The FY 2005 licensing and customer service performance measures and results are presented in Table 4.

Table 4: Licensing and Customer Service Performance Measures, FY 2005

Performance Measures	Target	Actual
Percentage licensing applications and notices filed electronically	35%	38%
Percentage of licensing applications and notices completed within established time frames	95%	96%
Average survey rating of the overall licensing services provided by OCC	≤ 1.5	1.19

Licensing Decisions

A responsive and efficient licensing operation is essential to meet the needs of banks that are part of, or seek to become part of, the national banking system. The OCC received 2,341 applications and 991 notices during FY 2005. The volume of corporate applications and notices decreased by 239 (6.7 percent) from FY 2004. Table 5 shows the corporate applications received in FY 2004 and FY 2005. Of the 2,128 decisions issued on applications during FY 2005, 96 percent were completed within the established time frames, the same as in FY 2004. Table 6 shows the timeliness of the OCC's actions by type of application for FY 2004 and FY 2005. The OCC met its goal while providing a consistently high level of services as rated by applicants. In addition, the OCC received 1,256 applications and notices electronically, an increase of 64 percent over the 875 received in FY 2004. Electronic filing reached 38 percent of all applications and notices received and increased from 34 percent in FY 2004.

Table 5: Corporate Application Activity, FY 2004 and 2005

	Applications Received		FY 2005 Decisions			
			Approved	Conditionally Approved [4]	Denied	Total
	FY 2004	FY 2005				
Branches	1,765	1,645	1,546	4	0	1,550
Capital / sub debt	136	141	49	8	0	57
Change in Bank Control	16	17	17	0	0	17
Charters	31	26	3	17	0	20
Conversions[1]	21	15	7	9	0	16
Federal Branches	4	2	0	0	0	0
Fiduciary Powers	22	22	5	6	0	11
Mergers[2]	90	69	59	4	0	63
Relocations	288	259	241	1	0	242
Reorganizations	137	116	98	9	0	107
Stock appraisals	1	2	0	0	0	0
Subsidiaries[3]	81	23	39	4	0	43
12 CFR 5.53 Change in Assets	NA	4	0	2	0	2
Total	2,592	2,341	2,064	64	0	2,128

[1] Conversions are conversions to national bank charters.
[2] Mergers include failure transactions when the national bank is the resulting institution.
[3] This count does not include 70 After-the-Fact notices received in FY 2004 and 128 After-the-Fact notices received in FY 2005.
[4] On April 14, 2000, the Licensing department issued guidance imposing special conditional approval for all bank charters requiring the OCC to be notified before a significant deviation or change in the operating plan during the first three years of operation.

Table 6: OCC Licensing Actions and Timeliness, FY 2004 and 2005

		FY 2004			FY 2005		
			Within Target			Within Target	
Application Type	Target time frames in days [1]	Number of Decisions	Number	%	Number of Decisions	Number	%
Branches	45 / 60	1,798	1,769	98	1,550	1,519	98
Capital / sub debt	30 / 45	48	46	96	57	48	84
Change in Bank Control	NA / 60	14	14	100	17	17	100
Charters [2]		38	22	58	20	17	85
Conversions	30 / 90	18	14	78	16	7	44
Federal Branches	NA / 120	2	2	100	0	0	NA
Fiduciary Powers	30 / 45	13	7	54	11	6	55
Mergers	45 / 60	96	86	90	63	53	84
Relocations	45 / 60	283	278	98	242	237	98
Reorganizations	45 / 60	123	100	81	107	88	82
Stock appraisals	NA / 90	0	0	NA	0	0	NA
Subsidiaries	NA	44	44	100	43	43	100
12 CFR 5.53 Change in Assets		0	0	NA	2	1	50
Total		2,477	2,382	96	2,128	2,036	96

Note: Most decisions (99 percent in 2004 and 98 percent 2005) were decided in the district offices and Large Bank Licensing under delegated authority. Decisions include approvals, conditional approvals, and denials.

[1] Those filings that qualify for the "expedited review" process are subject to the shorter of the time frames listed. The longer time frame is the standard benchmark for more complex applications. New time frames commenced in 1997 with the adoption of the revised Part 5. The target time frame may be extended if the OCC needs additional information to reach a decision, permits additional time for public comment, or processes a group of related filings as one transaction.

[2] For independent charter applications, the target time frame is 120 days. For holding-company-sponsored applications, the target time frame is 45 days for applications eligible for expedited review, and 90 days for all others.

The OCC made several significant charter decisions, including:

- OCC issued, for the first time, an approval under its new regulation (12 CFR 5.53) requiring prior OCC approval for a fundamental change in a bank's asset composition. Conditional Approval 662 (October 28, 2004).
- As part of an OCC approval of the acquisition of a corporation as an operating subsidiary of a national bank, the agency found that a number of international trade-related services were either part of, or incidental to, the business of banking. Corporate Decision 2005-02 (March 24, 2005).

- The OCC affirmed that a state bank organized as a limited liability company may convert to a national bank under 12 USC 35. Corporate Decision 2005-10 (June 30, 2005).

Other Licensing Accomplishments

The OCC publishes electronically the 22-booklet *Comptroller's Licensing Manual.* During FY 2005, several manual booklets were revised and posted to the OCC's Web site and made available on compact disc (CD) for examiners and the public. In addition, the OCC revised guidance on the national banking system in the manual's companion publication, "A Guide to the National Banking System," which is distributed at OCC's outreach meetings and recruitment efforts.

Change in Bank Control

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

During FY 2005, the OCC continued to review and determine whether the CBCA standards warrant a CBCA filer to execute an enforceable agreement with the OCC. In certain circumstances, the OCC may require an agreement that imposes substantive requirements equivalent to conditions and pre-opening requirements that apply to a de novo

Table 7: Change in Bank Control Act,[1] 2001–9/30/2005

Year	Received	Acted On	Not Disapproved	Disapproved	Withdrawn
2005 *	17	17	17	0	0
2004 *	16	14 [2]	13	0	0
2003 *	16	10	9	1	0
2002	10	10	9	1	0
2001	18	17	17	0	0

* Reported by fiscal year, starting in fiscal year 2003.
[1] Notices processed with disposition.
[2] Includes one notice with no activity. The OCC considered it abandoned.

charter. When the notice raises fundamental supervisory or other issues that cannot be mitigated through agreements, the OCC will disapprove the proposal.

The OCC's CBCA activity is reflected in Table 7. The OCC received 17 CBCA notices in FY 2005. During this period, the OCC acted on 17 notices, none of which was disapproved.

Community Reinvestment Act

Consistent with 12 CFR 5, the "Public Notice and Comments" booklet (February 2004) details the OCC's procedures for handling CRA issues in applications, including the treatment of adverse comments from the public. During FY 2005, the OCC received adverse comments from the public on three CRA-covered applications. Table 8 lists those decisions rendered during FY 2005 on applications presenting CRA issues that were published in the OCC's monthly *Interpretations and Actions.* This publication is available on the OCC's Web site.

Licensing Reviews

The OCC has several initiatives under way to evaluate and enhance its licensing programs. During the year, the OCC continued with the development of its new processing database, Licensing Information Systems (LIS). Also work continued to ensure the OCC and Federal Reserve Banks work together on change in bank control applications at the holding company level, where the OCC seeks certain safeguards from the acquiring holding company of a national bank. Initial efforts began during 2005 on a Quality Assurance Program (QAP) for licensing. The Licensing Department plans an early calendar year 2006 launch of the program.

Table 8: List of Applications Presenting Community Reinvestment Act Issues Decided, FY 2005

Bank, City, State	Interpretations and Actions	Document Number
Community Bank, NA, Canton, NY	December 2004	CRA Decision No. 124
Wachovia Bank, NA, Charlotte, NC	January 2005	CRA Decision No. 125
First American Bank, SSB, Bryant, TX	March 2005	Conditional Approval No. 676
PNC Bank, NA, Pittsburgh, PA	May 2005	Conditional Approval No. 687
Pacific Capital Bank, NA, Santa Barbara, CA	August 2005	Corporate Decision No. 2005-11

Partnership and Outreach

The OCC works with other regulators, industry, and community and consumer organizations to accomplish its mission and meet its strategic goals and objectives in an effective and efficient manner.

Financial Regulators

Primarily through the FFIEC, the OCC works closely with the other federal banking agencies (FRB, FDIC, OTS) and the NCUA to coordinate on issues that cut across the banking system, such as supervisory policies, regulations, regulatory reporting requirements, and examiner training. These efforts reduce regulatory burden by promoting greater uniformity, consistency, and efficiency in the supervision of insured depository institutions.

The OCC also works with other state, federal, and international regulators and supervisors, such as the SEC on securities, brokerage, and accounting and disclosure issues, and the FTC on consumer protection and privacy issues. The OCC has entered into information-sharing agreements with 48 state insurance departments and the District of Columbia, and meets with the National Association of Insurance Commissioners (NAIC) at the NAIC's national quarterly meetings. The OCC also assisted the NAIC in drafting a model bulletin that will inform insurers that supervisory information, such as a financial institution's supervisory rating, is confidential information and may not be disclosed to, or used by, a third party unless pursuant to federal banking agency regulations.

The OCC is a member of the administration's Financial and Banking Infrastructure Information Committee (FBIIC) and is working with other federal regulators to combat money laundering and terrorist financing. As noted elsewhere in this report, the OCC is collaborating with the other FFIEC-member agencies and FinCEN to coordinate BSA/AML activities and provide guidance to the industry in this critical area. In June 2005 the FFIEC agencies published a BSA/AML Examination Manual that provides bankers and bank examiners with comprehensive guidance and resources on the BSA requirements and the agencies' supervisory expectations. Following its publication, the agencies hosted training and outreach sessions for examiners and bankers to discuss the new manual. The OCC also worked with the other FFIEC-member agencies and FinCEN to provide additional guidance on providing banking services to money services businesses and to respond to questions regarding customer identification requirements for consumers affected by Hurricane Katrina.

The OCC continued its participation with the Basel Committee on Banking Supervision to update and revise the Basel Capital Accord to make the capital standards for internationally active banks more comprehensive, risk sensitive, and reflective of advances in banks' risk measurement and management practices (Basel II). These efforts included the Basel Committee's publication of a proposal for the application of Basel II to certain trading activities and the treatment of double default risk when the risk of both a borrower and a guarantor defaulting on the same obligation may be substantially lower than the risk of only one of the parties defaulting.

The OCC worked closely with other regulators during FY 2005 on projects to enhance consumer protection, address emerging risks facing the industry, reduce regulatory burden, and enhance regulatory efficiency. These efforts included:

- *Initiatives to Enhance Consumer Protections and Disclosures.* During FY 2005, the OCC worked with other regulatory agencies to strengthen regulations, policies, and disclosures that assist consumers in making financial decisions and in safeguarding their confidential financial and personal information.

  The OCC, FDIC, FRB, NCUA, FTC, and the SEC continued efforts to simplify consumer privacy notices to make them more understandable and useful for consumers and less burdensome for banks to provide. The OCC and the other agencies have engaged experts in plain language disclosures and consumer testing to assist in conducting focus groups and consumer interviews to find out what information consumers find most meaningful, and the most effective way to disclose that information. The agencies expect this consumer testing to be completed by the end of CY 2005; it may form the basis for a proposal to revise the current privacy notice rules.

  In October 2004, the FFIEC-member agencies published a new consumer resource, Protecting Yourself from Overdraft and Bounced-Check Fees. In February 2005, the agencies published Overdraft Protection Programs guidance to assist insured depository institutions in the responsible disclosure and administration of overdraft protection services. The guidance describes federal consumer compliance laws that may apply to such programs, and industry best practices for the marketing and communications of these programs. Such practices include clearly disclosing fees, explaining the impact of transaction-clearing policies on the overdraft fees consumers may incur, disclosing the types of consumer banking transactions covered by the program, and monitoring program usage. The agencies also advised financial institutions to alert consumers before a transaction triggers any fees; to provide consumers the opportunity either to opt-in or opt-out of the program; and to notify consumers promptly each time overdraft protection is used.

  Identity theft is a growing problem and concern for many Americans. As discussed in the Regulate Program section of this report, in December 2004 the OCC, FRB, FDIC, and OTS issued interagency final rules to require financial institutions to adopt measures for properly disposing of consumer information derived from credit reports. In March 2005, the agencies issued guidance on programs that banks should have in place to respond to unauthorized access to sensitive customer information. In early October 2005, the agencies issued updated guidance for the industry on effective methods that they can use to authenticate the identity of customers who use Internet-based banking services to help deter account fraud and identity theft.

- *Initiatives to Reduce Unnecessary Regulatory Burden and Enhance Efficiency.* The OCC continues to work with the other FFIEC-member agencies on a multi-year project to review their regulations to identify outdated, unnecessary, or burdensome regulatory requirements for insured depository institutions. During FY 2005, the agencies requested public comment about possible burden reduction in six categories: money laundering; safety and soundness; securities banking operations; directors, officers and employees; and rules of procedures. The agencies also continued their outreach meetings with bankers and community groups with outreach meetings for bankers held in March 2005 in Phoenix, June 2005 in New Orleans, and August 2005 in Los Angeles. Two outreach meetings for consumer groups took place in Washington, D.C., and Kansas in August and September 2005.

  As discussed in the Regulate Program section, in July 2005 the OCC, the FRB, and the FDIC issued a final amendment to their CRA regulations to reduce regulatory burden on community banks while making CRA evaluations more effective in encouraging banks to meet community development needs. The new rules reduce data collection and reporting burden for Intermediate Small Banks and, at the same time, encourage meaningful community development lending, investment, and services by these banks.

  In September 2005, the OCC, FDIC, and FRB implemented the agencies' Web-based Central Data Repository (CDR), which was created to modernize and streamline how the agencies collect, validate, manage, and distribute financial data submitted by banks in quarterly call reports. Through the use of new open data exchange standards the CDR system will facilitate faster delivery of accurate call report data for supervisors, bankers, and the public. Banks will use the system beginning with the submission of their September 30th call report data.

  The OCC along with other federal banking agencies testified before Congress on the challenge of reducing unnecessary regulatory burden and on suggestions for reforms to reduce such burdens.

- *Basel II Implementation and Revisions to Risk-Based Capital Standards.* In June 2004, the Basel Committee issued its "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (Framework). This Framework forms the basis for the U.S. banking agencies and representatives of the other Basel Committee member countries to develop proposed revisions to existing capital adequacy regulations and standards. Throughout FY 2005, the OCC worked closely with the other federal banking agencies (FDIC, FRB, and OTS) on implementation issues associated with the proposed Basel II Framework. This work included a fourth quantitative impact study (QIS), designed to provide the agencies with a better understanding of how the implementation of the Basel II Framework might affect minimum required risk-based capital within the U.S. banking industry overall, at consolidated U.S. institutions, and for specific portfolios. In April 2005, the agencies announced they would undertake additional analysis of the QIS results before proceeding with a planned notice of proposed rulemaking and on September 30, 2005, announced their revised plan for implementation of the Basel II framework. Concurrent with this effort, the agencies continued work on supervisory guidance that outlines the key components of the measurement and management structures that banks subject to the revised Framework will need to meet; benchmarking exercises to assess banks' progress in developing and implementing operational risk measurement techniques consistent with the Framework's requirements; and examiner training initiatives. The agency also developed and provided training to more than 160 examiners on the Basel II Corporate and Retail AIRB quantitative guidance. The abbreviation "AIRB" stands for the advanced internal ratings-based approach to determining credit risk.

The agencies also developed and, in early October 2005, issued for comment an advance notice of proposed rulemaking outlining potential changes to the agencies' risk-based capital rules for banks that would not be subject to Basel II.

- *Joint Examination Programs.* During 2005, the banking agencies continued their joint supervisory programs, including the Shared National Credit (SNC) Program, the Interagency Country Exposure Review Committee, and the interagency examination program for multi-regional data processing servicers (MDPS).

The interagency SNC program, governed by an interagency agreement between the FRB, FDIC, OTS, and OCC, provides uniformity and efficiency in analyzing and rating large, complex credits. A SNC is defined as any loan or formal loan commitment extended to a borrower by a supervised institution or any of its subsidiaries and affiliates that aggregates $20 million or more and is shared by three or more institutions under a formal lending agreement. The program benefits the regulatory agencies and the banks by: 1) eliminating the redundancy of reviewing the same credit in multiple institutions; 2) ensuring that credits are reviewed in a uniform and consistent manner; 3) maximizing resources; and 4) limiting disruptions to banks' operations. The FY 2005 SNC review covered about 6,817 loan facilities with commitments totaling $1.6 trillion. The review found that the quality of large syndicated bank loans continued to improve in 2005. Adversely rated loans, and loss loans in particular, declined significantly from the peak levels experienced in 2001 through 2003. This favorable trend is attributed to general improvement in the economy and liquidity in the secondary market for lower quality assets.

In December 2004, the agencies released for public comment a proposal to revise the scope, depth, and manner in which data is collected for the SNC program. The changes are designed to improve the effectiveness of the agencies' SNC program; support other agency supervisory goals by developing a standardized repository for SNC related documents that would support exchanging SNC data electronically; and use and apply advanced risk analytics to SNC data to benefit participating banks and supervisors.

- *Updated Supervisory Guidance.* The OCC and other federal banking agencies, issued supervisory guidance throughout the year to bankers on risks posed by bank activities, and methods banks can use to manage those risks.

  In addition to items previously cited, supervisory guidance to bankers was issued on:

  - The risks and controls associated with the use of free and open source software (OCC Bulletin 2004-47).
  - The purchase and risk management of bank-owned life insurance products (OCC Bulletin 2004-56).
  - The risk-based capital treatment for certain types of direct credit substitutes extended to asset-backed commercial paper programs (ABCP) (OCC Bulletin 2005-12) and clarification of the asset quality test that banks can use to determine the eligibility of an ABCP liquidity facility for certain risk-based capital treatments (OCC Bulletin 2005-26).
  - Accounting and reporting requirements for transactions involving commitments to originate and sell mortgage loans (OCC Bulletin 2005-10).
  - The confidentiality of supervisory ratings (OCC Bulletin 2005-4).
  - Sound credit risk management practices for institutions engaged in home equity lending (OCC Bulletin 2005-22).

  Training materials and examination procedures were issued for the implementation of the Check Clearing for the 21st Century Act (OCC Bulletin 2004-49); and interim examination procedures were issued for revised CRA rules for Intermediate Small Banks (OCC Bulletin 2005-22).

  Frequently asked questions and answers were issued on:

  - Independent appraisal and evaluation functions for real estate lending transactions (OCC Bulletin 2005-6) and appraisal and real estate lending requirements for residential tract developments (OCC Bulletin 2005-32).

- The USA PATRIOT Act's requirements for customer identification programs (OCC Bulletin 2005-16).
- The new Home Mortgage Disclosure Act (HMDA) data (OCC Bulletin 2005-17).

The agencies also sought comment on:

- Proposed changes to the agencies' classification system for commercial credit exposures (OCC Bulletin 2005-8).
- Proposed supervisory guidance on internal ratings-based systems for retail credit risk for regulatory risk-based capital under Basel II (OCC Bulletin 2004-48).
- Proposed advisory on the unsafe and unsound use of limitation of liability provisions and certain alternative dispute resolution provisions in external audit engagement letters (OCC Bulletin 2005-21).

Industry and Community Outreach

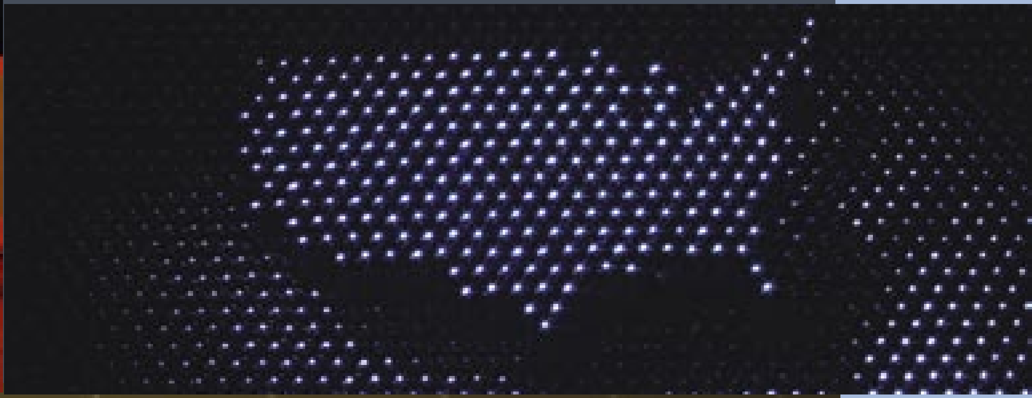
The OCC maintains open communications with key constituents affected by, and interested in, the OCC's mission. The Comptroller and senior managers seek comments on issues facing the banking industry through outreach meetings with industry and trade associations. One creative response to the need for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

The OCC participated in or conducted a variety of outreach activities during FY 2005. In addition to the interagency seminars and regional outreach meetings on the new FFIEC BSA/AML Examination Manual, the OCC continued its series of Web- and telephone-based seminars for bankers on selected topics. These convenient and cost-effective seminars allow bankers to listen to agency experts discuss their experiences and policy imperatives, and interact with them during question-and-answer sessions. The topics of the three FY 2005 seminars were, "Bank Secrecy Act/Anti-Money Laundering," "The Home Mortgage Disclosure Act," and "Corporate Governance and the Community Bank." Approximately 9,000 listeners participated in these seminars from 1,630 sites.

The OCC met with community and consumer organizations on policy matters relating to credit card fees and disclosures, home equity lending, electronic check cashing processes, financial literacy, predatory appraisals, and other consumer issues. These meetings provided the OCC with information about the challenges and opportunities for increased access to financial services for consumers in disadvantaged communities.

The OCC also continued and expanded its workshops for community bank directors. The OCC's workshop on "Understanding OCC's Risk Assessment Process" enhanced directors' understanding of risk-based supervision; increased familiarity with major risks in commercial banking; highlighted the types of questions to ask managers, auditors, and examiners; and reviewed common ways to identify, measure, monitor, and control risk. The workshop, "Credit Risk: A Director's Focus," increased directors' knowledge of effective credit risk management processes, taught them to assess and control their banks' risk profiles and improved their abilities to evaluate the quality of their banks' management information systems. The OCC added a new workshop in 2005, "Compliance Risk: What Directors Need to Know." This workshop focused on increasing a director's knowledge of major compliance risks, critical regulations, and the elements of an effective compliance risk management program. In all, approximately 500 directors attended these three workshops.

To ensure a safe and sound national banking system for all Americans, OCC must have an expert, highly motivated and diverse workforce that makes effective use of its resources. During FY 2005, OCC pursued management initiatives to achieve those goals.



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President's Management Agenda

OCC management devoted much of FY 2005 to creating initiatives to "get to green" on the scorecard for the President's Management Agenda (PMA), where "green" signals success. The PMA is the President's strategy to improve the management of the federal government.

Budget and Performance Integration

The OCC improved its planning, budgeting, and evaluation process for the FY 2006 budget cycle. The OCC's budget is driven by its strategic plan. The Executive Committee identified the strategic risks that OCC faces in pursuing its strategic goals and objectives and the steps in place, in development, or needed to mitigate those risks. While developing the FY 2006 budget, executives considered those strategic risks and ensured that plans were in place and resources were adequate to address them.

In FY 2006, the OCC will implement a performance measure that reflects the efficiency of its operations while meeting the increasing supervisory demands of a growing and more complex national banking system. The measure will weigh OCC's costs against national bank assets regulated. Bank assets represent the growth and complexity of the national banking system. The OCC's ability to control its costs while ensuring the safety and soundness of the banking system benefits all national bank customers.

The OCC evaluated the planning and budgeting process of four other entities (two federal agencies, one state agency, and one private company) to identify best practices, and implemented changes that reduced by two months the cycle time of OCC's budget process. The Executive Committee's Budget and Finance Subcommittee played a more prominent role in the FY 2006 budget process by being involved at all stages of the cycle. Business units continued to use staffing models to support their FTE needs, as documented in program plans that identified the activities to be accomplished with the related objectives and performance measures. These models were assessed to enhance budgeting and resource use.

Competitive Sourcing

This past year, the OCC's competitive sourcing efforts focused on assisting the Department of the Treasury in reforming the FAIR Act Inventory (FAI) to ensure compatibility and consistency across all bureaus. The inventory lists jobs that can be performed by contractors or government employees. This collaborative effort by all Treasury bureaus resulted in a complete and accurate FAI consistent across the bureaus. The OCC also participated in Treasury's shared services program that leverages Treasury-wide expertise in the area of competitive sourcing without increasing resources.

Expanded e-Government

Capital Planning and Investment Control — The OCC made major improvements to its Capital Planning and Investment Control (CPIC) process to ensure that projects are aligned to the mission, goals, and objectives of the agency. The re-engineered process has placed the OCC in a position to plan information technology (IT) initiatives strategically and effectively monitor return on investments and other benefits derived from IT investments. The OCC's capital planning process aligns with the Department of the Treasury's CPIC process and requirements. The OCC is recognized as a best-practice leader in capital planning across the department.

OCC has implemented a year-round project selection process in which the Investment Review Board (IRB) reviews new projects during quarterly control review meetings. This process allows customers to plan their projects carefully without rushing to meet an annual selection process. Through the new quarterly control process, the OCC also monitors the success of IT projects. The process focuses project and program managers and OCC senior management on project risks, costs, and schedule variances. As a result of the reviews of completed, deferred, or cancelled projects, approximately $3 million was made available to fund other OCC needs.

Participation in e-Government Initiatives — The OCC participates in government-wide technology initiatives including Integrated Acquisition, e-Authentication, e-Training, Enter on Duty, and Online Rulemaking.

e-Training — The OCC's Automated Learning Information Center (ALICE) is aligned with the federal GoLearn initiative. It is an operational-level data mart that enables OCC management to report on and analyze OCC's usage of the GoLearn environment more effectively. As an internal management and reporting tool, ALICE complements the functionality offered by the PMA GoLearn initiative. The ALICE system uses courseware through the Office of Personnel Management (OPM) and the GoLearn initiative. This courseware will help to identify skill gaps and ensure that the OCC workforce has the appropriate skills to meet the agency mission.

Federal Document Management System — The OCC is an active partner in the e-Gov Federal Document Management System. The interagency initiative will allow OCC customers to review and comment electronically on OCC regulations and rulemaking actions. This initiative will assist the OCC and other federal agencies in providing more timely service and more access to federal regulations.

Enter on Duty e-Gov Initiative — The OCC accepted the lead role on the e-Gov initiative to automate human resource-related forms (security, ethics, benefits, etc.) that employees complete when hired. This initiative will convert current government-wide and agency-unique human resources forms to electronic Web-based forms that can take up to 75 percent less time to complete and will eliminate duplicate entries. This initiative complements current OCC efforts to improve its hiring process.

Improving Financial Performance

In FY 2005, the OCC met all of its objectives for improving financial performance. The OCC successfully issued its FY 2004 Annual Report before November 15 for the fourth consecutive year. The agency received an unqualified opinion with no material weaknesses on the FY 2004 and FY 2005 financial statements. No material weaknesses have been identified since FY 1999. The OCC consistently closed its accounting records for month-end financial reporting on a timely and accurate basis. Financial reports are provided to the Executive Committee's Budget and Finance Subcommittee monthly and to the Executive Committee quarterly for timely operational decisions. Performance reporting is an integral part of these quarterly reports.

Human Capital

In FY 2005, Human Capital efforts focused on recruiting and retraining a highly expert and diverse workforce in anticipation of an increasing number of retirements, with an emphasis on succession planning and reallocating Large Bank Supervision examiner resources to areas of critical needs, such as New York City. The OCC had achievements in each of these areas.

The OCC is in the third year of an expanded recruitment program for entry-level bank examiners. This highly successful program has attracted diverse pools of applicants with superior qualifications. More than half of the entry-level examiners hired were female and more than 40 percent were minorities.

The OCC continually reviews its hiring policies and practices and conducts long term, in-depth hire and separation analyses to address barriers that may affect women, minorities, and persons with disabilities, who seek employment with the agency. In addition, new examiner hires are surveyed after their first six months with the OCC and annually for their first five years with the OCC to identify potential retention problems early and opportunities for improving recruitment and on-boarding processes.

The OCC recognizes that it could lose valuable skills and experience in the next three-to-five years because of retirements; therefore the OCC has integrated succession planning into its recruitment and career development initiatives. The OCC plans to implement a succession management development program in the bank supervision departments. Through this program, OCC seeks to provide a systemic way of identifying candidates for key positions to ensure a continuity of leadership and maintain a diverse pool of talent.

With the addition of JPMorgan Chase and Hong Kong Shanghai Bank Corporation to the national banking system, more than 80 examiner positions were added to the New York City metropolitan area. The OCC launched a major recruitment effort to encourage examiners with expertise in safety and soundness as well as specialty areas such as, capital markets, credit, bank information technology, compliance and asset management, to relocate to New York City. The OCC offered a range of relocation incentives and Large Bank managers conducted town hall meetings in offices throughout the OCC to make the workforce aware of the New York City opportunities and the many benefits associated with these opportunities. This recruitment effort was highly successful in enabling the OCC to meet its current staffing needs. Approximately 70 percent of OCC employees attending the town hall meetings ultimately applied for Large Bank positions in New York City, which traditionally have been difficult positions to fill.

The Office of Personnel Management's 2004 Federal Human Capital Survey ranked the OCC higher than the federal government average in all areas: personal work experience; learning; recruitment, development, and retention; benefits satisfaction; leadership; job satisfaction; and performance culture. Thirty-one percent of OCC survey items received 80 percent or more positive responses compared with 12 percent government-wide. The survey scores reflect the OCC's commitment to cultivating an employee-focused and performance-based culture where employees are expected to develop their skills and knowledge continuously.

Other Initiatives

OCC pursued other management initiatives to ensure a diverse and highly motivated workforce that operates efficiently. In FY 2005, those initiatives included:

Implemented the Collective Bargaining Agreement between OCC and NTEU

The Collective Bargaining Agreement between the OCC and the NTEU (National Treasury Employees' Union) went into effect on March 22, 2005. The agreement covers employee working conditions, such as processes for filling jobs and offering assignment opportunities, provisions for administering leave, work scheduling and work location, and provisions for remediation. The OCC's compensation and benefits are not subject to negotiation, and therefore, not covered by the agreement. All OCC managers received comprehensive training on their roles and responsibilities in implementing the agreement. The OCC and NTEU delivered joint training to all employees. In addition, the OCC is establishing a program to assist managers in implementing and ensuring compliance with the agreement.

Enhanced Education Programs, Skill Maintenance, and Delivery

During the year, OCC refined the examiner pre-commission training program. A comprehensive framework of classes and on-the-job experience is in place to ensure that new examiners are trained systemically to reach full competency as soon as possible. The OCC also ensured that instruction and the training-team experiences are consistent with the strategic training approach and training best practices.

The OCC made significant progress in conceptualizing the OCC future leadership development program and management succession efforts. The Executive Committee's Human Capital Subcommittee agreed to the proposed programmatic framework based on input from an internal task group, with assistance from OPM. Aspects of the leadership development program are being implemented to meet the needs of our current managers and leaders, including an executive coaching pilot for mid-level managers and senior managers.

Significant changes in procedures for administering the Examiner Specialized Skills Program provided timely and accurate resource and budget tracking. The program addresses examiner competency gaps in several specialty areas. The program inventories and develops examiner skills in asset management, compliance (BSA/AML), capital markets, retail credit, and bank information technology.

Deployed Lean Six Sigma

Lean Six Sigma (LSS) is a fact-based approach for improving OCC's business processes, eliminating waste, improving compliance with statutory and regulatory requirements, and delivering best value to customers. The principles of LSS are to assess value from the customer's perspective; involve and align employees; collaborate across boundaries; and continuously improve knowledge in pursuit of perfection. LSS addresses management-related programs.

A total of 21 process improvement studies were initiated in FY 2005. Completed projects have resulted in cost savings of $700,000, enabled the redirection of staff resources to higher priority needs, minimized the impact of complying with newly mandated or existing requirements, and matched internal customer expectations with service delivery.

Promoted Workplace Fairness and Alternative Resolutions

The OCC excels in promoting a professional, supportive environment for employees that attracts, develops, and retains a world-class team of professionals. In FY 2005, the OCC raised awareness and understanding of equal employment opportunity (EEO) and alternative dispute resolution by conducting special programs and developing training for managers and employees. The OCC provides additional training to employees serving as mediators and EEO counselors to comply with the requirements of the Equal Employment Opportunity Commission and Department of the Treasury. In FY 2005, the number of complaints at the OCC fell to 0.2 percent per employee, significantly less than the government-wide average of 0.7 percent.

Employees and managers also benefited from OCC's continued commitment to its Fair Alternatives and Innovative Resolutions (FAIR) process to address workplace disputes that were not related to equal employment opportunity.

The OCC also made significant strides in increasing the efficiency and effectiveness of its discrimination investigation processes. Treasury authorized an OCC pilot program to test a re-engineered process that was developed using Lean Six Sigma. The pilot is intended to produce quality products and services, reduce processing costs, and ensure the agency not only meets, but exceeds, statutory and regulatory standards.

Enhanced OCC's Effectiveness through Audits and Program Analyses

Audit and program analysis initiatives during the year continued to enhance the effectiveness of the OCC workforce and strengthen its organizational performance and corporate governance. This year's initiatives included:

- An assessment of BSA/AML supervision.
- A lessons-learned review of a failed bank.
- A field office onsite validation to test the adequacy of district quality assurance processes.
- An administrative systems cost/benefit analysis.
- An acquisition management benchmarking study.
- A review of process improvements related to a merit pay software application.
- An audit of timekeeping procedures.

Opened the District Human Resource Soloutions Service Center

The OCC consolidated the human resource (HR) services of four district offices into one service center. The District HR Solutions Service Center in Denver opened for business in April 2005. The center is staffed by a team of HR professionals with experience in all areas of human resources, including recruitment, merit promotion, benefits, retirement, and payroll. Each district continues to have services in employee and labor relations, performance management, and entry-level bank examiner recruitment provided by its local human resources consultant. This new delivery model positions OCC's HR function to better meet the needs of its client base.

The OCC is benefiting immediately from its enhanced capability to monitor and adjust resources according to peak workload times, more effective processes for providing training and hiring new Human Resources staff, and greater consistency in the delivery of services.

Ultimately, OCC anticipates realizing overall cost reductions in the delivery of its services and improved customer satisfaction.

Ensured the Effective Use of Real Estate and Capital Assets

In FY 2005, the OCC successfully exercised a renewal option on its headquarters facility while negotiating modifications to the original lease to bring it into compliance with current federal leasing regulations. During FY 2005, the OCC leased, planned, designed and completed construction of the relocated Northeastern District Office and a District Service Center in Denver, as well as the expansion of the Western District Office. The OCC also relocated three field offices, a large bank office, and a satellite office, and initiated the process of relocating its Central District Office and four field offices before FY 2008. The OCC's capital real estate projects met targets for funding, schedule, and performance. To further control costs and increase productivity, a review of the field office relocation process yielded a leaner process and more useful customer educational tools.

Pursued Information Technology Initiatives

Web-based Services — OCC continued to enhance its Web-based products and services to better support OCC employees, bankers, and other customers. The OCC developed requirements for comprehensively enhancing its Web services and began instituting governance processes to strengthen the management and effectiveness of its Web programs. In June 2005, OCC implemented a new look for its public Web site (www.occ.gov) to improve service to its 100,000 monthly visitors and reinforce OCC's identity as the premier bank regulatory agency. Additionally, 95 percent of all national banks are registered customers of the OCC's extranet site, National BankNet. In FY 2005, BankNet expanded its service by adding new tools to assist bankers with their business needs. New reporting forms improved the convenience and efficiency of communications with the OCC, and three existing applications were upgraded in response to user suggestions. Those changes resulted in an increase in usage of approximately 25 percent by customers, compared with FY 2004.

Information Security — OCC improved compliance with the Federal Information Security Management Act (FISMA); expanded the OCC secure messaging system that allows OCC employees to exchange sensitive information securely with national banks and other regulators; deployed additional intrusion detection sensors to identify possible compromises of network defenses; scanned all OCC Internet e-mail and Web browsing traffic for viruses and inappropriate content; tested the OCC's Internet security periodically using independent penetration tests; scanned the entire OCC network periodically to identify security vulnerabilities; maintained an incident response capability to respond to viruses, worms, and data-compromising incidents; and avoided attacks by worms and viruses that crippled other public and private organizations.

At the end of FY 2005, the OCC had certified and accredited 100 percent of its information systems as required by FISMA.

Systems Development Life Cycle — The OCC completed and implemented its systems development life cycle (SDLC) process in April 2005 following an independent assessment. The SDLC is now used for all new system development projects. It provides a series of best practice standards that application developers use to mitigate risks associated with each phase of the cycle. The method also standardizes project documentation to ensure that agency software systems can be updated and modified as needed.

Mainframe Retirement — The OCC plans to retire its mainframe computer by September 2007. The project team is working with business units and other federal financial agencies to coordinate the retirement of mainframe applications and ensure efficient transfers of interagency data. To date, 23 of 63 mainframe applications have been retired.

e-TIME — In June 2005, the OCC implemented e-TIME, a Web-based time and attendance system. All OCC employees are now able to submit their time and attendance data online each pay period, and supervisors certify the data electronically before it is submitted to the OCC's payroll services provider. The data gathered in e-TIME relates not only to the time and attendance of employees, but also helps OCC track where examinations are being conducted, and what resources are being used to accomplish OCC's mission. The system also interfaces with the OCC's Financial Management and Human Resource systems. This information technology initiative has facilitated final resolution of two prior-year audit findings and provides a solid foundation for important improvements to internal controls.

Licensing Information System — Testing and delivery of the LIS are scheduled for the last quarter of FY 2006. LIS, the replacement for the mainframe-based Corporate Activities Information System (CAIS), is the OCC's primary means for tracking and approving corporate applications from existing or prospective national banks.

Personal Backup Devices for All Personnel — The OCC distributed external hard drives to all employees to provide a convenient, cost-effective method to back up their computer hard drives. Each drive included usage instructions and a program to automate the process for backing up information.

Security Patches — The OCC has successfully implemented a System Management Server (SMS) to manage the automatic deployment of security patches to agency personal computers nationwide. The first enterprise-wide delivery of security patches was performed in July 2005, following extensive testing of the new environment. The automatic process is less intrusive, quicker, and more cost effective than the quarterly production of CD-ROMs formerly mailed to employees.

Tested and Updated Its Continuity of Operations Plan

The OCC Continuity of Operations Plan (COOP) formalizes and integrates IT recovery plans, relocation scenarios, alternative site logistics, emergency communication procedures, lines of succession, delegations of authority, and testing requirements into a comprehensive emergency management plan. The OCC tested elements of its COOP, including completing a comprehensive nationwide relocation/tabletop exercise; participating in the Treasury's Forward Challenge 05 and other interagency exercises; testing the IT recovery plan, completing internal and interagency communications drills; and practicing evacuation drills and shelter-in-place drills at OCC sites. The OCC updated its COOP based on lessons learned from those tests and exercises and incorporated requirements of the revised Federal Preparedness Circular 65 issued by the Federal Emergency Management Agency (FEMA). Key staff members completed training and were certified for the National Incident Management System.

Improved Emergency Preparedness

The OCC revised and enhanced processes and procedures for communicating with, and accounting for, employees during and after emergencies as well as communicating with national bank personnel during emergencies. The OCC equipped its headquarters Emergency Operations Center (EOC) with secure communications, upgraded laptop computers, and independent heating and air conditioning units during FY 2005. The EOC allows the OCC Executive Committee to continue to perform critical functions during shelter-in-place emergencies. The OCC enhanced the COOP site shared with other federal agencies to ensure operational readiness at all times. The site meets all federal regulations from the Department of Homeland Security and FEMA for designated alternate operating facilities.

The OCC continued to work with the FBIIC to provide secure communications systems throughout the financial services sector's regulatory community, to coordinate emergency response efforts across agencies, and to identify threats within the financial services industry. The OCC has established protocols for emergency communications and purchased new secure communications equipment for its COOP sites.

The OCC's COOP and emergency preparedness plans were put to the test during Hurricane Katrina. The plans enabled the OCC to assess the status of employees and banks in the affected areas quickly. An emergency response team was put in place to ensure all employees required to evacuate had access to suitable housing and resources to help them through the crisis.

Management Challenges and High-Risk Areas

In FY 2005, the Department of the Treasury Office of Inspector General (OIG), identified concerns for the department that included anti-money laundering and Bank Secrecy Act compliance. Through the year, the OIG conducted related audits and evaluations to assess administration of BSA requirements throughout the department and evaluate the effectiveness of a memorandum of understanding among the financial regulators, including the OCC, and FinCEN. The OIG began an audit of the OCC's supervision and enforcement of anti-money laundering activities at national banks in late FY 2005. The OIG's findings and conclusions will supplement the OCC's internal assessment and action plans for improving BSA/AML supervision.

Letter from the Chief Financial Officer

I am pleased to present the OCC's financial statements as an integral part of the FY 2005 Annual Report and am pleased to say that for FY 2005 the independent auditors rendered an unqualified opinion with no material weaknesses. Strong financial management and oversight is a strategic focus of the OCC, and the stewardship and safeguarding of agency resources remain my highest priority.

Reflecting on FY 2005, I would like to discuss some key achievements. The OCC has again received a "green" rating under the President's Management Agenda (PMA) from the Department of the Treasury for improving financial performance and has met all core criteria for each component of the measure. The OCC is committed to achieving all of the financial-related elements contained in the PMA and recognizes the value the PMA brings to financial management.

The OCC is fully engaged in implementing the stringent new requirements for federal agencies to assess internal controls over financial reporting. The agency is working to document and test internal controls and is developing a communication strategy that will ensure that the OCC has a strong internal control environment throughout the agency. We are committed to implementing the new requirements and continuing our ability to provide reasonable assurance that internal controls are operating effectively across all areas of the agency.

The Budget and Finance Subcommittee, which I chair, continues to play an overarching role in managing the financial performance of the agency. During FY 2005, the subcommittee oversaw the budgeting process and made key recommendations in establishing the direction of the approved FY 2006 budget. The subcommittee focused on ensuring that the budget was not only prudent but that it directly links with the agency strategic goals and objectives. The subcommittee also serves an important role as an investment review board for non-Information Technology investments, such as leasing arrangements. This year the subcommittee reviewed all agency plans for fixed asset replacement including office space. Further, the subcommittee oversaw a review of the agency budget formulation process, which involved benchmarking the budget formulation process of other public and private sector firms. As a result, the timeline of the OCC budget formulation process decreased by two months, without sacrificing the scrutiny needed to ensure the development of a fiscally responsible budget.

Last year, I discussed the Office of Management's (OM's) commitment to best business practices and to becoming a strategic-based, metrics-driven, customer-focused organization. This year I would like to update you on our progress. In FY 2005, the OM implemented the Balanced Scorecard and launched a Lean Six Sigma program. These programs are aligned in their focus on the "Voice of the Customer" in everything that the OM does. The entire OM staff has received training in Lean Six Sigma, and they have applied the methodology in a wide range of processes, including the monthly financial statement process. Thus far, the OM has completed 11 projects and has 10 on-going projects. We are already reaping the benefits of streamlined processes with reduced duplication and re-work.

Looking forward, the challenges of the coming year are reflective of the changing landscape in federal financial management. It is clear that the emphasis on internal controls will continue to increase, and that federal requirements will continue to evolve as efforts are made to strengthen the financial performance of the government as a whole. In closing, I would like to say that the OCC approach to meeting these challenges will be to ensure that the agency has the finest people and resources dedicated to these efforts and that managing and monitoring the effective and efficient use of agency resources will continue to be the mandate.

Thomas R. Bloom

Financial Discussion and Analysis

Strategic Focus

Financial management in today's environment presents challenges as the OCC responds to the increasing need for strong financial reporting, responsible and effective internal controls, and accountability for results. In FY 2005, the Office of Management's Financial Management department (FM) reconfirmed its dedication to these principles. Managing for results and using widely recognized best practices, such as the Balanced Scorecard and Lean Six Sigma, FM has made significant progress toward achieving key business goals. The Balanced Scorecard is a framework that allows FM to translate strategy into measurable results. Lean Six Sigma incorporates the voice of the customer into processes to ensure their efficiency and effectiveness.

Strategic Goals

The goal for FM is to become an efficient organization that reflects:

- An engaged workforce that is committed to the business strategy of operational excellence.
- A solid understanding of customer needs and expectations.
- Efficient processes that take advantage of system capabilities.
- An effective structure to handle varied levels of workload.
- A focus on developing staff competencies for the evolving organization.
- The effective management of projects and programs.

FM Strategy

The FM operating strategy for FY 2005 is shown in Figure 1. The FY 2005 strategy focuses on achieving and maintaining data integrity across all financial management system components. Data integrity assures FM's ability to provide consistently reliable information to OCC decision makers to manage their programs effectively. Throughout the year, FM carried out initiatives to ensure that all general ledger accounts were reconciled monthly at the transaction level, analyzed, properly supported by source documents, and adjusted as appropriate. To stabilize the core accounting system, FM engaged contractors to perform data analysis and an internal control evaluation. FM implemented all of the recommendations and finished the year with higher assurance in the system and data integrity than has been experienced during the past four years. FM began Lean Six Sigma business process reengineering projects for key processes, such as financial statement report preparation and requisitioning through disbursing. The benefits from such projects are just beginning, and staff expertise in using the Lean Six Sigma methodology is growing.

The FM strategy includes building a strong internal control environment to ensure that internal controls are in place and operating effectively in all processes and activities. FM has begun implementing the new internal control documentation and testing requirements published during FY 2005 in OMB Circular A-123, Appendix A, "Internal Control over Financial Reporting." FM strengthened detection and prevention controls for erroneous payments during FY 2005 and began documenting all processes and controls related to financial reporting. As FM staff review and document processes, management and staff are improving internal controls in all areas.

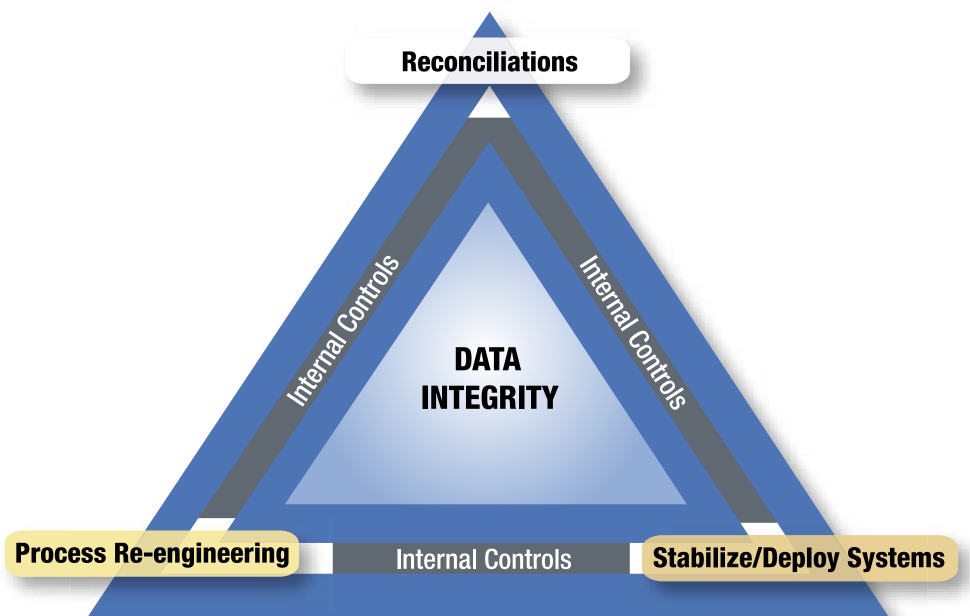
The OCC has also established an OCC SAT to ensure that the new internal control requirements for federal agencies are implemented effectively and communicated throughout the agency. The SAT will include an effective OCC communication strategy to continue strengthening the agency's internal control environment.

The FM Balanced Scorecard

The FM Balanced Scorecard covers performance measures and initiatives in four perspectives: customer, financial management, internal processes, and learning and growth.

The customer perspective ensures that FM identifies its customers and understands their needs and expectations. FM measures performance based on how well FM products and services meet customer needs and expectations. During FY 2005, FM began a communication strategy to meet regularly with customers and incorporate their input as FM

Figure 1: FY 2005 FM Operating Strategy



products and services are delivered. Using valuable input received from OCC customers, FM has improved the reporting capabilities of the OCC's financial management system. As the OCC's new time and attendance system, e-TIME, was deployed, FM fully incorporated the voice of the customer. From the customer perspective, the e-TIME deployment was clearly the most successful FM system implementation in the past several years. As part of an OM initiative, in August 2005 FM participated in an OCC-wide customer satisfaction survey that will be administered annually in the future. FM management and staff will use the results of this baseline survey to plan FY 2006 and later customer-focused initiatives.

The financial management perspective ensures that FM is using the OCC's financial resources to support the OCC's overall strategic financial goals and objectives. It serves as a mechanism to help FM use financial resources to produce the best value for the OCC. In FY 2005, primarily as a result of increased costs to resolve fully lingering system and data integrity issues, FM did not meet its Balanced Scorecard target of maintaining costs at or below 1.6 percent of total planned OCC operating costs. Actual performance was 1.68 percent. The FM operating strategy of achieving data integrity and strong internal controls increased costs once during FY 2005 and ensured that FM used the additional funds to achieve one of its highest priority business goals to stabilize the financial management system.

The internal processes perspective ensures that FM focuses on improving the processes that are most critical to achieving its business goals. As reflected in the FY 2005 operating and strategic business strategies, the processes that lead to financial reports received the most attention and effort this year. FM initiated several Lean Six Sigma projects, incorporating the voice of the customer as an integral part of the analysis. FM used Lean Six Sigma to enhance the financial reporting production cycle for disseminating financial information to customers. The newly streamlined approach allows FM to produce accurate monthly financial status reports that more fully meet timeliness and reliability standards and the needs of OCC decision makers. FM also began a project to streamline the process for requisitioning goods and services and the payment of invoices. The project thus far has provided useful data to help identify the areas that deserve the most re-engineering attention. Using this data, FM is now beginning four highly focused follow-on projects that will also provide value to its customers.

The learning and growth perspective ensures that FM identifies the critical staff skills needed to achieve its business goals and that management works with staff to ensure those skills are fully developed. During FY 2005, FM participated in OM's initiative to conduct annually the Gallup Q12 employee engagement survey. It also began working on action plans for each unit to improve employee engagement over time. The survey results have been distributed, and each FM unit began developing action plans to address the survey area identified as most important. FM has begun the transfer of critical knowledge from on-site contractors to its systems staff, and either advanced or refresher training was provided to many FM staff members from the financial system vendor, PeopleSoft. During FY 2005, 100 percent of FM employees received training in Lean Six Sigma, and many have participated in projects this year.

Additional Accomplishments

FM's FY 2005 performance demonstrates that the new strategy is helping to improve OCC financial management now and for the future. Additional notable FM accomplishments during FY 2005 include:

- Deployed e-TIME, a Web-based, self-service time and labor system that replaces the OCC's legacy time entry system.
- Resolved all prior year financial statement findings and consistently met Treasury's deadline for a three-day close for producing financial statements.
- Re-engineered the formal process for data retention and disposition of federal records.
- Increased the use of performance-based contracting.
- Led the development of the new OM information technology strategy.

Looking Forward

FM will continue to focus on achieving strategic business goals and to measure progress by using the Balanced Scorecard and Lean Six Sigma. This year the FM organization structure was expanded to include agency records management and procurement, and an upcoming reorganization of the financial management areas of FM was recently announced. As the reorganization is implemented in FY 2006, FM functions and workload will be better aligned to support the achievement of business goals. FM will continue to implement the new A-123 internal control requirements, and to meet the assessment and reporting deadlines for FY 2006. The OCC is considering implementing an e-Travel solution in FY 2006 and pursuing core financial management systems investments to modernize operations in line with OMB's recent Lines of Business guidance.

Funding Sources and Uses

Funding Sources

The OCC does not receive appropriations. The Comptroller, in accordance with 12 USC 482, establishes budget authority for a given fiscal year. The total budget authority available for use by the OCC in FY 2005 was $519.4 million and $476.9 million in FY 2004. The OCC's operations are funded primarily by assessments collected from national banks and other income, including interest on investments in U.S. Treasury securities.

Total revenue recognized for FY 2005 amounted to $577.7 million compared to $497.8 million in FY 2004. The increase of $79.9 million in total revenue recognized is due mostly to increased assessments ($75.5 million) as a result of the more than 26.2 percent growth in bank assets, which includes the assets of new large banks joining the national banking system in FY 2005. Table 9 depicts the components of total revenue recognized for FY 2005 and FY 2004.

Investment income is earned on the investment of available funds in U.S. Treasury securities. The increase in investment income for FY 2005 is due largely to the $125.7 million increase in the book value of OCC's portfolio during the fiscal year as a result of investing the increased revenue from assessments. The book value of the OCC's portfolio at September 30, 2005 was $607.3 million compared to $481.6 million at September 30, 2004.

Bank Assets and Assessment Revenue

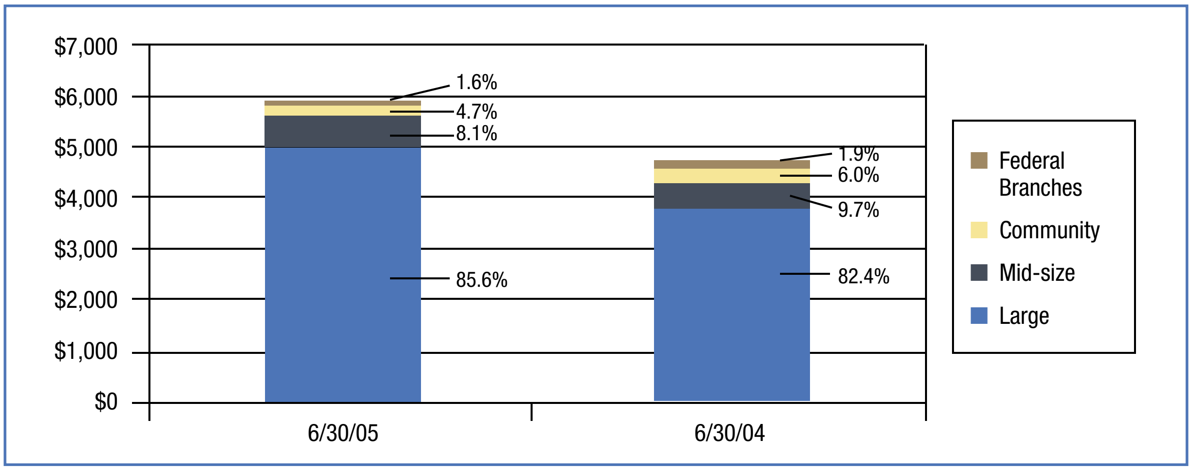
In FY 2005, the composition of national bank assets changed compared with FY 2004. For the same period, the percentage of total OCC assets attributable to large banks increased from 82.4 percent to 85.6 percent, while the mid-size, community, and federal branches share of total assets declined. Accordingly, large bank's share of total assessment revenue increased by 5.4 percentage points while mid-size and community banks' shares declined by 2.3 and 2.9 percentage points, respectively. National bank asset growth and the movement of assets into the national banking system were the impetus for higher assessments for FY 2005. Figure 2 shows the composition of national bank assets by large banks, mid-size banks, community banks, and federal branches for FY 2005 and FY 2004.

Table 9: Components of Total Revenue, FY 2005 and 2004 (in millions)

	FY 2005	FY 2004	Change
Assessments	$557.8	$482.3	$75.5
Investment Income	$17.0	$11.3	$5.7
Other Sources [1]	$2.9	$4.2	$(1.3)
Total Revenue	$577.7	$497.8	$79.9

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

Figure 2: Composition of National Bank Assets as of June 30, 2005 and 2004 (in billions)



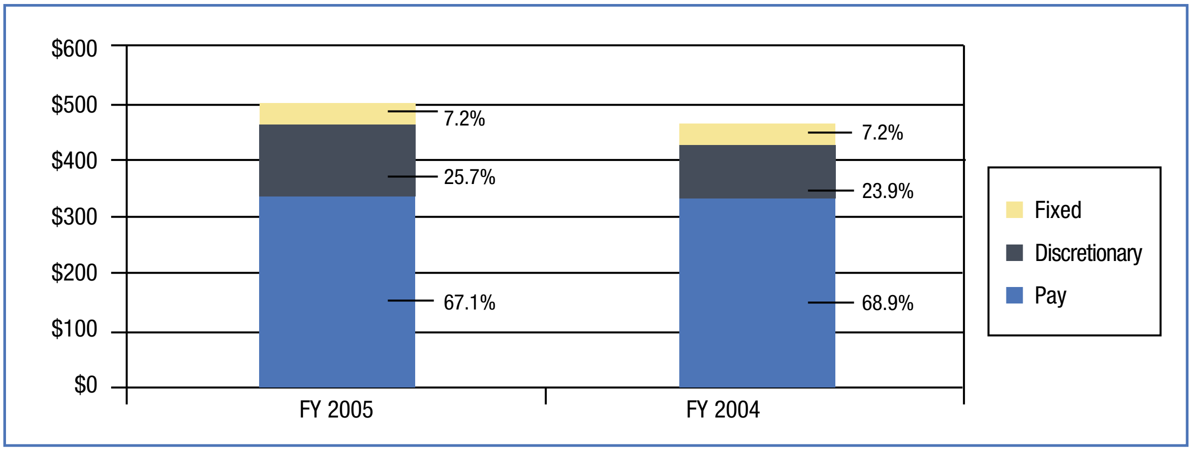
Funding Uses
The OCC classifies its funding uses as pay, discretionary, and fixed. Pay encompasses payroll-related costs; discretionary reflects all other funding uses, such as contractual services, travel, training, and capital projects; and fixed primarily includes rent, utilities, and office maintenance. In FY 2005, the OCC's total funds used were $500.2 million, an increase of 8.0 percent over the level in FY 2004. Of the total funds used in FY 2005, $335.6 million was categorized as pay, $128.6 million as discretionary, and $36.0 million as fixed. The OCC's operations are service-intensive; therefore, the majority of funds are used for pay. The OCC experienced a $20.6 million increase in non-pay funds used primarily for training, travel, relocations, and contractual services. Figure 3 depicts the uses of the OCC's funding for FYs 2005 and 2004.

Financial Review

The OCC received an unqualified opinion on its FY 2005 and 2004 financial statements. The financial statements include a Balance Sheet and Statements of Net Cost, Changes in Net Position, Budgetary Resources, Financing, and Custodial Activities. The financial statements and notes are presented on a comparative basis, providing financial information for FYs 2005 and 2004. These financial statements summarize the OCC's financial activity and position. Highlights of information presented on the financial statements follow.

Balance Sheet
The Balance Sheet, as of September 30, 2005 and 2004, presents the resources that are owned by the OCC and available for use (assets), the resources due to others or held for future recognition (liabilities), and the resources

Figure 3: FY 2005 and 2004 Funding Uses (in millions)



that comprise the residual (net position). For clarity in presentation, assets and liabilities are differentiated between those resulting from transactions between the OCC and other federal entities (intragovernmental) and transactions between the OCC and non-federal entities (with the public).

Composition of and Trends in OCC Assets
The Balance Sheet shows that total assets as of September 30, 2005, increased by $130.9 million from their level at September 30, 2004. The increase of $124.9 million in Investments and Accrued Interest was attributed to a rise in assessment collections during FY 2005. The increase of $6.0 million in Property and Equipment was due primarily to hardware, software, and telecommunications equipment purchases. Figure 4 shows the composition of the OCC's assets.

Composition of and Trends in OCC Liabilities
Total liabilities, as of September 30, 2005, increased by a net of $32.0 million over their level at September 30, 2004. The OCC's liabilities are largely comprised of deferred revenue, accounts payable, and accrued liabilities. Deferred revenue represents the unearned portion of semiannual assessments that have been collected but not yet earned. The increase of $21.6 million in deferred revenue was due to a rise in assessment collections during FY 2005. The increase of $9.0 million in accounts payable and accrued liabilities was due primarily to an increase in payroll and employee benefits over last year and to disbursement timing differences. Figure 5 illustrates the composition of the OCC's liabilities.

Figure 4: Composition of FY 2005 and FY 2004 Assets (in millions)

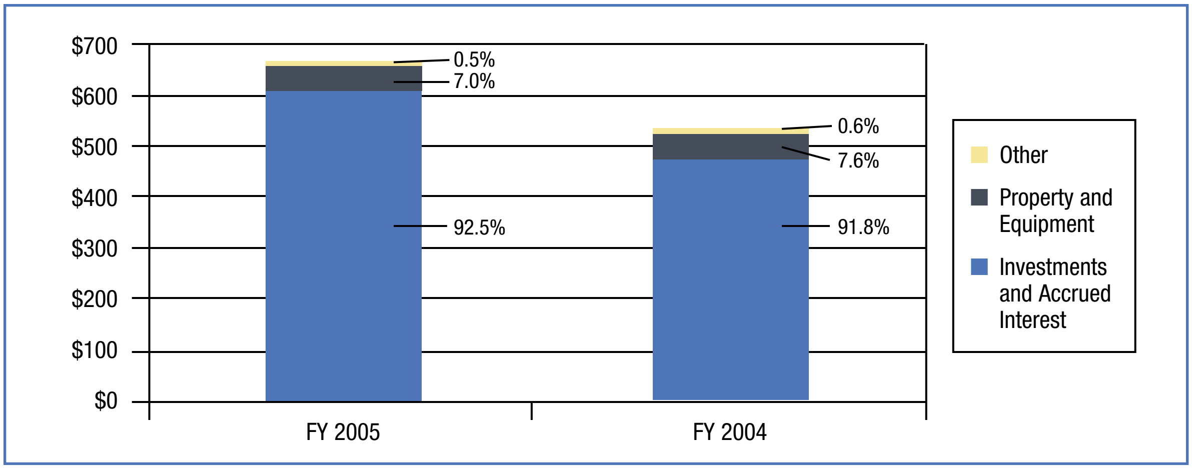


Figure 5: Composition of FY 2005 and 2004 Liabilities (in millions)

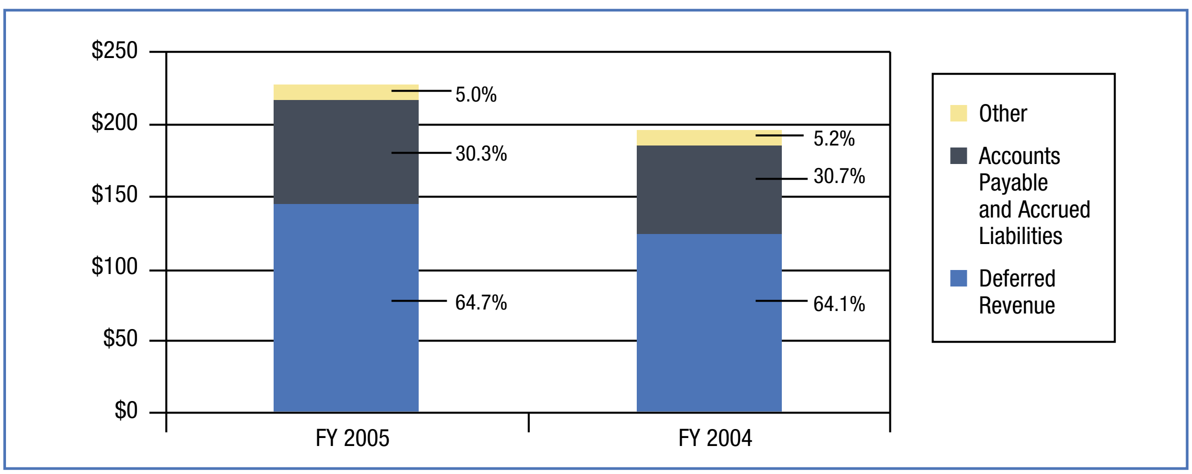
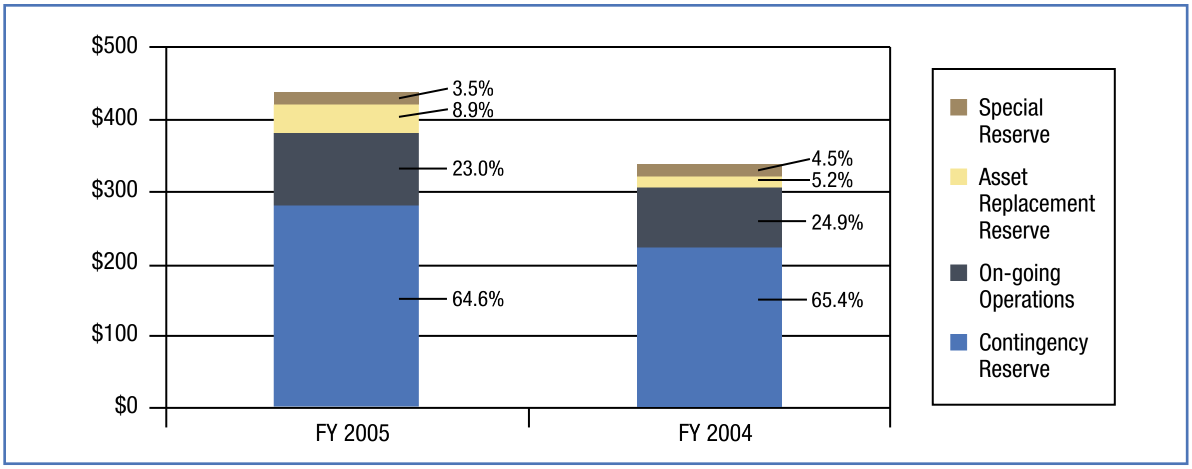


Figure 6: Composition of FY 2005 and 2004 Net Position (in millions)



Composition of and Trends in OCC Net Position

The OCC's net position of $434.4 million as of September 30, 2005, and $335.5 million as of September 30, 2004, represents the cumulative net excess of the OCC's revenues over its cost of operations since inception. The net position is presented on both the Balance Sheet and the Statement of Changes in Net Position. As discussed in the next section, the OCC reserves a significant portion of its net position to supplement resources made available to fund the OCC's annual budget and to cover foreseeable but rare events. The OCC also earmarks funds for on-going operations to cover undelivered orders, the consumption of assets, and capital investments. Figure 6 shows the composition of the OCC's net position.

Reserves

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

Statement of Net Cost

The Statement of Net Cost presents the full cost of operating the OCC's programs for the years ended September 30, 2005, and 2004. The net cost of operations is reported on the Statement of Net Cost, the Statement of Changes in Net Position, and on the Statement of Financing. The OCC uses an activity-based time allocation process to allocate costs between the programs. Costs are further differentiated between those resulting from transactions between the OCC and other federal entities (intragovernmental) and transactions between the OCC and non-federal entities (with the public). The full cost includes contributions made by OPM on behalf of the OCC to cover the cost of the Federal Employees Retirement System (FERS) and Civil Service Retirement System (CSRS) plans, totaling $22.9 million in FY 2005 and $22.5 million in FY 2004. The full program cost increased by $29.5 million, primarily due to increases in pay and benefits, contractual services, imputed costs, and non-capitalized IT investments. The full cost is reduced by earned revenues to arrive at net cost. Earned revenues increased by $79.9 million because of a rise in assessments collected during FY 2005.

Statement of Changes in Net Position

The Statement of Changes in Net Position presents the change in the OCC's net position resulting from the net cost of the OCC's operations and financing sources other than exchange revenues for the years ended September 30, 2005, and 2004. Imputed financing from costs absorbed by others, increased by $0.4 million. The OCC's financing source resulted from a contribution of $22.9 million in FY 2005 and $22.5 million in FY 2004, by the OPM toward the OCC's FERS and CSRS retirement plans.

Statement of Budgetary Resources

The Statement of Budgetary Resources presents the budgetary resources available to the OCC for the year, the status of these resources at the end of the year, and the net outlay of budgetary resources at the end of the year. The OCC obligated 49.0 percent of its budgetary resources for the year. The remaining 51.0 percent is available to cover FY 2006 first quarter operations and OCC's reserves.

Statement of Financing

The Statement of Financing demonstrates the relationship between the OCC's proprietary (net cost of operations) and budgetary accounting (net obligations) information. For FY 2005, the statement shows $85.2 million in excess resources available to finance activities, a net increase of $49.1 million over September 30, 2004. This net increase resulted from an $87.2 million increase in resources available netted against the increase of $37.7 million in resources used (obligations incurred). The increase in net resources available is due primarily to increased assessments and imputed financing, while the increase in resources used results primarily from various office space and IT investments as well as pay and employee benefits.

Statement of Custodial Activities

The Statement of Custodial Activities identifies revenues collected by the OCC on behalf of others. These revenues result primarily from CMPs that are assessed through court enforced legal actions against a national bank and/or its officers. CMP collections are transferred to the Department of the Treasury's General Fund.

Prompt Payment

The Prompt Payment Act and the OMB Circular A-125 require agencies to make payments on time, pay interest penalties when payments are late, and take discounts only when payments are made on or before the discount date. The OMB's goal is a prompt payment rate of greater than 98 percent. The OCC's prompt pay rate was 99.6 percent in FY 2005 as compared to 98.7 percent in FY 2004. Table 10 summarizes the OCC's prompt payment performance for FYs 2005 and 2004.

Electronic Funds Transfer

The use of EFT rather than a paper check for payments provides greater control over payment timing and reduces payment cost. During FY 2005, the OCC continued to maximize the use of payment mechanisms as required by the Debt Collection Improvement Act of 1996. Table 11 summarizes EFT usage for FYs 2005 and 2004.

Table 10: Prompt Payment Performance, FY 2005 and 2004

	FY 2005 Amount	FY 2004 Amount	FY 2005 Number	FY 2004 Number
Invoices paid	$81,266,691	$68,819,284	22,472	21,301
Invoices paid late	$2,247,318	$4,645,377	81	281
Interest penalties paid	$1,198	$6,642	53	196

Table 11: Electronic Funds Transfer Performance, FY 2005 and 2004

	FY 2005	FY 2004
Vendor payments	99.5%	99.4%
Employee payments	100.0%	99.9%

Erroneous Payments

The erroneous payments program meets the criteria of the Improper Payments Act of 2002 (IPIA) to support the Department of the Treasury's strategic goal. The goal is to: Ensure Professionalism, Excellence, Integrity and Accountability in the Management and Conduct of the Department of the Treasury. The OCC analyzed payments (excluding payroll) made during FY 2005 and identified 23 erroneous payments totaling $30,224. The OCC corrected and recovered all erroneous payments made during the year.

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

Methodology for Identifying Improper Payments

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

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

Limitations to the Financial Statements

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

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

Systems, Controls, and Legal Compliance

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

Fiscal Year 2005 Annual Assurance Statement

The Office of the Comptroller of the Currency (OCC) has made a conscientious effort during fiscal year 2005 to meet the internal control requirements of the Federal Managers' Financial Integrity Act (FMFIA) and the Federal Financial Management Improvement Act (FFMIA). OCC systems of management control are designed to ensure that:

a) Programs achieve their intended results.
b) Resources are used in accordance with the agency's mission.
c) Programs and resources are protected from waste, fraud, and mismanagement.
d) Laws and regulations are followed.
e) Controls are suffficient to minimize improper or erroneous payments.
f) Performance information is reliable.
g) Systems security is in substantial compliance with all relevant requirements.
h) Continuity of operations planning is sufficient to reduce risk to reasonable levels.
i) Financial management systems are in compliance with federal financial system standards.

For all OCC responsibilities, I can provide reasonable assurance that our office achieved the above management control objectives during FY 2005. Specifically, this assurance is provided relative to Sections 2 and 4 of the Federal Managers' Financial Integrity Act. I can further assure that our financial management systems are in substantial compliance with the requirements imposed by the Federal Financial Management Improvement Act.

John C. Dugan
Comptroller of the Currency

Federal Managers' Financial Integrity Act of 1982

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

- Programs achieve their intended results.
- Resources are used in a manner consistent with our mission.
- Programs and resources are protected from waste, fraud, and mismanagement.

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

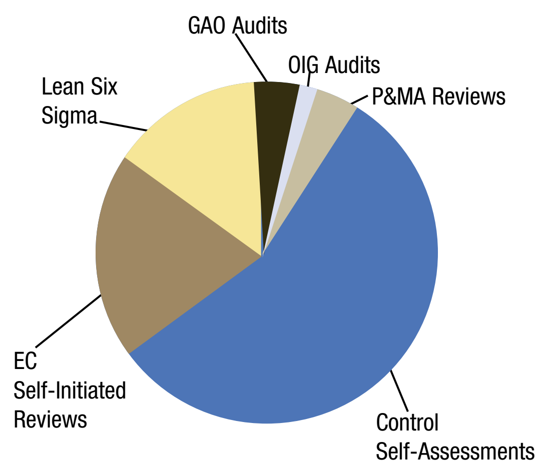
The OCC's evaluation of management controls, financial systems, and administrative processes for FY 2005 revealed that, as a whole, OCC programs are operating efficiently and effectively. The review revealed no material management control weaknesses that impair OCC's ability to fulfill its mission or significantly weaken established safeguards against waste, fraud, or mismanagement.

Management Control Program

The OCC's management control program is a continuous process extending to each major program with oversight responsibility assigned to the Program and Management Accountability Division (P&MA). To ensure identified weaknesses are responded to appropriately, the Executive Committee's Audit Subcommittee provides a forum for monitoring progress, resolving problems, and developing consensus recommendations regarding issues that arise from management control reviews, quality assurance activities, and audits. Each Executive Committee member maintains responsibility for protecting the resources under his or her direction, and is accountable for ensuring that new and existing programs are managed efficiently and effectively, to protect resources from waste, fraud, and mismanagement.

Figure 7 summarizes the distribution of management control assessments for FY

Figure 7: FY 2005 Review Activities



2005. P&MA completed 9 internal reviews and administered 120 management control self-assessments during this period. These reviews are in addition to self-initiated program reviews completed at an Executive Committee member's direction. The Government Accountability Office (GAO) issued an additional nine audit reports resulting in no action items for OCC. The OIG issued one audit report resulting in one recommendation, which has been implemented. No issues directly related to OCC are highlighted in GAO's 2005 high-risk report.

Executive Committee Program Certifications

In support of the management control program, each Executive Committee member submits a departmental certification that, in combination with the aforementioned internal reviews and external audits, forms the analytical basis of the annual Assurance Statement. The EC certifications are based on information gathered from various sources, including executive management's personal knowledge of day-to-day operations as supplemented by quality assurance activities, program reviews, and other management-initiated evaluations.

Risk Assessment Program

During FY 2005, P&MA worked closely with the Audit Subcommittee to formulate and establish a risk assessment program to determine risks and mitigating factors relative to the strategic goals and objectives outlined in OCC's Strategic Plan. This process resulted in the development of P&MA's Audit Plan for FY 2005 and FY 2006.

Audited Financial Statements

The Government Management Reform Act of 1994 amended the requirements of the Chief Financial Officers Act by requiring preparation and audit of department-wide financial statements for 24 major executive departments and agencies. As a bureau of the U.S. Department of the Treasury, OCC supports department-wide compliance with this requirement by means of an annual, independent audit of its financial statements.

Federal Financial Management Improvement Act of 1996

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

OCC implemented a FFMIA-compliant system in FY 2002, and upgraded to a Web-based platform during FY 2003. The system substantially complies with federal financial management system requirements.

Other Key Legal and Financial Regulatory Requirements

OCC is required to implement controls and periodically submit information to the Department of the Treasury in support of various department-wide compliance initiatives. Specific examples include compliance under FISMA, IPIA, the Erroneous Payments Recovery Act of 2002, and GPRA. The OCC continues to monitor its performance under these acts and has been responsive to each related data call from Treasury. The FY 2005 management control assessment considered OCC's level of compliance with each of these acts and concluded, with reasonable assurance, that OCC is achieving satisfactory results in each case.

OCC's Next Steps

The OCC will continue to closely monitor financial sectors and markets in FY 2006. The proliferation of non-traditional home mortgage products, rapid growth of home equity lines of credit, and the acceleration of home prices require close attention. A sudden and sustained rise in interest rates, or drop in housing prices, could present potential vulnerabilities to real estate-related portfolios, as well as other consumer-lending portfolios.

The OCC will continue its focus on compliance with the Bank Secrecy Act and anti-money laundering regulations, as well as maintain a watchful eye on issues related to privacy, predatory lending, and fairness in home mortgage lending practices.

Corporate governance, accounting transparency, strong internal controls and audit, and compliance programs remain important points of focus for the banking industry — and large banks in particular.

The OCC will work to ensure that banks that rely on models to measure risk and determine minimum regulatory capital, develop and implement effective control mechanisms and validation practices to govern the proper use of such models. This work will be done in accordance with the revisions to the Basel Capital Accord.

Credit quality, adequacy of ALLL, off-balance-sheet activities, liquidity, and interest-rate risk management will continue to require close supervisory attention by the agency.

Industry consolidation and earnings pressures will continue to create incentives for banks to reduce overhead costs, outsource technology operations and labor-intensive tasks to third party vendors, and search for new or expanded products and services. Assessing the adequacy and effectiveness of how banks manage the resulting risks will be a critical component of OCC's supervisory strategies.

In the aftermath of Hurricane Katrina, national banks in affected areas resumed services as quickly as possible and were operating within a few days, although some branches and facilities remained closed. Since then, national banks continue to cooperate with each other, their state bank counterparts, and federal, state and local officials to accommodate the needs of communities struck by the disaster. The OCC will remain in contact with these institutions to provide assistance as recovery and rebuilding efforts continue. Through the bank supervision process, the OCC will work with its federal counterparts to monitor the long-term economic impact of this disaster and take appropriate bank supervisory actions.

INDEPENDENT AUDITORS' REPORT

GARDINER KAMYA
& ASSOCIATES, PC

CERTIFIED PUBLIC ACCOUNTANTS | MANAGEMENT CONSULTANTS

<u>Independent Auditors' Report on Financial Statements</u>

The Inspector General, Department of the Treasury, and
the Comptroller of the Currency:

We have audited the accompanying balance sheets of the Office of the Comptroller of the Currency (OCC) as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended. These financial statements are the responsibility of the management of OCC. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the OCC as of September 30, 2005 and 2004, and its net costs, changes in net position, budgetary resources, the reconciliation of budgetary obligations to net costs, and custodial activities for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information in the 2005 Profile, Operations and Accomplishments, and Management sections of OCC's fiscal year 2005 Annual Report is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of this information. However, we did not audit this information and accordingly, we express no opinion on it.

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

In accordance with *Government Auditing Standards,* we have also issued reports dated October 27, 2005, on our consideration of the OCC's internal control over financial reporting, and on our tests of its compliance with certain provisions of applicable laws and regulations. These reports are an integral part of an audit performed in accordance with *Government Auditing Standards,* and these reports should be read in conjunction with this report in considering the results of our audits.

October 27, 2005

GARDINER KAMYA & ASSOCIATES, PC

CERTIFIED PUBLIC ACCOUNTANTS | MANAGEMENT CONSULTANTS

<u>Independent Auditors' Report on Internal Control over Financial Reporting</u>

The Inspector General, Department of the Treasury, and
the Comptroller of the Currency:

We have audited the balance sheets of the Office of the Comptroller of the Currency (OCC) as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity for the years then ended, and have issued our report thereon dated October 27, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

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

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

1717 K STREET, NW SUITE 601
WASHINGTON, DC 20036
P 202-857-1777 F 202-857-1778
WWW.GKACPA.COM

In addition, with respect to internal control related to performance measures determined by management to be key and reported in the 2005 Profile, Operations and Accomplishments, Management, and the Appendix sections of the OCC's Annual Report, we obtained an understanding of the design of significant internal controls relating to the existence and completeness assertions, as required by OMB Bulletin No. 01-02. Our procedures were not designed to provide assurance on internal controls over reported performance measures, and, accordingly, we do not provide an opinion on such controls. We noted no matters involving internal control and its operation that we considered to be material weaknesses as defined above. However, we noted other matters involving internal control and its operation that we have reported to the management of OCC in a separate letter dated October 27, 2005.

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

October 27, 2005

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GARDINER KAMYA
& ASSOCIATES, PC

CERTIFIED PUBLIC ACCOUNTANTS | MANAGEMENT CONSULTANTS

Independent Auditors' Report on Compliance with Laws and Regulations

The Inspector General, Department of the Treasury, and
the Comptroller of the Currency:

We have audited the balance sheets of the Office of the Comptroller of the Currency (OCC) as of September 30, 2005 and 2004, and the related statements of net cost, changes in net position, budgetary resources, financing, and custodial activity, for the years then ended, and have issued our report thereon dated October 27, 2005. We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, *Audit Requirements for Federal Financial Statements.*

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

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

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

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

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WASHINGTON, DC 20036
P 202-857-1777 F 202-857-1778
WWW.GKACPA.COM

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

October 27, 2005

Office of Comptroller of the Currency
Balance Sheets
As of September 30, 2005 and 2004

	FY 2005	FY 2004
Assets		
Intragovernmental:		
Fund balance with Treasury	$ 1,724,161	$ 1,701,674
Investments and related interest (Note 3)	611,975,767	487,121,232
Accounts receivable	13,300	144,332
Total intragovernmental	**613,713,228**	**488,967,238**
Cash	12,584	25,961
Accounts receivable, net	270,556	112,201
Property and equipment, net (Note 4)	46,190,939	40,147,991
Advances and prepayments	1,145,419	1,144,599
Total assets	**$ 661,332,726**	**$ 530,397,990**
Liabilities		
Intragovernmental:		
Other accrued liabilities	$ 1,405,550	$ 746,371
Total intragovernmental	**1,405,550**	**746,371**
Accounts payable	7,960,357	2,280,839
Accrued payroll and other employee benefits	17,555,891	16,203,165
Accrued annual leave	24,942,021	24,037,799
Other accrued liabilities	17,030,393	16,582,611
Deferred revenue (Note 5)	146,664,373	125,015,607
Post retirement benefits (Note 7)	11,352,850	10,071,983
Total liabilities	**226,911,435**	**194,938,375**
Net position (Note 8)	**434,421,291**	**335,459,615**
Total liabilities and net position	**$ 661,332,726**	**$ 530,397,990**

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

Office of Comptroller of the Currency
Statements of Net Cost
For the Years Ended September 30, 2005 and 2004

	FY 2005	FY 2004
Program Costs		
Supervise National Banks		
Intragovernmental	$ 57,553,452	$ 55,013,447
With the public	362,769,983	337,088,793
Subtotal - Supervise National Banks	**$ 420,323,435**	**$ 392,102,240**
Regulate National Banks		
Intragovernmental	$ 9,279,718	$ 9,119,549
With the public	56,650,420	54,522,477
Subtotal - Regulate National Banks	**$ 65,930,138**	**$ 63,642,026**
Charter National Banks		
Intragovernmental	$ 2,232,906	$ 2,418,481
With the public	13,228,352	14,049,294
Subtotal - Charter National Banks	**$ 15,461,258**	**$ 16,467,775**
Total Program Costs	**$ 501,714,831**	**$ 472,212,041**
Less: Earned revenues not attributed to programs	(577,742,644)	(497,764,476)
Net Cost of Operations	**$ (76,027,813)**	**$ (25,552,435)**

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

Office of Comptroller of the Currency
Statements of Changes in Net Position
For the Years Ended September 30, 2005 and 2004

	FY 2005	FY 2004
Beginning Balances	$ 335,459,615	$ 287,373,440
Other Financing Sources:		
Imputed financing from costs absorbed by others (Note 7)	22,933,863	22,533,740
Net Cost of Operations	76,027,813	25,552,435
Net Change	98,961,676	48,086,175
Ending Balances	**$ 434,421,291**	**$ 335,459,615**

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

Office of Comptroller of the Currency
Statements of Budgetary Resources
For the Years Ended September 30, 2005 and 2004

	FY 2005	FY 2004
Budgetary Resources:		
Unobligated balance:		
Beginning of period	$ 398,535,082	$ 339,989,380
Spending authority from offsetting collections:		
Earned		
Collected	596,213,085	507,438,496
Receivable from federal sources	(1,011,814)	569,956
Subtotal	595,201,271	508,008,452
Total Budgetary Resources	**$ 993,736,353**	**$ 847,997,832**
Status of Budgetary Resources		
Obligations incurred	$ 487,113,339	$ 449,462,750
Unobligated balance available	506,623,014	398,535,082
Total Status of Budgetary Resources	**$ 993,736,353**	**$ 847,997,832**
Relationship of Obligations to Outlays		
Obligated balance, net, beginning of period	80,658,172	82,639,683
Obligated balance, net, end of period:		
Accounts receivable	(4,678,768)	(5,690,582)
Undelivered orders	18,703,188	16,425,985
Accounts payable and accruals, net of assessments refunds	80,247,061	69,922,769
Outlays:		
Disbursements	$ 474,511,844	$ 450,874,306
Collections	(596,213,085)	(507,438,496)
Net Outlays	**$ (121,701,241)**	**$ (56,564,190)**

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

Office of Comptroller of the Currency
Statements of Financing
For the Years Ended September 30, 2005 and 2004

	FY 2005	FY 2004
Resources Used to Finance Activities:		
Budgetary Resources Obligated		
Obligations incurred	$ 487,113,339	$ 449,462,750
Less: Spending authority from offsetting collections	(595,201,271)	(508,008,452)
Net obligations	(108,087,932)	(58,545,702)
Other Resources		
Imputed financing from costs absorbed by others (Note 7)	22,933,863	22,533,740
Total resources used to finance activities	**(85,154,069)**	**(36,011,962)**
Resources Used to Finance Items not Part of the Net Cost of Operations		
Change in budgetary resources obligated for goods, services and benefits ordered but not yet provided	(2,278,023)	7,278,008
Resources that finance the acquisition of assets	(17,874,784)	(16,304,977)
Other resources or adjustments to net obligated resources that do not affect net cost of operations	(158,355)	320,570
Total resources used to finance items not part of the net cost of operations	**(20,311,162)**	**(8,706,399)**
Total resources used to finance the net cost of operations	**(105,465,231)**	**(44,718,361)**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods:		
Change in deferred revenue	21,648,766	7,967,380
Total components that will require or generate resources in future periods	21,648,766	7,967,380
Components not Requiring or Generating Resources:		
Depreciation and amortization	11,203,799	8,869,905
Net (increase) decrease in bond premium	(4,043,186)	2,091,916
Other	628,039	236,725
Total components that will not require or generate resources	7,788,652	11,198,546
Total components of net cost of operations that will not require or generate resources in the current period	**29,437,418**	**19,165,926**
Net Cost of Operations	**$ (76,027,813)**	**$ (25,552,435)**

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

Office of Comptroller of the Currency
Statements of Custodial Activity
For the Years Ended September 30, 2005 and 2004

	FY 2005	FY 2004
Revenue Activity:		
Sources of Cash Collections		
Civil Monetary Penalties	$ 31,264,157	$ 25,033,961
Accrual Adjustments	234,072	(733,784)
Total Custodial Revenue	31,498,229	24,300,177
Disposition of Custodial Revenue		
Transferred to Treasury	(31,117,164)	(25,577,843)
(Increase)/Decrease in Amounts Yet to be Transferred	(381,065)	1,277,666
Total Disposition for Custodial Revenue	(31,498,229)	(24,300,177)
Net Custodial Activity	$ -	$ -

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

Notes to the Financial Statements

Note 1 — Organization

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

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

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

The Departmental Offices (DO), another entity of the U.S. Department of the Treasury, provides certain administrative services to the OCC. The OCC pays the DO for services rendered pursuant to established interagency agreements. Administrative services provided by the DO totaled $2,933,794 in FY 2005, and $2,467,099 in FY 2004.

Note 2 — Significant Accounting Policies

Basis of Accounting
The OCC's financial statements have been prepared from its accounting records in conformity with generally accepted accounting principles (GAAP) in the United States of America. The financial statements consist of a balance sheet, and the statements of net cost, changes in net position, budgetary resources, financing, and custodial activity. These financial statements are presented on a comparative basis providing information for FYs 2005 and 2004.

The OCC collects CMPs due to the federal government that are assessed through court-enforced legal actions against a national bank and/or its officers. Outstanding CMPs at September 30, 2005, and 2004, amounted to $1,514,789 and $1,280,718, respectively.

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

Fund Balance with Treasury

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

Accounts Receivable

Accounts receivable represent monies owed to the OCC for services and goods provided. Accounts receivable from the public are reduced to their net realizable value by an Allowance for Doubtful Accounts. The OCC reserves an allowance equal to 100 percent of accounts with outstanding balances exceeding one year, and 50 percent of accounts with balances exceeding six months but less than one year. At September 30, 2005, and 2004, accounts receivable from the public amounted to $294,552 less an allowance of $23,996 and $147,597 less an allowance of $35,396, respectively.

Advances and Prepayments

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

Liabilities

Liabilities represent the amounts owing or accruing under contractual or other arrangements governing the transactions, including operating expenses incurred but not yet paid. Payments are made in a timely manner in accordance with the Prompt Payment Act. Interest penalties are paid when payments are late. Discounts are taken when cost effective, and the invoice is paid within the discount period. FY 2004 intragovernmental accounts payable are presented this year as other accrued liabilities.

Annual, Sick, and Other Leave

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

Use of Estimates

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

Note 3 — Investments and Related Interest

Investments are U.S. Treasury securities stated at amortized cost and the related accrued interest. The OCC plans to hold these investments to maturity. Premiums and discounts are amortized over the term of the investment using the straight-line method, which approximates the effective yield method. The fair market value of investment securities was $603,096,812 at September 30, 2005, and $484,401,551 at September 30, 2004.

Investments and Related Interest Receivable

	FY 2005	FY 2004
Par Value	$ 600,379,000	$ 478,652,000
Net Unamortized Discount/Premium	6,931,298	2,922,982
Net Unamortized Value	607,310,298	481,574,982
Interest Receivable	4,665,469	5,546,250
Total	**$ 611,975,767**	**$ 487,121,232**

FY 2005 Investment Portfolio

Maturity	Par Value	Coupon Rate
Overnight	$ 218,379,000	3.460%
During 2006	29,000,000	5.750%
	25,000,000	6.875%
During 2007	30,000,000	3.500%
	30,000,000	4.375%
During 2008	30,000,000	3.000%
	30,000,000	2.625%
During 2009	21,000,000	3.375%
	21,000,000	3.875%
During 2010	35,000,000	3.500%
	35,000,000	5.750%
During 2011	64,000,000	5.000%
During 2012	32,000,000	4.875%
Total	**$ 600,379,000**	

FY 2004 Investment Portfolio

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

Note 4 — Property and Equipment, net

Property and equipment purchased at a cost greater than or equal to the noted thresholds below with useful lives of five years or more are capitalized at cost and depreciated or amortized, as applicable. Leasehold improvements are amortized on a straight-line basis over the lesser of the terms of the related leases or their estimated useful lives. All other property and equipment are depreciated or amortized, as applicable, on a straight-line basis over their estimated useful lives. The tables presented below summarize property and equipment balances as of September 30, 2005, and 2004.

Note 5 — Deferred Revenue

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

FY 2005 Property and Equipment, net

Class of Assets	Capitalization Threshold/ Useful Life		Cost	Accumulated Depreciation	Net Book Value
Leasehold Improvements	$50,000	5-20	$ 26,429,648	$ (19,271,689)	$ 7,157,959
Equipment	$50,000	5-10	15,075,850	(9,379,463)	5,696,387
Furniture and Fixtures	$50,000	5-10	1,336,778	(971,877)	364,901
Internal Use Software	$500,000	5-10	31,383,723	(14,199,259)	17,184,464
Internal Use Software-Dev	$500,000	5-10	15,317,047	-	15,317,047
Leasehold Improvements-Dev	$50,000	5-20	470,181	-	470,181
Total			**$ 90,013,227**	**$ (43,822,288)**	**$ 46,190,939**

FY 2004 Property and Equipment, net

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

Note 6 — Leases

The OCC leases office space for headquarters operations in Washington, D.C., and for district and field operations. The lease agreements expire at various dates. In FY 2005, the OCC signed renewal options for its headquarters, Data Center and Central District leases. In addition, a new 10-year lease was executed for the Northeastern District. These leases are treated as operating leases.

FY 2005 Future Lease Payments

Year		Amount
2006	$	22,789,699
2007		24,954,737
2008		23,774,977
2009		22,589,732
2010		21,751,178
2011 and beyond		34,436,469
Total	**$**	**150,296,792**

FY 2004 Future Lease Payments

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

Note 7 — Retirement Plans and Other Benefits

Retirement

OCC employees are eligible to participate in one of two retirement plans. Employees hired prior to January 1, 1984, are covered by the CSRS, unless they elected to join the FERS and Social Security during the election period. Employees hired after December 31, 1983, are automatically covered by FERS and Social Security. The distribution of the OCC's workforce by retirement plan is 70 percent FERS and 29 percent CSRS. The remaining 1 percent of employees qualify only for Social Security benefits. For employees covered by CSRS, the OCC contributes 7 percent of their adjusted base pay to the plan. OCC contributions to CSRS were $6,219,879 in FY 2005 and $6,582,430 in FY 2004. For employees covered by FERS, the OCC contributes 11.2 percent of their adjusted base pay. OCC contributions totaled $17,001,247 in FY 2005, and $15,129,774 in FY 2004.

Furthermore, the OPM contributed an additional $22,933,863 toward these retirement plans during FY 2005, and $22,533,740 in FY 2004. The OCC recognized these contributions as "Imputed costs absorbed by others" and an offset in equal amount to "Imputed financing from costs absorbed by others" as a result of not having to reimburse the OPM.

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

Other Benefits

OCC employees are eligible to participate in the Federal Thrift Savings Plan (TSP). For those employees under FERS, a TSP account is automatically established, and the OCC contributes a mandatory 1 percent of adjusted base pay to this account. In addition, the OCC matches employee contributions up to an additional 4 percent of pay, for a maximum OCC contribution amounting to 5 percent of adjusted base pay. Employees under CSRS may participate in the TSP, but do not receive the automatic (1 percent) and matching employer contributions. TSP contributions by the OCC totaled $6,890,694 in FY 2005 and $6,437,886 in FY 2004. The OCC also contributed a total of $12,632,597 for Social Security and Medicare benefits for all eligible employees in FY 2005, and $12,332,480 in FY 2004.

Employees can elect to contribute up to 10 percent of their adjusted base pay in the OCC 401(k) Plan, subject to Internal Revenue regulations. Prudential Financial Incorporated administers the plan. Currently, the OCC contributes a fixed 2 percent of the adjusted base pay to the plan for all qualified employees, regardless of whether they contribute to the Plan or not. In addition, the OCC matches the first 1 percent of an employee's contribution to the Plan, for a total agency contribution of 3 percent. Approximately 2,390 employees receive the maximum of 3 percent contribution and 370 employees benefit from the basic 2 percent contribution. In FY 2005, the OCC funded a one-time contribution of $1,000 to be deposited in the 401(k) accounts of all permanent employees. The total cost of the OCC's contributions plus associated administration fees amounted to $9,227,442 during FY 2005, and $4,138,146 in FY 2004.

The OCC sponsors a life insurance benefit plan for current and retired employees. This plan is a defined benefit plan. Premium payments made during FY 2005 totaled $289,348 and $128,258 in FY 2004.

The weighted-average discount rate used in determining the accumulated post-retirement benefit obligation was 5.5 percent. Gains or losses due to changes in actuarial assumptions are amortized over the service life of the plan.

Employees and retirees of the OCC are eligible to participate in Federal Employees Health Benefits (FEHB) and Federal Employees Group Life Insurance (FEGLI) plans that involve a cost sharing of bi-weekly coverage premiums by employee and employer. Both of these employee benefit plans are administered by the OPM. Total OCC contributions for active employees who participate in the FEHB plans were $14,567,345 for FY 2005, and $13,589,369 for FY 2004. OCC contributions for active employees who participate in the FEGLI plan were $213,267 for FY 2005, and $201,697 for FY 2004.

The Federal Employees' Compensation Act (FECA) provides income and medical cost protection to covered federal civilian employees injured on the job, employees who

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

Components	FY 2005	FY 2004
Accumulated Post-Retirement Benefit Obligation	$ (16,272,887)	$ (12,613,233)
Unrecognized Transition Obligation	3,710,166	1,158,542
Unrecognized Net Gain	1,209,871	1,382,708
Total	$ (11,352,850)	$ (10,071,983)
Service Cost	$ 509,425	$ 468,500
Interest Cost	844,237	663,926
Amortization of Transition Obligation	172,837	172,837
Amortization of Unrecongnized Loss	186,069	-
Total	**$ 1,712,568**	**$ 1,305,263**

have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job-related injury or occupational disease. Claims incurred for benefits for the OCC's employees under FECA are administered by the U.S. Department of Labor (DOL) and later billed to the OCC. The OCC accrued $5,260,569 of workers' compensation costs as of September 30, 2005, and $6,001,044 as of September 30, 2004. This amount includes unbilled costs of $280,603 in FY 2005 and $436,140 in FY 2004 and an actuarial estimated liability of $4,979,966 in FY 2005 and $5,564,904 in FY 2004 based on calculations provided by the DOL at year-end.

Note 8 — Net Position

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

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

The Special Reserve supplements revenue from assessments and other sources that are made available to fund the OCC's annual budget. The Special Reserve reduces the effect on operations of unforecasted revenue shortfalls or unbudgeted and unanticipated requirements or opportunities.

Net Position Availability

Components	FY 2005	FY 2004
Contingency Reserve	$ 280,828,551	$ 219,473,390
Special Reserve	15,000,000	15,000,000
Asset Replacement Reserve	38,709,695	17,532,950
Earmarked for On-going Operations:		
Undelivered Orders	18,703,188	16,425,985
Consumption of Assets	55,488,907	45,401,954
Capital Investments	25,690,950	17,235,357
District Offices Restructuring	-	4,389,979
Net Position	**$ 434,421,291**	**$ 335,459,615**

The asset replacement reserve was established in FY 2004. It ensures the incremental funding of leasehold improvements and replacement of furniture and equipment scheduled for future years. A specific amount is accumulated each year based on the expected cost and useful life of the asset to ensure that adequate funds are available when the time comes for the leasehold improvement or asset replacement. The FY 2006 budget authorized the use of approximately $10.3 million from the reserve balance to fund various capital projects and set a target level for reserve contribution of $35.4 million by September 30, 2006.

Note 9 — Expenses by Budget Object Classification

The following table illustrates the OCC's costs by major budget object class for FYs 2005 and 2004.

Note 10 — Contingencies

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

Budget Object Class	FY 2005	FY 2004
Personnel Compensation	$ 256,653,020	$ 253,743,442
Personnel Benefits	85,542,831	72,166,389
Benefits to Former Employees	626,059	3,053,268
Travel and Transportation of Persons	31,160,567	27,366,170
Travel and Transportation of Things	1,446,824	1,893,377
Rent, Communication, and Utilities	33,530,892	32,130,835
Printing and Reproduction	859,851	914,616
Other Contractual Services	44,696,702	38,102,100
Supplies and Materials	3,382,594	3,365,474
Equipment	5,452,810	4,811,125
Land and Structures - Leasehold Improvements	3,521,380	2,872,330
Insurance Claims and Indemnities	75,601	152,545
Depreciation	11,203,799	8,869,905
Loss on Asset Disposal	628,038	236,725
Imputed Costs	22,933,863	22,533,740
Total	**$ 501,714,831**	**$ 472,212,041**

Appendix A —
FY 2005 Performance Measures and Results

The OCC's FY 2005 performance measures, workload indicators, customer service standards, and results are presented below.

OCC Program	Performance Measure Workload Indicator Customer Service Standard	FY 2002	FY 2003	FY 2004	FY 2005	
					Target	Actual [1]
Supervise	Percentage of national banks that are well capitalized	99%	99%	99%	95%	***99%***
	Percentage of national banks with composite CAMELS rating of 1 or 2	95%	94%	94%	90%	***94%***
	Percentage of critically undercapitalized banks on which responsible action is taken within 90 calendar days after they become critically undercapitalized	NA	100%	100%	100%	N/A[2]
	Rehabilitated problem national banks as a percentage of problem national banks one year ago (CAMELS 3, 4 or 5)	47%	32%	40%	40%	***44%***
	Percentage of national banks with consumer compliance rating of 1 or 2	NA	96%	96%	94%	***94%***
	Percentage of qualified Intermediate Small Banks to which the OCC offers to provide consultation on the Community Reinvestment Act and community development opportunities[3]	NA	100%	100%	100%	100%
	Percentage of consumer complaints closed within 60 calendar days of receipt	NA	87%	74%	80%	72%[4]
	Number of consumer complaints opened/closed during the fiscal year	NA	75,114 69,044	68,026 68,104	80,000 75,000	73,519 72,203
	Average survey response that the report of examination clearly communicated examination findings, significant issues and the corrective actions management needed to take	1.30	1.26	1.30	$\leq$ 1.75	1.28
Regulate	Percentage of external legal opinions issued within established time frames	NA	87%	87%	86%	86%
	Number of external legal opinions issued during the fiscal year	N/A	92	119	125	119

OCC Program	Performance Measure Workload Indicator Customer Service Standard	FY 2002	FY 2003	FY 2004	FY 2005 Target	FY 2005 Actual[1]
Charter	Percentage of licensing applications and notices filed electronically	NA	8%	34%	35%	38%
	Number of licensing applications and notices filed electronically during the fiscal year	NA	182	893	875	1,256
	Percentage of licensing applications and notices completed within established time frames	96%	97%	96%	95%	96%
	Number of licensing applications and notices completed during the fiscal year	NA	1,918	2,477	2,400	2,128
	Average survey rating of the overall licensing services provided by OCC	1.17	1.14	1.20	≤ 1.5	1.19

[1] FY 2005 performance numbers shown in bold italics are estimates. Some performance data is obtained from quarterly call reports from banks. The September 30, 2005 call reports are not due until 30 or 45 days after the end of the period. Additionally, examinations concluded late in the fiscal year are not finalized for another 30 to 60 days. As a result, complete fiscal year data is not yet available; therefore, estimates have been reported.
[2] There were no critically undercapitalized national banks during FY 2005.
[3] The OCC modified this performance measure to conform to the revised CRA regulations that were issued in the fourth quarter of FY 2005. Previously, the performance measure was: Percentage of community banks that are within one year of their first large bank Community Reinvestment Act examination in which the OCC offers to provide consultation on community development opportunities.
[4] The OCC did not achieve its target for closing 80 percent of consumer complaints within 60 calendar days. The volume of calls received increased by 1 percent, cases opened increased by 8 percent, and cases closed increased by 6 percent over FY 2004. In addition to the increased volume of work, the risks and complexity of the consumer complaints continued to increase requiring additional time for analysis and in many instances additional information from the consumer and/or the bank. This lengthened the average response time achieved in FY 2005.

Appendix B — Glossary of Acronyms

ABCP	Asset-Backed Commercial Paper
ACH	Automated Clearing House
AIRB	Advanced Internal Ratings-Based
ALICE	Automated Learning Information Center
ALLL	Allowance for Loan and Lease Losses
AML	Anti-Money Laundering
ATM	Automated Teller Machine
BSA	Bank Secrecy Act
CAG	Customer Assistance Group
CAIS	Corporate Activity Information System
CAMELS	Composite rating standing for Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk
CBCA	Change in Bank Control Act
CDR	Central Data Repository
CMP	Civil Money Penalty
COOP	Continuity of Operations Plan
CPIC	Capital Planning and Investment Control
CRA	Community Reinvestment Act
CSRS	Civil Service Retirement System
CY	Calendar Year
DO	Departmental Offices
DOL	Department of Labor
DRC	District Risk Committee
EC	Executive Committee

EEO	Equal Employment Opportunity
EFT	Electronic Funds Transfer
e-Gov	Electronic Government Initiatives
e-TIME	Electronic Time and Attendance Processing
EOC	Emergency Operations Center
FAI	Federal Activities Inventory Reform
FAIR	Fair Alternatives and Innovative Resolutions Program
FBIIC	Financial and Banking Infrastructure Information Committee
FDIC	Federal Deposit Insurance Corporation
FECA	Federal Employees Compensation Act
FEGLI	Federal Employees Group Life Insurance
FEHB	Federal Employees Health Benefits
FEMA	Federal Emergency Management Agency
FERS	Federal Employees Retirement System
FFIEC	Federal Financial Institutions Examination Council
FFMIA	Federal Financial Management Improvement Act
FinCEN	Financial Crimes Enforcement Network
FISMA	Federal Information Security Management Act of 2002
FM	Financial Management Division
FMFIA	Federal Managers' Financial Integrity Act
FPP	Financial Policy & Procedures
FRB	Board of Governors of the Federal Reserve System
FTC	Federal Trade Commission
FTE	Full-Time Equivalent
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles

GAO	Government Accountability Office
GLBA	Gramm-Leach-Bliley Act
GPRA	Government Performance Results Act
HMDA	Home Mortgage Disclosure Act
HR	Human Resources
IPIA	Improper Payments Act of 2002
IRB	Investment Review Board
IT	Information Technology
LIS	Licensing Information System
MDPS	Multi-Regional Data Processing Servicers
MLR	Money Laundering Risk
NA	Not Applicable
NAIC	National Association of Insurance Commissioners
NCUA	National Credit Union Administration
NRC	National Risk Committee
NRPT	National Resource Planning Tool
NTEU	National Treasury Employees Union
OCC	Office of the Comptroller of the Currency
OIG	Treasury's Office of Inspector General
OM	Office of Management
OMB	Office of Management and Budget
OPM	Office of Personnel Management
OTS	Office of Thrift Supervision
PMA	President's Management Agenda
P&MA	Program and Management Accountability Division
QAP	Quality Assurance Program

QIS	Quantitative Impact Statement
SAR	Suspicious Activity Report
SAT	Senior Assessment Team
SDLC	Systems Development Life Cycle
SEC	Securities and Exchange Commission
SGL	United States Government Standard General Ledger
SMS	System Management Server
SNC	Shared National Credit
TSP	Federal Thrift Savings Plan
U.S.	United States
USAPA	USA PATRIOT Act

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Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219