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The *Federal Reserve Bulletin* is issued annually under the direction of the staff publications committee. This committee is responsible for opinions expressed except in official statements and signed articles. It is assisted by the Publications Department under the direction of Lucretia M. Boyer.

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Preface

The *Federal Reserve Bulletin* was introduced in 1914 as a vehicle to present policy issues developed by the Federal Reserve Board. Throughout the years, the *Bulletin* has been viewed as a journal of record, serving to provide the public with data and research results generated by the Board. Authors from the Board's Research and Statistics, Monetary Affairs, International Finance, Banking Supervision and Regulation, Consumer and Community Affairs, Reserve Bank Operations, and Legal divisions contribute to the *Bulletin*, which includes topical research articles, the Report on the Condition of the U.S. Banking Industry, orders on banking applications, and enforcement actions.

Starting in 2004, the *Bulletin* was published quarterly rather than monthly. In 2006, in response to the increased use of the Internet—and in order to release articles and reports in a more timely fashion—the Board discontinued the quarterly print version of the *Bulletin* and began to publish the contents of the *Bulletin* on its public website as the information became available. All articles, banking condition reports, orders on banking applications, and enforcement actions that were published in the online *Bulletin* in 2007 are included in this print compilation.

The tables that appeared in the Financial and Business Statistics section of the *Bulletin* from 1914 through 2003 are now published monthly as a separate print publication, the *Statistical Supplement to the Federal Reserve Bulletin*. All statistical series are published with the same frequency as they were in the *Bulletin*, and the numbering system for the tables remains the same.

Online access to the *Bulletin* and the *Statistical Supplement* is free. A free e-mail notification service is available to alert subscribers to the release of articles and reports in the *Bulletin;* the monthly *Statistical Supplement;* and press releases, testimonies, and speeches. The message provides a brief description and a link to the recent posting.

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Articles

May 2007

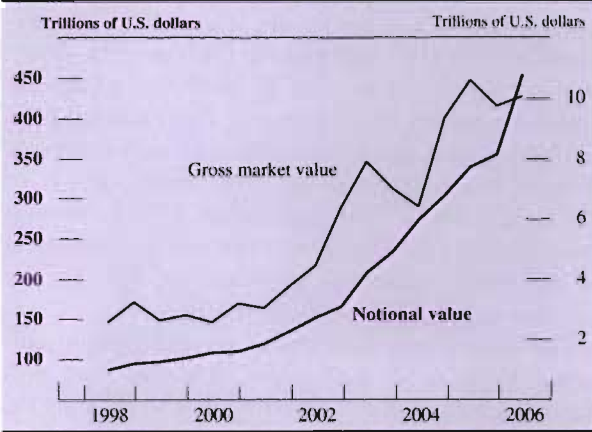
U.S. Cross-Border Derivatives Data: A User's Guide

Stephanie E. Curcuru, of the Board's Division of International Finance, prepared this article. Jonas J. Robison provided research assistance.

The global derivatives market has grown rapidly in the past decade. By one measure of market size—the notional value, which is used to determine the payments made on a derivatives contract—the derivatives market expanded from $87 trillion in June 1998 to $454 trillion in June 2006 (figure 1).[1] Measured by the price at which a derivatives contract can be purchased in a current transaction, or the market value, the derivatives market grew from $3 trillion in June 1998 to $10 trillion as of June 2006.

Available data suggest that cross-border derivatives deals—in which a resident of one country enters into a contract with a resident of another country—make up a substantial share of derivatives transactions.[2] Recognizing this fact, the International Monetary Fund (IMF) has recommended that its member countries include cross-border derivatives in their reports on external-sector finances.[3] Many countries with financial services firms active in the derivatives market have included derivatives in these reports since the mid-1990s. The United States, however, has to date published very little information on cross-border derivatives because of the limited availability of data.[4] As a result, U.S. reports on cross-border financial flows and holdings currently exclude the bulk of transactions and positions in cross-border derivatives.

1. Gross market value and notional value of global derivatives outstanding, 1998–2006



NOTE: The data are semiannual and extend through June 2006. Gross market value is the sum of the total gross positive market value of contracts with all counterparties and the absolute value of the total gross negative market value of contracts with nonreporting counterparties. The term *gross* indicates that for multiple contracts with the same counterparty, contracts with positive market values and contracts with negative market values are not netted. For an explanation of notional value, refer to text note 1. To adjust for double counting, the notional values of contracts with reporting counterparties are divided by 2.

SOURCE: Bank for International Settlements.

To address these gaps in data and reporting, the U.S. Department of the Treasury, the Federal Reserve Bank of New York, and the Federal Reserve Board began collecting data on U.S. cross-border transactions and positions in derivatives in March 2005. They collect the data through the Treasury International Capital (TIC) reporting system, which for many years has collected similar data for securities such as stocks and bonds.[5] Because existing TIC

1. The notional value of a derivative is specified in the contract and serves as one basis for computing the payments made on the contract. For example, for a contract known as a foreign exchange forward, in which two parties agree to exchange an amount of currency at a future date, the notional value is the amount of currency to be exchanged.

2. For example, data for the United Kingdom indicate that cross-border derivatives with a positive market value to the domestic counterparty totaled $1.8 trillion in that country at the end of 2005. Refer to Office of National Statistics (2006), *United Kingdom Balance of Payments: The Pink Book 2006* (New York: Palgrave Macmillan). Data for other countries are available in the *Balance of Payments Statistics Yearbook*, published annually by the International Monetary Fund.

3. In 1993 the IMF recommended including derivatives as a line item under the reporting category of "portfolio investment"; in 1998 it further recommended that member countries report such data as a separate reporting category—"financial derivatives." Refer to International Monetary Fund (1993), *IMF Balance of Payments Manual*, 5th ed. (Washington: IMF); and International Monetary Fund (1998), "Financial Derivatives," paper prepared for the Eleventh Meeting of the IMF Committee on Balance of Payments Statistics, held at the International Monetary Fund, Washington, Oct. 21–23, www.imf.org/external/bopage/agenda.htm.

4. Some cross-border transactions in exchange-traded futures are included in the quarterly U.S. balance of payments data, table 8a, line B18 ("Commercial liabilities; Advance receipts and other liabilities"), available at www.bea.gov/international.

5. The TIC reporting system collects information on cross-border transactions in, and holdings of, portfolio securities and on other claims and liabilities, including deposits. Reports are filed by banks

reporting forms were ill equipped to capture cross-border derivatives transactions and positions, the Treasury developed a new form specifically for this purpose—TIC form D.

This article introduces the new data collected by form D and provides helpful information for data users. The article begins with a discussion of the relevance of derivatives to the U.S. external-sector reports published by the U.S. Department of Commerce, Bureau of Economic Analysis. To date, derivatives have been largely excluded from these reports. The article explains in detail the effects of the exclusion on two such reports—the U.S. balance of payments and the U.S. international investment position. In particular, it shows how the omission of derivatives from reports on cross-border flows and holdings can lead to mistaken inferences about what is driving changes in the international investment position of the United States. The implications of the analysis extend beyond the omission of derivatives. The effect of any other systematic omission of data on the external-sector reports may be similar.

The article then summarizes the information collected by form D and shows how the data will improve external-sector reporting. It also presents the 2006 data and discusses their relation to the derivatives data reported by other countries. The article concludes with a discussion of the use of the data to estimate risk exposures. Because the terminology associated with derivatives can be somewhat daunting, detailed definitions are provided in the boxes accompanying the main text.

Derivatives and the U.S. External-Sector Reports

The purpose of TIC form D is to collect the information needed for the inclusion of cross-border derivatives transactions and holdings in U.S. external-sector reports. This section examines the effect of the inclusion of derivatives data in external-sector reports through examples of accounting entries in two such reports. The examples illustrate the current and future treatment of derivatives transactions in the U.S. balance of payments as well as the current and future treatment of derivatives holdings in the U.S. international investment position.

Types of Derivatives

A derivative is a financial contract whose value is derived from something else (such as the value of a stock or bond), referred to as the "underlying." Anything that can be measured can serve as the underlying to a derivative. The underlying can be the price of a stock, the yield on a bond, a credit rating, the value of an index, or even something more exotic, like the average temperature in a region over a given period.

Common types of derivatives include options, forwards, futures, and swaps. In an options contract, the buyer pays an up-front premium for the right, but not the obligation, to purchase or sell a specified quantity of the underlying at a specified price on (or, in some contracts, until) the expiration date. The two parties to a forward or futures contract agree to exchange assets or their cash equivalent at, or until, a future date. The two parties to a swap agree to exchange assets or their cash equivalent periodically until a future date (for more information, refer to box "Overview of Derivatives").

The U.S. Balance of Payments

A country's balance of payments (BOP) is the record of the economic transactions between its residents and those of the rest of the world in a given period. The Bureau of Economic Analysis (BEA) publishes the U.S. BOP quarterly in three sections: the current account, the capital account, and the financial account.[6] The current account records transactions in goods and services, income, and unilateral transfers between residents of the United States and nonresidents. Items recorded in the capital account include nonproduced assets and other capital transfers, such as debt forgiveness and transfers of goods and financial assets by foreign residents as they enter or leave the United States. Transactions in the current and capital accounts give rise to financial flows, which are recorded, in turn, in the financial account. The financial account also records cross-border transactions arising from trade in financial instruments such as stocks and bonds, including transactions associated with the purchase or sale of the securities and those associated with payment for them.

Transactions in the BOP accounts are recorded as credit or debit entries (refer to box "Accounting in the U.S. Balance of Payments"). Credit entries are given a positive sign, and debit entries a negative sign. Transactions that generate a receipt of funds into the United States, such as an export, the sale of a security to a foreign resident, the withdrawal of U.S. deposits from a foreign bank, and the deposit of funds

and bank holding companies; securities brokers, dealers, and custodians; and nonfinancial companies with sizable commercial or financial claims and liabilities vis-à-vis foreign residents.

6. Before 1999, the BOP had only two sections—the current account and the capital account. The capital account included items that now appear in the financial account.

Overview of Derivatives

A derivatives contract can take many forms, but each form has one thing in common—the value of the contract is derived from something else, such as the value of a stock or bond; that "something else" is referred to as the underlying. As noted in the main text, anything that can be measured can serve as the underlying to a derivative. The following discussion covers several common types of derivatives, their associated cash flows, and their uses. Most other types of derivatives are variants of those discussed here.

Forward Contract

A forward contract is an agreement to purchase or sell a specified quantity of an underlying asset or its cash equivalent at a stated price on the given maturity date of the contract. Forwards trade in the over-the-counter (OTC) market, in which contract terms are negotiated between each pair of counterparties. Forwards typically have a zero initial cost to the contracting parties—that is, the counterparties set the delivery price so that each is willing to enter into the contract without an initial payment. The only payment is on the maturity date, when the counterparties will either exchange the assets specified in the contract or their cash equivalent.[1]

Forwards can be used to lock in, or "hedge," future expenses. They provide protection against future adverse movements in the value of the underlying asset, but they do so at the expense of losing future gains from favorable movements. For example, consider a firm that imports products into the United States. If the value of the U.S. dollar falls relative to the foreign currency, the dollar cost of the imported products will rise. To limit potential losses from exchange rate moves, the firm can enter into a foreign exchange forward contract to exchange a specified quantity of U.S. dollars for a specified quantity of the foreign currency at a future date, thereby locking in the exchange rate.

Swap Contract

A swap contract is basically a series of forwards, all with the same delivery price and quantity. As with individual forwards, swaps trade in the OTC market, and many are zero cost. Interest rate swaps are commonly used to change the flows of claims or liabilities from fixed to floating, or vice versa. For example, if a firm desires a loan with a fixed interest rate but can obtain a more favorable loan with a floating rate, the firm may choose the floating-rate loan and then enter into an offsetting swap agreement in which it pays a fixed rate and receives a floating rate. Because a swap is equivalent to a series of forwards, the counterparties will exchange assets or their cash equivalents periodically over the life of the contract.

1. Generally, forward contracts are not sold before maturity. Instead, one or both parties to the contract will enter into an offsetting contract with a third party.

Futures Contract

A futures contract is similar to a forward contract, but it trades on an organized exchange with standardized contract terms, including maturity date and quantity. Futures are subject to daily settlement to limit credit exposure. Each day, the current value of the contract, the "variation margin," is added to or subtracted from the owner's account, thereby returning the value of the contract to zero. Traders are required to maintain enough funds on deposit in a margin account to cover potential losses.

As with forwards and swaps, futures are also typically zero cost.[2] However, because of daily settlement, many cash flows occur between the purchase date and the sale or maturity date. Futures can be used for the same hedging purposes as forwards.

Option Contract

The owner of an option has the right, but not the obligation, to purchase (call option) or sell (put option) a fixed quantity of the underlying asset at a predetermined price, the strike price, on a predetermined date, the exercise date. Unlike forwards, swaps, and futures, which are typically zero cost, options can have a sizable initial cost, or premium. To the option purchaser, the option premium represents the maximum potential loss, whereas for forwards, swaps, and futures, the loss potential of both counterparties is unlimited. A call (or put) option has value if the possibility remains that the price of the underlying will be above (or below) the strike price on the exercise date. An option is "in the money" if the current price of the underlying is above (call option) or below (put option) the strike price. Options trade in the OTC market, with customized contract terms between the two parties; and on exchanges, with standard contract terms, such as set dates, strikes, and notional amounts.

For calls and puts, one of three scenarios is possible before or on the expiration date. If the option is sold, the sale proceeds are transferred to the owner. If the option is in the money on the expiration date, funds are transferred to the owner, and the amount transferred corresponds to the difference between the strike price and the price of the underlying, multiplied by the quantity of the underlying specified in the contract.[3] If the option expires worthless, no funds are transferred.

Options can be used for the same hedging purposes as other derivatives. For example, a firm seeking protection against adverse exchange rate movements can enter into an option contract to exchange a quantity of currency or its cash equivalent at a future date if the exchange rate moves beyond the strike price.

2. For exchange-traded derivatives, an initial margin deposit is required before the start of trading. Unless it is in the form of securities, the deposit is recorded as a banking transaction, not a derivatives transaction. When securities are used as margin deposits, no banking or other category of transaction is recorded.

3. This example assumes that the option contract specifies cash settlement as opposed to physical settlement. If the option underlying is an equity or commodity, physical settlement will involve actual physical delivery of the underlying, whereas cash settlement will involve an exchange of cash equal to the intrinsic value of the option.

Accounting in the U.S. Balance of Payments

Transactions in the U.S. balance of payments (BOP) are recorded on the basis of the double-entry system of accounting.[1] In this system all transactions are classified as debits or credits. For every debit entry there must be a corresponding credit entry; hence the term *double entry*. Corporations use this accounting method in preparing their financial statements. In corporate financial statements, receipts and expenses, as well as assets and liabilities, are shown as positive numbers, and balances are derived through subtraction. For example, expenses are deducted from receipts to derive net income, and liabilities are deducted from assets to derive net worth. In the BOP the convention is somewhat different. Transactions that generate credit entries in an accounting sense (increases in liabilities or decreases in assets, or increases in revenues or decreases in expenses) are shown with a positive sign in the balance of payments, and transactions that generate debit entries (decreases in liabilities or increases in assets, or decreases in revenues or increases in expenses) are shown with a negative sign; the positive and negative entries are added to derive BOP balances, such as the balance in the current account, the capital account, or the financial account.

A single international transaction will frequently involve four parties—a purchaser, a seller, and their respective banks—and each party that is a U.S. resident will contribute one or more entries to the BOP, possibly in more than one accounting period. For example, when a U.S. resident purchases a bond from a foreign resident, U.S. holdings of foreign securities will rise (a debit entry in the BOP) and liabilities to foreign residents will also rise in recognition of the new obligation to pay for the bond (a credit entry). When the U.S. investor pays for the bond in the subsequent accounting period, its own liabilities to foreign residents will fall to zero (a debit entry) and its bank's liabilities to foreign residents will increase (a credit entry). The means by which U.S. bank liabilities increase may not be obvious. The increase occurs because the U.S. investor could extinguish its liability by issuing a check against its account at a U.S. bank, which the foreign investor would deposit at its local bank abroad. That bank would, in turn, present the check to the U.S. investor's U.S. bank for settlement. Thus, the series of transactions ultimately results in an increase in foreign bank claims on U.S. banks and an increase in U.S. holdings of foreign securities.

The BOP uses a similar accounting treatment for imports or exports of goods and services. When a business purchases goods from a foreign resident, U.S. imports will rise (a debit entry in the BOP), and liabilities to foreign residents will also rise because of the new obligation to pay for the imported goods (a credit entry). When the U.S. importer pays for those goods, its own liabilities to foreign residents fall to zero (a debit entry), and its bank's liabilities to foreign residents increase (a credit entry).

A transaction may be recorded in one or more BOP accounts depending on the type of transaction. Some transactions, such as the purchase of a foreign bond, result in only financial account entries, whereas others, such as the importation of goods, result in entries in more than one set of accounts (in the example of goods purchased from a foreign resident, both the current account and the financial account recorded entries). Nonetheless, transactions summed across all BOP accounts should equal zero because, in principle, each transaction should have a corresponding positive or negative entry. Incomplete or erroneous information affects the "statistical discrepancy" in the BOP. The statistical discrepancy is derived by summing all recorded BOP transactions and reversing the sign of the total; it reflects the (net) value of all BOP entries during a given period that were not fully or correctly captured in the accounts.

1. Additional information is in Bureau of Economic Analysis (1990), *The Balance of Payments of the United States: Concepts, Data Sources, and Estimating Procedure* (Washington: BEA, May), www.bea.gov/scb/pdf/internat/bpa/meth/bopmp.pdf.

in a U.S. bank by a foreign resident, are each recorded with a credit (positive) entry. They have offsetting debit (negative) entries to reflect transactions that generate payments of funds to foreign residents. For example, an import, the purchase of a security from a foreign resident, the deposit of new or additional U.S. funds in a foreign bank, and the withdrawal of a foreigner's deposit from a U.S. bank are each recorded with a debit (negative) entry. Because of this accounting convention, the international transactions accounts should always have a zero balance, as every positive entry in the BOP should have a corresponding negative entry.

For most current account transactions, the offsetting entry is in the financial account. For example, a U.S. firm's purchase of steel from a foreigner generates a debit (negative) entry in the current account for the imported steel. The associated payment is recorded as an offsetting positive entry in the financial account and can take any of several forms, including decreased U.S. deposits in a foreign bank or increased foreign deposits in a U.S. bank.

Accounting for Financial Instruments Other Than Derivatives

Many transactions do not involve a current account payment or receipt but instead are recorded entirely in the financial account. For example, for transactions that involve the purchase or sale of financial instruments such as stocks or bonds, both the change in financial instrument holdings and the offsetting in-

1. Example of entries in the financial account of the U.S. balance of payments: Purchase by a foreign resident of a U.S. stock from a U.S. resident, and subsequent sale of the stock

U.S. dollars

Foreign-owned assets in the United States	Financial flow	
	Year 1	Year 2
U.S. securities other than U.S. Treasury securities	100	−50
U.S. liabilities reported by U.S. banks, not included elsewhere	−100	50
Statistical discrepancy	0	0

NOTE: Here and in subsequent tables, refer to text for details: a positive value indicates a net financial inflow to the United States, and a negative value indicates a net financial outflow from the United States.

crease or decrease in deposits are reported in the financial account. For most financial account transactions, the relevant information is collected through the TIC system.[7]

By way of illustration, suppose that in year 1 a foreign resident purchases $100 of U.S. stock through a U.S. broker using funds that had been on deposit at a U.S. bank (table 1). The U.S. financial services firms that facilitate this cross-border transaction are responsible for reporting it on the TIC forms. The U.S. broker in the example is responsible for reporting the stock purchase in its monthly report of TIC securities transactions. The U.S. bank records the foreigner's deposit balance at the end of each month on the TIC banking report; the decline in deposits is inferred from changes in these month-end balances.

In the example, the values reported through the TIC system generate two financial account entries. The account for U.S. securities held by foreigners ("U.S. securities other than U.S. Treasury securities") increases by $100, which is the purchase price of the stock, shown as a positive amount, or credit. The account of U.S. banking liabilities to foreigners ("U.S. liabilities reported by U.S. banks, not included elsewhere") decreases by the $100 used to purchase the stock, shown as a negative amount, or debit.

Continuing with the example, also suppose that the value of the stock falls to $50 and that in the second year the foreign resident sells the $50 worth of stock. After the sale, the cash proceeds are transferred to the U.S. bank account of the foreign resident, and so the banking deposit balance of the foreign resident increases by an amount equal to the proceeds from the sale of the stock and will be captured on the monthly TIC banking reports. As with the stock purchase, the stock sale will be included in the reports of TIC securities transactions. Accordingly, two financial account entries arise from values reported through the TIC system: a decrease (debit) of $50 in U.S. securities held by foreigners and an increase (credit) of the same amount in U.S. banking liabilities to foreigners. No entry in the financial account records the change in the stock value.[8]

The final line in the BOP is a reconciliation line labeled "statistical discrepancy." Because the BOP is based on the double-entry accounting system, the sum of all current account, capital account, and financial account transactions should equal zero. Any remaining balance due to errors or omissions in the recorded international transactions is reported as a statistical discrepancy. In the example of the stock purchase and sale, each transaction has an exactly offsetting transaction within the financial account, the sum of all transactions recorded in each year is zero, and therefore no statistical discrepancy arises in either year.

The current presentation of the U.S. financial account includes direct investment, securities (stocks and bonds), currency, and loans and deposits (banking and brokerage). Transactions in all these instruments are recorded in the financial account as described in the example, but transactions in derivatives contracts are recorded on only a limited basis.

Accounting for Derivatives

As with transactions involving stocks or bonds, transactions involving derivatives are recorded in the financial account as increases or decreases in U.S. banking claims on, or liabilities to, foreigners. However, to date, no corresponding entry in the financial account reflects the change in the quantity of U.S. *derivatives* claims on, or liabilities to, foreigners. Thus, the international transactions accounts shown in the BOP capture only one side of most derivatives transactions.[9]

The effect of the incomplete accounting for derivatives transactions in the BOP can be seen in the following example. Suppose that instead of purchasing a U.S. stock from a U.S. broker, as in the earlier example, a foreign resident purchases a *derivative* (such as an option) for $100 from a U.S. resident with funds on deposit in a U.S. bank (table 2). The change in the foreigner's deposit balance, reported by the U.S. bank at the end of each month on its TIC

7. Exceptions are direct investment, currency shipments, and some U.S. government transactions, all of which are collected through other means. The TIC data include commissions paid to intermediaries, which are recorded in the current account, not the financial account. The BEA adjusts the TIC data by subtracting estimated brokerage commissions to determine financial account transactions.

8. Valuation changes are included in the U.S. international investment position, discussed later in the article.

9. The BEA plans to include derivatives in the U.S. BOP starting in June 2007.

2. Example of entries in the financial account of the U.S. balance of payments: Purchase by a foreign resident of a derivative from a U.S. resident, and subsequent sale of the derivative

U.S. dollars

Foreign-owned assets in the United States	Financial flow	
	Year 1	Year 2
U.S. financial derivatives liabilities[1]	n.a.	n.a.
U.S. liabilities reported by U.S. banks, not included elsewhere	−100	50
Statistical discrepancy	100	−50

1. Transactions in derivatives liabilities are shown for illustrative purposes only. As discussed later in the article, derivatives transactions are collected on a net basis and will appear on that basis in the BEA's presentations of the U.S. balance of payments and the U.S. international investment position.

n.a. Not available.

banking report, reflects the banking transaction associated with the purchase of the derivative (in addition to banking activity arising from other transactions). The deposit balance is reported to the compilers of the financial account, and so a decrease (debit) in U.S. banking liabilities to foreigners equal to the purchase price of the derivative, or $100, is recorded in that account.

However, in the absence of TIC form D, the U.S. resident has no way of reporting a purchase or sale of a derivative, as this type of transaction is recorded on no other TIC report. As a result, the compilers of the financial account have no way of knowing that the banking transaction was for the purchase of a derivative, and thus no entry in the financial account reflects the increase in derivatives liabilities to foreigners. The failure to record a credit entry for the changes in derivatives liabilities creates an imbalance in the international transactions accounts, which results in a statistical discrepancy of $100, the purchase price of the derivative.[10]

Also suppose that during year 1 the value of the derivative falls to $50 and that in year 2 the foreign resident sells the derivative. After the sale the $50 proceeds are transferred to the U.S. bank account of the foreign resident. Because banking deposits are reported on the TIC banking reports, an increase in U.S. banking liabilities of $50 is recorded in the financial account when the derivative is sold. However, nothing in the financial account reflects the decrease in derivatives liabilities to foreigners, and so a statistical discrepancy of negative $50, equal to the proceeds from the sale of the derivative, results in year 2. This example illustrates how the current BOP reporting system, in which data on cross-border derivatives transactions are incompletely recorded, gives rise to a statistical discrepancy in the BOP accounts.

10. The statistical discrepancy is found by summing all recorded transactions and reversing the sign of the total. In this example, the only recorded transaction is negative $100, and so the statistical discrepancy is positive $100.

The U.S. International Investment Position

Like the BOP, the U.S. international investment position (IIP) currently includes only a limited amount of derivatives claims and liabilities. The IIP reports the value of U.S.-owned assets abroad and that of foreign-owned assets in the United States. In other words, it reports the current value of the assets accumulated through the transactions recorded in the financial account of the BOP. In the IIP, the BEA decomposes each outstanding position at the end of each calendar year into three parts: the position at the end of the previous year, net transactions recorded in the BOP during the current calendar year, and valuation adjustments attributable to changes in exchange rates, prices, and other factors, such as the inclusion of data from new reporters.

Accounting for Financial Instruments Other Than Derivatives

The categories in the IIP are similar to those in the financial account of the BOP, and the transactions reported in the IIP come directly from the BOP. As previously mentioned, U.S. banking deposit claims on, and liabilities to, foreigners are collected on the monthly TIC banking reports; these data are used in the IIP. For the U.S. stock and bond holdings of foreign residents and the foreign stock and bond holdings of U.S. residents, the custodial firms holding the securities report them on periodic TIC surveys of claims and liabilities, and the BEA uses the holdings information to construct the IIP.

The presentation of holdings on the IIP can be illustrated with a variation on the previous example of the purchase and eventual sale of U.S. stock by a foreign resident. Besides the details already mentioned, we suppose that the foreign resident has $200 on deposit at a U.S. bank at the end of year 0 and that the deposit balance is reported as the year-end position on the IIP for that year (table 3). Using the BOP transactions data from the earlier example, the IIP for year 1 reports an increase in U.S. securities held by foreigners and a decrease in U.S. banking liabilities to foreigners, both of which correspond to the purchase price of the stock ($100). As before, we suppose that the value of the stock decreases by $50 between the purchase date and the end of year 1. The year-end market value of the stock, as reported on the TIC

3. Example of entries in the U.S. international investment position: Purchase by a foreign resident of a U.S. stock from a U.S. resident, and subsequent sale of the stock

U.S. dollars

Foreign-owned assets in the United States	Year 0	Year 1			Year 2		
	Ending balance	Transaction recorded in BOP	Valuation adjustment	Ending balance	Transaction recorded in BOP	Valuation adjustment	Ending balance
U.S. securities other than U.S. Treasury securities	0	100	−50	50	−50	0	0
U.S. liabilities reported by U.S. banks, not included elsewhere	200	−100	0	100	50	0	150
Total	200	0	−50	150	0	0	150

BOP U.S. balance of payments.

holdings survey, is recorded in the IIP as the ending balance for year 1 ($50). The IIP reports this $50 decline in value as a valuation adjustment due to price changes. For year 1, the value of the total position decreases by the amount of the valuation adjustment, to $150. If the stock is sold before the end of year 2 and there are no further price changes, the total value of the position is unchanged. At the end of year 2, no stock claims by foreigners remain—only a banking deposit balance.

The IIP captures only the banking deposit transactions and positions associated with purchases and sales of cross-border derivatives. Just as cross-border derivatives transactions go largely unrecorded in the BOP, so cross-border derivatives positions are also mostly missing from the IIP.

Accounting for Derivatives

The current treatment of derivatives in the BEA's presentation of the IIP is illustrated by the next example, in which a foreign resident purchases a derivative instead of a stock from a U.S. resident (table 4). A recorded transaction will reflect the decrease in U.S. bank liabilities to foreigners corresponding to the purchase price of the derivative, and the remaining balance of $100 in U.S. bank liabilities to foreigners will be correctly reported at the end of year 1. As in the BOP, no transaction corresponding to the purchase of the derivative will be reported. Although the value of the derivative decreases to $50 before the end of year 1, the IIP will not report the valuation adjustment. The total foreign liability position of $100 at the end of year 1 will include the correct value of the banking deposits but not the value of the derivative. When the derivative is sold in year 2, the increase in U.S. banking liabilities to foreigners equal to the total sale proceeds ($50) will be recorded correctly, but no transaction will reflect the decreased derivatives liabilities to foreigners resulting from the sale of the derivative.

The positions at the end of years 0 and 2 on the IIP are both correct, as derivatives were held at the end of neither of those years—only at the end of year 1. However, total transactions and total valuation adjustments over the two-year period are both incorrect. The IIP attributes the $50 change in the position over the period—from $200 to $150—to a net outflow of $50, when in fact the $50 change in the position is due to a price change.

As shown in this analysis, the current omission of derivatives positions from the IIP adversely affects external-sector reporting and can lead to incorrect inferences about the cause of position changes in the IIP. In the IIP presented in the example, the failure to

4. Example of entries in the U.S. international investment position: Purchase by a foreign resident of a derivative from a U.S. resident, and subsequent sale of the derivative

U.S. dollars

Foreign-owned assets in the United States	Year 0	Year 1			Year 2		
	Ending balance	Transaction recorded in BOP	Valuation adjustment	Ending balance	Transaction recorded in BOP	Valuation adjustment	Ending balance
U.S. financial derivatives liabilities[1]	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
U.S. liabilities reported by U.S. banks, not included elsewhere	200	−100	0	100	50	0	150
Total	200	−100	0	100	50	0	150

1. Refer to table 2, note 1.
BOP U.S. balance of payments.
n.a. Not available.

account for transactions in, and holdings of, derivatives contracts created two problems. First, it misrepresented the cross-border positions. At the end of year 1, the true foreign position of $150 ($100 plus the correct value of the derivative—$50) was recorded as $100. Second, the valuation adjustments in derivatives positions incorrectly appear as net foreign outflows of $50. These problems can be resolved through the inclusion of specific information about cross-border derivatives transactions and positions in the IIP—the information collected on TIC form D.

Overview of TIC Form D

U.S. regulatory agencies have collected some information on derivatives holdings for many years in reports outside of the TIC system. However, the reports do not collect most of the information needed to include derivatives in the international transactions accounts. For example, the reported data have excluded cross-border transactions and have either excluded some cross-border positions—such as those between a parent firm and its cross-border affiliates—or collected positions on an ultimate-risk basis rather than a locational basis.[11] As noted earlier, to address the gaps in data collection, the Treasury Department introduced TIC form D in 2005 to gather information on cross-border derivatives transactions and positions.[12]

Information Collected

TIC form D collects information on U.S. residents' derivatives contracts with foreign entities, including all foreign affiliates of U.S. multinational firms. It focuses on two values: (1) the amount for which a derivatives contract can be exchanged in a transaction as of the end of the quarter, referred to as the fair value, and (2) the sum of all derivatives transactions that occur within the reporting quarter, including the proceeds from the purchases and sales of derivatives and all contractual flows, referred to as net settlements.[13]

As is the case on other regulatory reports, fair values on form D are aggregated according to whether, from the reporter's perspective, the value on the last day of the quarter is positive or negative. The gross positive (or negative) fair value is the sum of all positions with positive (or negative) balances from the perspective of the reporter.[14]

Along with fair values as of the end of the quarter, the net payments, or settlements, between the reporter and foreign residents in each quarter are reported on form D. All transactions occurring during each quarter, including those that arise from the purchases and sales of derivatives as well as from periodic contractual payments, are aggregated and reported as net settlements.

In part 1 of form D, reporters provide totals by type of contract and type of underlying (table 5). Contracts that trade in the over-the-counter (OTC) market are reported separately from those that trade on exchanges. OTC contracts are categorized by the predominant type of underlying (that is, single-currency interest rate, foreign exchange, or other).[15] Data on exchange-traded contracts are reported separately for U.S. reporting firms' own contracts on foreign exchanges, the contracts of their U.S. customers on foreign exchanges, and foreign counterparties' contracts on U.S. exchanges. The fair values of OTC derivatives are reported separately for common contract types (that is, forwards, swaps, or options), while only the aggregate fair values of all types of exchange-traded contracts (such as futures and options) are reported. Aggregate fair values are also

11. The TIC forms collect data on cross-border transactions and positions on a locational basis, as is required for reporting in the international transactions accounts. In other words, counterparties are identified according to the country in which the immediate transactor is located or the country in which the position is booked, as transactions and positions are recorded in this way in the BOP and IIP. Other reports collect cross-border position information on an ultimate-risk basis. These reports identify counterparties according to the country in which the ultimate risk lies. For example, a claim against a subsidiary firm will be reported vis-à-vis the country of the parent to the subsidiary. For more information on the differences between data collected on a locational basis and data collected on an ultimate-risk basis, refer to Carol C. Bertaut, William L. Griever, and Ralph W. Tryon (2006), "Understanding U.S. Cross-Border Securities Data," *Federal Reserve Bulletin*, vol. 92, pp. A59–A75, www.federalreserve.gov/pubs/bulletin/default.htm.

12. TIC form D and instructions for its use are available at www.treas.gov/tic/forms-d.shtml.

13. If a derivatives contract is not actively traded, the reporter must estimate the fair value using the prices of other financial instruments. Additional information on the calculation of fair values is available in Financial Accounting Standards Board (1998), "Statement of Financial Accounting Standards No. 133: Accounting for Derivative Instruments and Hedging Activities" (Norwalk, Conn.: FASB). For a discussion of why contractual payments on derivatives are included in the financial account instead of the current account, refer to box "Derivatives in the International Transactions Accounts."

14. Although reporters are encouraged to report fair values on a gross basis, the instructions state that multiple contracts with a single counterparty can be reported on a net basis if a master netting agreement is in place and if the contracts are carried at net values in the reporting entity's accounting records and statements of financial position. A master netting agreement is a contract between two counterparties to net their trades with positive and negative balances. This practice reduces credit exposure, which, in turn, reduces collateral requirements. To date, a limited number of TIC form D reporters have provided some of their fair values on a net basis.

15. Other underlying types include credit ratings, equity prices, and commodity prices.

5. Data reported on TIC form D: U.S. holdings of, and transactions in, derivatives contracts with foreign residents, as of 2006:Q4

Millions of U.S. dollars

Holdings and transactions, by contract type and by foreign economies and organizations	Fair value of derivatives contracts with foreign residents at end of reporting quarter		U.S. net settlements during the quarter with foreign residents	U.S. net settlements during 2006 with foreign residents
	Gross positive	Gross negative		
PART 1 OF FORM: CONTRACT TYPES				
Over-the-counter contracts	1,211,924	1,155,726	–2,125	14,553
Single-currency interest rate contracts	789,994	746,635	–2,543	11,201
Forwards	1,747	1,622	. . .	. . .
Swaps	702,266	678,278	. . .	. . .
Options	85,981	66,735	. . .	. . .
Foreign exchange contracts	175,713	150,272	142	–211
Forwards	44,928	47,063	. . .	. . .
Swaps	102,255	77,621	. . .	. . .
Options	28,530	25,588	. . .	. . .
Other contracts	246,217	258,819	276	3,563
Exchange-traded contracts	25,640	22,903	342	14,209
Total on foreign exchanges	7,471	6,765	1,056	10,365
Own derivatives contracts on foreign exchanges	4,589	4,027	162	6,628
U.S. customers' derivatives contracts on foreign exchanges	2,882	2,738	894	3,737
Foreign counterparty derivatives contracts on U.S. exchanges	18,169	16,138	–714	3,844
Total	**1,237,564**	**1,178,629**	**–1,783**	**28,762**
MEMO				
Contracts with own foreign offices	318,987	312,853	. . .	. . .
Contracts with foreign official institutions	10,746	9,601	211	2,120
Contracts of U.S. depository institutions with foreigners	415,979	397,523	. . .	. . .
PART 2 OF FORM: FOREIGN ECONOMIES AND ORGANIZATIONS				
Europe[1]	1,045,720	993,391	147	19,855
Belgium	9,881	9,291	–15	–315
France	72,559	66,746	–570	759
Germany	97,243	85,356	–1,515	–687
Ireland	80,219	77,926	340	4,415
Italy	12,228	5,863	–556	215
Netherlands	23,396	21,280	439	1,914
Switzerland	29,412	28,054	–1,371	4,849
United Kingdom	697,207	668,332	4,422	6,550
Euro area	308,976	286,459	–2,487	9,158
European Union	1,013,071	962,042	2,068	n.a.
Canada	31,527	27,059	42	–4,507
Latin America	14,346	13,299	–1,369	–1,464
Caribbean	67,156	73,000	–608	5,325
Cayman Islands	49,661	57,345	–705	4,840
Asia	58,723	53,938	102	5,862
Japan	39,075	37,568	–933	–346
Africa	3,085	2,153	243	610
Other countries	14,294	11,173	–1,543	–2,317
Australia	13,369	10,444	–1,648	–2,505
International and regional organizations[2]	2,713	4,616	1,203	5,396

1. Selection of economies listed in form.
2. Summation of organizations listed in form.
. . . Not applicable.
n.a. Not available.
SOURCE: Treasury International Capital reporting system. www.treas.gov/tic.

reported for three memoranda items: contracts with the reporting firms' own foreign offices, contracts with foreign official institutions, and contracts of U.S. depository institutions with foreigners. In part 2 of form D, fair values and net settlements are reported in aggregate by the counterparty's country of residence.

For many OTC contracts, cash flows are few or even nonexistent during a quarter, while fair values are significant. For those exchange-traded products (such as futures) that settle daily, the fair value is at most the change in value on the last day of the quarter, and so it will generally be quite small. The difference between net settlements and fair values for exchange-traded products will generally be smaller than the corresponding difference for OTC contracts, as net settlements for exchange-traded products include the sum of all the daily changes in the value of a contract over the quarter.

Reporting Threshold and Requirements

The reporting threshold used to determine who must file TIC form D is based on a common measure of the size of total derivatives positions, the notional value, defined earlier in the article as an amount used to determine contractual payments. All U.S. banks, securities dealers, and other firms with worldwide holdings of derivatives exceeding $100 billion in notional value (in their own and their customers' accounts) are required to fill out form D on a quarterly basis. The

Derivatives in the International Transactions Accounts

Derivatives do not fit neatly into the international transactions accounts for two reasons. The first is that, unlike financial instruments such as bonds and stocks, some derivatives contracts cannot be categorized solely as claims or liabilities. Clearly an option written by a U.S. resident and purchased by a foreign resident is a U.S. liability to foreigners; but the distinction is less clear for products such as swaps, forwards, and futures. Over the lives of these products, the fair market value may be positive at times and negative at times, and it may switch signs several times within a quarter. So these instruments are neither strictly claims, with consistently positive fair values and payments to the U.S. resident counterparty to the contract, nor strictly liabilities, with consistently negative fair values and payments from the U.S. resident counterparty.

The second reason that derivatives are not easily incorporated into the international transactions accounts is the ambiguous status of the associated payments. The periodic payments on derivatives can be considered returns on invested capital, which are recorded in the current account; alternatively, they can be considered realized gains from changes in the contractual value, which are recorded in the financial account. Because the return from derivatives for many end users comes in the form of trading gains and losses, the International Monetary Fund has recommended that periodic payments on derivatives be recorded as financial account transactions.[1]

1. Refer to Robert M. Heath (1998), "The Statistical Measurement of Financial Derivatives," IMF Working Paper 98/24 (Washington: International Monetary Fund, March).

reporting threshold was intentionally set at a high level because, according to results obtained by other forms that collect global derivatives information, derivatives activity is concentrated in a small number of firms; fifty companies met the threshold in 2006. Forms are filed with, and validated by, the Federal Reserve Bank of New York. After further evaluation by the Federal Reserve Board, results are forwarded to the Treasury Department for release to the public.

To ease the burden on reporters, reporting requirements for form D were phased in over the first three quarters of 2005. In the first quarter, reporters were required to provide all categories of gross positive and gross negative fair values, net settlements of OTC foreign exchange contracts, and net settlements with foreign official institutions. In the second quarter, net settlements of exchange-traded contracts were added to the requirements. Finally, in the third quarter, all remaining information was required.

TIC Form D and Reporting on the U.S. External Sector

Starting in mid-2007, the compilers of the financial account at the BEA will have access to information from TIC form D on transactions and positions in cross-border derivatives. Unlike other financial instruments, derivatives do not fit easily into the standard BOP and IIP frameworks. For example, some derivatives contracts are difficult to classify strictly as claims or liabilities (refer to box "Derivatives in the International Transactions Accounts"). Because of this difficulty, in the international transactions accounts, the gross positive fair value will be recorded as the claims position, the gross negative fair value as the liabilities position, and net settlements as the net of claims and liabilities transactions.

To show how the information collected on form D will be used in the BOP and IIP, we return to the second example, in which a foreign resident purchases a derivative from a U.S. resident for $100 in year 1. Recall that the value decreases to $50, and the foreign resident sells the derivative for $50 in year 2. As shown previously, without the information collected on form D, at the end of year 1 the banking transaction corresponding to the payment of $100 for the derivatives contract is included in the BOP as a decrease in U.S. bank liabilities to foreigners, but the offsetting transaction corresponding to the increased U.S. derivatives liabilities to foreigners is not recorded in the accounts; rather, it appears as a statistical discrepancy. When the derivative is sold, there is an increase of $50 in U.S. bank liabilities to foreigners but no offsetting decrease in U.S. derivatives liabilities to foreigners, and so another statistical discrepancy is recorded.

That situation will change once the net settlements data collected on form D are incorporated into the BOP. Because the purchase price of the derivative ($100) and the sale proceeds ($50) will be included in net settlements on the U.S. resident's form D reports, the compilers of the financial account will have the information needed to include derivatives transactions in that account (table 6). The transactions will be correctly recorded in years 1 and 2, and no statistical discrepancy will be reported in either year.

6. Example of entries, including those for derivatives data, in the financial account of the U.S. balance of payments: Purchase by a foreign resident of a derivative from a U.S. resident, and subsequent sale of the derivative

U.S. dollars

Foreign-owned assets in the United States	Financial flow	
	Year 1	Year 2
U.S. financial derivatives liabilities[1]	100	–50
U.S. liabilities reported by U.S. banks, not included elsewhere	–100	50
Statistical discrepancy	0	0

1. Refer to table 2, note 1.

The fair values and transaction information collected on form D will also enable the compilers of the IIP to include derivatives contracts. The purchase price of the derivative ($100) and the year-end fair value ($50) will be included in the IIP for year 1, and the decrease in the total value of foreign assets from $200 to $150 will be correctly attributed to the price change of the derivative (table 7). The position at the start of year 2 will be correctly reported, as will the transactions in that year. As shown in this example, the information collected on form D substantially improves the reporting of both the BOP and the IIP.

Results from the 2006 Form D Data

The Treasury Department recently released aggregate values of the data reported on TIC form D in 2006. In December 2006, the gross positive fair value of derivatives totaled $1.238 trillion, and the gross negative fair value $1.179 trillion (table 5, row labeled "Total"). Data for December 2006 are representative of broader trends for the year as a whole in terms of the relative magnitudes of the fair values reported in each category of form D. The largest fair values are for OTC derivatives, primarily single-currency interest rate swaps. The fair values reported for exchange-traded derivatives are much smaller. As discussed previously, this result is expected because exchange-traded futures that settle daily account for the bulk of exchange-traded derivatives; for these products, the fair values generally consist entirely of one-day market moves. For most types of derivatives, the reported gross positive fair value exceeds the reported gross negative fair value. Therefore, residents of the United States have net derivatives claims on foreign residents.

Unlike fair values, reported net settlements vary widely between quarters, and the flows associated with both OTC and exchange-traded derivatives are significant. During the fourth quarter of 2006, total net settlements represented a $1.783 billion outflow from the United States, primarily associated with single-currency interest rate products (table 5, row labeled "Total"). However, the result over the previous three quarters was quite different: a net inflow to residents of the United States, also primarily from single-currency interest rate products. So for all of 2006, net settlements represented a $28.8 billion inflow to the United States. The amount was evenly split between inflows associated with OTC contracts and those associated with exchange-traded contracts.

As with other TIC data on securities and banking, the bulk of fair values and net settlements is vis-à-vis the United Kingdom, but large balances are also recorded against other European countries, the Caribbean financial center countries (such as the Cayman Islands), and Japan.[16] In December 2006, the gross positive fair value of derivatives vis-à-vis residents of the United Kingdom totaled $697 billion, while the gross negative fair value totaled $668 billion, each of which represented more than half of the total reported gross fair values (table 5, row labeled "United King-

16. Because TIC transactions are recorded against the country through which the transaction occurred, the data exhibit "financial center bias"; in other words, a majority of transactions are recorded vis-à-vis countries in which many financial services firms active in the derivatives market are located. For more information on the issue of financial center bias in TIC data, refer to Bertaut, Griever, and Tryon, "Understanding U.S. Cross-Border Securities Data."

7. Example of entries, including those for derivatives data, in the U.S. international investment position: Purchase by a foreign resident of a derivative from a U.S. resident, and subsequent sale of the derivative

U.S. dollars

Foreign-owned assets in the United States	Year 0	Year 1			Year 2		
	Ending balance	Transaction recorded in BOP	Valuation adjustment	Ending balance	Transaction recorded in BOP	Valuation adjustment	Ending balance
U.S. financial derivatives liabilities[1]	0	100	–50	50	–50	0	0
U.S. liabilities reported by U.S. banks, not included elsewhere	200	–100	0	100	50	0	150
Total	200	0	–50	150	0	0	150

1. Refer to table 2, note 1

BOP U.S balance of payments.

8. Effect of derivatives data on the statistical discrepancy in the international transactions accounts of the U.S. balance of payments, by quarter, 2006

Billions of U.S. dollars

Account	Financial flow				
	2006	Q1	Q2	Q3	Q4
Scenario A (without derivatives)					
Current account	−857	−214	−218	−229	−196
Capital account	−4	−2	−1	−1	−1
Financial account	719	171	154	230	165
Total	−141	−44	−65	0	−32
Statistical discrepancy	141	44	65	0	32
Scenario B (with derivatives)					
Current account	−857	−214	−218	−229	−196
Capital account	−4	−2	−1	−1	−1
Financial account	719	171	154	230	165
Derivatives	29	2	14	15	−2
Total	−113	−43	−51	15	−34
Statistical discrepancy	113	43	51	−15	34

NOTE: Components may not sum to totals because of rounding. Data for financial derivatives represent net settlements as reported on TIC form D.

SOURCE: Bureau of Economic Analysis, "U.S. International Transactions," www.bea.gov/international; and TIC form D.

dom"). Net settlements vis-à-vis U.K. residents totaled $4.4 billion during the fourth quarter of 2006 and $6.6 billion for all of 2006, the largest flows (in absolute magnitude) into or out of any single country.

The 2006 Data in the BOP and IIP

The important role played by cross-border derivatives in U.S. financial markets becomes apparent when the TIC form D aggregates are compared with the transactions and positions in other financial instruments recorded in the international transactions accounts in 2006. Derivatives transactions reported on form D varied substantially throughout 2006, ranging from a $15 billion inflow in the third quarter to a $2 billion outflow in the fourth quarter (table 8, row labeled "Derivatives"). This variability is typical of cross-border flows in securities such as stocks and bonds. For 2006, derivatives net settlements amounted to inflows of $29 billion, or 4 percent of the $719 billion in total financial inflows reported in the BOP.

Derivatives net settlements appear more significant when they are compared with the magnitude of the statistical discrepancy. As shown in previous examples, if the international transactions accounts contained no errors or omissions except the omission of derivatives, the inclusion of derivatives data would reduce the BOP statistical discrepancy to zero. Although including the 2006 data on total form D net settlements in the BOP would not erase the statistical discrepancy, it would reduce it in that year.[17] For 2006, the statistical discrepancy totaled $141 billion (table 8, scenario A); the inclusion of derivatives net settlements in the BOP would have lowered the discrepancy roughly 20 percent (table 8, scenario B).[18] As the quarterly data show, the effect of derivatives on the statistical discrepancy may vary from quarter to quarter and year to year, as errors and omissions elsewhere in the international transactions accounts may outweigh the effect of derivatives.

9. Net international investment position of the United States and selected components, and aggregate fair values of derivatives, year-end 2005

Billions of U.S. dollars

Item	Amount
Net position	**−2,694**
U.S.-owned assets abroad	**10,009**
U.S. official reserve assets	188
U.S. government assets other than official reserve assets	78
U.S. private assets	9,743
Direct investment abroad (current cost)	2,454
Foreign securities	4,074
Bonds	988
Corporate stocks	3,086
U.S. claims on unaffiliated foreigners reported by U.S. nonbanking concerns	785
U.S. claims reported by U.S. banks, not included elsewhere	2,431
Foreign-owned assets in the United States	**12,702**
Foreign official assets in the United States	2,216
Other foreign assets	10,486
Direct investment in the United States (current cost)	1,874
U.S. Treasury securities	705
U.S. securities other than U.S. Treasury securities	4,391
Corporate and other bonds	2,275
Corporate stocks	2,115
U.S. currency	352
U.S. liabilities to unaffiliated foreigners reported by U.S. nonbanking concerns	564
U.S. liabilities reported by U.S. banks, not included elsewhere	2,601
Aggregate fair values of derivatives	
Gross positive	1,190
Gross negative	1,132

SOURCE: For net international investment position, Bureau of Economic Analysis (2006), *Survey of Current Business*, vol. 86 (July), table 1, pp. 9–19; for aggregate fair values, TIC form D.

The U.S. gross positions in derivatives are comparable in magnitude with the U.S. positions in other financial instruments (table 9). The gross positive fair value of derivatives totaled $1,190 billion at the end of 2005, slightly more than U.S. residents' holdings of foreign bonds, which totaled $988 billion. The gross negative fair value of derivatives totaled $1,132 billion, about half of foreign holdings of U.S. bonds or stocks. On net, however, the inclusion of derivatives has little effect on the net international investment position of the United States. Adding the net position in derivatives of $58 billion (aggregate

17. Because, as previously discussed, some derivatives transactions are already included in the international transactions accounts, this estimate is only a rough approximation of the effect of derivatives data on the statistical discrepancy in the BOP financial account.

18. For a discussion of other possible sources of the statistical discrepancy, refer to Norman S. Fieleke (1996), "What Is the Balance of Payments?" Special Report No. 3 (Boston: Federal Reserve Bank of Boston, October), www.bosfed.org/economic/special/balofpay.pdf.

Other Derivatives Reports

As discussed in the main text, TIC form D was developed because most of the information necessary to include derivatives in the U.S. balance of payments and the U.S. international investment position was not captured on other reports. For example, most of the existing derivatives forms require firms to provide consolidated exposure to both domestic and foreign counterparties. Although the information collected on these other forms is not exactly comparable with that collected on form D, it is useful for data verification at the firm and product levels.

One form with data on global derivatives holdings is the FR Y-9C ("Consolidated Financial Statements for Bank Holding Companies," prepared by the Federal Reserve Board), which is required of bank holding companies; the data are publicly available and are used by the Office of the Comptroller of the Currency in its *Bank Derivatives Quarterly Report*. For U.S. branches of foreign banks, similar information is collected on form FFIEC 002 ("Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks," prepared by the Federal Financial Institutions Examination Council, or FFIEC). Another form that requests data on derivatives' fair values is the FR 2436 ("Semiannual Report of Derivatives Activity," prepared by the Federal Reserve Board), which collects information on gross positions in over-the-counter (OTC) derivatives from the largest U.S. bank and nonbank dealers. The reported results are confidential, and aggregates are forwarded to the Bank for International Settlements, which consolidates them with results from other global reporters for publication in its quarterly *Consolidated Bank Statistics* and in other of its reports, such as the *Regular OTC Derivatives Market Statistics*.

Although cross-border derivatives are included in the totals, most of the existing derivatives forms do not require separate reporting of cross-border derivatives. The few reports that do separately report the cross-border exposure, like the FFIEC 009 ("Country Exposure Report," prepared by the FFIEC), collect it on an ultimate-risk basis instead of the locational basis required for reporting in the international transactions accounts.[1]

Whereas holdings are included in some form on other reports, no report other than TIC form D collects payments information for OTC derivatives. For exchange-traded derivatives, however, net settlements are often equivalent to net trading profits and losses (excluding commissions). Because reporters already provided such profits and losses to the U.S. tax authorities, existing systems could be adapted to fulfill form D requirements.

1. An exception is the Commodity Futures Trading Commission's form 40, which collects daily position data on futures and futures options from the largest traders on U.S. exchanges. The information includes the trader's country of residence. The Bureau of Economic Analysis has used this information in compiling the U.S. balance of payments and the U.S. international investment position.

gross positive fair value minus aggregate gross negative fair value) only slightly improves the U.S. net international investment position, from negative $2,694 billion to negative $2,636 billion.

Comparison of U.S. and Foreign Aggregate Totals

From a global perspective, a relationship exists between the cross-border transactions into and out of the United States and those into and out of other countries. Many other countries currently report derivatives transactions and positions separately on their balance of payments and international investment position. If all countries were to report cross-border transactions accurately and on the same basis, then the summation of all cross-border flows in each asset class into and out of all countries would equal zero. That is, the derivatives outflows from one country should be recorded as derivatives inflows to other countries. The same relationship holds for positions: The sum across countries of net cross-border positions in each asset class should equal zero. Such comparisons of international flows and positions represent two checks at the macro level on the reasonableness of the information reported on form D, and they complement the cross-checks performed at the micro level by the Federal Reserve Bank of New York (refer to box "Other Derivatives Reports").[19]

A comparison of aggregate form D net settlements with the cross-border transactions and positions reported by other countries suggests that U.S. residents are counterparties to a significant share of the transactions in the global cross-border derivatives market. Total U.S. transactions as reported on form D were larger in absolute value than those reported by any other country in 2006 (table 10). In 2005 and 2006, all other countries recorded a net derivatives outflow, while in 2006 the United States recorded a net inflow. The recorded net derivatives inflow into the United

19. Countries other than the United States, including Australia and the United Kingdom, have reported problems with the collection and quality of cross-border derivatives data. Refer to Graham Semken (2005), "Financial Derivatives in the UK Sector Balance Sheets and Financial Accounts," *Economic Trends*, vol. 618 (May), pp. 37–44; and Australian Bureau of Statistics, International and Financial Accounts Branch (1998), "Financial Derivatives in Australia's International Accounts," paper prepared for the Eleventh Meeting of the IMF Committee on Balance of Payments Statistics, held at the International Monetary Fund, Washington, Oct. 21–23, www.imf.org/external/bopage/agenda.htm.

10. Aggregate cross-border derivatives transactions for selected foreign countries, the United States, and the world, 2005–06

Billions of U.S. dollars

Country or area	2005	2006	2006 Q1	2006 Q2	2006 Q3	2006 Q4
Australia	−1.6	.5	−.2	.6	−.5	.6
Denmark	1.7	2.8	1.2	.4	.3	.9
France	9.9	4.3	1.1	3.0	2.2	−2.0
Hong Kong	4.0	5.1	.3	1.9	1.1	1.8
Italy	3.1	−1.6	.3	.4	−1.8	−.5
Japan	−6.6	2.0	−.4	1.8	−.1	.7
Netherlands	−4.4	−7.1	−2.8	−.6	−1.6	−2.1
United Kingdom	−4.4	−26.2	−10.5	−5.3	−7.6	−2.8
United States	n.a.	28.8	1.6	14.0	14.9	−1.8
World excluding the United States	−22.5	−23.0	−18.4	.6	−1.8	−3.4
World	−22.5	5.8	−16.8	14.6	13.1	−5.2

Note: Components may not sum to totals because of rounding. Net flows reported in balance of payments statistics. World totals include flows of countries not shown.

n.a. Not available.

Source: For selected foreign countries and the world, individual country pages of the IMF website, www.imf.org; for the United States, TIC form D.

States in 2006 ($28.8 billion) is similar in magnitude to the sum of the outflows reported by all other countries (negative $23.0 billion). Although on a quarterly basis the inclusion of U.S. derivatives transactions in the calculation of net world transactions resulted in values that varied considerably from zero, for the year as a whole it resulted in a value much closer to zero, an indication that U.S. data from TIC form D will significantly reduce the gap in world accounting in the BOP.[20]

A comparison of U.S. aggregate derivatives claims and liabilities with those of other countries further shows the sizable role played by the United States in the global derivatives market. In 2005 U.S. derivatives claims and liabilities, approximated using the gross positive and gross negative fair values on form D, were greater than those reported by all countries except the United Kingdom (table 11). On a net basis, the U.S. year-end derivatives position for 2005 was a net claim of $58 billion. This U.S. net claim is similar in magnitude and opposite in sign to the sum of the net derivatives positions reported by all other countries, which is a $55 billion liability. As with transactions, including the U.S. position in the

20. This analysis is incomplete, however, because some countries and organizations with significant flows vis-à-vis the United States do not report cross-border transactions (for example, Caribbean financial center countries, Switzerland, and the Bank for International Settlements).

11. Aggregate cross-border derivatives claims and liabilities, and net positions in derivatives, for selected foreign countries, the United States, and the world, 2000–05

Billions of U.S. dollars

Year	Australia	Denmark	France	Hong Kong	Italy	Japan	Netherlands	United Kingdom	United States	World excluding the United States	World
						Claims					
2000	13	14	95	17	4	3	29	669	n.a.	876	876
2001	15	11	110	18	4	3	45	858	n.a.	1,101	1,101
2002	20	31	108	23	11	3	72	1,245	n.a.	1,562	1,562
2003	33	24	136	20	23	5	87	1,393	n.a.	1,803	1,803
2004	38	37	169	22	28	6	86	1,594	n.a.	2,087	2,087
2005	27	9	226	17	30	26	70	1,761	1,190	2,262	3,452
						Liabilities					
2000	13	13	98	13	3	3	24	674	n.a.	869	869
2001	13	11	105	12	5	4	49	861	n.a.	1,088	1,088
2002	21	28	112	21	9	4	87	1,259	n.a.	1,579	1,579
2003	37	20	148	20	16	7	95	1,424	n.a.	1,848	1,848
2004	38	33	175	21	26	11	99	1,624	n.a.	2,132	2,132
2005	28	0	243	17	38	33	87	1,780	1,132	2,317	3,449
						Net position (claims less liabilities)					
2000	−1	1	−3	4	1	0	5	−5	n.a.	7	7
2001	2	0	5	5	0	−1	−5	−3	n.a.	13	13
2002	−1	2	−4	1	2	0	−15	−14	n.a.	−17	−17
2003	−3	3	−11	0	7	−2	−8	−32	n.a.	−45	−45
2004	0	4	−6	1	2	−5	−13	−30	n.a.	−45	−45
2005	−1	9	−17	0	−8	−7	−17	−19	58	−55	3

Note: Components may not sum to totals because of rounding. World totals include positions of countries not shown. U.S. claims are aggregate gross positive fair values, and U.S. liabilities are aggregate gross negative fair values. The claims and liabilities positions of some countries include values reported on a net basis. For countries other than the United States, data on cross-border claims, liabilities, and net positions for year-end 2006 were not available as of the publication date.

n.a. Not available.

Source: For selected foreign countries (except the United Kingdom) and the world, International Monetary Fund, *Balance of Payments Statistics Yearbook 2006* (Washington: IMF); for the United Kingdom, Office of National Statistics (2006), *United Kingdom Balance of Payments: The Pink Book 2006* (New York: Palgrave Macmillan), table FD, p. 114; for the United States, TIC form D.

Implied Valuation Change

The information on TIC form D can be used to estimate exposure to the underlyings through calculation of the valuation change implied by quarter-end movements in the fair values and net settlements. Specifically, the change in net fair value (gross positive fair value minus gross negative fair value) between two consecutive reporting quarters is the result of the combination of cash flows and valuation changes due to underlying price movements. That is, aside from the effect of trading activity, the following accounting relationship must hold:

Net fair value (start) + Valuation changes =
Net fair value (end) + Net payments received.

In addition to measuring exposure, if the implied valuation changes are too large, they signal possible misreporting on form D. Because the magnitude of valuation changes can vary with the number and value of positions, dividing each valuation change by a scaling factor such as the average of gross positive fair values at the start and end of the quarter assists in error identification.

The following example shows how implied valuation change can be used to identify exposure to the underlying and errors in reported net settlements and fair values. A U.S. resident has one swap contract with a foreign counterparty. The fair value of the swap is $100, due the U.S. resident at time 1 (refer to table). Between time 1 and time 2, the U.S. resident receives a $20 payment, and, if the price does not change, the fair value of the swap at time 2 is $80. If everything is reported correctly on form D, the implied valuation change is zero (scenario A).[1] But if net settlements are erroneously reported as $150, the implied valuation change is $130 (scenario B); if that value is divided by the average gross positive fair value, the scaled implied valuation change is 144 percent.[2] Alternatively, if the gross positive fair value at time 2 is erroneously reported as $20, the implied valuation change is negative $60, which corresponds to a scaled implied valuation change of negative 100 percent (scenario C).[3] In scenarios B and C, a high absolute value for the scaled implied valuation change signifies a reporting error.

Example of the use of implied valuation change to identify errors in the net settlements and net fair values reported on TIC form D

U.S. dollars except as noted

Period	Gross positive fair value	Net settlement	Implied valuation change	
			Amount	Scaled (percent)
Scenario A				
Time 1	100	0	...	...
Time 2	80	20	0	0
Scenario B				
Time 1	100	0	...	...
Time 2	80	150[1]	130	144
Scenario C				
Time 1	100	0	...	...
Time 2	20[1]	20	-60	-100

1. Erroneously reported.
... Not applicable.

The effectiveness of implied valuation change as an error-identification tool depends on the number of purchases and sales of derivatives and on movements in the underlyings. At one extreme, given no changes in a reporter's derivatives contracts and on market moves in the underlying prices, the valuation changes should be small; in such cases, the calculation of large implied valuation changes will effectively indicate the presence of an error. At the other extreme, given significant purchases or sales of derivatives or high volatility in the underlying markets, relating the implied valuation change to the movements in the underlyings will be difficult, and thus this methodology will be less effective at identifying errors.

1. The implied valuation change is $80 – $100 + $20 = $0.
2. The implied valuation change is $80 – $100 + $150 = $130; the scaled implied valuation change is $130 / [($100 + $80)/2] = 1.44, or 144 percent.
3. The implied valuation change is $20 – $100 + $20 = –$60. If the implied valuation change is divided by the average of the gross positive fair values, the scaled implied valuation change is –$60 / [($100 + $20)/2] = –1.00, or –100 percent.

calculation of the net world position moves the world position closer to zero.

Using the Data to Estimate Risk Exposure

Form D data can be used to estimate two types of risk exposure of interest to users of the data. The first type concerns the potential losses incurred if counterparties fail to fulfill their obligations, usually referred to as credit exposure. The data can be used to estimate an upper bound on cross-border credit exposure as of the report date. Because the total gross positive fair value is the sum of the fair values of all claims with a positive balance from the reporters' perspective, it is the maximum loss that would be sustained if foreign counterparties defaulted on their obligations.[21] In practice, most of these positions are covered by legally enforceable netting agreements. In such cases, in the event of a counterparty default, positions with a counterparty that have positive fair values are reduced by the value of positions with the same counterparty that have negative fair values. As a result, the actual

21 An estimate of cross-border credit exposure should exclude those positions with affiliates, also reported on TIC form D.

credit exposure is much less than would be implied by the gross positive fair value. Similarly, the gross fair value vis-à-vis foreign residents of a given country is somewhat indicative of the maximum credit exposure of U.S. residents to residents of that country. However, because all TIC data are reported on a locational basis rather than an ultimate-risk basis, the true nationality of counterparty exposure is unknown.

Another type of risk exposure of interest to users of the form D data concerns U.S. investors' potential losses or gains from changes in certain underlyings, such as exchange rates or interest rates, referred to as market exposure. Although form D fair values and net settlements may be related to the magnitude of market exposure, the information needed to accurately gauge that exposure is not collected. Fair values are a weak proxy for market exposure for several reasons. One reason is that a positive fair value does not indicate the direction of exposure; depending on the nature of the contract, the value of the derivative may either increase or decrease when the value of the underlying increases.

Another source of difficulty in gauging market exposure is that derivatives can be highly leveraged. Accordingly, small movements in the value of the underlying can cause very large changes in the fair value. The net aggregate fair value may include both the fair values of contracts with high leverage and those of contracts with little or no leverage. Finally, the D data provide at most a partial picture of reporters' market exposure because they include no information about positions with offsetting risks.

Nevertheless, a rough estimate of the exposure to the underlyings may be constructed by examining the changes in quarter-end fair values and net settlements. For example, a comparison of the valuation changes implied by the reported quarter-end net fair values and net settlements of single-currency interest rate contracts with the quarter-end moves in interest rates can be used to construct a rough estimate of the aggregate exposure to underlying interest rates (refer to box "Implied Valuation Change"). However, this analysis may be misleading because of changes in the number of derivatives contracts within the quarter.

SUMMARY

This article introduced the new data on transactions in, and holdings of, U.S. cross-border derivatives and discussed the new form that will collect the data—TIC form D. To date, the United States has published very little information on cross-border derivatives because of the limited availability of data. The article showed how the omission of derivatives from reports on cross-border flows and positions gives rise to a statistical discrepancy in the BOP accounts and can also lead to mistaken inferences about what is driving changes in the international investment position of the United States.

The article demonstrated how the information collected on form D substantially improves the reporting of both the BOP and the IIP. Because the compilers of the financial account will have the information needed to include derivatives transactions in that account, the contribution of derivatives to the statistical discrepancy will be reduced. Similarly, the fair values and transaction information collected on form D will enable the compilers of the IIP to include derivatives contracts, thereby improving the IIP's accuracy.

The article also presented the results from the 2006 form D data and showed that they are consistent with expectations. For example, although including the 2006 data on total form D net settlements in the BOP would not erase the statistical discrepancy, it would reduce it in that year. Moreover, when U.S. transactions are included, net world transactions in derivatives in 2006 are closer to zero. Finally, including the U.S. position moves the net world position closer to zero. Although the data collected thus far are consistent with expectations, the Treasury Department, the Federal Reserve Bank of New York, and the Federal Reserve Board continue to seek ways to improve data quality and reduce the burden on reporters. □

May 2007

Industrial Production and Capacity Utilization: The 2006 Annual Revision

Charles Gilbert and Maria Otoo, of the Board's Division of Research and Statistics, prepared this article. Betsy Wang provided research assistance.

On December 11, 2006, the Federal Reserve published revisions to its index of industrial production and the related measures of capacity and capacity utilization. The revision affected the data from 1972 through October 2006, but the largest changes were for the period beginning in 2003. From the fourth quarter of 2002 to the third quarter of 2006, industrial production, as revised, increased about 1¾ percentage points less than previously reported. By year, the change in output was revised down a little for 2003, down substantially for 2004, up a little for 2005, and down a touch for 2006 (table 1).[1] Revisions for previous years were small.

On balance, the revision to capacity utilization was relatively small. For the fourth quarter of 2005, the rate of capacity utilization for total industry was revised up ¼ percentage point, to 80.7 percent. For the third quarter of 2006, capacity utilization, at 82.3 percent, was only slightly lower than previously reported and was 1.3 percentage points above its 1972–2005 (long-run) average.[2] The operating rate for manufacturing was revised down about ¼ percentage point for both the fourth quarter of 2005 and the third quarter of 2006. Downward revisions in several industries, including computers, communications equipment, and textiles, were partly offset by sizable upward revisions in the semiconductor and chemical industries.

In mining, the capacity utilization rate was revised up 2¼ percentage points for the fourth quarter of 2005, to 85 percent, but the revised rate for the third quarter of 2006, at 90.9 percent, was only a bit above the previous estimate. The operating rate for utilities was revised down in both 2005 and 2006.

Compared with the previous estimates, total industrial capacity is now reported to have grown more slowly in 2003, 2004, and 2005. In 2006, total industrial capacity expanded more rapidly than previously estimated, and the gains appeared in all three major industrial sectors—manufacturing, mining, and utilities.

The updated measures of production, which incorporate the Census Bureau's 2004 and 2005 Annual Surveys of Manufactures (ASM), show slightly lower annual levels of output than previously estimated. Other new source data for the revision include selected 2005 Current Industrial Reports (also from the Census Bureau), new annual data on mineral extraction for 2004 and 2005 from the U.S. Geological Survey, and updated deflators from the Bureau of Economic Analysis. The new monthly production estimates reflect the incorporation of updated seasonal factors and monthly source data that became available (or were revised) after the close of the regular four-month reporting window.[3]

The revised capacity utilization rates incorporate the results from the Census Bureau's 2005 Survey of Plant Capacity for the fourth quarter of that year. In addition, the revisions to the capacity indexes and capacity utilization rates incorporate the revised production indexes and newly available data on industrial capacity from the U.S. Geological Survey, the Energy Information Agency of the Department of Energy, and other organizations.

NOTE: Charles Gilbert directed the 2006 revision and, with Kimberly Bayard, David Byrne, Wendy Dunn, Christopher Kurz, Paul Lengermann, Norman Morin, Maria Otoo, John Stevens, and Daniel Vine, prepared the revised estimates of industrial production. David Byrne prepared the improved estimates for communications equipment. Norman Morin, John Stevens, and Daniel Vine prepared the revised estimates of capacity and capacity utilization.

1. Revised data reported in this article extend through year-end 2006 and were first published in the Board of Governors of the Federal Reserve System (2007), Statistical Release G.17, "Industrial Production and Capacity Utilization" (May 16). Data referred to in this article as "previous," which appeared in the G.17 release published on November 16, 2006, extend through year-end 2006 for capacity but only through the third quarter of 2006 for production and capacity utilization. Therefore, for 2006, statements comparing revised with previously reported data for production and capacity utilization cover the year only through the third quarter, whereas such comparisons for capacity in 2006 cover the entire year.

2. These comparisons use quarterly average data.

3. After the initial estimate of industrial production is issued, it may be revised in the next three monthly releases and will then be left unchanged until the next major revision to industrial production.

1. Revised rates of change in industrial production and capacity, revised rates of capacity utilization, and the difference between revised and previously reported rates, 2002–06

Percent except as noted

Item	Memo: 2006 pro-portion	Revised rate						Difference between rates (revised minus previous, percentage points)					
		2002–06 avg.	2002	2003	2004	2005	2006	2002–06 avg.	2002	2003	2004	2005	2006
Production													
Total index	100.0	2.7	2.7	1.2	3.0	3.2	3.5	–.2	.5	–.4	–1.4	.2	–.1
Manufacturing	81.9	3.0	2.7	1.3	3.4	4.4	3.4	–.2	.6	–.4	–1.7	.2	.1
Excluding selected high-tech industries[1]	77.0	2.1	2.3	.3	3.0	2.9	2.0	–.2	.3	–.2	–1.3	.0	.0
Selected high-tech industries	4.8	17.7	8.3	17.2	10.4	28.1	24.6	–.8	3.5	–4.0	–8.0	2.4	2.0
Mining and utilities	18.1	1.2	2.7	.5	.7	–1.6	3.9	–.1	.0	–.1	.2	.4	–1.2
Capacity													
Total index	100.0	.7	.8	–.9	.1	1.1	2.4	–.2	.1	–.7	–.5	–.5	.4
Manufacturing	82.5	.8	.4	–.9	.0	1.7	2.7	–.3	.0	–.8	–.5	–.3	.1
Excluding selected high-tech industries[1]	77.0	.1	–.4	–.8	–.2	.6	1.4	–.3	–.2	–.4	–.3	.0	–.4
Selected high-tech industries	5.5	11.2	12.6	1.4	4.3	18.3	19.6	.2	3.1	–6.6	–2.5	–2.5	7.4
Mining and utilities	17.5	1.1	2.6	1.0	1.2	–.9	1.4	.3	.3	–.4	.0	–.8	1.8
Capacity utilization													
Total index	100.0	78.7	75.3	76.8	79.0	80.7	81.5	.0	.0	.3	–.4	.2	–.2
Manufacturing	82.5	77.1	73.4	75.0	77.6	79.6	80.1	–.2	.0	.3	–.6	–.2	–.3
Excluding selected high-tech industries[1]	77.0	77.7	74.8	75.7	78.1	79.8	80.3	–.2	.1	.2	–.5	–.5	–.4
Selected high-tech industries	5.5	70.3	57.8	66.8	70.7	76.5	79.7	–.5	–.7	1.1	–2.1	.8	–1.5
Mining and utilities	17.5	86.8	87.2	86.8	86.4	85.8	87.9	.2	–.1	.2	.3	1.3	–.5

NOTE: For production, the revised rates of change are from the fourth quarter of the previous year to the fourth quarter of the year indicated; the differences between revised and previously reported production are also calculated from Q4-to-Q4 rates except for 2006, for which they are calculated from annualized rates of change between 2005:Q4 and 2006:Q3.

For capacity, the revised rates of change are calculated in a manner identical to that for production; the differences between revised and previous capacity, including those for 2006, are calculated from Q4-to-Q4 rates.

Capacity utilization rates are for the fourth quarter of the year indicated; differences between revised and previously reported capacity utilization are calculated from Q4 rates except for 2006, for which they are calculated from Q3 rates.

1. Manufacturing excluding semiconductors and related electronic components, computers and peripheral equipment, and communications equipment.

RESULTS OF THE REVISION

As revised, total industrial production for the third quarter of 2006 was 112.3 percent of output in 2002, and capacity stood at 136.5 percent of output in 2002. Both indexes are lower than reported previously. The capacity utilization rate for total industry in the third quarter of last year, at 82.3 percent, was revised down slightly. Results of the revision can be found in the appendix tables.[4]

Industrial Production

The overall contour of industrial production (IP) in this revision is similar to that published previously. As reported earlier, total IP increased in each year from 2003 through 2006, albeit at a slower pace for this period as a whole. Data from the 2004 and the 2005 Annual Survey of Manufactures, the most significant contributors to the revision, show that the slower growth in total output over this period was due mostly to a downward revision of 1.4 percentage points in 2004. Revisions in other years were relatively modest (figure 1).[5]

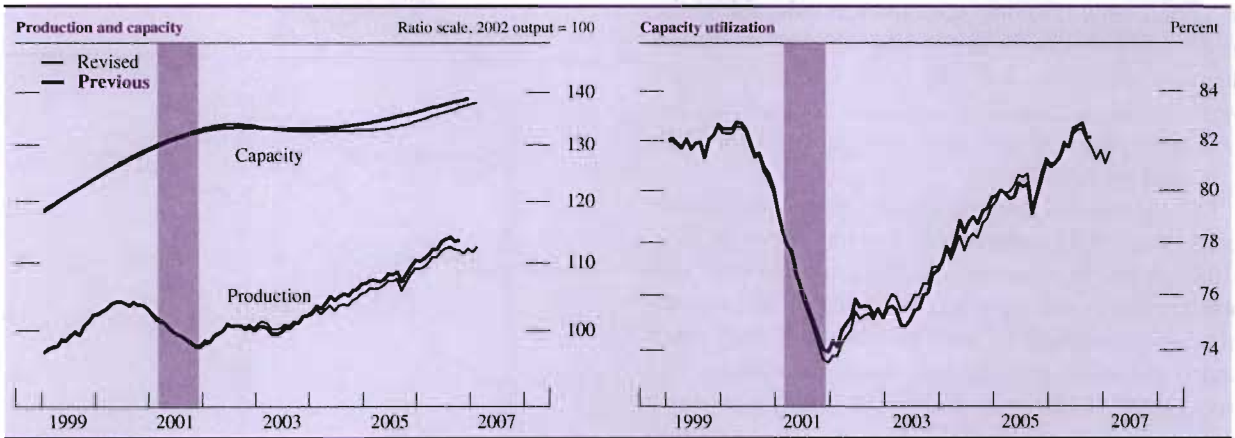
Market Groups

The most prominent change to the production index for final products and nonindustrial supplies occurred in 2004, when widespread revisions caused growth in this index to be adjusted down 1.7 percentage points (figure 2 and table A.3). In addition, gains in the index were revised down ½ percentage point in 2003 and ¼ percentage point in 2006. No change was made to the increase in the index in 2005. Nevertheless, the output of this market group accelerated from 2003 through 2005 and advanced further in 2006; it is now

4. Table A.1 shows the revised data for total industrial production, and table A.2 shows the revised data for capacity and capacity utilization for total industry. Tables A.3 and A.4 show the revised rates of change (fourth quarter to fourth quarter) of industrial production for market groups, industry groups, special aggregates, and selected detail for the years 2002 through 2006. Table A.5 shows the revised rates of change of annual industrial production indexes for market and industry groups for the years 2002 through 2006. Tables A.6 and A.7 show the revised figures for capacity and capacity utilization. Table A.8 shows the annual proportions of market groups and industry groups in total IP. Tables A.3, A.4, A.5, and A.6 also show the difference between the revised and previous rates of change. Table A.7 shows the difference between the revised and previous rates of capacity utilization for the final quarter of the year.

5. The gains in total industrial production were revised up 0.5 percentage point in 2002, down 0.4 percentage point in 2003, down 1.4 percentage points in 2004, up 0.2 percentage point in 2005, and down 0.1 percentage point in 2006.

1. Industrial production, capacity, and capacity utilization: Total industry, January 1999–April 2007

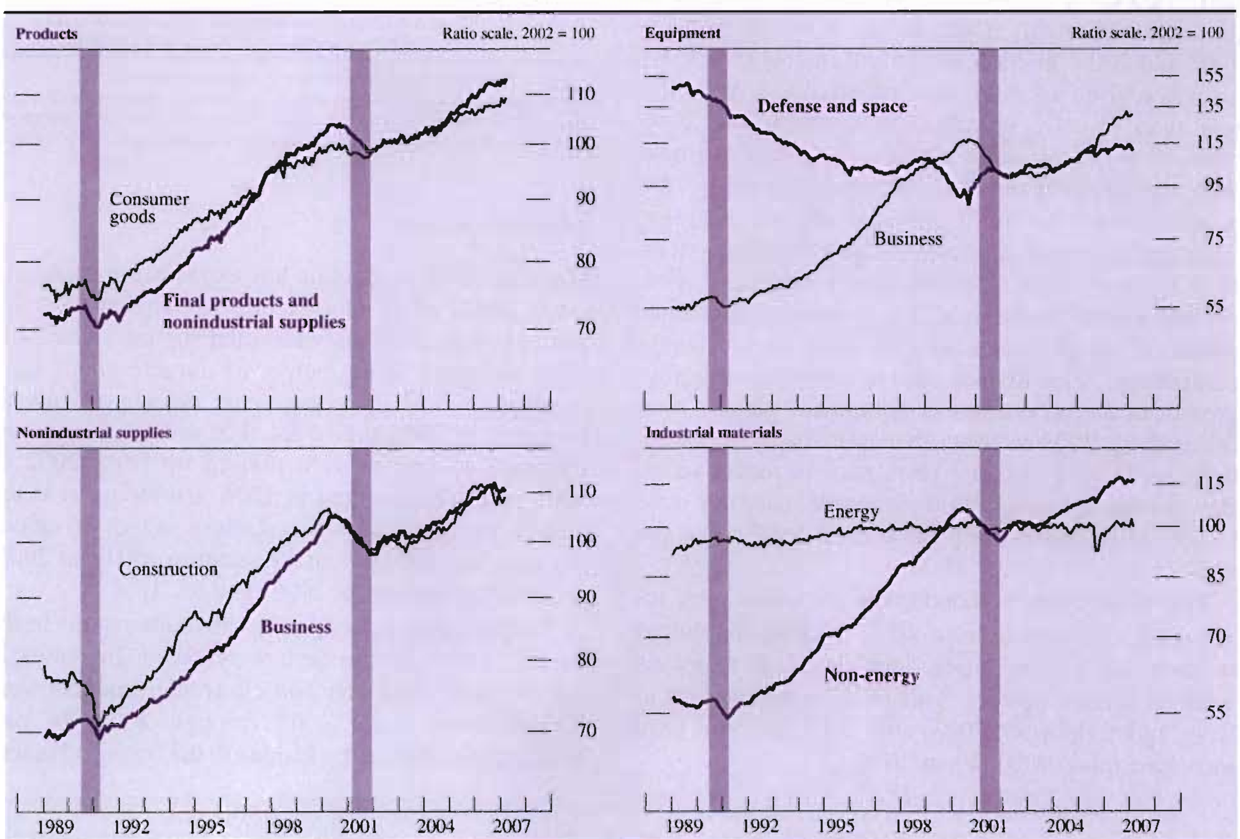


NOTE: Here and in the following figures, the shaded areas are periods of business recession as defined by the National Bureau of Economic Research. Data labeled "revised" are the corresponding data in the Federal Reserve Statistical Release G.17," Industrial Production and Capacity Utilization," published on May 16, 2007. Data labeled "previous" are those published before the December 11, 2006, annual revision. The "previous" data for capacity extend through the end of 2006 because the capacity indexes are based on annual projections that are converted to a monthly basis.

reported to have increased 1.3 percent in 2003, 2.6 percent in 2004, 4.8 percent in 2005, and 2.6 percent in 2006.

Over the 2003–06 period, revisions to the index for consumer goods were small, on balance, as substantial downward revisions to the output of consumer durable goods were in large part offset by upward revisions for nondurables. Among durable goods producers, the output of automotive products was revised down sharply and is now shown to have increased 4.8 percent in 2003 but to have fallen each year from 2004 through 2006. In contrast, the production gains

2. Industrial production: Market groups, January 1989–April 2007



for home electronics in 2004 and 2006 were revised up appreciably. Among consumer nondurables, the production indexes for foods and tobacco, consumer chemical products, and consumer energy products were revised up overall. The indexes for clothing and for paper products are now noticeably lower than estimated previously.

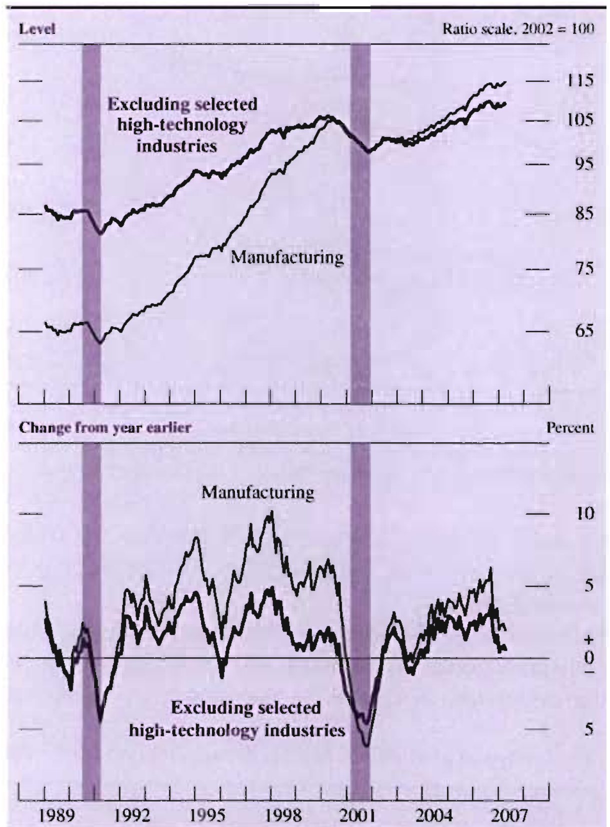
The increase in the production of business equipment since 2002 is now reported to have been weaker. Although the increase in transit equipment over this period was revised up a bit, the gains in information processing equipment and in industrial and other equipment were both revised down noticeably. The production of defense and space equipment also increased less over the 2003–06 period than reported initially.

The 2004 increase for construction supplies was revised down to 1.6 percent and is now about in line with the increases in 2002 and 2003. A strong gain in 2005—8.0 percent—was followed by a decrease of 2.1 percent in 2006. Increases in the output of business supplies over the 2003–06 period were revised down slightly. After rising about 1 percent in 2003, production of business supplies advanced nearly 3 percent, on average, from 2004 to 2006.

The increase in the output of materials over the 2003–06 period was little changed, on balance. The production of energy materials was about the same in 2003 and 2004. In 2005, the output of energy materials was revised up and is now reported to have fallen less than initially reported. In contrast, the 2006 rebound in output, at 5.4 percent, is a lower estimate than that initially reported. Excluding energy, the production of materials grew briskly, on average, from 2003 through 2006 despite downward revisions in 2003 and 2004. Durable goods materials were revised down, on balance. The index for consumer parts, in which motor vehicle parts is a sizable component, was revised down as well. Although growth in the production of equipment parts is now lower from 2003 to 2005 than previously reported, output still advanced at a brisk pace in recent years. Revisions to the index of other durable materials were largely offsetting and left the overall level about the same.

The production of nondurable materials was revised up, on balance, from 2003 to 2006; the output indexes for textile, paper, and chemical materials were all revised upward. This index is now shown to have fallen less in 2003 and 2005 and to have increased more in 2004 and 2006.

3. Industrial production: Manufacturing, and manufacturing excluding selected high-technology industries, January 1989–April 2007



NOTE: For definition of manufacturing, refer to text note 6.

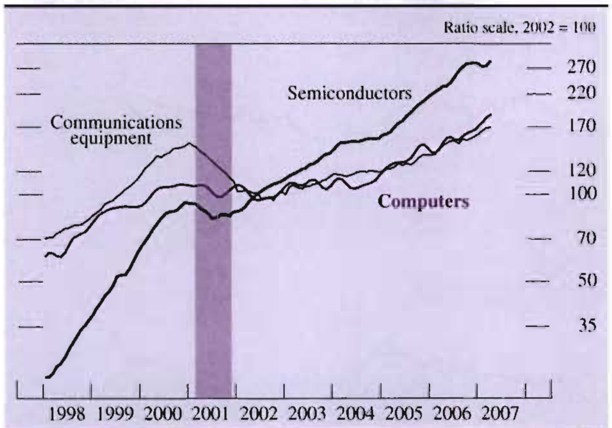
The selected high-technology industries are semiconductors and related electronic components (NAICS 334412–9), computers and peripheral equipment (NAICS 3341), and communications equipment (NAICS 3342).

Industry Groups

Manufacturing production has expanded in each year since 2002, albeit at a somewhat slower rate, on average, than previously reported (figure 3 and table A.3). Increases in the output of durable goods have remained robust in recent years despite downward revisions in 2003 and 2004. For nondurable goods, increases in output were revised up from 2002 to 2005 and little changed in 2006. Excluding selected high-technology industries, factory output advanced ¼ percent in 2003, about 3 percent in 2004 and 2005, and about 2 percent in 2006 (table A.4).

Across industry groups, downward revisions in the durable goods sector were widespread. Increases in the output of computer and electronic products were revised down from 2003 through 2005, in part because of downward revisions to the strong advances

4. Industrial production: Selected high-technology industries, January 1998–April 2007



NOTE: For the NAICS categories of these industries, refer to the note to figure 3.

for communications equipment and for semiconductors and related electronics (figure 4). The production of motor vehicles and parts over this period is now reported to have been weaker than originally estimated. For 2004, the output of machinery was revised down substantially, but gains for that year and subsequent years were still strong. Within the nondurable goods sector, the indexes for apparel and leather goods and for plastics and rubber products were revised down for the period since 2002. The cumulative increases since 2003 for all the other major components of nondurable goods are now higher than previously reported.

The revision lowered the rate of change in the output of the publishing and logging industries about 1 percentage point per year, on average, from 2003 to 2006; the IP index continues to include these two industries under manufacturing, although they are classified elsewhere under the North American Industry Classification System (NAICS).[6]

The output of mining received small revisions in 2003 and 2004 and is now reported to have decreased somewhat less in 2005. Although it rose 2 percentage points more slowly than initially reported for 2006, the mining index still surged 8 percent. The output of utilities is now estimated to have grown more slowly from 2003 through 2006.

6. In the IP index, manufacturing comprises the following NAICS categories: the manufacturing sector, the logging industry, and the newspaper, periodical, book, and directory publishing industries. Logging and publishing are not classified under manufacturing in NAICS (they are under agriculture and information respectively), but historically they were considered to be manufacturing industries and were classified as such under the Standard Industrial Classification (SIC) system. In December 2002, the Federal Reserve reclassified all its industrial output data from the SIC system to NAICS.

Capacity

Total industrial capacity is estimated to have expanded less rapidly over the 2003–06 period (table A.6). Relative to previous reports, it is estimated to have fallen ¾ percentage point more rapidly in 2003 and to have risen ½ percentage point more slowly in both 2004 and 2005. In 2006, however, capacity is estimated to have increased nearly 2½ percent, roughly ½ percentage point more quickly than initially published. The contour of manufacturing capacity and the revisions to that contour are similar to those for total industry. The revision shows that, relative to previous reports, aggregate capacity for the selected high-technology industries rose less quickly from 2003 to 2005 but increased more rapidly in 2006. Excluding high-technology industries, manufacturing capacity declined in 2003 and 2004 and expanded in 2005 and 2006; the rates of increase were marked down in each year except 2005, which was unrevised.

Capacity at mines is still estimated to have contracted from 2003 to 2005 but is now shown to have increased in 2006. Capacity at electric and gas utilities was revised upward in 2006 but was revised little in previous years.

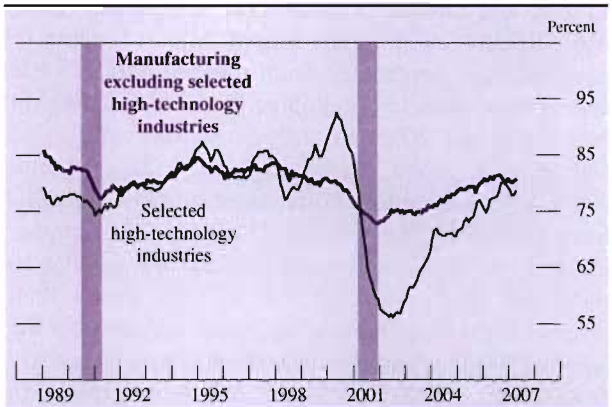
By stage of processing, capacity in the crude stage fell from 2003 to 2005 and is estimated to have edged up 0.3 percent in 2006. Capacity at the primary and semifinished stages declined in 2003 but rose from 2004 through 2006. Capacity for finished goods expanded from 2003 to 2006.

Capacity Utilization

Overall, capacity utilization for total industry was little changed by the revision from 2003 to 2006 (table A.7). In the third quarter of 2006, the capacity utilization rate for total industry was 82.3 percent, 1.3 percentage points above its 1972–2005 average and 0.2 percentage point lower than reported previously. The utilization rate for total industry was revised up ¼ percentage point in the fourth quarters of 2003 and 2005 and revised down 0.4 percentage point in the fourth quarter of 2004 and 0.2 percentage point in 2006.

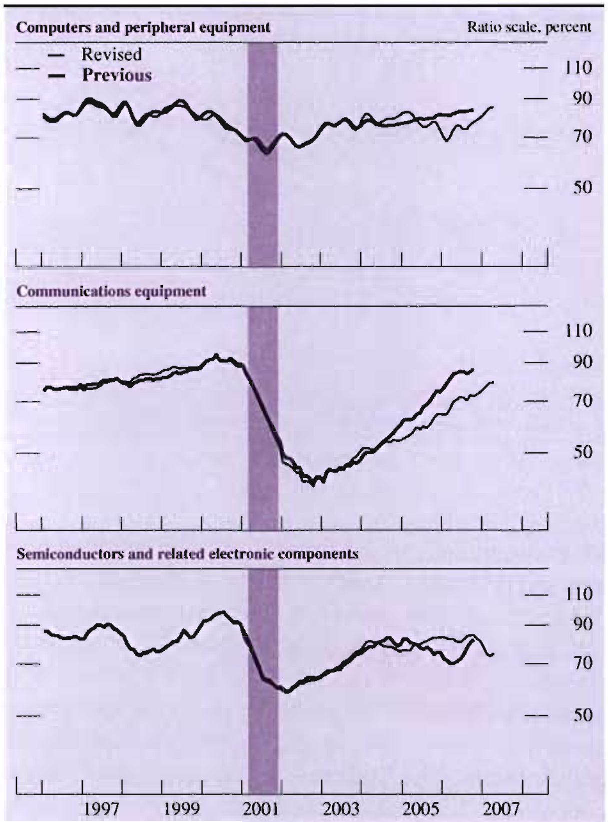
The manufacturing operating rate was 80.9 percent in the third quarter of 2006, 0.3 percentage point below the previous estimate but 1.1 percentage points above its 1972–2005 average. For 2004 and 2005, the rates were also marked down: 0.6 percentage point and 0.2 percentage point, respectively. For 2003, the rate was revised up 0.3 percentage point. Utilization rates for durable goods manufacturers were lower

5. Capacity utilization: Selected high-technology industries, and manufacturing excluding selected high-technology industries, January 1989–April 2007



NOTE: The high-technology industries are identified in the note to figure 3.

6. Capacity utilization: Selected high-technology industries, January 1996–April 2007



from 2004 to 2006 than previously published. Some of the largest downward revisions were in machinery and in electrical equipment, appliances, and components. Revisions generally were upward for wood products, primary metals, fabricated metal products, and furniture. On balance, utilization rates for nondurable goods industries were revised upward; the largest upward revisions were in textile and product mills, petroleum and coal products, and chemicals. The largest downward revisions were in food, apparel and leather, and plastics and rubber products. Capacity utilization in the other (non-NAICS) manufacturing industries was revised upward in 2003 and 2004 and downward in 2005 and 2006.

Among selected high-technology industries, the operating rates for computers and peripheral equipment and for communications equipment were lowered noticeably in recent years, whereas utilization in the semiconductor industry was revised up substantially (figures 5 and 6). On balance, the aggregate of selected high-technology industries now shows that utilization was lower in 2004 and 2006 but higher in 2003 and 2005. By the third quarter of 2006, the operating rate had climbed to 78.8 percent, ¾ percentage point above its 1972–2005 average.

Capacity utilization in mining was revised up between 2003 and 2006, mainly because of higher operating rates in the oil and gas extraction industries. As of the third quarter of 2006, the utilization rate for mining is now estimated to be 90.9 percent, up 5.9 percentage points from the fourth quarter of 2005, when the effects of Hurricane Katrina reduced the operating rates of oil and gas extraction facilities. In electric and gas utilities, capacity utilization rates were revised down in 2005 and 2006 but were little changed in previous years. At 86.4 percent in the third quarter of 2006, the operating rate for utilities was 0.4 percentage point below its long-run average.

Technical Aspects of the Revision

The benchmark indexes for manufacturing—defined for each six-digit NAICS industry as nominal gross output divided by a price index—were updated to include new as well as revised information for 2003, 2004, and 2005 from the 2004 and 2005 ASMs. This revision also incorporates the 2005 Survey of Plant Capacity, other annual industry reports, recent information on prices, and revised monthly source data on physical product and production-worker hours.

As in the 2003 ASM, the reports for 2004 and 2005 did not provide data for all six-digit NAICS industries but combined some of them into higher-level industry aggregates. The benchmark indexes for manufacturing IP are calculated from gross output for six-digit industries and then aggregated to the IP industry level using proportions based on value added. To maintain benchmark references that are consistent over time, the Federal Reserve imputed estimates of gross output for industries no longer reported separately, which are based on values for the aggregate industries that contained them and the gross output shares for the disaggregate industries in 2002.

Communications Equipment

The Federal Reserve's production indexes for communications equipment (NAICS 3342) have been developed, updated, and expanded over a period of years. The benchmark production indexes developed for the 2000 revision incorporated a quality-adjusted price index for the networking equipment (routers, switches, and hubs) used by businesses and telecommunications service providers; the detail underlying the series was expanded to include wireless networking equipment in the 2005 revision. The 2002 revision introduced a new annual price index for other types of communications equipment that included, among other items, the transmission (fiber optic) equipment that had grown rapidly in relative importance in the 1990s. The 2005 revision updated and refined that effort.[7]

This revision introduced further enhancements to the IP index for communications equipment. The improvements affected data from 1972 forward and included (1) refined estimates of the annual value of U.S. production for detailed product groups, (2) newly developed annual price indexes for mobile phones and related equipment and for satellites and related equipment, (3) updated annual and quarterly price indexes for networking equipment that use new source data for selected components, (4) new benchmark price indexes that incorporate price indexes for secondary products and miscellaneous receipts, and (5) newly incorporated indicator data for networking equipment—a part of the index for telephone apparatus manufacturing (NAICS 334210).[8]

The first four of these improvements affect the benchmark indexes for communications equipment (discussed in the sections below on specific types of equipment), and the fifth affects a monthly indicator used in IP (discussed in "Changes to Individual Production Series").[9]

The refinements to values of production for detailed product groups were based in large part on information in the Census Bureau's restructured Current Industrial Report (CIR) on Telecommunications, which was issued in August 2006. The report presented new groupings of data that better represent the communications equipment industry and that are better aligned with the price indexes estimated by the Federal Reserve. Previously issued data for 2004 were restated to be consistent with the new groupings, and the Federal Reserve developed historical series for the new data groupings based on data in previous years' CIRs.

In addition to the new price and production indexes for mobile phones and for satellite-based equipment that were developed for this revision, industry and government sources on prices were used to update the previously developed indexes for networking equipment, central office equipment, transmission (fiber optic) equipment, and PBX (private branch exchange) equipment. The remaining price indexes for communications equipment products and for secondary products and miscellaneous receipts were updated based on producer price indexes from the Bureau of Labor Statistics.[10]

The new product prices for communications equipment declined more than estimated previously (figure 7). Accordingly, the output of communications equipment is now shown to have risen about 6 percent more per year, on average, from 1972 through 2005. The yearly pattern was little changed; exceptions were 2004 and 2005, when upward revisions from faster falling prices were more than offset by downward revisions caused by benchmarking to the 2004 and the 2005 ASM.

Mobile Phones and Related Equipment

The revision incorporated a new price index for mobile phones (excluding satellite phones) and related network equipment that was constructed from detailed data available from Gartner. Previously, the IP index relied on the producer price index for these products. The revised index fell 17.2 percent, on average, from 1994 to 2005 (table 2).

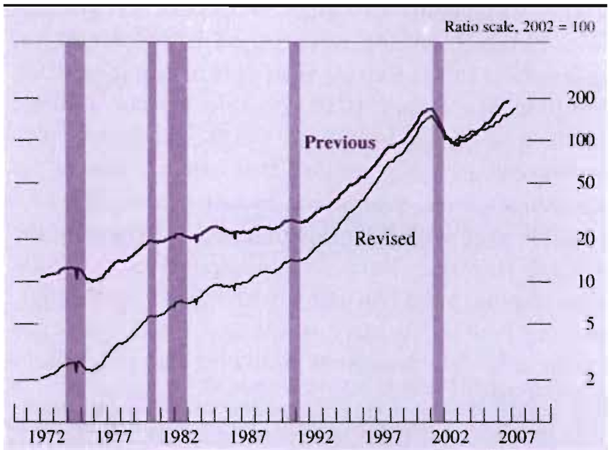
7. Refer to the following *Bulletin* articles on the 2000, 2002, and 2005 revisions for further details: Carol Corrado (2001), "Industrial Production and Capacity Utilization: The 2000 Annual Revision" *Federal Reserve Bulletin*, vol. 87 (March), pp. 132–48; Carol Corrado (2003), "Industrial Production and Capacity Utilization: The 2002 Historical and Annual Revision," *Federal Reserve Bulletin*, vol. 89 (April), pp. 151–76; and Kimberly Bayard and Charles Gilbert (2006), "Industrial Production and Capacity Utilization: The 2005 Annual Revision," *Federal Reserve Bulletin*, vol. 92, www.federalreserve.gov/pubs/bulletin.

8. The price indexes for secondary products (noted in item 4 above) fall notably slower than the indexes for primary products. The resulting industry price index falls about 1 percentage point slower, on average, than the index for primary products.

9. The benchmark indexes for most industries in the Federal Reserve's IP index incorporate updated price indexes from the industry output program of the Bureau of Economic Analysis. However, the price indexes for semiconductors and communications equipment are constructed by the Federal Reserve from alternative sources.

10. Producer price indexes are used as price indexes for broadcast and studio equipment, alarm systems, vehicular and pedestrian traffic equipment, intercom systems, and other voice equipment.

7. Industrial production: Communications equipment, January 1972–April 2007



Average annual percent change

Period	Previous	Revised
1972–94 average	6.8	12.7
1995–2002 average	13.2	19.7
2001	-10.2	-3.1
2002	-30.0	-23.5
2003	.1	7.6
2004	16.6	9.7
2005	24.4	7.9

Data on U.S. unit sales and prices of mobile phones categorized by function (basic, enhanced, smart, and cellular PDA) and type of signal (that is, GSM, CDMA, TDMA, and so on) were used to create a Fisher price index, which fell, on average, 17.8 percent per year.[11] For mobile phone network equipment, a price index was constructed using prices and units for U.S. sales of base stations, which transmit signals to and receive signals from mobile phones, and related switching equipment. This index declined an average of 14 percent per year from 1994 to 2005. In contrast, the producer price index for this category was little changed over this period.

The combined price index for mobile phones and related equipment was extended backward to 1972 using the producer price index for the product class containing mobile phones adjusted by the average bias (14 percent) from 1994 to 2005.[12]

Estimates of the annual gross value of U.S. production of mobile phones and related equipment were

11. GSM (Global System for Mobile Communications), CMDA (Code Division Multiple Access), and TDMA (Time Division Multiple Access) are common types of cell phone signals.

12. Jerry Hausman (1999), "Cellular Telephone, New Products, and the CPI," *Journal of Business & Economic Statistics*, vol. 17 (April), pp. 188–94; Hausman suggests that mobile phone prices dropped substantially during the years before 1994, whereas the producer price index for that product class changes very little between 1972 and 1994.

2. Price changes for communications equipment, by type, 1994–2005

Type	Annual average percent change
Satellites and related equipment	-14.8
Mobile phones and related equipment	-17.2
Networking equipment	-18.5
Previous	-19.8

NOTE: The previous estimate for networking equipment is that published for the 2005 annual revision to industrial production.

developed using information from Current Industrial Reports issued by the U.S. Census Bureau and other government and industry sources. These gross value estimates were deflated by the price indexes just described to obtain benchmark indexes of real output of mobile phones and related equipment.

Satellites and Related Equipment

Data from industry groups on prices for satellites and related ground equipment were used to construct a price index for this product class. The index fell 14.8 percent, on average, from 1994 to 2005 (table 2).

Information from Futron on satellite manufacturing revenues and total satellite capacity launched, proxied by transponder bandwidth, was used to construct an estimate of satellite unit costs, which fell 27 percent, on average, over the 2000–05 period. Pricing information for the highly diverse ground equipment category is not widely available. Detailed information from the NPD Group on one such product—GPS navigation equipment—yielded a price index that fell an average of 12.2 percent per year from 2002 to 2006. The technologies underlying mobile phone networking equipment and satellite ground equipment are similar, so the geometric mean of the GPS index and the price index for mobile phone networking equipment was used as a deflator for ground equipment.

From 2000 to 2005, the FRB price index for satellites and related equipment fell about 15 percent per year on average, more than 12 percentage points faster than the annual PPI that previously represented these products in the deflator used to calculate the benchmark index for IP. The FRB price index was extended back before 2000 using a bias-adjusted PPI.

Networking Equipment

The IP series for the production of networking equipment is not published in the monthly statistical release, but it is included in the broader IP aggregate for communications equipment and updated on an ongoing basis. Tables 3 and 4 report the price index

3. Price indexes for communications equipment manufacturing, 1997–2005

2002 price = 100

Year	Total	Networking equipment and service-provider routers	Other communications equipment
1997	210.7	333.8	186.2
1998	179.3	240.7	164.8
1999	157.3	197.2	147.3
2000	140.4	175.3	131.5
2001	119.1	132.7	114.0
2002	100.0	100.0	100.0
2003	86.5	80.6	88.6
2004	78.4	67.3	81.7
2005	71.3	60.5	74.6
Memo			
Average percent change, 1997–2005	−12.5	−18.5	−10.9

for networking equipment. For the 1994–2000 period, the price index is based on detailed price and quantity information from Gartner on routers, switches, and hubs. With this revision, the component price indexes for routers and switches are based on data from Synergy from 2001 on. The price index for wireless networking equipment, such as adapters and access ports, is based on data from Gartner from 1994 to 2005.

The previous price indexes for routers and switches required a downward adjustment of 8 percentage points to align their results with quality-adjusted price indexes based on research using item-level prices and characteristics for 1995–2000.[13] A similar exercise was conducted to update the bias adjustment. A price index was computed from data for constant-quality, high-end routers (that is, specific models of a particular type and brand of router) from 2002 to 2005. The Fisher price index based on the quarterly Synergy data yielded results that were very close to the price index based on the specific models, so the previous downward adjustment was phased out between 2000 and 2004.

On average, the movements in the overall networking price index and the component price indexes are revised only slightly, but the pattern is somewhat different, particularly in the router index, primarily because of the switch to Synergy source data.

Changes to Individual Production Series

With this revision, the monthly production indicators for some series have changed, and some new series have been created.

13. Mark Doms and Christopher Forman (2005), "Prices for Local Area Network Equipment," *Information Economics and Policy*, vol. 17 (July), pp. 365–88.

4. Production and prices for U.S. networking equipment, 1998–2005

Period	Index, 2002=100		Value of production (millions of dollars)
	Production	Prices	
Annual estimates			
1998	58.7	240.7	20,556.4
1999	82.5	197.2	23,781.6
2000	113.8	175.3	29,160.7
2001	124.7	132.7	25,202.6
2002	100.0	100.0	15,747.5
2003	90.7	80.6	13,088.5
2004	89.1	67.3	11,151.3
2005	102.0	60.5	11,455.9
Quarterly estimates			
1998:Q1	49.9	288.3	19,361.9
Q2	59.1	255.3	21,667.2
Q3	62.5	198.5	20,516.9
Q4	63.3	220.3	20,806.8
1999:Q1	78.3	225.3	23,513.5
Q2	82.7	202.0	23,906.1
Q3	82.1	173.7	23,545.0
Q4	87.0	185.8	24,224.3
2000:Q1	103.3	199.9	27,993.8
Q2	113.9	178.8	28,940.9
Q3	117.4	153.7	29,722.5
Q4	120.6	166.7	29,970.2
2001:Q1	136.7	160.2	29,004.9
Q2	124.1	143.6	25,699.2
Q3	120.5	110.1	23,512.1
Q4	117.4	118.3	22,504.3
2002:Q1	101.1	126.2	17,062.0
Q2	102.5	122.7	16,765.8
Q3	98.5	74.6	14,914.0
Q4	97.9	82.4	14,158.7
2003:Q1	94.0	103.5	13,208.2
Q2	86.7	95.6	13,634.8
Q3	89.8	64.5	13,349.1
Q4	92.3	64.0	12,057.9
2004:Q1	95.9	81.8	12,689.1
Q2	89.6	75.2	10,716.9
Q3	86.3	55.9	10,995.1
Q4	84.5	58.7	10,241.2
2005:Q1	88.7	72.7	10,456.8
Q2	109.9	64.6	11,598.7
Q3	100.9	52.7	11,607.9
Q4	108.4	54.3	12,090.7

Ethanol

A new industrial production index for ethyl alcohol (also known as ethanol, NAICS 325193) was introduced with this revision. The index begins in 1997 and uses as a monthly indicator data on fuel-ethanol production from the Monthly Oxygenate Report, published by the Energy Information Agency of the Department of Energy. Previously, ethanol production had been included in the production index for organic chemicals (NAICS 32511, 32519), which used the output of eight basic organic chemicals as its high-frequency indicator. The data for those eight chemicals now serve as the indicator for a new series that covers the combined output of petrochemicals (NAICS 32511) and other organic chemicals (NAICS 32519), except ethanol. The new ethanol series is classified both in the energy materials market group (86.5 percent by weight) and in the business supply market group (13.5 percent by weight). Like the old series for all of organic chemicals, the new series for organic chemicals other than ethanol is classified both in non-energy chemical materials (86.5 percent) and in business supplies (13.5 percent).

Unitary Air Conditioners

The output of unitary air conditioners is now represented by separate production indexes for residential and nonresidential units for the period 1997 to the present. Unitary air conditioners include both central air units and heat pumps and are a part of NAICS industry 333415, which covers air conditioners, non-household refrigeration equipment, and warm air furnaces. Previously, a single production index for unitary air conditioners was based on data for shipments and inventories from the Air-Conditioning and Refrigeration Institute (ARI).

The new indexes take advantage of additional detail available in the ARI report both to develop indexes for the residential and nonresidential markets and to weight units of various sizes by relative prices. The ARI shipments data are available for seventeen size categories that range from units with cooling capacity of less than 16,500 British Thermal Units per hour (BTUH) to those with cooling capacity of 640,000 BTUH or more. The shipments for each size category are split between residential and nonresidential units; the bulk of the units with cooling capacity less than 65,000 BTUH are assumed to be residential, and the bulk of the units with cooling capacity of at least 65,000 BTUH are assumed to be nonresidential. The shipments of the smaller units are split into eight size categories; the units are assumed to be 97 percent residential in the smallest category, 96 percent in the next smallest category, and so on, until the share decreases to 90 percent in the largest of these mostly residential categories. A share of the larger-sized units is assumed to be for use in apartments and other multifamily residential buildings. The residential share of units with cooling capacity between 65,000 and 96,000 BTUH is assumed to be 20 percent. This share decreases 2 percentage points for each larger category, falling to 4 percent for units with cooling capacity of 640,000 BTUH or more.

Relative prices for the various size categories are derived from the Current Industrial Report (CIR) on Refrigeration, Air Conditioning, and Warm Air Heating Equipment from the Census Bureau for 2004 and 2005; previously, the single index was based on an unweighted sum of units. Annual shipments in terms of both unit volumes and dollars are available from the CIR for several types of unitary air conditioners broken down by size categories very similar to the ARI size categories. Unit values were calculated for the various size categories in the CIR. These values were very nearly proportional to the midpoint of the cooling capacity range in each category, which allowed the calculation of unit values for those ARI size categories that did not exactly line up with the CIR categories. The relative prices appeared stable across time, so the indicators for the new IP indexes were constructed as fixed-weight aggregates of the ARI shipments series.

ARI published estimates of the change in manufacturers' overall inventories—not broken into size categories—up through the summer of 2006. Previously, the inventory change figures had been added to unit shipments to construct an estimate of unit production. These data on inventory change were extended with model-based estimates of inventory change and used the method implemented for other industries in recent annual revisions to industrial production.[14] The weighted shipments aggregates are then multiplied by the ratio of implicit production to shipments for overall unitary air conditioners to compute the monthly product indicators for the residential and nonresidential production indexes.

Audio and Video Equipment

The monthly indicator for audio and video equipment (NAICS 3343) was updated to include both digital televisions and speakers for the period 2002 to the present. Previously, the index reflected shipments of analog televisions with diagonal sizes of 24 inches or larger that were adjusted for imports, but the rapid transition of the market from analog to digital televisions in the past few years made it necessary to expand the scope of the index. In addition, data on the output of speakers were included in the new indicator; shipments of speakers and commercial sound systems account for about 15 percent to 20 percent of U.S. audio and video equipment shipments in recent years.[15]

The new monthly indicator is a Fisher quantity index, which in late 2006 was based on eighteen distinct components. Unit and dollar sales of digital televisions are available by technology (plasma, LCD, projection, and digital tube) and by size (length of diagonal) from the Consumer Electronics Association (CEA). In late 2006, sales of plasma TVs were available for three size groupings: sets with diagonals up to 49 inches, sets with diagonals between 50 and 59 inches, and sets with diagonals 60 inches and above. In addition, sales of LCD TVs were available

14. Kimberly Bayard and Charles Gilbert (2005). "Industrial Production and Capacity Utilization: The 2004 Annual Revision," *Federal Reserve Bulletin*, vol. 91 (Winter), pp. 9–25.

15. U.S. Census Bureau, Current Industrial Reports, *Consumer Electronics: 2005*, www.census.gov/cir/www/334/ma334m.html.

in seven size categories that ranged from sets with diagonals up through 18 inches to those with diagonals 40 inches and longer. Data for projection TVs were grouped into four categories: diagonals less than 50 inches, diagonals from 50 to 54 inches, diagonals from 55 to 59 inches, and diagonals 60 inches and above. Data for digital tube sets were available for two groups: those with diagonals less than 30 inches and those with diagonals of 30 inches or more. Speakers and analog television sets with diagonals 24 inches and above were included as separate components of the Fisher index. Smaller analog TV sets are generally imported.

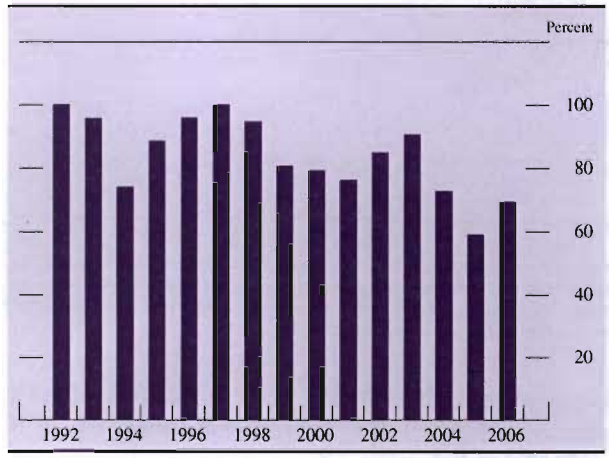
A price index was derived for each of the components of the Fisher index. For the digital televisions, the price indexes were just the unit values calculated from the dollar and unit sales figures. For the analog televisions, the price index was assumed to equal the price index for personal consumption expenditures on televisions from the national income and product accounts. For speakers, a producer price index was used.

The source data from the CEA are sales figures, so an adjustment was made so they better represent U.S. production. The Current Industrial Report for Consumer Electronics includes domestic factory shipments data for speaker systems, flat panel televisions (plasma and LCD), projection TVs, and tube TVs (digital and analog). The ratios of these data to the nominal sales data were used to adjust the nominal values for each of the components in the Fisher index.[16]

Semiconductors

As in previous years, the index for the production of semiconductors is based on worldwide sales data from the Semiconductor Industry Association, adjusted for net trade using a domestic production share estimated from various government and industry sources. Before this revision, Current Industrial Reports issued by the U.S. Census Bureau and announcements from major manufacturers of microprocessor units (MPUs) were used to estimate shares. With this revision, annual information from Gartner on the location of specific facilities and information from Instat on quarterly production at specific establishments were used to refine production share estimates (figure 8). The resulting shares are noticeably different from previous estimates; the revised pattern of

8. U.S. share of worldwide production of microprocessors, 1992–2006



production of MPUs contains more-noticeable decelerations in 1994, 2001, and 2005 and a more rapid acceleration in 1995. Abrupt and pronounced movements in the series coincide with changes to the small number of facilities that account for the bulk of worldwide production, such as idling a plant to install upgraded equipment.

Communications Equipment Quarterly Indicator

This revision introduced a new data source, Synergy Research Group, for the quarterly indicator for data networking equipment, which is part of telephone apparatus manufacturing (NAICS 334210). Synergy provided data from 2002 forward on U.S. sales of routers and switches that were more comprehensive and timely than the previous source.

Periodicals and Other Publishers

The index for periodicals and other publishers (NAICS 51112, 51114, and 51119) was split into separate indexes for periodicals (NAICS 51112) and other publishers (NAICS 51114, 51119). Both new indexes use production-worker hours as monthly indicators and begin in 1987. The separate indicators will allow comparisons to other industry data.

Series Switched from Product Data to Production-Worker Hours

Product data used as indicators for several IP indexes were discontinued in the past few years and have been replaced by production-worker hours for 2002 to the present. The industries affected are coffee (NAICS 31192), cotton and synthetic fabrics (part of NAICS 31321), wool fabrics (part of NAICS 31321),

16. Nominal sales data from the CEA are used for the digital televisions and the speakers. Nominal sales of analog TVs are derived as the product of the unit sales and the price index.

5. Industrial production data, by type, available in reporting window, 2005

Percentage

Type of data	Month of estimate			
	1st	2nd	3rd	4th
Product-based	27	42	54	54
Production-worker hours	43	43	43	43
Total available	70	84	96	97
Federal Reserve estimates	30	16	4	3

NOTE: Industrial production for a month is issued in the middle of the following month and revised in the subsequent three monthly G.17 releases. The columns in this table show the percentages of industrial production, based on value added, that have been derived from different types of source data for the initial estimate and subsequent revisions.

tire cord (NAICS 314992), hosiery (NAICS 31511), pigments (NAICS 31523), synthetic rubber (NAICS 325212), and electron tubes (NAICS 334411).

Reliability of Monthly Estimates

The first estimate of output for a month is preliminary and is subject to revision in each of the subsequent three months as new source data become available. By the third revision (the fourth month of estimate), the product-based content of IP is 54 percent (table 5).

Changes to Individual Capacity Series

The capacity index for organic chemicals (NAICS 32511, 9) was split into two series—ethyl alcohol (or ethanol, NAICS 325193) and organic chemicals excluding ethanol (NAICS 32511, 9 except 325193)—for 1997 and onward. The capacity indicator for ethanol is gallons of ethanol capacity from the Renewable Fuels Association (RFA). The capacity index and corresponding index of capacity utilization were constructed as follows: A physical utilization rate was calculated as the ratio of production data from the Monthly Oxygenate Report (published by the Energy Information Agency of the Department of Energy) and the physical capacity indictor from the RFA. This physical utilization rate was then divided into the industrial production index for ethanol to create a corresponding capacity index.[17] The capacity indicator for organic chemicals excluding ethanol is based on utilization rates from the Survey of Plant Capacity.

Capacity for synthetic rubber is now based on utilization rates from the Survey of Plant Capacity and begins in 2002. Capacity for previous years is still derived from physical capacity data from the International Institute of Synthetic Rubber Producers.

Weights for Aggregation

The IP index is a Fisher index. This revision uses information from the Census of Manufactures to obtain updated estimates of the industry value-added weights used in the aggregation of IP indexes and capacity utilization rates. The Federal Reserve derives estimates of value added for the electric and gas utility industries from annual revenue and expense data issued by other organizations. The weights for aggregation, expressed as unit value added, were estimated using the latest data on producer prices. Table A.8 shows the annual value-added proportions in the IP index from 1997 through 2005.

Revised Monthly Data

This revision incorporates product data that became available after the regular four-month reporting window for monthly IP was closed. These data are released with too great a lag to be included with monthly IP estimates; however, the data are available for inclusion in the annual revision.

Revised Seasonal Factors

Seasonal factors for all series were reestimated using data that extend into 2006. Factors for production-worker hours—which adjust for timing, holiday, and monthly seasonal patterns—were updated with data through September 2006 and were prorated to correspond with the seasonal factors for hours aggregated to the three-digit NAICS level. The updated factors for the physical product series, which include adjustments for holiday and workday patterns, used data through 2006. Seasonal factors for unit motor vehicle assemblies have been updated, and projections through June 2007 are on the Federal Reserve Board's website at www.federalreserve.gov/releases/g17/mvsf.htm. □

17. Typically, the capacity indexes resulting from this methodology are further smoothed using a model-based approach that accounts for features of the data collection process or different measurement errors. With the short history of these series, we did not find it necessary to smooth the resulting capacity indexes as a part of this revision. However, the capacity index was constructed using the production index before applying the correction factor that aligns the production indicator to the benchmark output information in the Census of Manufactures and Annual Surveys of Manufactures. This correction factor was then applied to both the production and the capacity indexes.

Appendix tables start on page A29

Appendix Tables Based on the G.17 Statistical Release, May 16, 2007

A.1. Revised data for industrial production for total industry

Seasonally adjusted data except as noted

Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual avg.[1]
	Industrial production (percent change)																
1977	−.6	1.5	1.3	.9	.8	.7	.2	.1	.5	.3	.0	.2	8.4	12.8	4.9	2.9	7.7
1978	−1.3	.4	1.8	2.1	.3	.7	.0	.4	.3	.9	.7	.6	−1.2	16.8	3.6	7.6	5.5
1979	−.7	.6	.3	−1.1	.8	.0	−.2	−.7	.1	.6	−.1	.1	2.0	−.5	−1.4	1.4	3.1
1980	.5	.0	−.3	−2.0	−2.5	−1.3	−.6	.3	1.6	1.3	1.7	.6	1.7	−15.9	−6.2	16.2	−2.6
1981	−.5	−.5	.6	−.5	.7	.5	.7	.0	−.6	−.7	−1.1	−1.1	1.0	1.5	4.3	−8.5	1.4
1982	−1.9	2.0	−.7	−.8	−.7	−.4	−.3	−.8	−.4	−.8	−.4	−.8	−7.6	−4.9	−5.9	−7.4	−5.1
1983	1.9	−.6	.9	1.2	.7	.6	1.6	1.1	1.5	.9	.3	.5	4.4	9.6	14.8	11.0	2.7
1984	2.0	.5	.5	.6	.5	.4	.3	.1	−.1	−.1	.4	.1	12.5	6.5	2.9	.5	9.1
1985	−.3	.4	.2	−.2	.1	.1	−.6	.5	.4	−.4	.3	1.0	1.2	.7	−.5	2.7	1.4
1986	.5	−.8	−.6	.1	.2	−.3	.6	−.2	.2	.4	.5	.9	2.4	−2.4	1.7	4.6	1.1
1987	−.3	1.3	.2	.6	.7	.5	.6	.7	.3	1.5	.5	.5	5.4	7.2	7.3	9.9	5.1
1988	.0	.4	.3	.5	−.1	.2	.2	.5	−.3	.6	.2	.4	3.4	3.4	2.1	3.3	5.1
1989	.2	−.5	.3	.0	−.7	.0	−.9	1.0	−.3	−.1	.3	.7	1.5	−1.8	−2.4	1.8	.9
1990	−.6	.9	.5	−.1	.2	.3	−.2	.3	.2	−.7	−1.2	−.7	3.0	2.8	1.4	−5.9	1.0
1991	−.5	−.7	−.5	.2	1.0	1.0	.0	.2	.9	−.2	−.1	−.3	−7.6	2.7	5.7	1.0	−1.5
1992	−.5	.7	.8	.7	.4	.1	.8	−.5	.2	.7	.4	.1	−.3	7.1	3.1	4.0	2.9
1993	.5	.3	.0	.3	−.4	.3	.4	.0	.5	.8	.4	.6	3.7	1.1	2.4	6.4	3.4
1994	.5	.0	1.0	.5	.5	.7	.2	.5	.3	.9	.7	1.1	5.6	7.3	5.1	8.3	5.5
1995	.4	.1	.1	−.1	.2	.3	−.4	1.3	.4	−.2	.3	.3	6.0	1.0	3.8	3.5	5.0
1996	−.8	1.5	−.2	.9	.7	.9	−.2	.7	.5	.0	.9	.7	2.0	8.4	5.2	6.1	4.3
1997	.2	1.2	.8	−.1	.6	.4	.5	1.3	.9	.8	1.0	.4	8.3	5.5	9.0	11.1	7.2
1998	.5	.1	.0	.5	.7	−.5	−.3	2.2	−.2	.7	−.1	.4	4.7	3.3	3.8	5.3	6.1
1999	.6	.5	.2	.2	.8	−.1	.7	.5	−.4	1.3	.6	.9	4.9	4.0	4.4	8.2	4.7
2000	.1	.4	.4	.8	.3	.1	−.3	−.3	.5	−.5	.0	−.4	5.3	5.9	−.5	−1.6	4.5
2001	−.7	−.6	−.4	−.3	−.7	−.6	−.4	−.4	−.4	−.6	−.5	.0	−5.7	−5.4	−5.6	−5.1	−3.5
2002	.5	.1	.8	.4	.4	.9	−.3	.2	.1	−.3	.4	−.4	2.7	6.4	2.3	−.4	.0
2003	.6	.3	−.2	−.8	−.1	.2	.4	−.1	.5	−.1	.8	.0	2.3	−3.2	2.5	3.3	1.1
2004	.2	.7	−.6	.6	.6	−.7	.6	.2	−.2	.7	.2	.6	3.3	2.5	1.8	4.3	2.5
2005	.3	.6	−.1	.1	.4	.6	.0	.3	−1.6	1.2	1.1	.8	4.6	2.8	.8	4.7	3.2
2006	.0	.3	.5	.9	−.1	.9	.4	.2	−.3	−.2	−.4	.6	5.0	6.5	4.0	−1.5	3.9
2007	−.5	.8	−.3	.7	...	...	...	...	...	...	...	...	.9	...	...	...	...
	Industrial production (2002=100)																
1977	49.7	50.5	51.1	51.6	52.0	52.4	52.5	52.5	52.8	52.9	53.0	53.1	50.4	52.0	52.6	53.0	52.0
1978	52.3	52.6	53.5	54.7	54.8	55.2	55.2	55.4	55.6	56.0	56.5	56.8	52.8	54.9	55.4	56.4	54.9
1979	56.4	56.8	56.9	56.3	56.8	56.8	56.7	56.3	56.3	56.6	56.6	56.7	56.7	56.6	56.4	56.6	56.6
1980	56.9	56.9	56.8	55.6	54.2	53.5	53.2	53.4	54.2	54.9	55.9	56.2	56.9	54.5	53.6	55.7	55.1
1981	55.9	55.6	55.9	55.6	56.0	56.3	56.7	56.7	56.4	55.9	55.3	54.7	55.8	56.0	56.6	55.3	55.9
1982	53.7	54.7	54.4	53.9	53.5	53.3	53.2	52.7	52.5	52.1	51.8	51.4	54.3	53.6	52.8	51.8	53.1
1983	52.4	52.1	52.5	53.2	53.6	53.9	54.7	55.3	56.2	56.7	56.9	57.1	52.3	53.5	55.4	56.9	54.5
1984	58.3	58.6	58.9	59.2	59.5	59.8	59.9	60.0	59.9	59.8	60.1	60.1	58.6	59.5	59.9	60.0	59.5
1985	60.0	60.2	60.4	60.2	60.3	60.3	60.0	60.2	60.5	60.3	60.5	61.1	60.2	60.3	60.2	60.6	60.3
1986	61.4	60.9	60.6	60.6	60.7	60.5	60.9	60.8	60.9	61.2	61.5	62.0	61.0	60.6	60.9	61.6	61.0
1987	61.8	62.6	62.7	63.1	63.5	63.8	64.2	64.7	64.9	65.8	66.2	66.5	62.4	63.5	64.6	66.1	64.1
1988	66.5	66.7	66.9	67.2	67.2	67.3	67.4	67.8	67.6	68.0	68.1	68.4	66.7	67.3	67.6	68.2	67.4
1989	68.6	68.2	68.4	68.4	68.0	68.0	67.3	68.0	67.8	67.7	67.9	68.4	68.4	68.1	67.7	68.0	68.1
1990	68.0	68.6	68.9	68.8	68.9	69.1	69.0	69.2	69.4	68.9	68.1	67.6	68.5	69.0	69.2	68.2	68.7
1991	67.2	66.8	66.5	66.6	67.3	68.0	68.0	68.1	68.7	68.5	68.4	68.2	66.8	67.3	68.2	68.4	67.7
1992	67.9	68.3	68.8	69.3	69.6	69.6	70.2	69.9	70.0	70.5	70.8	70.9	68.3	69.5	70.0	70.7	69.7
1993	71.2	71.5	71.5	71.7	71.4	71.6	71.9	71.9	72.3	72.8	73.1	73.5	71.4	71.6	72.0	73.1	72.0
1994	73.9	73.9	74.7	75.0	75.4	75.9	76.1	76.4	76.6	77.3	77.8	78.7	74.1	75.4	76.4	77.9	76.0
1995	79.0	79.0	79.2	79.1	79.2	79.5	79.2	80.2	80.6	80.4	80.7	81.0	79.1	79.3	80.0	80.7	79.8
1996	80.3	81.6	81.4	82.1	82.7	83.4	83.3	83.8	84.3	84.3	85.1	85.7	81.1	82.8	83.8	85.1	83.2
1997	85.9	86.9	87.6	87.5	88.0	88.4	88.8	89.9	90.8	91.5	92.4	92.8	86.8	87.9	89.9	92.3	89.2
1998	93.3	93.3	93.4	93.8	94.4	94.0	93.7	95.7	95.5	96.1	96.1	96.4	93.3	94.1	95.0	96.2	94.6
1999	96.9	97.5	97.6	97.8	98.6	98.5	99.2	99.7	99.3	100.6	101.3	102.1	97.4	98.3	99.4	101.3	99.1
2000	102.2	102.7	103.1	103.9	104.2	104.3	104.0	103.8	104.2	103.7	103.7	103.3	102.7	104.1	104.0	103.6	103.6
2001	102.6	102.0	101.6	101.3	100.6	100.0	99.6	99.2	98.8	98.3	97.8	97.7	102.1	100.7	99.2	97.9	100.0
2002	98.3	98.4	99.1	99.5	99.9	100.9	100.6	100.7	100.8	100.5	100.9	100.4	98.6	100.1	100.7	100.6	100.0
2003	101.1	101.4	101.1	100.3	100.2	100.4	100.8	100.8	101.3	101.2	102.0	102.0	101.2	100.3	101.0	101.8	101.1
2004	102.3	103.0	102.4	103.1	103.7	102.9	103.6	103.8	103.6	104.4	104.7	105.3	102.6	103.2	103.7	104.8	103.6
2005	105.6	106.2	106.1	106.2	106.6	107.3	107.3	107.6	105.8	107.1	108.2	109.1	106.0	106.7	106.9	108.1	106.9
2006	109.1	109.4	110.0	110.9	110.9	111.9	112.3	112.5	112.2	112.0	111.5	112.2	109.5	111.2	112.3	111.9	111.1
2007	111.7	112.6	112.2	113.0	...	...	...	...	...	...	...	...	112.2	...	...	...	...

NOTE: Monthly percent change figures show the change from the previous month; quarterly figures show the change from the previous quarter at a compound annual rate of change. Production and capacity indexes are expressed as percentages of output in 2002.

Estimates from February 2007 through April 2007 are subject to further revision in the upcoming monthly releases.

1. Annual averages of industrial production are calculated from not seasonally adjusted indexes.

... Not available as of May 16, 2007.

Appendix Tables Based on the G.17 Statistical Release, May 16, 2007—*Continued*

A.2. Revised data for capacity and capacity utilization for total industry

Seasonally adjusted data except as noted

Year	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Annual avg.[1]
	Capacity (percent of 2002 output)																
1977	61.5	61.7	61.8	62.0	62.2	62.4	62.5	62.7	62.9	63.1	63.3	63.5	61.7	62.2	62.7	63.3	62.5
1978	63.7	63.9	64.1	64.2	64.4	64.6	64.8	65.0	65.1	65.3	65.5	65.6	63.9	64.4	65.0	65.5	64.7
1979	65.8	65.9	66.1	66.2	66.4	66.5	66.7	66.8	66.9	67.1	67.2	67.4	65.9	66.4	66.8	67.2	66.6
1980	67.5	67.6	67.8	67.9	68.0	68.2	68.3	68.5	68.6	68.8	68.9	69.1	67.6	68.0	68.5	68.9	68.3
1981	69.2	69.4	69.6	69.7	69.9	70.1	70.2	70.4	70.6	70.8	70.9	71.1	69.4	69.9	70.4	70.9	70.2
1982	71.3	71.4	71.6	71.8	71.9	72.1	72.2	72.3	72.4	72.5	72.6	72.7	71.4	71.9	72.3	72.6	72.1
1983	72.7	72.8	72.8	72.9	72.9	72.9	73.0	73.0	73.0	73.1	73.2	73.2	72.8	72.9	73.0	73.2	73.0
1984	73.3	73.4	73.5	73.6	73.7	73.8	74.0	74.1	74.3	74.5	74.7	74.8	73.4	73.7	74.1	74.7	74.0
1985	75.0	75.2	75.4	75.6	75.8	76.0	76.2	76.3	76.5	76.6	76.8	76.9	75.2	75.8	76.3	76.8	76.0
1986	77.0	77.1	77.2	77.3	77.4	77.5	77.6	77.7	77.8	77.9	78.0	78.1	77.1	77.4	77.7	78.0	77.5
1987	78.2	78.4	78.5	78.7	78.9	79.0	79.2	79.3	79.5	79.6	79.7	79.8	78.4	78.9	79.3	79.7	79.1
1988	79.9	79.9	80.0	80.1	80.1	80.1	80.2	80.2	80.3	80.4	80.5	80.5	79.9	80.1	80.2	80.5	80.2
1989	80.6	80.8	80.9	81.0	81.2	81.3	81.5	81.6	81.8	82.0	82.2	82.3	80.8	81.2	81.6	82.2	81.4
1990	82.5	82.7	82.8	83.0	83.2	83.3	83.5	83.6	83.8	83.9	84.1	84.2	82.7	83.2	83.6	84.1	83.4
1991	84.4	84.5	84.6	84.8	84.9	85.0	85.1	85.3	85.4	85.5	85.6	85.8	84.5	84.9	85.3	85.6	85.1
1992	85.9	86.1	86.2	86.4	86.5	86.7	86.9	87.0	87.2	87.4	87.5	87.7	86.1	86.5	87.0	87.5	86.8
1993	87.8	87.9	88.1	88.2	88.3	88.4	88.6	88.7	88.8	89.0	89.1	89.3	87.9	88.3	88.7	89.1	88.5
1994	89.5	89.7	89.9	90.1	90.4	90.6	90.9	91.2	91.5	91.8	92.2	92.5	89.7	90.4	91.2	92.2	90.9
1995	92.9	93.2	93.6	94.0	94.4	94.8	95.1	95.5	95.9	96.4	96.8	97.2	93.2	94.4	95.5	96.8	95.0
1996	97.6	98.1	98.5	98.9	99.4	99.8	100.3	100.7	101.2	101.7	102.1	102.6	98.1	99.4	100.7	102.1	100.1
1997	103.1	103.6	104.1	104.7	105.2	105.8	106.4	107.1	107.7	108.4	109.1	109.8	103.6	105.3	107.1	109.1	106.3
1998	110.6	111.3	112.0	112.7	113.5	114.1	114.8	115.4	116.0	116.5	117.1	117.6	111.3	113.4	115.4	117.1	114.3
1999	118.2	118.7	119.2	119.7	120.2	120.7	121.2	121.7	122.2	122.7	123.2	123.7	118.7	120.2	121.7	123.2	120.9
2000	124.3	124.8	125.3	125.8	126.3	126.8	127.2	127.6	128.1	128.5	128.9	129.3	124.8	126.3	127.6	128.9	126.9
2001	129.6	130.0	130.3	130.6	131.0	131.3	131.6	131.9	132.1	132.4	132.7	132.9	130.0	131.0	131.8	132.7	131.4
2002	133.1	133.3	133.5	133.6	133.7	133.8	133.9	133.9	133.8	133.8	133.7	133.6	133.3	133.7	133.9	133.7	133.6
2003	133.5	133.3	133.2	133.0	132.9	132.8	132.7	132.6	132.5	132.5	132.4	132.4	133.3	132.9	132.6	132.4	132.8
2004	132.4	132.4	132.5	132.5	132.5	132.5	132.6	132.6	132.6	132.6	132.6	132.7	132.4	132.5	132.6	132.6	132.5
2005	132.7	132.7	132.8	132.9	133.0	133.1	133.2	133.4	133.6	133.8	134.1	134.3	132.7	133.0	133.4	134.1	133.3
2006	134.6	134.8	135.1	135.4	135.7	136.0	136.2	136.5	136.8	137.0	137.3	137.5	134.9	135.7	136.5	137.3	136.1
2007	137.8	138.0	138.2	138.5	...	...	...	...	...	...	...	...	138.0	...	...	...	...
	Capacity utilization (percent)																
1977	80.8	81.8	82.7	83.2	83.6	84.0	83.9	83.8	83.9	83.9	83.7	83.6	81.8	83.6	83.9	83.7	83.2
1978	82.2	82.3	83.6	85.1	85.1	85.5	85.2	85.3	85.3	85.8	86.2	86.5	82.7	85.2	85.3	86.2	84.9
1979	85.8	86.1	86.2	85.1	85.5	85.4	85.0	84.2	84.1	84.4	84.2	84.1	86.0	85.3	84.5	84.3	85.0
1980	84.3	84.2	83.8	81.9	79.7	78.5	77.9	77.9	79.0	79.8	81.0	81.3	84.1	80.1	78.3	80.7	80.8
1981	80.7	80.1	80.3	79.8	80.2	80.4	80.7	80.5	79.8	79.1	78.0	77.0	80.4	80.1	80.4	78.0	79.7
1982	75.3	76.6	75.9	75.1	74.4	74.0	73.6	72.9	72.5	71.8	71.4	70.8	75.9	74.5	73.0	71.3	73.7
1983	72.0	71.5	72.1	73.0	73.5	73.9	75.0	75.8	76.9	77.5	77.7	78.0	71.9	73.4	75.9	77.8	74.8
1984	79.5	79.8	80.1	80.5	80.8	80.9	81.0	80.9	80.6	80.3	80.5	80.4	79.8	80.7	80.8	80.4	80.4
1985	80.0	80.1	80.0	79.7	79.6	79.4	78.7	78.9	79.1	78.6	78.8	79.5	80.0	79.6	78.9	79.0	79.4
1986	79.8	79.0	78.4	78.4	78.4	78.1	78.5	78.3	78.3	78.6	78.8	79.4	79.1	78.3	78.4	78.9	78.7
1987	79.0	79.9	79.9	80.2	80.5	80.8	81.1	81.6	81.6	82.7	83.0	83.3	79.6	80.5	81.4	83.0	81.1
1988	83.2	83.5	83.6	84.0	83.9	84.0	84.1	84.5	84.2	84.6	84.7	84.9	83.4	84.0	84.2	84.7	84.1
1989	85.0	84.5	84.6	84.4	83.7	83.6	82.6	83.3	82.8	82.6	82.7	83.1	84.7	83.9	82.9	82.8	83.6
1990	82.4	83.0	83.2	82.9	82.9	83.0	82.7	82.8	82.8	82.1	80.9	80.2	82.9	82.9	82.7	81.1	82.4
1991	79.7	79.0	78.5	78.6	79.3	79.9	79.8	79.8	80.4	80.1	79.9	79.5	79.1	79.3	80.0	79.9	79.6
1992	79.0	79.4	79.9	80.3	80.4	80.3	80.8	80.3	80.3	80.8	80.9	80.8	79.4	80.3	80.5	80.8	80.3
1993	81.1	81.3	81.1	81.3	80.9	81.0	81.2	81.1	81.4	81.8	82.0	82.3	81.2	81.1	81.2	82.1	81.4
1994	82.6	82.4	83.1	83.3	83.5	83.8	83.7	83.8	83.8	84.2	84.4	85.1	82.7	83.5	83.8	84.6	83.6
1995	85.1	84.8	84.6	84.1	84.0	83.9	83.2	84.0	84.0	83.5	83.4	83.3	84.8	84.0	83.7	83.4	84.0
1996	82.3	83.2	82.6	83.0	83.2	83.6	83.0	83.2	83.3	83.0	83.3	83.5	82.7	83.3	83.2	83.3	83.1
1997	83.3	83.8	84.1	83.6	83.6	83.5	83.5	84.0	84.3	84.4	84.7	84.5	83.7	83.6	83.9	84.5	83.9
1998	84.3	83.9	83.3	83.2	83.2	82.3	81.6	82.9	82.3	82.5	82.0	81.9	83.8	82.9	82.3	82.2	82.8
1999	82.1	82.1	81.9	81.8	82.1	81.6	81.8	81.9	81.3	82.0	82.2	82.6	82.0	81.8	81.7	82.3	81.9
2000	82.3	82.3	82.3	82.6	82.5	82.3	81.8	81.3	81.4	80.8	80.5	79.9	82.3	82.5	81.5	80.4	81.7
2001	79.2	78.5	78.0	77.5	76.8	76.2	75.7	75.3	74.8	74.2	73.7	73.6	78.5	76.9	75.3	73.8	76.1
2002	73.8	73.8	74.3	74.5	74.7	75.4	75.1	75.2	75.3	75.1	75.5	75.2	74.0	74.9	75.2	75.3	74.8
2003	75.7	76.0	75.9	75.4	75.4	75.7	76.0	76.0	76.4	76.4	77.1	77.1	75.9	75.5	76.1	76.8	76.1
2004	77.2	77.8	77.3	77.8	78.2	77.7	78.1	78.3	78.2	78.7	78.9	79.4	77.5	77.9	78.2	79.0	78.1
2005	79.6	80.0	79.9	79.9	80.2	80.6	80.5	80.7	79.2	80.0	80.7	81.3	79.8	80.2	80.1	80.7	80.2
2006	81.1	81.1	81.4	81.9	81.7	82.3	82.4	82.4	82.0	81.7	81.3	81.6	81.2	82.0	82.3	81.5	81.7
2007	81.1	81.6	81.2	81.6	...	...	...	...	...	...	...	...	81.3	...	...	...	...

NOTE: Estimates from February 2007 through April 2007 are subject to further revision in the upcoming monthly releases.

Refer also to the general note in table A.1.

... Not available as of May 16, 2007.

Appendix Tables Based on the G.17 Statistical Release, May 16, 2007—*Continued*

A.3. Rates of change in industrial production, by market and industry groups, 2002–06[1]

Item	NAICS code[2]	Revised rate of change (percent)					Difference between rates of change: revised minus previous (percentage points)				
		2002	2003	2004	2005	2006	2002	2003	2004	2005	2006
Total industry	...	**2.7**	**1.2**	**3.0**	**3.2**	**3.5**	**.5**	**–.4**	**–1.4**	**.2**	**–.1**
MARKET GROUPS											
Final products and nonindustrial supplies	...	1.8	1.3	2.6	4.8	2.6	.4	–.5	–1.7	.0	–.2
Consumer goods	...	2.7	1.4	1.8	2.7	1.1	.0	.0	–.2	.4	.0
Durable	...	7.1	3.4	–.2	2.3	–2.5	–.8	–.9	–1.5	–.8	.1
Automotive products	...	11.7	4.8	–3.2	–1.8	–4.6	–.7	–1.7	–3.6	–4.3	–1.3
Home electronics	...	–10.1	20.4	14.2	16.8	13.1	–2.4	2.0	17.9	–.4	11.2
Appliances, furniture, carpeting	...	1.9	2.3	2.2	3.1	–4.7	–2.1	.1	–.2	.9	–.7
Miscellaneous goods	...	5.1	–1.3	2.1	6.4	–.6	.2	–.5	–.9	3.2	–.2
Nondurable	...	1.0	.6	2.6	2.9	2.2	.3	.4	.2	.8	–.3
Non-energy	...	–.6	1.1	2.2	3.4	2.7	.4	.5	–.2	1.2	–.6
Foods and tobacco	...	–2.9	2.7	2.3	4.8	2.2	.2	.5	.4	1.9	–1.0
Clothing	...	–10.6	–10.9	–10.5	–.3	.7	–3.5	–1.6	–7.7	1.0	–3.5
Chemical products	...	5.6	2.3	3.8	.9	3.8	1.6	1.3	.8	.6	.7
Paper products	...	–.2	–4.3	3.2	2.2	3.3	.3	–.8	–2.7	–1.5	–.6
Energy	...	9.2	–1.7	3.7	1.7	.7	–.3	.2	2.0	.0	.7
Business equipment	...	–1.0	1.1	5.3	11.2	9.7	1.3	–1.7	–5.5	.7	–1.1
Transit	...	–10.8	.4	6.0	20.5	16.9	.0	–3.2	–3.7	5.5	4.0
Information processing	...	–6.7	7.0	7.2	13.7	10.1	2.2	.5	–7.4	–5.7	–5.1
Industrial and other	...	6.6	–2.0	3.9	6.7	6.9	1.2	–2.4	–5.2	2.4	–.7
Defense and space equipment	...	.6	1.5	2.5	3.8	2.3	–.2	–3.9	–7.2	–5.5	–1.3
Construction supplies	...	1.7	1.0	1.6	8.0	–2.1	.4	–.7	–3.1	1.4	.0
Business supplies	...	3.1	.9	2.9	3.4	2.4	.6	.0	–.9	–.4	.4
Materials	...	4.0	1.0	3.4	1.1	4.7	.6	–.2	–.8	.5	.0
Non-energy	...	5.2	1.4	4.8	3.5	4.5	.8	–.3	–1.2	.2	.8
Durable	...	6.0	2.9	5.4	7.0	5.6	.6	–.9	–2.2	.0	1.3
Consumer parts	...	7.5	–1.5	.2	1.7	–3.2	1.5	–.3	–1.8	–.5	–.7
Equipment parts	...	8.3	8.8	9.4	16.0	19.4	.9	–3.0	–4.7	–.2	4.7
Other	...	3.2	.5	4.5	2.7	–.7	–.1	.5	–.5	.6	.1
Nondurable	...	3.7	–1.1	3.8	–2.1	2.6	1.0	.6	.6	1.0	.2
Textile	...	5.7	–7.6	–3.4	.2	–7.3	.7	–1.1	3.0	4.6	–1.6
Paper	...	1.4	–5.2	3.9	–.2	2.5	.5	1.3	–.7	.7	.2
Chemical	...	6.0	2.4	7.7	–6.5	4.7	2.1	.9	2.4	2.1	.0
Energy	...	.5	.1	–.2	–4.2	5.4	.1	.2	.0	1.2	–1.9
INDUSTRY GROUPS											
Manufacturing[3]	...	2.7	1.3	3.4	4.4	3.4	.6	–.4	–1.7	.2	.1
Manufacturing (NAICS)	31–33	3.1	1.6	3.5	4.6	3.6	.6	–.4	–1.7	.3	.2
Durable manufacturing	...	4.3	2.6	3.7	7.9	4.7	.5	–1.4	–3.4	.2	.6
Wood products	321	1.5	4.6	1.8	10.5	–14.5	.6	.6	–1.3	3.1	.8
Nonmetallic mineral products	327	1.2	1.9	3.8	5.8	–1.9	.2	–.2	–1.2	2.9	1.1
Primary metal	331	5.5	4.3	7.4	–2.3	–3.5	–1.1	3.3	3.6	–.6	2.7
Fabricated metal products	332	1.8	–2.2	1.6	6.1	3.8	.6	–1.5	–3.7	2.1	–.5
Machinery	333	6.3	–2.0	5.0	8.2	5.3	2.2	–3.0	–6.5	1.9	.4
Computer and electronic products	334	4.3	13.6	10.2	18.3	18.3	1.5	–2.1	–5.9	–4.7	2.5
Electrical equipment, appliances, and components	335	–3.8	–1.0	2.0	3.8	2.4	–1.7	–.3	–3.1	–3.2	–5.8
Motor vehicles and parts	3361–3	12.4	3.1	–1.6	.2	–3.8	.2	–1.5	–4.3	–2.1	–.1
Aerospace and miscellaneous transportation equipment	3364–9	–7.3	–3.7	2.0	15.0	14.7	.0	–3.3	–3.3	3.1	2.2
Furniture and related products	337	5.8	.1	3.5	1.7	–1.2	–1.6	–.1	1.3	3.7	.2
Miscellaneous	339	9.1	.1	2.2	8.7	4.8	–.5	–.5	–1.7	3.9	–1.1
Nondurable manufacturing	...	1.5	.4	3.2	.9	2.3	.7	.8	.4	.9	–.1
Food, beverage, and tobacco products	311,2	–1.7	2.6	1.2	5.3	2.6	.5	.9	–.5	1.9	–1.0
Textile and product mills	313,4	2.8	–4.7	–.7	2.0	–7.7	.6	–.5	3.1	2.3	–.1
Apparel and leather	315,6	–10.7	–10.5	–9.6	.4	–.1	–3.8	–1.1	–7.5	.8	–3.3
Paper	322	4.1	–5.4	3.0	–.1	–.1	.7	.6	–1.5	.6	.7
Printing and support	323	–3.3	–2.4	1.9	1.9	5.2	–.1	.7	.4	.2	–1.1
Petroleum and coal products	324	2.3	1.0	10.0	–3.6	2.6	–.6	.7	3.7	2.4	–.2
Chemical	325	5.4	2.0	6.1	–2.5	3.8	1.8	1.3	1.8	1.0	.3
Plastics and rubber products	326	5.0	–.2	.8	3.0	.2	.6	.0	–2.4	–.9	–.5
Other manufacturing (non-NAICS)	1133, 5111	–2.5	–3.4	2.6	.6	.2	.1	–.4	–1.2	–1.2	–1.1
Mining	21	–3.7	.6	–.8	–5.5	8.0	.1	.1	–.3	1.4	–2.3
Utilities	2211,2	7.0	.6	1.6	2.1	.3	.0	–.2	.4	–.7	.1
Electric	2211	5.6	1.8	2.2	3.4	.0	.0	–.1	.2	–.4	–.1
Natural gas	2212	15.7	–6.0	–1.4	–3.4	1.9	.1	–.4	1.5	–1.8	1.4

1. Rates of change are calculated as the percent change in the seasonally adjusted index from the fourth quarter of the previous year to the fourth quarter of the year specified in the column heading. For 2006, the differences between the rates of change are calculated from annualized rates of change between the fourth quarter of 2005 and the third quarter of 2006.

2. North American Industry Classification System.

3. Manufacturing comprises North American Industry Classification System (NAICS) manufacturing industries (sector 31–33) plus the logging industry and the newspaper, periodical, book, and directory publishing industries. Logging and publishing are classified elsewhere in NAICS (under agriculture and information respectively), but historically they were considered to be manufacturing industries and were included in the industrial sector under the Standard Industrial Classification (SIC) system. In December 2002, the Federal Reserve reclassified all its industrial output data from the SIC system to NAICS.

... Not applicable.

Appendix Tables Based on the G.17 Statistical Release, May 16, 2007—*Continued*

A.4. Rates of change in industrial production, special aggregates and selected detail, 2002–06[1]

Item	NAICS code[2]	Revised rate of change (percent)					Difference between rates of change: revised minus previous (percentage points)				
		2002	2003	2004	2005	2006	2002	2003	2004	2005	2006
Total industry	...	**2.7**	**1.2**	**3.0**	**3.2**	**3.5**	**.5**	**–.4**	**–1.4**	**.2**	**–.1**
Energy	...	2.8	.6	1.5	–1.8	4.0	.0	.1	.8	.7	–.8
Consumer products	...	9.2	–1.7	3.7	1.7	.7	–.3	.2	2.0	.0	.7
Commercial products	...	4.3	4.8	4.5	.5	2.3	–.2	–.4	2.0	–2.3	2.5
Oil and gas well drilling	213111	–15.2	21.2	8.3	11.8	14.7	.0	.0	.0	.0	.5
Converted fuel	...	4.3	1.0	2.1	–2.5	2.2	.2	.4	.5	–.3	–1.9
Primary materials	...	–1.5	–.3	–1.3	–4.9	6.8	.1	.1	–.3	1.9	–1.9
Non-energy	...	2.7	1.3	3.3	4.6	3.3	.6	–.4	–1.8	.2	.0
Selected high-technology industries	...	8.3	17.2	10.4	28.1	24.6	3.5	–4.0	–8.0	2.4	2.0
Computers and peripheral equipment	3341	–2.9	4.8	6.6	30.4	12.1	–.3	–.9	2.0	18.3	–4.9
Communications equipment	3342	–13.6	13.9	6.2	12.9	14.8	9.0	4.0	–16.1	–12.5	–8.9
Semiconductors and related electronic components	334412–9	28.0	24.4	13.7	33.8	34.8	2.0	–9.6	–7.7	3.9	12.1
Excluding selected high-technology industries	...	2.2	.3	2.8	3.1	1.9	.3	–.2	–1.4	.1	–.2
Motor vehicles and parts	3361–3	12.4	3.1	–1.6	.2	–3.8	.2	–1.5	–4.3	–2.1	–.1
Motor vehicles	3361	13.7	7.8	–3.0	–2.5	–6.0	–.7	–2.6	–4.6	–2.4	–.3
Motor vehicle parts	3363	11.1	–2.1	–1.1	1.3	–.2	.9	–.6	–3.3	–2.0	–.5
Excluding motor vehicles and parts	...	1.3	.0	3.2	3.4	2.4	.3	–.1	–1.2	.2	–.3
Consumer goods	...	.2	1.0	2.4	3.6	1.8	.2	.4	.1	1.3	–.5
Business equipment	...	.5	–1.5	4.4	8.9	10.2	.2	–2.0	–4.6	–.7	.3
Construction supplies	...	1.8	.8	1.5	8.0	–2.2	.4	–.8	–3.1	1.5	–.1
Business supplies	...	2.0	–1.0	2.1	3.1	1.0	.6	.5	–1.3	.4	–.6
Materials	...	2.3	–.4	4.4	.7	2.3	.5	.4	–.3	.1	.0
Measures excluding selected high-technology industries											
Total industry	...	2.3	.3	2.5	1.9	2.4	.3	–.2	–1.0	.1	–.3
Manufacturing[3]	...	2.3	.3	3.0	2.9	2.0	.3	–.2	–1.3	.0	.0
Durable	...	3.5	.7	2.8	5.2	2.0	.0	–1.0	–2.8	–.3	.1
Measures excluding motor vehicles and parts											
Total industry	...	2.0	1.0	3.3	3.4	3.9	.5	–.3	–1.1	.3	–.2
Manufacturing[3]	...	1.9	1.1	3.9	4.7	3.9	.6	–.3	–1.4	.3	.0
Durable	...	2.7	2.5	4.8	9.3	6.0	.5	–1.3	–3.2	.4	.4
Measures excluding selected high-technology industries and motor vehicles and parts											
Total industry	...	1.5	.1	2.9	2.1	2.8	.3	.0	–.7	.2	–.4
Manufacturing[3]	...	1.3	.0	3.4	3.1	2.5	.3	.0	–1.0	.2	–.1
Measures of non-energy materials inputs to											
Finished processors	...	6.7	2.2	5.2	8.3	9.0	1.0	–1.3	–2.8	.0	1.9
Primary and semifinished processors	...	3.8	.7	4.4	–.1	1.3	.5	.5	.1	.7	.2
Stage-of-process groups											
Crude	...	–.2	–.4	3.1	–7.2	6.9	.9	1.3	1.1	1.5	–1.4
Primary and semifinished	...	4.5	.6	3.2	4.3	2.3	.3	–.6	–1.3	.1	.6
Finished	...	1.2	2.4	2.6	5.6	4.1	.6	–.5	–2.2	.2	–.8

1. Rates of change are calculated as the percent change in the seasonally adjusted index from the fourth quarter of the previous year to the fourth quarter of the year specified in the column heading. For 2006, the differences between the rates of change are calculated from annualized rates of change between the fourth quarter of 2005 and the third quarter of 2006.

2. North American Industry Classification System.

3. Refer to footnote 3 in table A.3.

... Not applicable.

Appendix Tables Based on the G.17 Statistical Release, May 16, 2007—*Continued*

A.5. Rates of change for annual industrial production indexes, 2002–06[1]

Item	Revised rate of change (percent)					Difference between rates of change: revised minus previous (percentage points)				
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006
Total industry	**.0**	**1.1**	**2.5**	**3.2**	**4.1**	**–.1**	**.4**	**–1.6**	**.1**	**–.2**
MARKET GROUPS										
Consumer goods	1.9	1.3	1.4	2.8	1.3	–.3	.3	–.7	.7	–.2
Durable	5.4	3.4	1.4	1.0	.0	–.9	–.6	–1.4	–.9	–.5
Nondurable	.6	.5	1.4	3.5	1.7	–.1	.7	–.3	1.3	–.1
Business equipment	–7.1	.2	4.3	7.9	11.7	.7	.2	–5.0	–1.1	–.8
Defense and space equipment	–.6	3.8	.2	5.5	2.3	–.4	–1.2	–7.6	–5.2	–4.0
Construction supplies	–.5	–.2	2.0	4.8	3.5	–.3	.7	–3.5	.8	–.5
Business supplies	.0	1.5	2.2	3.4	3.2	–.2	.8	–1.0	–.2	–.1
Materials	.9	.9	3.1	2.2	4.7	–.1	.5	–1.2	.2	.3
Non-energy	1.2	1.3	4.3	3.6	5.9	–.1	.6	–1.5	.1	.5
Energy	.0	–.1	–.2	–1.3	1.8	.0	.3	–.2	.5	.0
INDUSTRY GROUPS										
Manufacturing[2]	.0	1.1	2.9	3.9	4.7	–.1	.5	–1.9	.0	–.2
Manufacturing (NAICS)	.2	1.3	3.0	4.0	5.0	–.1	.6	–2.0	.1	–.1
Durable manufacturing	–.4	2.3	4.0	5.5	7.6	–.2	.0	–3.3	–1.0	.3
Nondurable manufacturing	1.0	.1	1.9	2.4	2.1	.0	1.3	–.3	1.6	–.2
Other manufacturing (non-NAICS)	–3.1	–3.0	.9	1.8	–1.3	–.1	–.1	–.9	–1.3	–.9
Mining	–4.3	–.1	–.6	–1.6	2.7	.0	.1	–.4	.5	–.2
Utilities	3.1	1.9	1.4	2.0	.7	.0	–.1	.2	–.4	.1

1. The rates of change are calculated from annual averages of seasonally adjusted industrial production indexes rather than between the fourth quarter of one year and the fourth quarter of the next. The differences between revised and earlier changes for 2006 are computed from annualized rates of change between the full year 2005 and the first three quarters of 2006.

2. Refer to footnote 3 in table A.3.

A.6. Rates of change in capacity, by industry groups, 2002–06[1]

Item	Revised rate of change (percent)					Difference between rates of change: revised minus previous (percentage points)				
	2002	2003	2004	2005	2006	2002	2003	2004	2005	2006
Total industry	**.8**	**–.9**	**.1**	**1.1**	**2.4**	**.1**	**–.7**	**–.5**	**–.5**	**.4**
Manufacturing[2]	.4	–.9	.0	1.7	2.7	.0	–.8	–.5	–.3	.1
Manufacturing (NAICS)	.5	–.7	.0	1.8	2.8	.0	–.8	–.5	–.4	.1
Durable manufacturing	.9	–.2	.5	3.3	4.2	–.2	–1.4	–.9	–.7	.5
Nondurable manufacturing	.1	–1.1	–.3	.3	1.0	.4	.0	.4	.5	–.3
Other manufacturing (non-NAICS)	–2.4	–3.8	–.1	.6	.9	.3	–.7	–.5	.1	.8
Mining	–.5	–2.1	–.3	–1.7	.6	.8	–1.1	.3	–1.1	2.0
Utilities	4.5	3.2	2.6	.0	2.1	.0	.1	.0	.0	1.4
Selected high-technology industries	12.6	1.4	4.3	18.3	19.6	3.1	–6.6	–2.5	–2.5	7.4
Manufacturing except selected high-technology industries[2]	–.4	–.8	–.2	.6	1.4	–.2	–.4	–.3	.0	–.4
Stage-of-process groups										
Crude	.2	–2.2	–.1	–1.1	.3	1.3	–.1	1.0	–.2	1.4
Primary and semifinished	.9	–1.4	.4	1.4	3.0	.0	–1.3	–.5	–1.1	1.0
Finished	.6	.3	.5	2.0	2.3	.0	–.3	–.3	.8	–.5

1. Rates of change are calculated as the percent change in the seasonally adjusted index from the fourth quarter of the previous year to the fourth quarter of the year specified in the column heading.

2. Refer to footnote 3 in table A.3.

Appendix Tables Based on the G.17 Statistical Release, May 16, 2007—*Continued*

A.7. Capacity utilization rates, by industry groups, 1972–2006

Item	NAICS code[1]	Revised rate (percent of capacity, seasonally adjusted)					Difference between rates of change: revised minus previous (percentage points)			
		1972–2005 avg.	2003:Q4	2004:Q4	2005:Q4	2006:Q3	2003:Q4	2004:Q4	2005:Q4	2006:Q3
Total industry	**...**	**81.0**	**76.8**	**79.0**	**80.7**	**82.3**	**.3**	**–.4**	**.2**	**–.2**
Manufacturing[2]	...	79.8	75.0	77.6	79.6	80.9	.3	–.6	–.2	–.3
Manufacturing (NAICS)	31–33	79.5	74.6	77.2	79.3	80.8	.2	–.6	–.2	–.2
Durable manufacturing	...	78.0	72.4	74.8	78.1	79.5	.2	–1.5	–.9	–.9
Wood products	321	80.2	80.3	81.3	88.5	80.4	1.8	.3	1.4	1.3
Nonmetallic mineral products	327	79.4	79.2	81.1	83.8	82.3	–.2	–1.3	.6	1.0
Primary metal	331	80.6	80.4	86.8	83.7	88.8	–.2	1.8	.2	2.2
Fabricated metal products	332	77.2	72.2	73.6	78.0	80.7	2.1	–.3	1.9	2.1
Machinery	333	78.6	70.2	73.5	78.8	82.1	.8	–4.8	–4.7	–5.4
Computer and electronic products	334	78.4	67.1	71.7	75.1	77.2	.1	–1.2	–3.1	–3.7
Electrical equipment, appliances, and components	335	83.2	75.9	79.1	83.4	85.4	.1	–2.0	–4.3	–8.0
Motor vehicles and parts	3361–3	77.6	79.9	79.0	78.6	75.6	–.4	–1.5	–1.0	–.3
Aerospace and miscellaneous transportation equipment	3364–9	72.4	60.4	61.5	70.3	77.6	–1.9	–3.7	–1.4	–.4
Furniture and related products	337	78.5	72.4	76.5	78.6	79.5	–1.3	1.3	5.3	5.7
Miscellaneous	339	76.7	75.3	75.0	78.2	78.1	.6	–1.7	–.2	–.8
Nondurable manufacturing	...	81.7	77.4	80.1	80.6	82.4	.2	.2	.5	.6
Food, beverage, and tobacco products	311,2	81.6	77.8	78.2	81.4	81.1	–.5	–1.2	–.5	–.8
Textile and product mills	313,4	82.4	73.3	75.6	79.8	78.3	–1.3	.6	2.6	2.7
Apparel and leather	315,6	78.9	66.2	67.9	71.5	74.1	–.5	–5.0	–8.8	–11.3
Paper	322	87.9	81.7	84.5	85.0	85.4	.4	–1.0	–.1	.4
Printing and support	323	83.8	72.9	76.0	78.0	79.3	1.3	1.1	.7	–1.1
Petroleum and coal products	324	86.1	89.0	94.4	87.9	93.1	.6	1.0	.6	.5
Chemical	325	78.3	75.2	78.5	75.7	79.5	.7	1.2	1.6	2.1
Plastics and rubber products	326	83.8	81.6	85.0	87.3	87.5	.4	.1	–1.7	–2.5
Other manufacturing (non-NAICS)	1133, 5111	84.8	82.9	85.2	85.2	83.2	.8	.2	–.9	–2.0
Mining	21	87.3	88.8	88.4	85.0	90.9	.7	.1	2.3	–.1
Utilities	2211,2	86.8	85.5	84.7	86.5	86.4	–.1	.2	–.4	–1.2
Selected high-technology industries	...	78.0	66.8	70.7	76.5	78.7	1.1	–2.1	.8	–1.5
Computers and peripheral equipment	3341	78.2	74.5	79.8	76.2	74.5	–.4	3.5	–4.2	–8.6
Communications equipment	3342	75.6	49.0	54.4	63.8	71.8	1.9	–4.3	–10.4	–12.8
Semiconductors and related electronic components	334412–9	80.5	75.6	76.8	83.2	83.5	1.4	–2.6	8.0	5.7
Measures excluding selected high-technology industries										
Total industry	...	81.1	77.5	79.5	80.9	82.6	.2	–.3	.0	–.2
Manufacturing[2]	...	79.9	75.7	78.1	79.8	81.3	.2	–.5	–.5	–.4
Stage-of-process groups										
Crude	...	86.4	85.2	88.0	83.0	89.4	.2	.2	1.6	.2
Primary and semifinished	...	82.2	79.3	81.3	83.5	84.1	.7	.0	.9	.6
Finished	...	77.8	72.2	73.9	76.5	77.9	–.2	–1.4	–1.8	–1.9

1. North American Industry Classification System.
2. Refer to footnote 3 in table A.3.
... Not applicable.

Appendix Tables Based on the G.17 Statistical Release, May 16, 2007—*Continued*

A.8. Annual proportion in industrial production, by market groups and industry groups, 1998–2006

Item	NAICS code[1]	1998	1999	2000	2001	2002	2003	2004	2005	2006
Total industry	...	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
MARKET GROUPS										
Final products and non-industrial supplies	...	58.1	57.6	57.6	59.1	58.9	58.3	57.3	57.5	57.4
Consumer goods	...	28.1	28.2	28.6	30.1	31.1	31.1	30.4	30.3	29.3
Durable	...	7.9	8.0	7.9	8.1	8.9	8.7	8.0	7.5	7.2
Automotive products	...	3.7	3.9	3.7	4.0	4.7	4.6	4.0	3.6	3.3
Home electronics	...	.4	.4	.4	.4	.4	.4	.4	.4	.4
Appliances, furniture, carpeting	...	1.4	1.4	1.4	1.4	1.4	1.4	1.3	1.3	1.2
Miscellaneous goods	...	2.4	2.4	2.4	2.3	2.4	2.3	2.2	2.2	2.2
Nondurable	...	20.2	20.2	20.7	22.0	22.2	22.4	22.5	22.8	22.2
Non-energy	...	16.9	16.7	16.9	18.2	18.3	18.1	17.4	17.0	16.9
Foods and tobacco	...	9.2	9.2	9.4	10.0	9.8	9.8	9.5	9.3	9.2
Clothing	...	1.5	1.4	1.2	1.1	.9	.8	.7	.6	.6
Chemical products	...	3.8	3.8	3.9	4.5	5.0	5.0	4.9	4.8	4.8
Paper products	...	1.9	1.9	1.9	2.0	2.0	1.9	1.9	1.8	1.8
Energy	...	3.2	3.5	3.7	3.8	3.9	4.3	5.1	5.8	5.3
Business equipment	...	12.2	11.8	11.6	11.1	10.1	9.6	9.4	9.4	9.9
Transit	...	2.5	2.3	2.0	2.0	1.8	1.6	1.6	1.7	2.0
Information processing	...	4.0	4.0	4.0	3.7	3.0	2.9	2.8	2.7	2.8
Industrial and other	...	5.8	5.5	5.6	5.4	5.3	5.1	4.9	4.9	5.1
Defense and space equipment	...	1.9	1.8	1.5	1.8	1.8	1.8	1.7	1.7	1.7
Construction supplies	...	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.4	4.6
Business supplies	...	11.2	11.1	11.2	11.2	11.2	11.1	11.0	11.1	11.0
Materials	...	41.9	42.4	42.4	40.9	41.1	41.7	42.7	42.5	42.6
Non-energy	...	33.3	33.1	32.3	30.9	30.7	30.2	30.2	29.8	30.8
Durable	...	21.4	21.4	20.9	19.6	19.1	18.7	18.6	18.3	19.2
Consumer parts	...	4.2	4.4	4.1	3.8	4.0	3.8	3.6	3.4	3.3
Equipment parts	...	8.1	8.1	8.1	7.3	6.7	6.5	6.4	6.2	6.6
Other	...	9.1	9.0	8.6	8.4	8.4	8.3	8.6	8.7	9.2
Nondurable	...	11.9	11.7	11.4	11.3	11.6	11.5	11.6	11.5	11.6
Textile	...	1.0	1.0	.9	.8	.8	.8	.7	.6	.6
Paper	...	2.8	2.9	2.8	2.8	2.7	2.5	2.4	2.3	2.3
Chemical	...	4.6	4.5	4.3	4.2	4.5	4.7	5.2	5.3	5.5
Energy	...	8.6	9.3	10.1	10.1	10.4	11.5	12.5	12.7	11.8
INDUSTRY GROUPS										
Manufacturing[2]	...	86.4	85.8	84.5	84.1	83.9	82.5	81.5	80.9	81.8
Manufacturing (NAICS)	31–33	81.8	81.0	79.7	79.2	79.0	77.9	77.0	76.6	77.7
Durable manufacturing	...	47.1	46.6	45.5	44.2	43.4	42.3	41.0	40.2	41.5
Wood products	321	1.5	1.6	1.5	1.4	1.5	1.6	1.6	1.5	1.4
Nonmetallic mineral products	327	2.3	2.3	2.2	2.3	2.3	2.2	2.2	2.3	2.4
Primary metal	331	2.9	2.8	2.5	2.3	2.3	2.4	2.8	2.8	3.3
Fabricated metal products	332	6.1	6.0	6.1	5.9	5.7	5.6	5.4	5.4	5.6
Machinery	333	6.2	5.8	6.0	5.6	5.3	5.0	4.9	4.9	5.1
Computer and electronic products	334	10.2	10.3	10.3	9.1	8.0	7.9	7.8	7.4	7.5
Electrical equipment, appliances, and components	335	2.6	2.5	2.5	2.4	2.2	2.0	2.0	1.9	2.0
Motor vehicles and parts	3361–3	6.6	7.0	6.6	6.5	7.5	7.3	6.5	5.9	5.5
Aerospace and miscellaneous transportation equipment	3364–9	4.1	3.8	3.3	3.8	3.6	3.3	3.1	3.3	3.8
Furniture and related products	337	1.7	1.7	1.7	1.7	1.8	1.7	1.6	1.6	1.6
Miscellaneous	339	2.8	2.8	2.9	3.1	3.3	3.3	3.1	3.2	3.2
Nondurable manufacturing	...	34.7	34.4	34.2	35.0	35.6	35.6	36.0	36.4	36.2
Food, beverage, and tobacco products	311,2	10.6	10.4	10.7	11.4	11.4	11.5	11.1	10.8	10.8
Textile and product mills	313,4	1.6	1.5	1.4	1.4	1.4	1.3	1.2	1.1	1.1
Apparel and leather	315,6	1.6	1.4	1.3	1.2	1.0	.9	.7	.7	.6
Paper	322	3.2	3.2	3.2	3.1	3.1	2.9	2.8	2.6	2.6
Printing and support	323	2.6	2.6	2.6	2.6	2.4	2.3	2.1	2.0	2.0
Petroleum and coal products	324	1.5	1.7	1.9	1.8	1.8	2.2	3.3	4.2	3.8
Chemical	325	9.9	9.6	9.4	9.8	10.8	10.9	11.4	11.5	11.8
Plastics and rubber products	326	3.7	3.8	3.7	3.7	3.8	3.7	3.5	3.4	3.5
Other manufacturing (non-NAICS)	1133, 5111	4.7	4.8	4.9	4.9	4.8	4.6	4.5	4.3	4.2
Mining	21	4.8	5.5	6.5	6.4	6.4	7.5	8.7	9.2	8.6
Utilities	2211,2	8.7	8.7	9.0	9.5	9.7	9.9	9.8	9.9	9.6
Electric	2211	7.6	7.4	7.6	8.1	8.3	8.3	8.1	8.1	8.1
Natural gas	2212	1.2	1.2	1.4	1.4	1.4	1.6	1.7	1.7	1.5

NOTE: The IP proportion data are estimates of the industries' relative contributions to the overall IP change between the reference year and the following year. For example, a 1 percent increase in durable goods manufacturing between 2006 and 2007 would account for a 0.415 percent increase in total IP.

1. North American Industry Classification System.
2. Refer to footnote 3 in table A.3.
... Not applicable.

Profits and Balance Sheet Developments at U.S. Commercial Banks in 2006

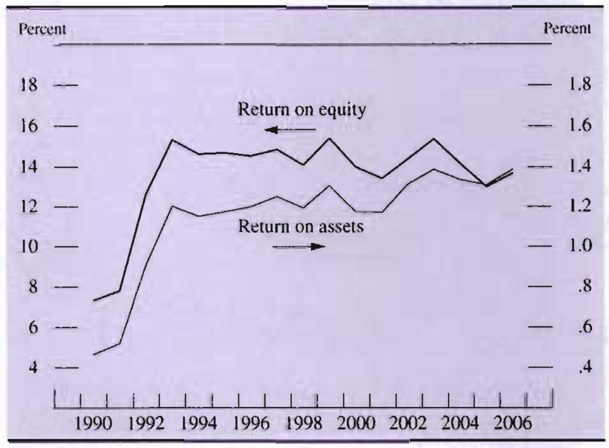
Mark Carlson and Gretchen C. Weinbach, of the Board's Division of Monetary Affairs, prepared this article. Thomas C. Allard assisted in developing the database underlying much of the analysis. Isaac L. Laughlin provided research assistance.

The U.S. commercial banking industry continued to be quite profitable in 2006, and industry assets grew considerably. The strength in profitability and growth of bank balance sheets last year reflected favorable U.S. financial market conditions and the generally solid economic expansion. Industry return on equity advanced from its 2005 level, and the return on assets edged up to match its highest annual level in recent decades (figure 1). Profitability was supported by brisk growth in non-interest income and generally strong asset quality; the flattening of the yield curve and competitive pressures, however, further weighed on net interest margins.

In U.S. financial markets during 2006, short-term interest rates generally moved higher with the target federal funds rate, which increased 1 percentage point over the first half of the year as monetary policy was tightened and then held steady thereafter (figure 2). Intermediate- and longer-term interest rates also rose significantly over the first half of the year, but much of those increases were later reversed. The Treasury yield curve flattened further and at times was inverted. Interest rates on fixed-rate home mortgages rose somewhat on average and, like Treasury yields, peaked around midyear. Corporate risk spreads generally remained quite narrow, and spreads on high-yield corporate bonds fell to levels seldom seen since 1997.

The U.S. economy expanded at a brisk pace over the first quarter of 2006 and then grew moderately, on average, over the rest of the year. In the corporate sector, spending picked up relative to 2005 as businesses increased their investment in fixed assets and inventories. Although hefty corporate profits and substantial cash balances helped fund business spending, firms' demand for external financing still rose notably. Demand was also supported by heavy merger and acquisition activity and record levels of share repurchases. Availability of bank-intermediated business credit also increased during the year as banks reportedly eased terms on their commercial and industrial (C&I) loans, particularly spreads of loan rates over

1. Bank profitability, 1990–2006

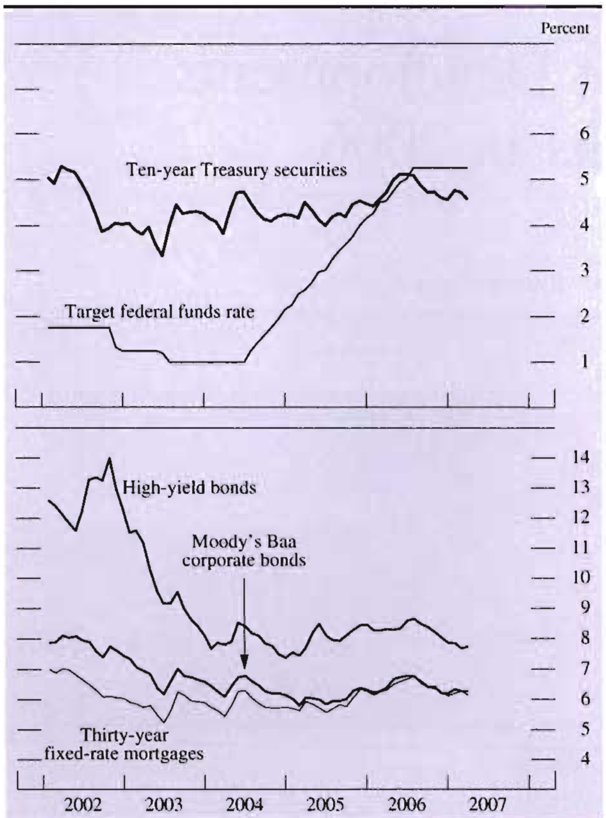


NOTE: The data are annual.

NOTE: The data in this article cover insured domestic commercial banks and nondeposit trust companies (hereafter, banks). Except where otherwise indicated, the data are from the Consolidated Reports of Condition and Income (Call Report). The Call Report consists of two forms submitted by domestic banks to the Federal Financial Institutions Examination Council: FFIEC 031 (for those with domestic and foreign offices) and FFIEC 041 (for those with domestic offices only). The data thus consolidate information from foreign and domestic offices, and they have been adjusted to take account of mergers and the effects of push-down accounting. For additional information on the adjustments to the data, refer to the appendix in William B. English and William R. Nelson (1998), "Profits and Balance Sheet Developments at U.S. Commercial Banks in 1997," *Federal Reserve Bulletin*, vol. 84 (June), p. 408. Size categories, based on assets at the start of each quarter, are as follows: the 10 largest banks, large banks (those ranked 11 through 100), medium-sized banks (those ranked 101 through 1,000), and small banks. At the start of the fourth quarter of 2006, the approximate asset sizes of the banks in those groups were as follows: the 10 largest banks, more than $136.7 billion; large banks, $7.3 billion to $135.7 billion; medium-sized banks, $481 million to $7.2 billion; and small banks, less than $480 million.

Data shown in this article may not match data published in earlier years because of revisions and corrections. Call Report data reflect information available as of April 13, 2007. In the tables, components may not sum to totals because of rounding. Appendix table A.1, A–E, reports portfolio composition, income, and expense items, all as a percentage of overall average net consolidated assets, for all banks and for each of the four size categories. Appendix table A.2 reports income statement data for all banks.

2. Selected interest rates, 2002–07



NOTE: The data are monthly and extend through March 2007.

SOURCE: For Treasury securities, mortgages, and Moody's corporate bonds, Federal Reserve Board, Statistical Release H.15, "Selected Interest Rates" (www.federalreserve.gov/releases/h15); for federal funds, Federal Reserve Board (www.federalreserve.gov/fomc/fundsrate.htm); for high-yield bonds, Merrill Lynch Master II index.

their costs of funds. Strong fundamentals in the commercial real estate sector, including rising property values and declining vacancy rates, bolstered the demand for commercial mortgages.

In the household sector, higher mortgage rates and a cooling of the pace of house-price appreciation combined to damp residential housing activity. By the end of 2006, home sales had ebbed markedly, and home construction activity had slowed significantly. In addition, mortgage refinancing activity declined, on average, last year. Moderate growth in consumer spending was supported by continued strength in the labor market and gains in household wealth from significant increases in equity prices and advances in home prices during the first half of the year.

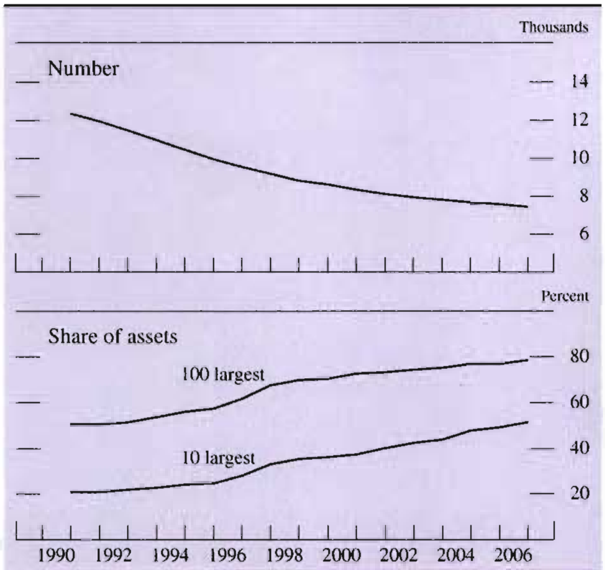
These financial and economic conditions shaped balance sheet developments at commercial banks. On the asset side, borrowing by businesses to finance capital expenditures and merger and acquisition activity contributed to the rapid growth in C&I lending for the second consecutive year. The financing of residential home construction likely helped fuel the construction and land development component of commercial real estate loans in recent years, but the pace of such lending moved lower in 2006 as home construction activity slowed. Apart from the consolidation of a sizable amount of thrift assets onto banks' books in the fourth quarter that resulted from a reorganization within a large bank holding company, residential real estate lending also decelerated. Growth in consumer loans—which had been particularly lackluster in 2005, when households apparently substituted mortgage debt for consumer debt—picked back up to a moderate pace.[1] The attractiveness of mortgage financing relative to consumer loans probably diminished last year as mortgage rates rose and appreciation in house prices slowed. On the liability side, increases in short-term interest rates likely contributed to some shifts in the profile of banks' deposits. Small time deposits, whose yields track market rates relatively closely, grew particularly quickly, whereas other components of core deposits expanded more slowly or even contracted.[2] With their rates lagging market rates on average, core deposits as a whole grew at a slower pace than total assets, and banks tapped managed liabilities, particularly large time and foreign-booked deposits, to fund their asset growth.

Economic and financial conditions also had a strong effect on bank profitability. Brisk growth in non-interest income supported profits; for large banks, trading revenue surged, and income from securitization and investment banking activity also grew notably, the latter likely boosted in part by the financing of corporate mergers and acquisitions. Although non-interest expense grew—mainly because of an increase in salaries and benefits costs—its growth lagged that of non-interest income. The configuration of market interest rates and competitive pressures caused the industry's net interest margin to edge lower, and margins at large banks were affected the most. Loss provisioning continued to be near the low end of its historical range as a share of assets, although this measure turned up a bit in the fourth quarter. The low level of provisioning reflected asset quality that generally remained solid. Banks' direct exposure to subprime mortgages generally appeared limited. Still,

1. In this article, consumer loans consist of loans to households that are not secured by real estate, and they include credit card loans.

2. In this article, core deposits consist of transaction deposits, savings deposits (including money market deposit accounts), and small-denomination time deposits (those issued in denominations of less than $100,000). Managed liabilities consist of large time deposits booked in domestic offices, deposits booked in foreign offices, subordinated notes and debentures, federal funds purchased and securities sold under repurchase agreements, Federal Home Loan Bank advances, and other borrowed money.

3. Number of banks, and share of assets at the largest banks, 1990–2006



NOTE: The data are as of year-end. For the definition of bank size, refer to the general note on the first page of the main text.

delinquency rates associated with residential real estate moved up in the second half of the year from exceptionally low levels. Charge-off rates remained quite low for all major loan categories.

The number of new banks chartered in 2006 picked up for the fourth consecutive year but remained below the number of bank mergers and consolidations. As a result, the number of banks declined further, to 7,403 at year-end 2006 from 7,522 at year-end 2005 (figure 3). Merger and consolidation activity involving the top 10 banks pushed the share of industry assets accounted for by these banks up 2.3 percentage points, to 51.7 percent, at year-end. The share of assets held at the 100 largest banks rose 1.6 percentage points, to 78.5 percent. According to the Federal Deposit Insurance Corporation (FDIC), 2006 was the second consecutive year with no bank failures.

There was more merger activity at the holding-company level in 2006 than in 2005, and the rate at which bank holding companies were formed held about steady. There were 5,102 bank holding companies at year-end 2006, 52 less than at year-end 2005 (for multitiered bank holding companies, only the top-tier organization is counted in these figures). At the end of 2006, the 50 largest bank holding companies with major commercial banking operations accounted for 76 percent of all bank holding company assets, a figure unchanged from 2005.[3] The number of financial holding companies rose last year—it moved up from 625 at year-end 2005 to 643 at year-end 2006. Most of the largest bank holding companies are also financial holding companies. As a result, about 86 percent of the assets of bank holding companies were held by financial holding companies.[4]

Balance Sheet Developments

Total bank assets expanded 12.4 percent in 2006, the largest annual gain in the past two decades and about 5 percentage points faster than total domestic nonfinancial sector debt (table 1). Bank loans grew at a rate of 12 percent; the increase importantly reflected strong C&I lending, which was spurred by greater financing needs related to inventory accumulation and capital investment by nonfinancial firms as well as from increased merger-related financing activity. Robust real estate lending was a significant contributor to bank loan growth, especially in the first half of the year, but—excluding the effects of the sizable thrift-to-bank consolidation noted above—growth in real estate loans slowed notably later in the year as home construction and sales decelerated. Banks' securities holdings expanded at a rate of 11.5 percent. Total bank assets expanded at a faster pace than either loans or securities in 2006 as federal funds sold and securities purchased under resale agreements and balances due from depository institutions, which together account for 7 percent of assets, increased 20 percent.

On the liability side of the balance sheet, core deposit growth remained moderate. Rising short-term interest rates in the first half of the year made liquid deposits less attractive because their interest rates adjust sluggishly to changes in market rates. This slow growth, however, was partly offset by the brisk expansion of small time deposits, interest rates on

3. The 50 largest bank holding companies are defined here as the 50 largest (as measured by total consolidated assets) after the exclusion of a few institutions whose commercial banking operations account for only a small portion of their assets and earnings. The quarterly article in the *Federal Reserve Bulletin*, "Report on the Condition of the U.S. Banking Industry," at www.federalreserve.gov/pubs/bulletin/default.htm, provides information on the 50 large bank holding companies (the 50 largest as defined here) and on the banking industry from the perspective of bank holding companies (including financial holding companies) that file reports FR Y-9C and FR Y-9LP; currently, only about 1,000 top-tier bank holding companies are required to file those reports (refer to "Report on the Condition" table 1, last row, and note 1).

4. Financial holding company statistics include both domestic bank holding companies that have elected to become financial holding companies and foreign banking organizations operating in the United States as financial holding companies and subject to the Bank Holding Company Act. For more information, refer to the Board of Governors of the Federal Reserve System (2003), *Report to the Congress on Financial Holding Companies under the Gramm-Leach-Bliley Act* (Washington: Board of Governors, November), at www.federalreserve.gov/pubs/ reports_other.htm.

1. Change in balance sheet items, all U.S. banks, 1997–2006

Percent

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Memo Dec. 2006 (billions of dollars)
Assets	9.22	8.18	5.44	8.76	5.11	7.19	7.18	10.78	7.72	12.36	9,996
Interest-earning assets	8.66	8.16	5.87	8.66	3.95	7.54	7.28	11.29	7.96	12.44	8,687
Loans and leases (net)	5.32	8.70	8.10	9.24	1.82	5.90	6.51	11.20	10.38	11.98	5,853
Commercial and industrial	12.02	12.94	7.88	8.54	−6.73	−7.41	−4.56	4.35	12.53	11.86	1,132
Real estate	9.30	7.99	12.22	10.74	7.94	14.44	9.75	15.41	13.80	14.94	3,395
Booked in domestic offices	9.53	7.97	12.36	11.02	8.02	14.85	9.66	15.09	13.93	15.06	3,339
One- to four-family residential	9.67	6.36	9.70	9.28	5.70	19.86	10.01	15.75	11.95	15.15	1,891
Other real estate	9.32	10.29	16.06	13.31	10.95	8.81	9.19	14.20	16.61	14.94	1,448
Booked in foreign offices	.34	8.79	6.28	−1.62	3.97	−7.41	15.74	35.59	7.19	8.68	56
Consumer	−2.19	.34	−1.48	8.04	4.16	6.55	9.31	10.11	2.24	6.30	849
Other loans and leases	−7.91	13.46	7.17	7.01	−2.02	−.03	8.31	3.57	−.18	2.97	547
Loan-loss reserves and unearned income	−.45	3.08	2.37	7.98	13.15	5.73	−2.68	−4.19	−5.74	1.81	70
Securities	8.85	8.40	5.11	6.36	7.22	16.20	9.44	10.58	2.40	11.53	2,099
Investment account	8.66	12.07	6.68	2.85	8.88	13.53	8.70	6.15	1.19	6.91	1,633
U.S. Treasury	−8.85	−25.17	−1.89	−32.72	−40.27	41.92	14.14	−15.87	−17.59	−19.30	40
U.S. government agency and corporation obligations	14.18	17.01	1.83	3.75	12.84	18.09	9.68	9.46	−1.83	4.71	1,016
Other	11.21	26.99	20.90	13.39	12.18	2.72	5.98	3.02	10.12	13.68	577
Trading account	10.00	−13.32	−6.93	37.16	−3.72	36.12	14.01	36.81	7.96	31.46	466
Other	38.53	3.78	−8.37	10.30	13.02	−2.92	6.82	14.28	5.81	19.14	736
Non-interest-earning assets	13.03	8.37	2.64	9.45	12.79	5.10	6.61	7.60	6.18	11.85	1,308
Liabilities	9.11	8.06	5.58	8.59	4.45	7.13	7.24	9.55	7.74	12.10	8,971
Core deposits	4.52	7.04	.23	7.53	10.55	7.58	7.29	8.25	6.41	5.80	4,474
Transaction deposits	−4.55	−1.41	−8.97	−1.31	10.20	−5.12	2.82	3.20	−1.21	−4.24	704
Savings deposits (including MMDAs)	12.96	18.32	6.68	12.51	20.68	18.46	13.71	11.72	6.94	5.52	2,898
Small time deposits	4.18	.53	−.76	7.20	−7.23	−4.92	−6.79	1.58	12.91	16.72	872
Managed liabilities[1]	13.79	9.44	15.54	8.79	−2.73	5.34	6.96	12.06	12.23	19.51	3,904
Large time deposits	20.14	9.10	14.19	19.37	−3.65	5.05	1.42	21.86	22.85	16.16	1,006
Deposits booked in foreign offices	11.13	8.71	14.60	7.84	−10.96	4.49	12.63	16.84	6.32	29.67	1,193
Subordinated notes and debentures	21.05	17.00	5.07	13.98	9.56	−.59	5.08	10.49	11.41	22.60	149
Gross federal funds purchased and RPs	30.51	4.35	1.56	6.49	5.72	12.75	−8.70	8.40	15.62	9.47	695
Other managed liabilities	−4.04	15.65	35.27	1.80	−.28	.97	22.00	1.37	6.15	18.90	861
Revaluation losses held in trading accounts	36.94	3.44	−13.20	7.47	−17.06	33.44	14.02	−12.61	−17.86	6.89	144
Other	14.82	12.73	−1.26	20.61	14.90	5.23	5.28	17.08	−1.74	22.24	449
Capital account	10.44	9.53	3.89	10.65	12.30	7.84	6.61	23.14	7.59	14.74	1,025
Memo											
Commercial real estate loans[2]	10.13	11.37	15.42	12.16	13.10	6.82	8.99	13.93	16.87	14.89	1,444
Mortgage-backed securities	14.16	22.12	−3.34	3.29	29.05	15.54	10.12	13.45	2.06	8.92	960
Federal Home Loan Bank advances	n.a.	n.a.	n.a.	n.a.	n.a.	17.21	3.71	3.73	10.00	29.80	349

Note: Data are from year-end to year-end and are as of April 13, 2007.

1. Measured as the sum of large time deposits in domestic offices, deposits booked in foreign offices, subordinated notes and debentures, federal funds purchased and securities sold under repurchase agreements, Federal Home Loan Bank advances, and other borrowed money.

2. Measured as the sum of construction and land development loans secured by real estate; real estate loans secured by nonfarm nonresidential properties or by multifamilly residential properties; and loans to finance commercial real estate, construction, and land development activities not secured by real estate.

n.a. Not available.

MMDA Money market deposit account.

RP Repurchase agreement.

which moved more in line with market rates. On net, growth in overall core deposits was modest, and banks, especially the largest ones, turned to managed liabilities to fund the rapid expansion of assets.

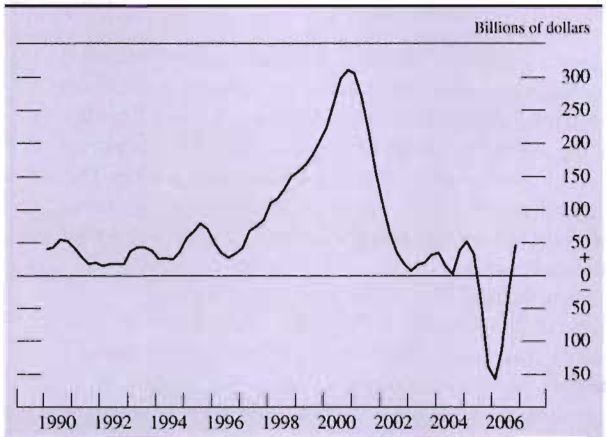
Banks' capital expanded somewhat faster than assets. Equity capital was boosted by increased goodwill and by strong retained earnings. Regulatory capital, which generally excludes goodwill, grew a touch slower than equity capital. Nevertheless, regulatory capital expanded a bit faster than risk-weighted assets, and regulatory capital ratios ticked higher.

Loans to Businesses

Increases in both fixed and inventory investment boosted spending by U.S. nonfinancial corporations in 2006. The stepped-up pace of capital expenditures pushed the financing gap into positive territory despite firms' strong profits and robust cash positions (figure 4).[5] To help fund investment, businesses relied

5. The net financing gap is defined here as the difference between capital expenditures and internally generated funds. The rise in the

4. Financing gap at nonfarm nonfinancial corporations, 1990–2006



NOTE: The data are four-quarter moving averages. The financing gap is the difference between capital expenditures and internally generated funds.

SOURCE: Federal Reserve Board, Statistical Release Z.1, "Flow of Funds Accounts of the U.S.," table F.102 (www.federalreserve.gov/releases/z1).

more on external resources, including C&I loans and corporate bond issuance. Merger and acquisition (M&A) activity among nonfinancial firms has been strong over the past few years and continued apace in 2006. Financing needs associated with this activity also added to C&I loan demand. Equity share repurchases remained very strong last year and likely supported the growth of business borrowing. C&I loan growth last year reflected importantly a substantial expansion in syndicated loans (refer to box "Syndicated Loans"). Commercial real estate lending expanded robustly, but the pace was a bit slower than it was in 2005.

The strength in C&I lending was evident at commercial banks of all sizes last year, as this category of loans expanded 12 percent at both larger and smaller banks. According to respondents to the Senior Loan Officer Opinion Survey on Bank Lending Practices (BLPS), loan demand was rising as the year started and held steady thereafter (figure 5). Banks reporting stronger demand during the year generally pointed to increased needs by businesses to finance M&A activity, accumulate inventory, or invest in plant and equipment.

In light of the rapid pace of corporate merger activity in 2006 and the frequency with which BLPS respondents cited customer M&A financing needs as an important reason for increased demand, the October 2006 survey contained some special questions on the influence of M&A activity on C&I lending. About 15 percent of institutions, including some of the largest C&I lenders, reported that between 11 percent and 30 percent of the C&I loans on their books were related to mergers and acquisitions. Most of the remaining banks noted that these loans accounted for less than 10 percent of their C&I loan portfolio. Half the respondents, again including some of the largest C&I lenders, indicated that the share of loans on their books that were M&A-related had increased over the past twelve months, a pattern consistent with other reports suggesting that this type of activity has supported the growth in C&I lending. A sizable portion of the recent wave of mergers and acquisitions took the form of leveraged buyouts. As with M&A-related loans in general, a few banks reported significant involvement in these transactions, with about 15 percent of respondents indicating that more than 30 percent of the M&A-related loans on their books were used to finance leveraged buyouts. Close to 80 percent of banks, however, reported that they were not very involved in providing loans to finance this type of deal.

Changes in lending standards and terms may also have supported C&I loan growth in 2006. Early in the year, a modest net share of BLPS respondents indicated that they had eased their lending standards for C&I loans. Somewhat larger net fractions also reported easing lending terms on C&I loans, especially by reducing the spread of loan rates over their cost of funds. Respondent banks most frequently cited competition from other funding sources as a reason for easing their C&I lending policies. A small number of institutions reported tightening lending terms—in particular by raising the premiums charged on riskier loans—and frequently pointed to a less-favorable or more-uncertain economic outlook, as well as a reduced tolerance for risk, as reasons for doing so.

Commercial real estate (CRE) loans also expanded briskly last year, but the pace of the advance was down slightly from 2005. All banks registered strong growth in this loan category, but the expansion was a bit faster at the banks outside the top 100. As a result of this rapid growth, CRE loans now account for slightly more than 45 percent of the loans of these smaller institutions, well above the levels of the 1990s (figure 6). This level of concentration has not gone unnoticed by bank supervisors, and in December of 2006, the Federal Reserve, FDIC, and Office of the Comptroller of the Currency issued interagency guidance to promote sound risk-management practices at banks regarding their CRE loans.

For the third year in a row, CRE lending was boosted by rapid growth of construction and land

financing gap at the end of 2004 is due in part to a large dividend payout by Microsoft. The drop during 2005 generally reflects the repatriation of profits held at foreign subsidiaries of U.S. nonfinancial corporations, which was encouraged by temporary tax provisions.

Syndicated Loans

Syndicated business loans grew briskly in 2006 and remained an important component of bank-intermediated credit. According to the latest data from the Shared National Credit (SNC) Program, syndicated loan commitments totaled \$1.9 trillion in mid-2006, slightly below their 2001 peak of \$2 trillion (figure A).[1] The volume of such commitments expanded 15 percent over the previous year, the largest annual increase this decade. The strong growth was fueled, in part, by the financing of corporate mergers, acquisitions, and leveraged buyouts.

Although a wide and growing array of institutional investors are participating in the syndicated loan market, domestic commercial banks continue to account for a considerable share of such commitments. The share of all commitments accounted for by domestic banks stood at 44 percent in mid-2006, a portion that has remained fairly steady over the past several years. By contrast, the portion of all syndicated loan commitments held by nonbanks has trended higher over the same period—mainly at the expense of foreign banking organizations—and it reached 14 percent in mid-2006.[2] The growing competition from nonbank institutional investors and the increased liquidity of the secondary market have reportedly led to a compression of credit spreads in the syndicated loan market. This combination has also reportedly resulted in some easing of underwriting standards and terms, particularly looser loan covenants.

Nonetheless, the credit quality of syndicated loans generally stayed solid in 2006. The share of total commitments that were adversely rated was again around 5 percent last year, a figure in the lower portion of its historical range (figure B).[3] However, the credit quality of syndicated loan commitments varies significantly by holder. Classified commitments accounted for roughly 2 percent of total commitments at both domestic banks and foreign banking organizations in mid-2006, but at nonbanks they made up nearly 12 percent.[4] The relatively low portion of classified syndicated loan credits at banks likely reflects the fact that banks are predominantly exposed to investment-grade, rather than leveraged, syndicated credits.

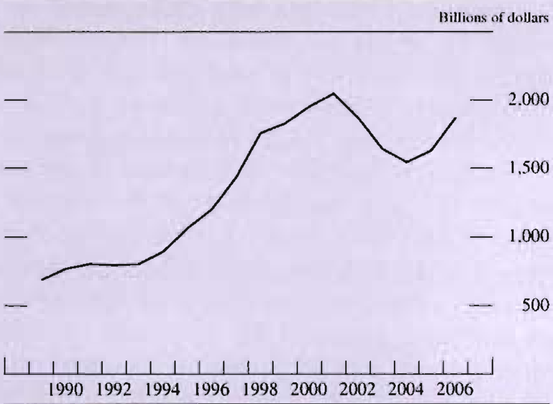
1. The SNC Program generally covers credits of at least \$20 million that are shared by three or more regulated financial institutions. Credits include syndicated loans and loan commitments, letters of credit, and commercial leases, as well as other forms of credit. Credit commitments include both drawn and undrawn portions of credit facilities. For more information, refer to the Board of Governors of the Federal Reserve System (2006), Statistical Release, "Shared National Credit Program" (September 29), www.federalreserve.gov/boarddocs/press/bcreg/2006/20060925.

2. Nonbanks include a wide range of institutional investors, such as brokerage firms, mutual funds, insurance companies, hedge funds, and securitization vehicles.

3. Adversely rated credits are those considered special mention, substandard, doubtful, or loss.

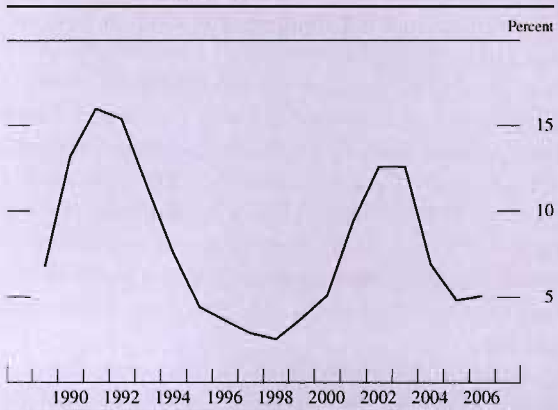
4. Classified credits are those rated substandard, doubtful, and loss.

A. Total syndicated loan commitments, 1989–2006



NOTE: The data are annual.
SOURCE: Federal Reserve Board, Statistical Release, "Shared National Credit Program" (www.federalreserve.gov/releases/snc/).

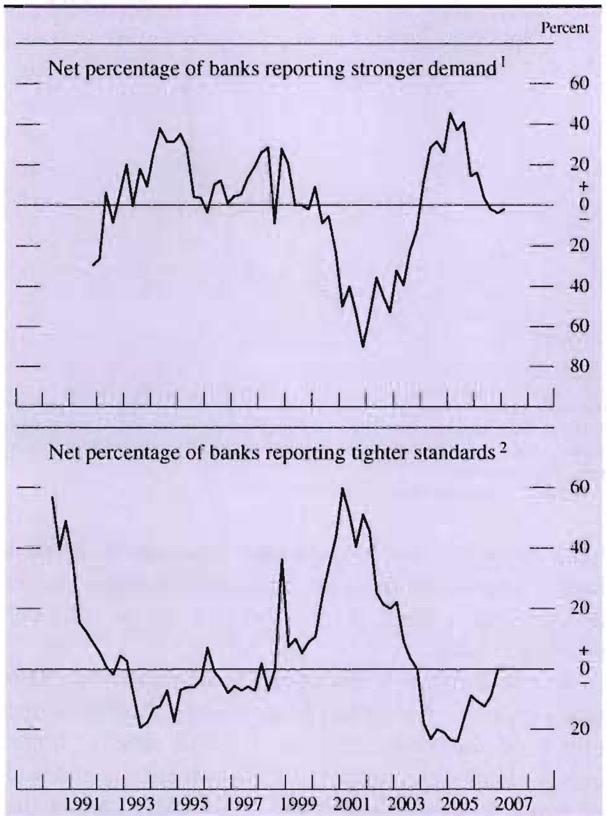
B. Adversely rated commitments as share of total commitments, 1989–2006



NOTE: The data are annual.
SOURCE: Federal Reserve Board, Statistical Release, "Shared National Credit Program" (www.federalreserve.gov/releases/snc/).

development loans. Such loans expanded at a rate of 27 percent and accounted for more than one-third of all CRE loans at the end of 2006 (figure 7). A considerable portion of the rapid growth in recent years likely reflects loans to residential developers, consistent with the strength in housing construction that was evident until early last year. However, the housing market cooled significantly over the course of 2006, and the

5. Changes in demand and supply conditions at selected banks for C&I loans to large and middle-market firms, 1990–2007



NOTE: The data are drawn from a survey generally conducted four times per year; the last observation is for the January 2007 survey, which covers 2006:Q4. Net percentage is the percentage of banks reporting an increase in demand or a tightening of standards less, in each case, the percentage reporting the opposite. The definition for firm size suggested for, and generally used by, survey respondents is that large and middle-market firms have sales of $50 million or more.

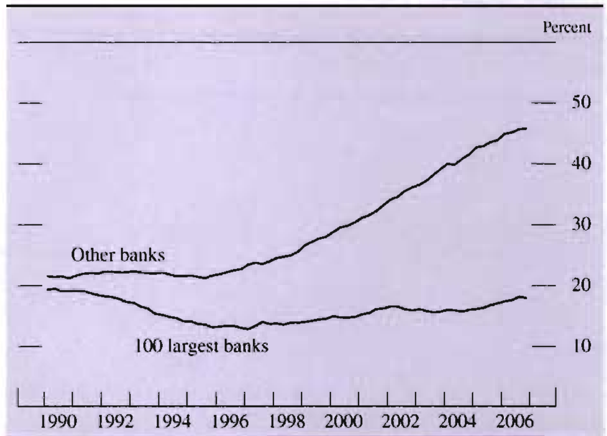
1. Series begins with the November 1991 survey.
2. Series begins with the May 1990 survey.

SOURCE: Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices (www.federalreserve.gov/boarddocs/snloansurvey).

growth rate of construction and land development loans stepped down markedly. Real estate loans backed by nonfarm nonresidential structures, the largest category of CRE loans, grew 9.6 percent last year, a pace about equal to the average growth rate over the past decade. CRE loans secured by multifamily dwellings expanded somewhat more slowly than in 2005.

The slightly slower growth of CRE loans relative to the previous year appears to reflect shifts in demand for such loans as well as a tightening of lending standards (figure 8). Banks responding to the BLPS indicated that demand for CRE loans strengthened a touch early in the year but then weakened notably later in the year, a pattern that roughly matches the changes in the growth rates of construction and land development loans. Similarly, survey

6. Share of all loans consisting of commercial real estate loans, by bank size, 1990–2006

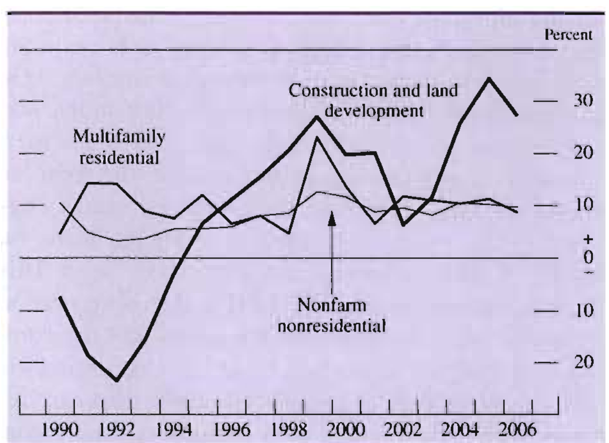


NOTE: The data are quarterly. Other banks are those not included in the 100 largest. For the definition of bank size, refer to the general note on the first page of the main text.

respondents reported little change in their standards for approving CRE loans in the first two surveys of 2006, but considerable net fractions reported tightening standards later in the year.

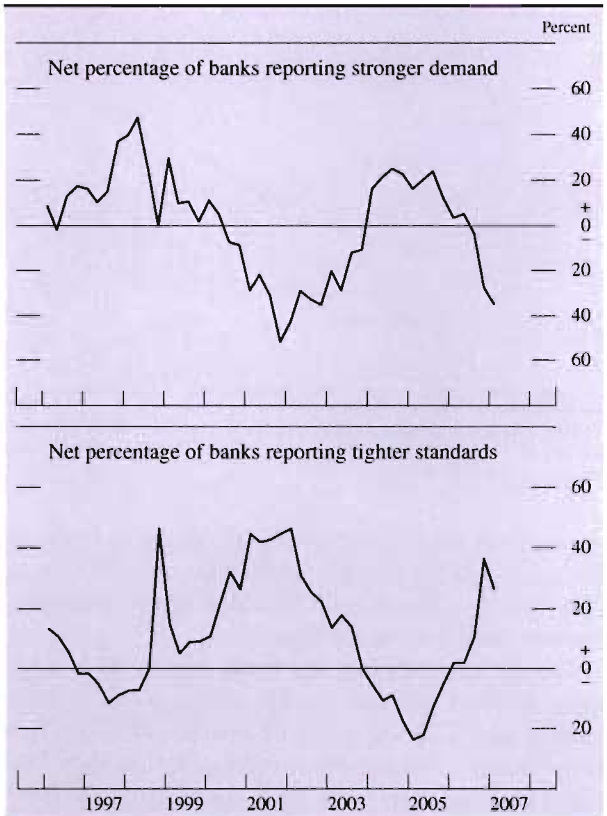
The competition that led to an easing of lending terms in the C&I loan market also appears to have influenced CRE lending. In the January 2007 BLPS, a large share of respondents indicated that they had eased lending terms on CRE loans over the past twelve months, in particular by reducing the spread of loan rates over their cost of funds. More-aggressive competition from other banks or nonbank lenders was frequently cited as a somewhat important or very important reason for easing lending terms. The increased competition may in part reflect further growth in the market for commercial-mortgage-backed securities, which has increased the number of investors

7. Change in commercial real estate loans, by major components, 1990–2006



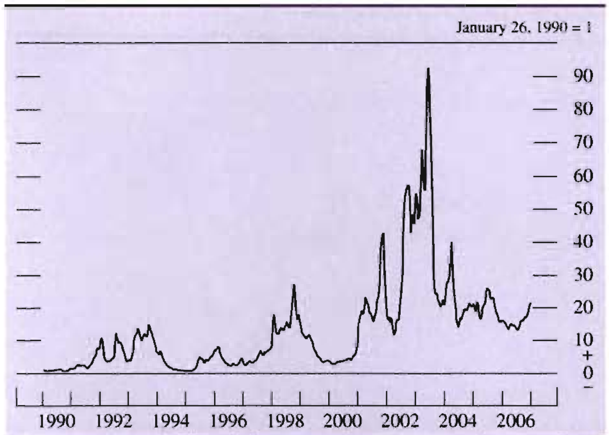
NOTE: The data are annual.

8. Changes in demand and supply conditions at selected banks for commercial real estate loans, 1996–2007



NOTE: Refer to figure 5, general note and source note.

9. Level of refinancings of residential mortgages, 1990–2006



NOTE: The data are four-week moving averages. Residential mortgages include both first- and second-lien loans secured by one- to four-family residential properties.

SOURCE: Mortgage Bankers Association.

participating in the commercial mortgage market. Some banks reported tightening terms on CRE loans during 2006; these institutions often cited concern about the general economic outlook or about the CRE market in general as reasons for tightening terms.

Loans to Households

Rising mortgage rates and a slowing housing market had a marked effect on bank lending to households last year. The higher level of mortgage rates in 2006 pushed down residential mortgage originations and refinancing activity, although there was a bit of a rebound in refinancing at the end of the year as mortgage rates came off their midyear peaks (figure 9). The value of residential mortgage loans on banks' books expanded 15 percent last year. This increase, however, was due partly to the incorporation of assets previously held by nonbanks into the commercial banking sector as a result of a consolidation within a large holding company of some thrift subsidiaries with a commercial bank subsidiary. Apart from the effect of this consolidation, residential real estate loans on banks' books expanded 7 percent in 2006, a further step-down from the rapid growth earlier in the decade and a pace more reflective of the slowing housing market.

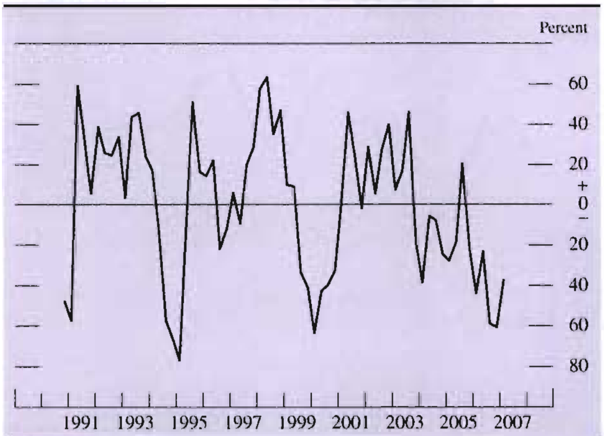
A slowdown in home equity loan growth in 2006 was particularly notable. After an adjustment for the effect of the consolidation of thrift assets, home equity loans expanded just 5 percent, a marked decrease from the rapid pace of the early part of the decade. Because interest rates on home equity loans are often tied to other short-term interest rates, the increase in these rates during 2006 likely contributed to the deceleration.

The slowdown in residential real estate lending was mirrored by reports of decreased demand for residential real estate loans in the BLPS (figure 10).[6] In each of the surveys conducted during 2006, considerable net shares of respondents reported reduced demand for such loans over the preceding three months. Terms on residential real estate loans were reportedly eased a bit, on net, during the middle of the year as mortgage rates peaked, but they were tightened again toward the end of the year, when mortgage rates reversed a portion of their earlier rise.

During the past few years, financial institutions introduced a variety of nontraditional mortgage products, and more mortgages were made to subprime borrowers. The July 2006 BLPS contained several questions about the importance of these mortgage

6. In asking banks how demand for mortgages to purchase homes has changed over the past three months, the BLPS instructs banks to consider only new originations as opposed to the refinancing of existing mortgages. However, this distinction may be difficult for banks to make in practice.

10. Net percentage of selected banks reporting stronger demand for residential mortgages, 1990–2007



NOTE: Series begins with the October 1990 survey. For definition of residential mortgages, refer to figure 9, general note. Refer also to figure 5, general note and source note.

products for commercial banks.[7] According to the responses, commercial banks generally appear not to have been involved significantly in making nontraditional and subprime mortgages. About 45 percent of banks indicated that less than 5 percent of their mortgage holdings were nontraditional loans. About half the respondents did not answer the questions on subprime lending; the nonresponse suggests that they are not engaged in this type of lending. In addition, about 70 percent of those that did respond indicated that subprime loans accounted for less than 5 percent of loans on their books. Some banks, however, did report that these products were a significant part of their residential real estate portfolios. About one-fifth of the respondents indicated that nontraditional mortgages accounted for more than 20 percent of the residential mortgages on their books. One-tenth of banks responding to the subprime loan questions indicated that these loans accounted for more than 20 percent of the residential mortgages loans on their books. A few banks reported that they had tightened their price-related terms for both nontraditional and subprime mortgages during the previous year, for instance, by increasing fees or widening the spreads over the bank's cost of funds.[8]

Consumer lending at banks expanded 6.3 percent in 2006, up from 2.2 percent in 2005. Credit card loans, which account for slightly less than half of consumer loans, rose at banks of all sizes. By contrast, growth in other consumer lending was confined to the ten largest banks. Consumer lending may have been restrained in recent years as homeowners withdrew equity from their houses to finance purchases. The rebound in consumer lending in 2006 may reflect in part a decline in this substitution as rising mortgage rates and slower home-price appreciation made the use of home equity less attractive.

The expansion in consumer lending occurred despite repeated reports of weaker demand for such loans by BLPS respondents. On average last year, a net fraction of around one-third of respondents indicated that consumer loan demand had weakened. Standards for approving consumer loans were reportedly not much changed on net during 2006 (figure 11). Most lending terms also did not change much; however, a sizable fraction of banks indicated that they had increased the minimum percentage of outstanding credit card balances that they required to be repaid each month.

Other Loans and Leases

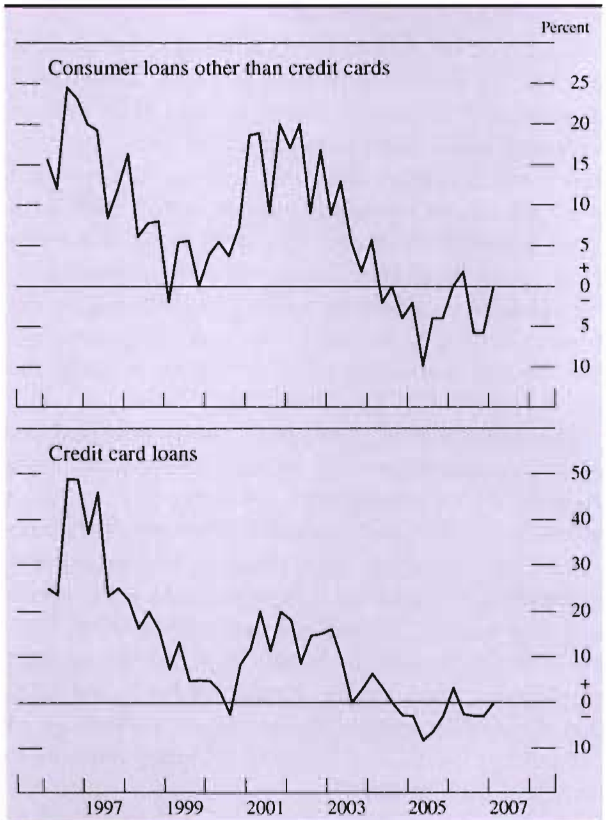
Other loans and leases grew a modest 3 percent during 2006. Loans to purchase or carry securities, which are relatively volatile, expanded 25 percent. As in 2005, the fiscal position of many state and local governments was supported by rising incomes and property valuations; nevertheless, lending to these entities grew robustly in 2006, possibly to finance a pickup in construction-related expenditures. Agricultural loans expanded at a pace roughly in line with that of the preceding two years; loans in most farm loan categories continued to rise.[9] Growth in the

7. The July 2006 BLPS defined "nontraditional mortgage products" to include, but not be limited to, adjustable-rate mortgages with multiple payment options, interest-only mortgages, and so-called "alt-A" products, such as mortgages with limited income verification and mortgages secured by non-owner-occupied properties. Respondents to that survey were instructed to exclude standard adjustable-rate mortgages and common hybrid adjustable-rate mortgages—those on which the interest rate is initially fixed for a multiyear period and subsequently adjusts more frequently. Subprime mortgages were defined as loans made to borrowers who had one or more of the following characteristics at the time of origination: weakened credit histories that include payment delinquencies, charge-offs, judgments, and/or bankruptcies; reduced repayment capacity as measured by credit scores or debt-to-income ratios; or incomplete histories. Respondents were asked to consider only first-lien loans.

8. In September 2006, federal banking regulators provided guidance to financial institutions on managing the risks associated with nontraditional mortgage products. The guidance also proposed consumer protection practices; refer to the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and National Credit Union Association (2006), "Federal Financial Regulatory Agencies Issue Final Guidance on Nontraditional Mortgage Product Risks," press release, September 29, www.federalreserve.gov/boarddocs/press/bcreg/2006.

9. Using its Survey of Terms of Bank Lending to Farmers, the Federal Reserve estimates non-real-estate bank loans made to farmers by purpose of the loan, such as to obtain farm equipment and machinery or to cover operating expenses. This information is published quarterly in the Board of Governors of the Federal Reserve

11. Net percentage of selected banks reporting tighter standards for consumer lending, 1996–2007



NOTE: Refer to figure 5, general note and source note.

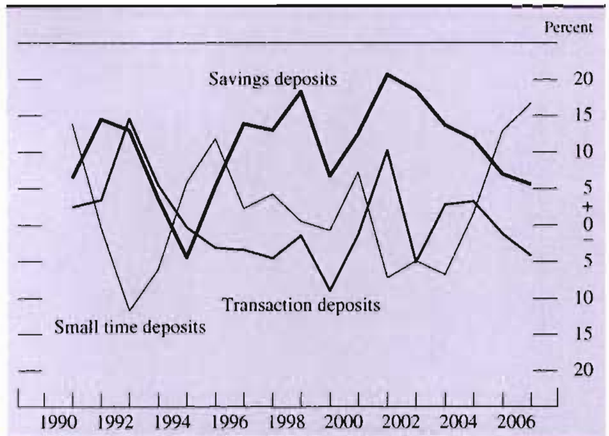
remaining components of other loans, such as lease financing receivables and loans and leases to depository institutions, which account for around half of the total, was about flat or declined last year.[10]

Securities

Banks expanded their securities holdings a robust 11.5 percent last year. Growth was particularly rapid for securities held in banks' trading accounts, which can fluctuate considerably year to year; the rise reflected increased holdings of a wide variety of security types.

Holdings of securities in banks' investment accounts grew at a more moderate rate of 6.9 percent. Banks' accumulation of mortgage-backed securities in their investment accounts picked up in 2006 from its slow pace in 2005. By contrast, holdings of Treasury securities and of securities issued by state and local governments declined.

12. Change in selected domestic liabilities at banks, 1990-2006



NOTE: The data are annual. Savings deposits include money market deposit accounts.

Liabilities

Bank liabilities increased 12.1 percent in 2006, an advance about in line with bank assets. Core deposits grew only 5.8 percent, the slowest rate since 1999. Transaction deposits contracted for the second consecutive year, and the rate of expansion of savings deposits slowed (figure 12). By contrast, small time deposits grew 17 percent, their largest advance since 1989. Interest rates on liquid deposits, which include both transaction and savings deposits, tend to move sluggishly, so rising market rates increase the opportunity cost of holding these deposits and restrain their growth; interest rates on small time deposits generally track market rates closely, and as short-term rates rose, the attractiveness of these deposits relative to liquid deposits increased. Core deposits are generally a more important funding source for smaller banks than larger institutions, and the growth rate of core deposits at banks outside the 100 largest was 8.2 percent last year, noticeably faster than at larger banks.

The expansion of managed liabilities moved up to 19.5 percent, the fastest pace in more than a decade, and growth was especially strong at the 10 largest banks. These funding sources now account for 44 percent of the liabilities of all banks, the largest share in the past two decades. The rapid growth in managed liabilities was supported by the expansion of deposits

System, Statistical Release E.15, "Agricultural Finance Databook," section A, www.federalreserve.gov/releases/e15.

10. The decline in lending to depository institutions was due in large part to the consolidation of subsidiaries within a large holding company. In the absence of this consolidation, growth in this "other loans" category would have been roughly flat.

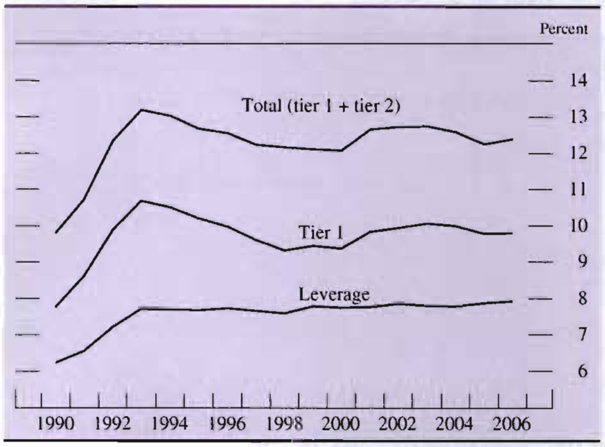
booked in foreign offices, the largest component of managed liabilities. Large time deposits, the next largest component of managed liabilities, also grew at a solid rate.[11]

Capital

Banks' capital expanded a rapid 14.7 percent in 2006, nearly double the rate of growth in 2005. There was a sizable expansion in goodwill as the result of merger and consolidation activity involving some large banks. Retained earnings continued to be strong and also added notably to capital. As in previous years, banks' capital was also boosted by funding from parent holding companies and shares issued to the public.

Regulatory capital expanded smartly last year. Tier 1 capital grew 11.8 percent, and tier 2 capital increased 17.1 percent.[12] Risk-weighted assets expanded 11.6 percent, a touch slower than total assets. The difference is due, in part, to the slightly more rapid growth in assets having relatively lower risk weights, such as mortgage-backed securities and first-lien residential mortgages. As a result, banks' tier 1 and total capital ratios ended the year higher than in 2005 (figure 13). The leverage ratio, which is based on tangible average assets, also edged higher.[13] The share of assets held at well-capitalized banks was above 99 percent in 2006, and the average margin by which banks remained well capitalized moved up some after having slipped a bit over the preceding few years (figure 14).[14]

13. Regulatory capital ratios, 1990–2006



NOTE: The data are as of year-end. For the components of the ratios, refer to text notes 12 and 13.

Derivatives

The notional principal value of derivative contracts held by banks rose 30 percent last year, surpassing $130 trillion (table 2). Even though the notional value of derivative contracts grew at banks of all sizes, the share of industry contracts accounted for by the 10 largest banks has continued to edge higher and is now above 98 percent. The share of contracts at the largest banks likely reflects their role as dealers in derivatives markets. As dealers, these banks often enter into offsetting positions, which significantly boost the notional value of their derivative contracts. The fair market value of derivative contracts held by banks, which reflects their replacement cost, is far smaller than the notional principal amount. The fair market value of contracts with a positive value in 2006 was about $1.2 trillion. This value edged down for the second consecutive year. The fair market value of contracts with a negative value, which was also roughly $1.2 trillion in 2006, slipped lower as well.[15]

One important way for banks to hedge interest rate risk, including that related to interest-sensitive assets

11. The thrift consolidation boosted the growth rates of all types of liabilities, but the only category for which the impact was substantial was "federal funds purchased and securities sold under repurchase agreements."

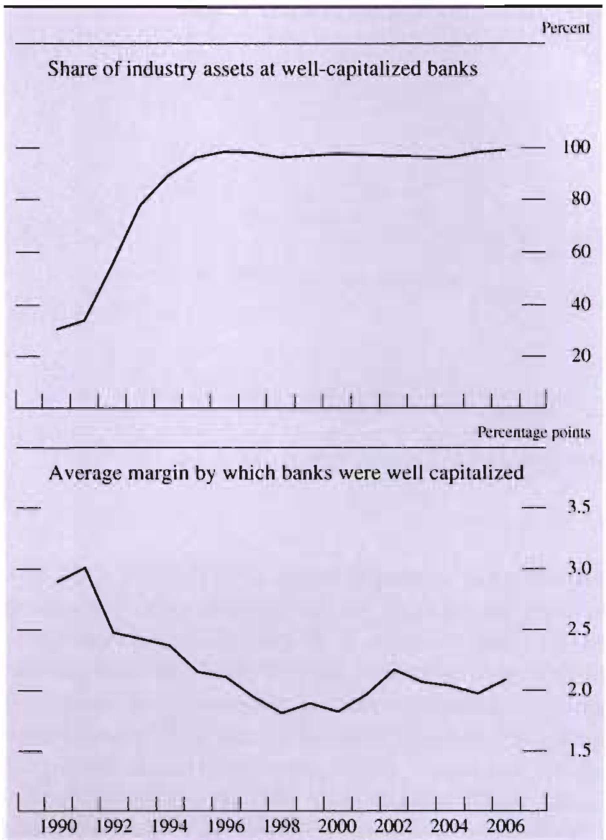
12. Tier 1 and tier 2 capital are regulatory measures. Tier 1 capital consists primarily of common equity (excluding intangible assets such as goodwill and excluding net unrealized gains on investment account securities classified as available for sale) and certain perpetual preferred stock. Tier 2 capital consists primarily of subordinated debt, preferred stock not included in tier 1 capital, and loan-loss reserves up to a cap of 1.25 percent of risk-weighted assets. Risk-weighted assets are calculated by multiplying the amount of assets and the credit equivalent amount of off-balance-sheet items (an estimate of the potential credit exposure posed by the items) by the risk weight for each category. The risk weights rise from 0 to 1 as the credit risk of the assets increases. The tier 1 ratio is the ratio of tier 1 capital to risk-weighted assets; the total ratio is the ratio of the sum of tier 1 and tier 2 capital to risk-weighted assets.

13. The leverage ratio is the ratio of tier 1 capital to tangible assets. Tangible assets are equal to total average consolidated assets less assets excluded from common equity in the calculation of tier 1 capital.

14. Well-capitalized banks are those with a total risk-based capital ratio of 10 percent or greater, a tier 1 risk-based ratio of 6 percent or greater, a leverage ratio of 5 percent or greater, and a composite CAMELS rating of 1 or 2. Each letter in CAMELS stands for a key element of bank financial condition—Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risks. The estimated average margin by which banks were well capitalized was computed as follows: Among the leverage, tier 1, and total capital ratios of each well-capitalized bank, the institution's "tightest" capital ratio is defined as the one closest to the regulatory standard for being well capitalized. The bank's margin is then defined as the percentage point difference between its tightest capital ratio and the corresponding regulatory standard. The average margin among all well-capitalized banks—the measure referred to in figure 14—is the weighted average of all the individual margins; the weights are each bank's share of the total assets of well-capitalized banks.

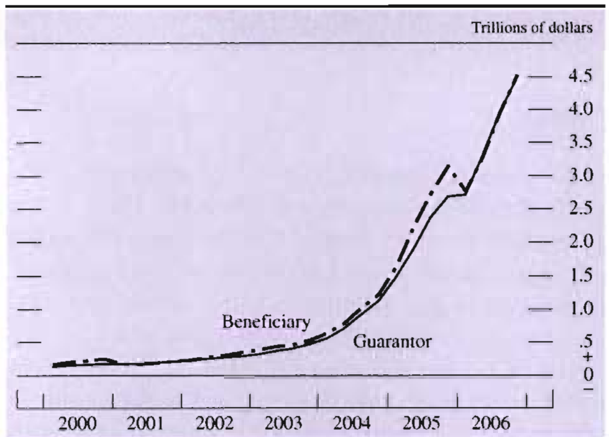
15. The positive and negative fair market values of banks' derivatives contracts are of roughly the same aggregate magnitude because the vast majority of the activity is accounted for by a few large dealers. The similarity in size does not mean that banks' aggregate exposure to the market and credit risk associated with the contracts are offsetting because, for example, the counterparties to banks' positive- and negative-valued contracts may differ.

14. Assets and regulatory capital at well-capitalized banks, 1990–2006



NOTE: The data are annual. For the definitions of "well capitalized" and of the margin by which banks remain well capitalized, refer to text note 14.

15. Notional amounts of credit derivatives for which banks were beneficiaries or guarantors, 2000–06



NOTE: The data are quarterly.

such as mortgages and mortgage-backed securities, is through the use of interest rate swaps.[16] These swaps are the most common type of derivative that banks use, and they account for around 60 percent of the notional value of banks' derivative contracts. The notional value of these derivatives increased 26 percent in 2006, a rate of expansion about in line with the average pace over the past decade. The solid growth in the notional value of these instruments likely reflects the overall growth of the derivatives market and the role that some of the largest banks play as dealers in that market. In addition to swaps, banks employ other types of interest rate derivative contracts, such as futures, forwards, and options contracts, although not nearly to the same extent. The notional value of these derivative contracts also expanded at a brisk rate last year. Despite the increase in different types of interest rate derivative contracts, even faster growth in the use of other derivative contracts pushed the proportion of total derivative contracts accounted for by interest rate derivatives down 2 percentage points, to 81 percent.

One of the fastest growing components of banks' derivative portfolios in recent years has been credit derivatives. The notional value of such derivatives at banks jumped 55 percent, but this increase was only about one-third of that registered in 2005. However, the fair market value of such contracts increased 90 percent in 2006, a somewhat faster pace than in 2005. The 10 largest banks held more than 99 percent of the notional value of all the industry's credit derivative contracts at the end of 2006. As dealers, these banks buy and sell contracts, an activity that makes them, respectively, beneficiaries of credit protection or providers of protection (also referred to as guarantors). Typically, banks are net beneficiaries of protection and generally were again in 2006. However, the difference at year-end between the $4.52 trillion in contracts for which they were beneficiaries of protection and the $4.50 trillion in contracts for which they were the guarantors of protection was considerably smaller than it was at the end of 2005 (figure 15).

Banks also use derivatives related to foreign exchange, equities, and commodities. Collectively, however, these instruments account for only 12 percent of the notional value of the derivative contracts held by banks. The notional value of banks' foreign-exchange-related contracts grew 29 percent in 2006; much of the increase was due to a rise in the notional value of options contracts. Banks' notional holdings of equity and commodity derivatives surged 75 percent in 2006, a jump influenced importantly by one institution that has continued to expand rapidly its trading of commodity derivatives.

16. Interest rate swaps are agreements in which two parties contract to exchange two payment streams, one based on a floating interest rate and one based on a fixed interest rate; the payment streams are calculated on the basis of a specific notional principal amount.

2. Change in notional value and fair value derivatives, all U.S. banks, 2001–06

Percent

Item	2001	2002	2003	2004	2005	2006	Memo Dec. 2006 (billions of dollars)
Total derivatives							
Notional amount	11.47	24.14	26.54	23.69	15.38	29.75	132,145
Fair value							
Positive	26.42	85.41	.36	13.71	–6.46	–4.52	1,205
Negative	20.82	89.18	1.00	13.75	–5.78	–4.29	1,193
Interest rate derivatives							
Notional amount	15.93	26.83	27.62	22.07	11.92	27.10	107,399
Fair value							
Positive	63.87	108.20	–5.95	13.14	–5.52	–14.55	839
Negative	56.55	113.02	–5.07	12.94	–5.15	–15.06	816
Exchange rate derivatives							
Notional amount	–7.00	7.34	18.81	21.03	7.69	29.27	12,564
Fair value							
Positive	–16.21	8.67	41.81	14.86	–35.84	22.68	180
Negative	–15.65	15.73	38.81	12.74	–37.36	21.21	175
Credit derivatives							
Notional amount	–1.20	52.47	55.98	134.52	148.09	54.92	9,019
Guarantor	21.84	38.57	61.82	139.07	137.87	67.69	4,496
Beneficiary	–16.89	66.36	51.13	130.46	157.53	44.02	4,523
Fair value							
Guarantor	n.a.	n.a.	68.31	69.92	81.43	92.95	69
Positive	n.a.	n.a.	378.09	74.56	–5.62	201.36	50
Negative	n.a.	n.a.	–68.87	38.37	827.98	–1.59	19
Beneficiary	n.a.	n.a.	19.85	51.28	83.50	90.25	78
Positive	n.a.	n.a.	–63.13	2.64	505.51	3.96	23
Negative	n.a.	n.a.	295.74	66.36	2.79	187.44	55
Other derivatives[1]							
Notional amount	–12.06	6.70	3.77	32.66	29.43	75.17	3,163
Fair value							
Positive	–34.72	20.28	3.16	8.55	58.51	18.99	113
Negative	–42.63	24.62	–5.25	19.73	74.29	24.15	128

NOTE: Data are from year-end to year-end and are as of April 13, 2007.

1. Other derivatives consist of equity and commodity derivatives and other contracts.

n.a. Not available.

Trends in Profitability

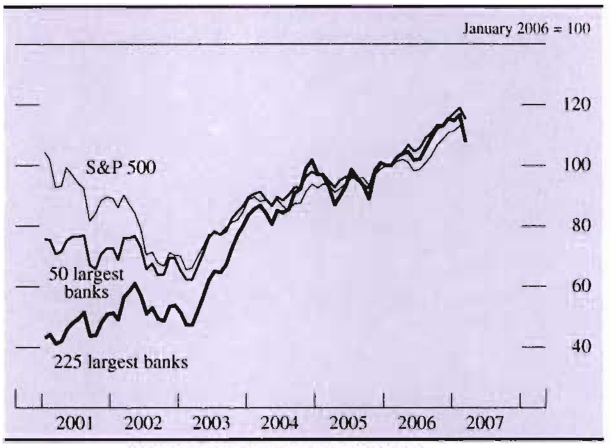
The profitability of the commercial banking industry remained quite strong in 2006. Although mergers boosted the goodwill component of reported equity again in 2006, return on equity (ROE) moved up to 13.67 percent last year, a level well within the high range that has prevailed since the mid-1990s.[17] Banks' return on assets (ROA) increased to 1.39 percent, matching the peak annual level reached in 2003. Last year's rise in both ROE and ROA can be traced to large banks and to those specializing in credit card loans; these two broad measures of profitability declined modestly for other banks.[18] The fraction of banks that incurred losses rose for the second year in a row, to 7.4 percent, but such banks accounted for just under 0.5 percent of industry assets, the lowest share on record.

The flattening of the yield curve and ongoing competitive pricing pressure, particularly in the C&I loan and deposit markets, reportedly caused the industry net interest margin to edge lower last year. The decline was concentrated at the ten largest banks, for whom pricing competition may be especially intense; banks of other sizes experienced stable net interest margins, and those specializing in credit card loans saw a sizable increase in margins. Non-interest income grew briskly last year and as a share of total revenue was the second highest in more than two decades. A surge in trading revenue and in income related to investment banking activity at the ten largest banks and a sharp rise in income related to securitization at large banks drove the increase in non-interest income. Banks' investment banking activity may have been lifted by the wave of merger and

17. For information on the effects of large mergers on bank capital and profitability in 2005, refer to Elizabeth C. Klee and Gretchen C. Weinbach (2006), "Profits and Balance Sheet Developments at U.S. Commercial Banks in 2005," *Federal Reserve Bulletin*, vol. 92, www.federalreserve.gov/pubs/bulletin.

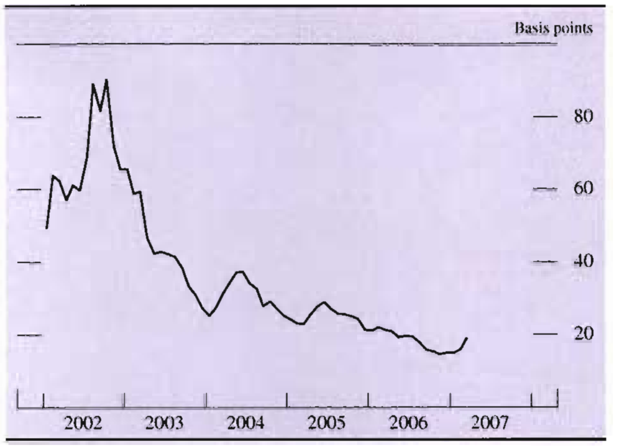
18. The adjustments made to the data take account of mergers between banks but do not capture the effects of mergers between banks and thrifts. However, the sizable thrift-to-bank consolidation in the fourth quarter of 2006 (noted above) did not have a material impact on aggregate industry profitability measures in 2006. For information on the merger adjustments to the data, refer to the appendix in English and Nelson, "Profits and Balance Sheet Developments at U.S. Commercial Banks in 1997," p. 408.

16. Bank stock prices, by market value of bank, and the S&P 500, 2001–07



NOTE: The data are monthly and extend through March 2007. Stock prices are weighted by market value.
SOURCE: Standard & Poor's and *American Banker*.

17. Premium on credit default swaps on subordinated debt at selected bank holding companies, 2002–07



NOTE: The data are monthly and extend through March 2007.
SOURCE: Markit.

acquisition activity. The continued trend decline in the ratio of non-interest expense to total revenue also contributed to profitability. Profits were boosted in the fourth quarter by a rise in extraordinary items because of an asset trade between two large banks. This event is estimated to have boosted industry ROA 2 basis points for 2006 as a whole.

Asset quality generally remained solid in 2006, a factor that helped buoy bank profits. The health of business and household balance sheets was supported by continued economic growth, hefty corporate profits, and increases in household wealth stemming from gains in equity prices. Indeed, the delinquency rate on all loans and leases averaged 1.57 percent again last year. However, some pockets of distress in the real estate sector became evident in the second half of 2006, when the overall delinquency rate rose 18 basis points, reaching 1.69 percent by year-end. Banks continued to provision for losses at about the same low average rate as a share of assets as in 2005, providing support for profits. On a quarterly basis, banks increased their provisioning moderately toward the end of the year.

Supported by strong profitability, the growth of dividend payments surged in 2006. The share of profits paid out as dividends increased several percentage points last year, and, as a result, retained earnings expanded only a bit. Nevertheless, retained earnings remained high in 2006 and provided support for equity capital. Against this backdrop, the stocks of bank holding companies outperformed the robust gains posted by the S&P 500 in 2006 (figure 16). Credit default swap premiums on banks' subordinated debt moved down a bit further last year from already low levels (figure 17).

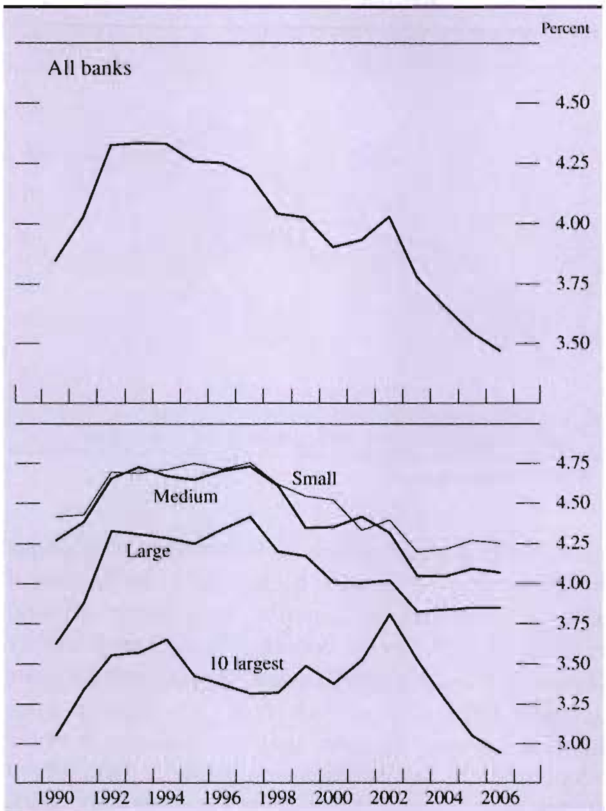
Interest Income and Expense

For a second year in a row, the average rates of interest earned on banks' assets and paid on banks' liabilities rose in 2006; both were lifted in part by the monetary policy tightenings in the first half of the year. However, the average rate earned increased less than the average rate paid, and the industry net interest margin narrowed 7 basis points, to 3.47 percent. Last year's decline extended the downward trend in this measure that has been evident since the mid-1990s (figure 18). The industry net interest margin declined early in 2006 but widened in the fourth quarter; at year-end it stood a few basis points above its year-earlier level.

The decline in the industry net interest margin last year was driven almost entirely by a decrease of 11 basis points at the 10 largest banks; net interest margins for banks outside the 10 largest, by contrast, remained about flat. At the 10 largest banks, however, the share of interest-earning assets rose to its highest level since 1993, and the return on such assets increased 96 basis points. But the ratio of interest-bearing liabilities to interest-earning assets reached another record high, likely a reflection of these banks' increased reliance on managed liabilities (noted earlier), and interest expense as a share of interest-earning assets rose 107 basis points. Still, net interest margins at the ten largest banks rose significantly in the fourth quarter; these banks registered a particularly large increase in interest income on loans that quarter.[19]

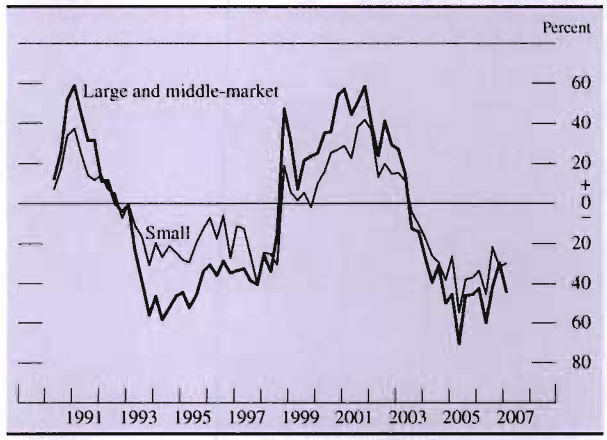
19. The fourth-quarter increase in the net interest margin at the ten largest banks did not appear to have been driven by the sizable thrift-to-bank consolidation that quarter.

18. Net interest margin, by size of bank, 1990–2006



NOTE: The data are annual. Net interest margin is net interest income divided by average interest-earning assets. For definition of bank size, refer to the general note on the first page of the main text.

19. Net percentage of selected domestic banks reporting increased spreads of rates on C&I loans over cost of funds, by size of borrower, 1990–2007



NOTE: Refer to figure 5, general note and source note.

The increases in rates earned by banks last year were highest for credit card and other consumer loans. Indeed, the net interest margins of banks that specialized in credit card loans rose for the third year in a row, and the profitability of these banks moved up considerably more than for the industry as a whole. Rates earned on C&I loans increased significantly last year, but their rise was the lowest among major loan components. The increase in C&I loan rates was particularly small for the ten largest banks. As noted earlier, significant net fractions of respondents to BLPS surveys had trimmed spreads of C&I loan rates over their cost of funds last year, which likely helped to restrain the rise in these loan rates (figure 19). The survey banks, which tend to be large, have reported lower C&I loan rate spreads, on balance, since the middle of 2003. Nearly all the banks that trimmed their rate spreads on C&I loans last year indicated that more-aggressive competition from other banks or nonbank lenders was the most important reason for having done so.

The average rates that banks paid on deposits rose in 2006 by the largest amount in more than 15 years, putting downward pressure on net interest margins. Growth of generally lower-cost core deposits was down last year from 2005. By contrast, the growth of managed liabilities surged in 2006, lifting the share of these higher-cost liabilities in total interest-bearing liabilities to a five-year high.

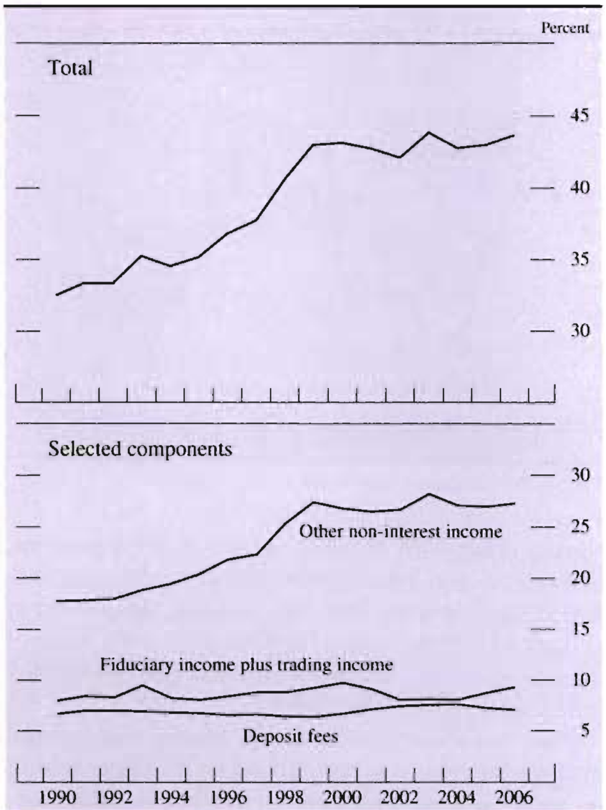
The downward pressure on banks' net interest margins last year was partially offset by higher returns on assets funded with non-interest-bearing liabilities and capital.[20] Because these instruments, by definition, have no explicit interest expense, the level of the return on bank assets, which rose significantly last year—rather than the spread between the average rates earned on assets and those paid on liabilities, which declined last year—helped to buoy banks' net interest margins. However, after holding about steady in 2005, the share of interest-earning assets funded by non-interest-bearing instruments declined somewhat last year because of a considerably smaller increase in non-interest-bearing savings deposits.

Non-interest Income and Expense

Non-interest income grew briskly in 2006—its 11 percent rise was the highest in 7 years. The share of total revenue accounted for by non-interest income climbed to almost 44 percent last year, the high end of its range this decade (figure 20). The rise in this share was nearly fully accounted for by a surge in trading revenue, which is highly concentrated at the ten

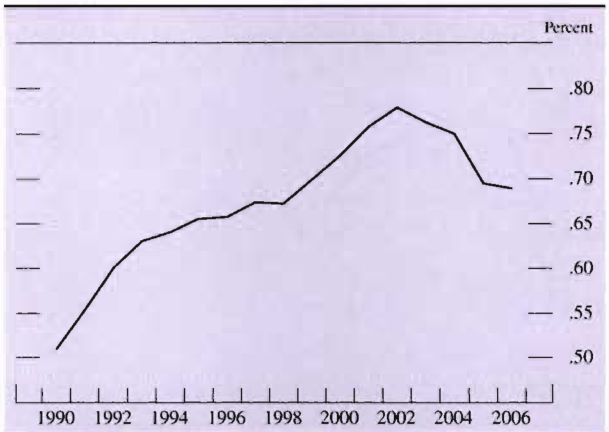
20. For more discussion, refer to box "The Role of Non-Interest-Bearing Instruments in the Net Interest Margin" in Mark Carlson and Roberto Perli (2004), "Profits and Balance Sheet Developments at U.S. Commercial Banks in 2003," *Federal Reserve Bulletin*, vol. 90 (Spring), p. 173.

20. Non-interest income and selected components as a proportion of revenue, 1990–2006



NOTE: The data are annual. Revenue is calculated as the sum of non-interest income and net interest income.

21. Deposit fee income as a proportion of total domestic deposits, 1990–2006



NOTE: The data are annual.

largest banks. Increases in equity- and foreign-exchange-related trading income drove the pickup in industry trading revenue. The rise in equity-related trading income coincided with broad gains in share prices last year. In addition, after notable growth in 2005, industry trading revenue associated with interest rate and commodity exposures rose further in 2006, perhaps because of banks' expanding derivatives activities. Although growth in both fiduciary and deposit fee income picked up relative to 2005, each declined slightly as a share of total revenue. Despite the higher growth in deposit fee income, it was again exceeded by the expansion in deposits, and the ratio of deposit fees to deposits moved down for the fourth straight year (figure 21).

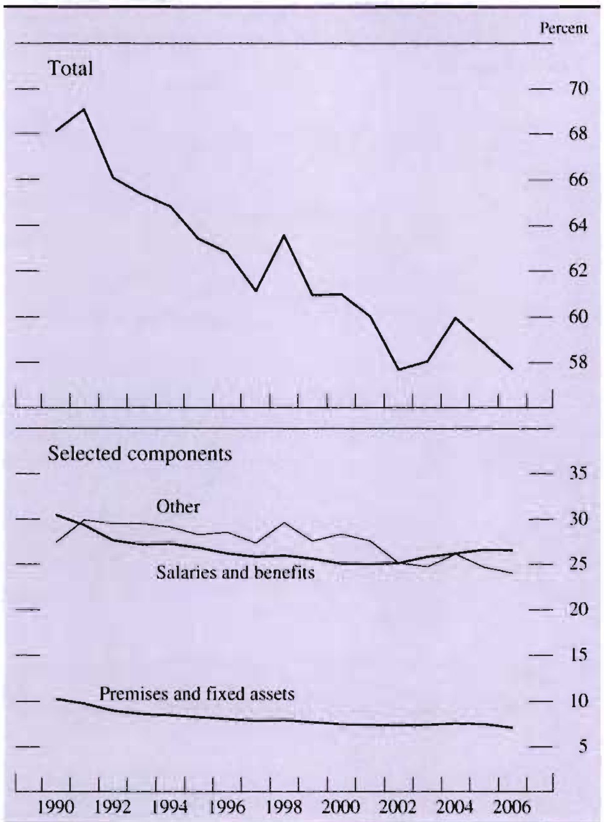
Taken together, the other components of non-interest income rose about in line with industry revenue last year. Income related to securitization and investment banking activity grew briskly. The considerable amount of merger and acquisition activity and relatively hefty volume of corporate bond issuance last year likely fueled, at least in part, the pickup in banks' income related to investment banking activity.

Although the rate of growth in non-interest expense in 2006 was somewhat higher than its historical average, non-interest expense as a share of total revenue moved lower, boosting banks' profitability (figure 22). Brisk growth in salaries and benefits costs accounted for most of last year's increase in non-interest expense, but the share of industry revenue accounted for by salaries and benefits held about steady after rising in each of the previous four years. The number of bank employees rose a bit faster than its average rate of the past several years, and pay per employee moved up. Expenses associated with banks' premises grew at a relatively slow rate, and they declined as a share of total revenue. Other components of non-interest income also grew at a slower pace than total revenue.

Loan Performance and Loss Provisioning

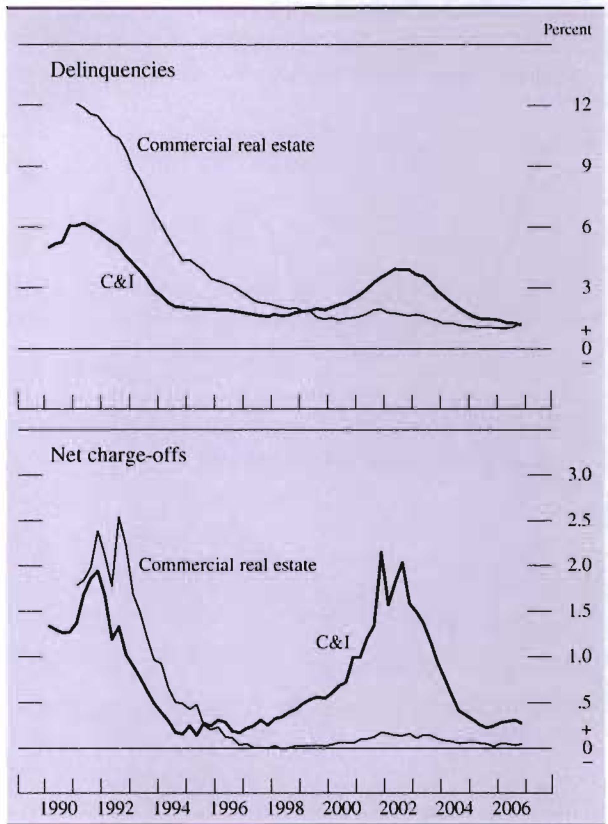
Overall credit quality generally remained solid last year, although delinquency rates for some loan categories may have bottomed out around the middle of last year. Delinquency rates on both residential and commercial real estate loans turned up noticeably in the second half of the year—especially in the fourth quarter—albeit from very low levels. By contrast, delinquency rates on C&I loans declined last year, and those on consumer loans moved up only a little. Charge-off rates on all loans and leases declined further, reaching their low point in the fourth quarter of the year. Meanwhile, banks provisioned for losses at a relatively low rate, although provisioning rose a bit late in the year. In the January 2007 BLPS, banks reported that they expected a deterioration in the quality of their loans to both businesses and households during the year, a judgment based on the

22. Non-interest expense and selected components as a proportion of revenue, 1990–2006



NOTE: The data are annual.

23. Delinquency and charge-off rates for loans to businesses, by type of loan, 1990–2006



NOTE: The data are quarterly and seasonally adjusted; the data for commercial real estate begin in 1991. Delinquent loans are loans that are not accruing interest and those that are accruing interest but are more than thirty days past due. The delinquency rate is the end-of-period level of delinquent loans divided by the end-of-period level of outstanding loans. The net charge-off rate is the annualized amount of charge-offs over the period, net of recoveries, divided by the average level of outstanding loans over the period. For the computation of these rates, commercial real estate loans exclude loans not secured by real estate (refer to table 1, note 2).

assumption that economic activity progresses in line with consensus forecasts. The net fraction of banks that anticipated deterioration this year was notably higher than in the year-earlier survey.

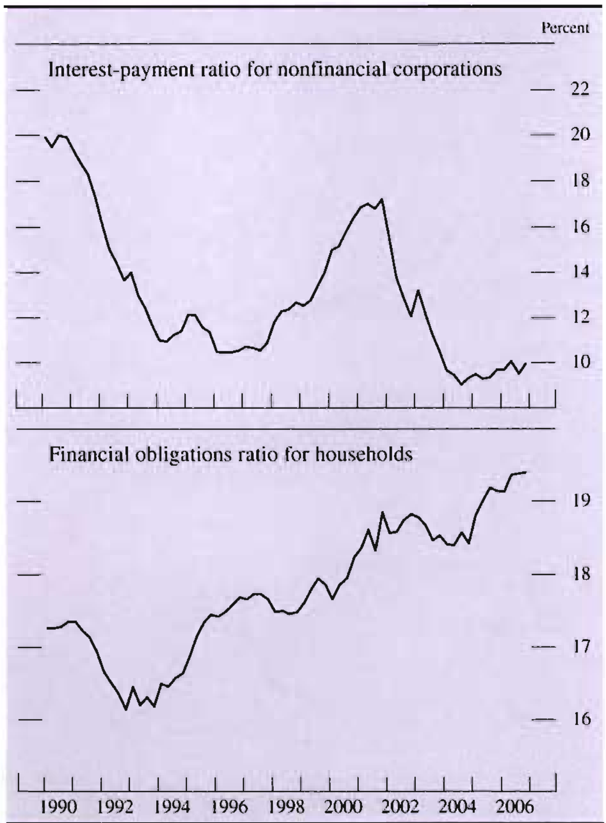
C&I Loans

The credit quality of banks' C&I loan portfolios improved further in 2006. The delinquency rate on C&I loans drifted lower for the fourth straight year and dropped below 1.2 percent in the fourth quarter, the lowest level in more than 15 years (figure 23). The decline was concentrated at the 100 largest banks, but the rest of the industry registered an improvement in C&I loan quality as well. The continued high credit quality of C&I loans likely reflected generally healthy corporate balance sheets—the interest-payment ratio for nonfinancial corporations remained quite modest last year (figure 24)—and a very low incidence of corporate default. Moreover, the rapid growth in C&I loans over the past two years may have temporarily reduced delinquency rates because loans are presumably less likely to become delinquent soon after they are extended. Although the net charge-off rate on C&I loans edged up a couple of basis points last year on a quarterly average basis, it remained exceptionally low.

Commercial Real Estate Loans

The credit quality of commercial real estate loans generally remained strong in 2006, although it appeared to deteriorate some in the second half of the year. As noted earlier, fundamentals in the sector continued to improve last year—commercial property values and rents rose, vacancy rates in both the office and industrial sectors continued to drift down, and the vacancy rate for retail buildings remained low. Accordingly, both delinquency and net charge-off rates on commercial real estate loans generally remained around historically low levels. Delinquency rates drifted lower during the first half of last year, but they rose noticeably over the second half at banks of all

24. Interest-payment ratio for businesses, and financial obligations ratio for households, 1990–2006



NOTE: The data are quarterly. The interest-payment ratio is calculated as interest payments as a percentage of cash flow. The financial obligations ratio is an estimate of debt payments and recurring obligations as a percentage of disposable personal income; debt payments and recurring obligations consist of required payments on outstanding mortgage debt, consumer debt, auto leases, rent, homeowner's insurance, and property taxes.

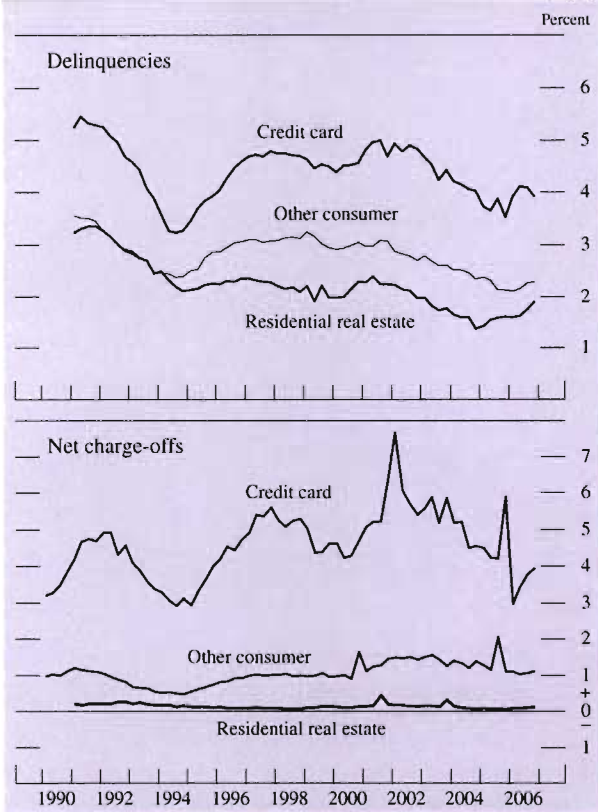
SOURCE: For interest-payment ratio, national income and product accounts and Federal Reserve Board; for financial obligations ratio, Federal Reserve Board (www.federalreserve.gov/releases/housedebt).

sizes. The upturn was concentrated in loans for construction and land development, a category of funding that includes loans to residential real estate developers. By contrast, net charge-offs on commercial real estate loans held about steady at a low level over the four quarters of last year. In credit markets, spreads on commercial-mortgage-backed securities widened a bit, on average, in 2006 but remained relatively narrow.

Loans to Households

Even though bank-intermediated household debt grew more slowly in 2006 than in 2005, household credit quality deteriorated somewhat on balance last year—higher interest rates increased households' debt service payments further and lifted their financial obligations ratio to an all-time high. After holding steady for several quarters, the delinquency rate on residential

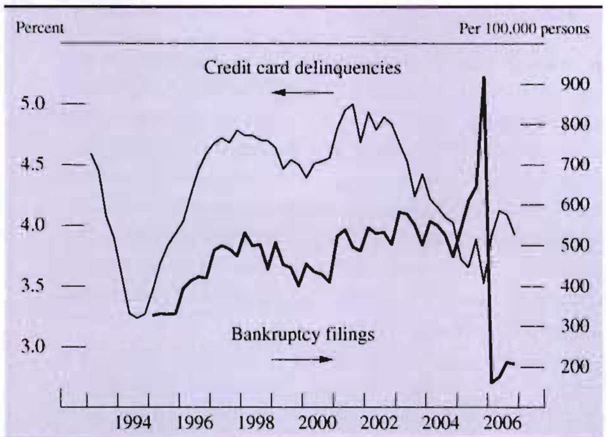
25. Delinquency and charge-off rates for loans to households, by type of loan, 1990–2006



NOTE: The data are quarterly and seasonally adjusted; data for delinquencies and for net charge-offs of residential real estate loans begin in 1991. For definitions of delinquencies and net charge-offs, refer to the note for figure 23.

real estate loans climbed in the second half of 2006, reaching 1.9 percent in the fourth quarter (figure 25). Although the fourth-quarter rate was a multiyear high, it was well below the rates seen in the early 1990s. The rise in delinquencies on residential real estate loans in the second half of last year was widespread: Delinquency rates rose for mortgages on one- to four-family residences and on revolving home equity loans, and they rose at banks of all sizes. Last year's increase may have been, at least in part, the result of higher variable-rate mortgage rates, on balance, and a slowing in home-price appreciation in the second half of the year, a combination of factors that likely put pressure on households with variable-rate mortgages. Indeed, broad measures of delinquency rates on variable-rate subprime mortgages moved up considerably last year. (For further discussion, refer to box "Credit Quality of Subprime Residential Mortgages.") Net charge-off rates on residential real estate loans edged higher in 2006 but remained at very low levels. Charge-off rates on one- to four-family residential mortgages ticked down over the first half of

26. Credit card delinquency rate and household bankruptcy filings, 1993–2006



NOTE: The data are quarterly and seasonally adjusted. The series shown for bankruptcy filings begins in 1995:Q1. For definition of delinquencies, refer to the note for figure 23.

SOURCE: For bankruptcy filings, staff calculations are based on data from Lundquist Consulting.

the year, but they increased over the second half when gains in homeowners' equity cooled.

The rate of household bankruptcy filings plunged in the wake of the bankruptcy reform law that took effect in October 2005, and a markedly lower rate of bankruptcy prevailed in 2006 (figure 26).[21] Nonetheless, the delinquency rate on credit card loans rose, on average, last year. The increase occurred in the first half of the year—credit card delinquencies receded in the second half but ended the year at 3.9 percent, somewhat above their year-earlier level. By contrast, the net charge-off rate on credit card loans on banks' books fell significantly last year relative to 2005, even after excluding the large fluctuation in charge-offs caused by the new bankruptcy law.[22] Last year's decline continued the downward trend in credit card charge-offs that has been evident, on balance, for the past few years.

Banks were queried about the effects of the bankruptcy reform legislation on their lending policies for credit card loans to individuals and households in the January 2007 BLPS survey. Nearly all domestic institutions indicated no change in their lending policies for these credit card loans in response to the bankruptcy reform; only two reported that they had tightened credit standards for approving credit card loan applications. In addition, about one-fourth stated that, after accounting for changes in their lending standards and terms, they anticipated that charge-offs on their credit card loans would be lower in the long term because of the reform.

In the April 2006 BLPS, banks were queried about their minimum required payment on credit card balances for individuals and households. One-third of respondents, on net, had increased their required minimum payment over the previous year.[23] Despite concerns raised by some industry commentators regarding the effects of higher minimum payments on defaults and loan losses, these increases do not appear to have had a significant effect on such measures.

The delinquency rate on other consumer loans edged lower, on average, in 2006, and charge-off rates on such loans stepped down significantly. On a quarterly basis, however, delinquency and charge-off rates on other consumer loans rose in the second half of last year; their levels at year-end were above those registered early in the year.

Securitized Loans

After declining in 2005, the delinquency rates on many types of securitized loans registered mixed changes last year but remained relatively low. Although the average delinquency rate on securitized residential mortgages was unchanged relative to 2005, it dipped markedly in the first quarter of 2006 and then increased steadily over the remainder of the year: At year-end 2006, this rate stood 50 basis points higher than its year-end 2005 level, but that was still below the year-end levels of the previous several years. For the third year in a row, the delinquency rate on securitized home equity loans moved up. By

21. For a discussion of the change in bankruptcy law that was implemented in 2005 and its effect on credit card loans, refer to box "The New Bankruptcy Law and Its Effect on Credit Card Loans" in Klee and Weinbach, "Profits and Balance Sheet Developments at U.S. Commercial Banks in 2005," p. A89.

22. The new bankruptcy law caused a surge in the rate of credit card charge-offs in the fourth quarter of 2005 that was followed by a relatively low rate in the first quarter of 2006 (figure 25). Excluding these values, the rate of credit card charge-offs averaged 4.3 percent in 2005 and 3.7 percent in 2006 (without excluding those values, charge-off rates averaged 4.7 percent and 3.5 percent respectively).

23. The increases in required minimum payments in 2006 may be related to guidance that was issued by federal banking regulators in January 2003 governing account management and loss allowance practices for credit card lending. The guidance outlined the supervisory agencies' expectations for prudent risk management, income recognition, and loss allowance practices and provided guidance for minimum payments and negative amortization. When the guidance was issued, it was recognized that some banks might require additional time to implement changes in policies, practices, and systems. Refer to the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (2003), "FFIEC Agencies Issue Guidance on Credit Card Account Management and Loss Allowance Practices," press release, January 8, www.federalreserve.gov/newsevents.htm.

Credit Quality of Subprime Residential Mortgages

Serious delinquency rates on residential mortgages—that is, the fraction of loans that are ninety days or more past due or are in foreclosure—have moved higher, on balance, since mid-2005. This rise is largely accounted for by a sharp increase in the delinquency rate on subprime residential mortgages (figure A).[1] By contrast, delinquency rates on prime residential mortgages, which make up the majority of outstanding residential loans, have remained fairly low and stable over this period. The deterioration in the subprime sector has been concentrated among borrowers whose mortgages have variable interest rates; serious delinquency rates on subprime fixed-rate mortgages have barely budged, on net (figure B). Amid slowing house-price appreciation and rising interest rates, one would expect residential mortgage defaults to rise because borrowers have slimmer equity cushions with which to buffer increases in their mortgage payments or other sources of financial stress. However, adjustable-rate subprime loans originated in 2006 have also been plagued by so-called "early payment defaults," in which the borrower defaults well before their mortgage payment resets.

In June 2007, the federal financial regulatory agencies issued a "Statement on Subprime Mortgage Lending" to address issues relating to certain adjustable-rate mortgage products that can cause payment shock.[2] The statement described the prudent safety and soundness and consumer protection practices that institutions should follow to ensure borrowers obtain loans that they can afford to repay. The safety and soundness practices included loan underwriting based on both principal and interest obligations at the fully indexed rate with a fully amortizing repayment schedule, plus a reasonable estimate for real estate taxes and insurance. The statement also cautioned about risk-layering features. The consumer protection practices included clear and balanced product disclosures to customers and limits on prepayment penalties that allow for a reasonable period of time for customers to refinance before the expiration of the initial fixed interest rate period without penalty.

Available evidence suggests that commercial bank exposure to troubled subprime mortgages is generally small. Delinquency rates on all residential mortgage loans on banks' books have risen a bit since mid-2005, but these rates have remained relatively low. Disaggregating these delinquency rates reveals that the increase in such rates has occurred at banks that held a fairly small portion of all residential mortgage loans (figure C). Banks that responded to the special questions in the July 2006 Senior Loan Officer Opinion Survey on Bank Lending Practices reported that their holdings of subprime mortgages were generally small—just 3 of the 56 banks surveyed indicated that their holdings of subprime mortgages accounted for more than 20 percent of all residential mortgages on their books at that time. And although the dollar amount of foreclosed residential properties on banks' books rose to $2.5 billion at the end of 2006, compared with a level of around $1.5 billion at the end of both 2005 and 2004, such assets accounted for less than 0.2 percent of all outstanding residential real estate loans.[3] Finally, banks may be exposed to subprime mortgages through their holdings of mortgage-backed securities, but these holdings are largely backed by the U.S. government or by government-sponsored enterprises.

The credit quality of residential mortgages is significantly lower in some areas of the U.S. than in the nation

1. The subprime category of residential mortgages typically includes loans made to borrowers who had one or more of the following characteristics at the time the loans were originated: weakened credit histories that include payment delinquencies, charge-offs, judgments, or bankruptcies; reduced repayment capacity as measured by credit scores or debt-to-income ratios; or incomplete credit histories. The prime category of residential mortgages includes loans made to borrowers who typically had relatively strong, well-documented credit histories; relatively high credit scores; and relatively low debt-to-income ratios at the time the loans were originated.

2. For more information, refer to the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision (2007), "Federal Financial Regulatory Agencies Issue Final Statement on Subprime Mortgage Lending," press release, June 29, www.federalreserve.gov/boarddocs/press/bcreg/2007/.

3. These figures are based on the sum of two components of other real estate owned reported on the Call Reports: "1–4 family residential properties in domestic offices" and "foreclosed properties from 'GNMA (Government National Mortgage Association) loans.'" Excluding the GNMA item, which was added to the Call Reports in March 2006, the total for year-end 2006 was $1.7 billion, up from an average of $1.5 billion at year-end for both 2005 and 2004.

contrast, the delinquency rate on securitized credit card receivables continued its multiyear decline in 2006, although the decrease was much smaller than in previous years.

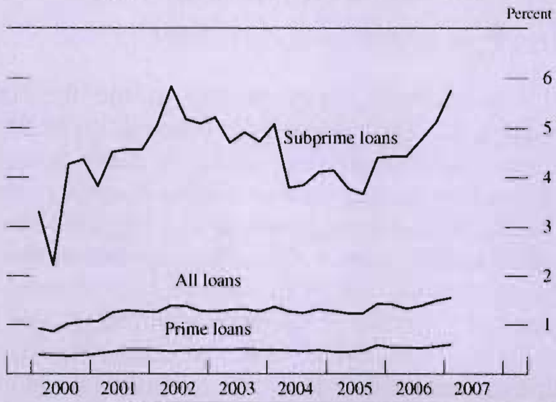
Loss Provisioning

With credit quality generally remaining strong in 2006, banks continued to provision for loan losses at about the same average rate as in 2005.[24] Measured as a share of average net consolidated assets or as a proportion of total revenue, banks' provisioning for loan and lease losses declined a couple of basis points

24. Banks boosted their provisioning in the third and fourth quarters of 2005 because of the surge in personal bankruptcies associated with the bankruptcy reform law that took effect in October 2005 and the effects of Hurricanes Katrina and Rita.

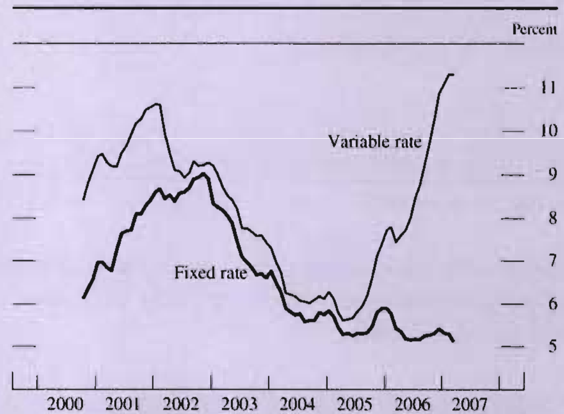
as a whole. According to the Mortgage Bankers Association, the share of residential loans of all types in foreclosure in the first quarter of 2007 was highest in Ohio, Indiana, and Michigan—states that have been particularly hard-hit by recent troubles in the auto industry. Foreclosures were also relatively high in Louisiana and in Mississippi early this year, states where losses related to Hurricanes Katrina and Rita have been significant. Banks that experienced losses in 2006 were not particularly concentrated in these states, but the average return on assets of banks located in these states was lower than that for the industry as a whole last year.

A. Rate of serious delinquency on residential mortgages, by loan category, 2000–07



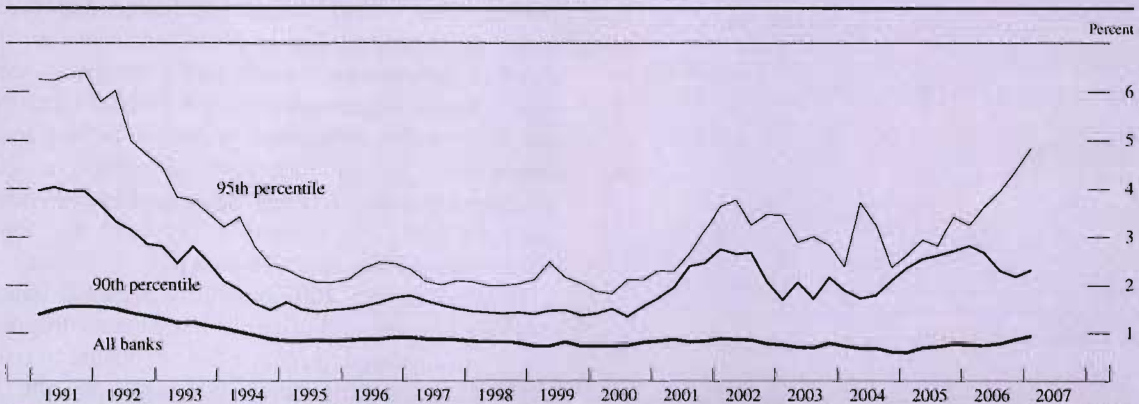
NOTE: The data are quarterly and extend through 2007:Q1. Seriously delinquent loans are ninety days or more past due or in foreclosure. The prime category contains some near-prime loans.
SOURCE: Mortgage Bankers Association, National Delinquency Survey.

B. Rate of serious delinquency on subprime residential mortgages, by type of interest rate, 2000–07



NOTE: The data are monthly and extend through March 2007. Seriously delinquent loans are ninety days or more past due or in foreclosure.
SOURCE: First American LoanPerformance.

C. Rate of serious delinquency on residential real estate loans, 1991–2007

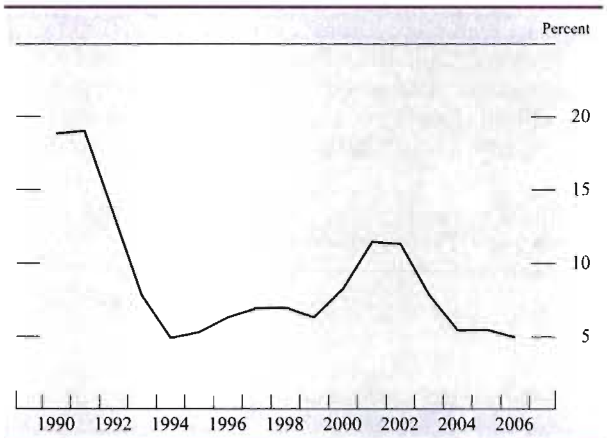


NOTE: The data are quarterly and extend through 2007:Q1. Delinquency rates are for loans ninety days or more past due or non-accrual. The 90th and 95th percentiles are weighted by residential real estate loan portfolios.

last year (figure 27). By either measure, the rate of provisioning continued to be in the low end of the range seen over the past two decades. On a quarterly basis, banks' provisioning was moderately higher in the fourth quarter of last year relative to the first three quarters, a reflection of a rise in provisioning by the ten largest banks and by small banks. Although banks that specialize in credit card loans provisioned less as a share of average assets last year than in 2005, their provisioning rose significantly in the fourth quarter.

Provisioning outpaced charge-offs in 2006, so that loan-loss reserves increased in dollar terms, but the ratio of loss reserves to total loans and leases declined further (figure 28). However, the ratio of reserves to delinquent loans remained near the high end of its range of the past two decades. Reserves as a share of

27. Provisions for loan and lease losses as a proportion of total revenue, 1990–2006



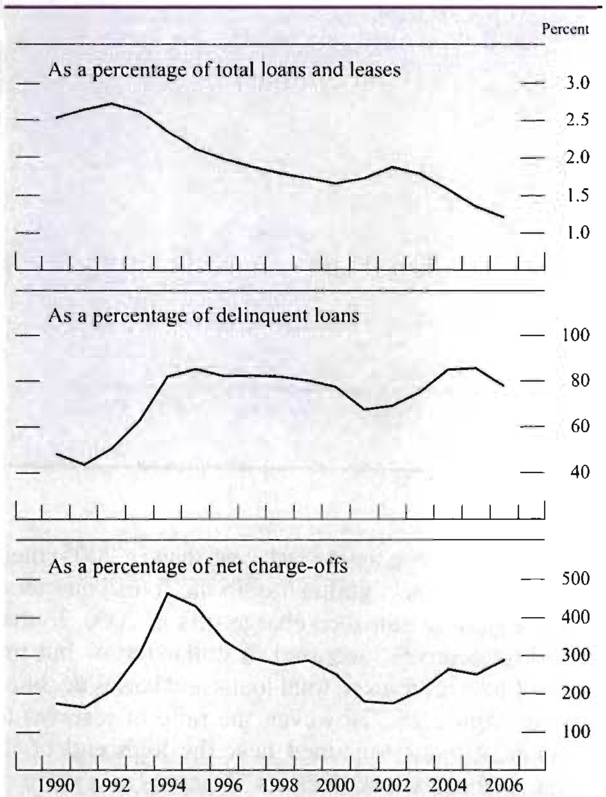
NOTE: The data are annual.

net charge-offs increased in 2006—as it has in three out of the past four years—and stood near its highest level of the past decade.

International Operations of U.S. Commercial Banks

The share of assets of U.S. banks booked in foreign offices increased 115 basis points, to 12.9 percent, in

28. Reserves for loan and lease losses, 1990–2006



NOTE: The data are annual. For definitions of delinquencies and net charge-offs, refer to the note for figure 23.

2006. Rapid growth in banks' lending and derivatives activities with Asian economies lifted U.S. institutions' total exposure to such countries as a share of tier 1 capital to nearly 35 percent (table 3).[25] By this measure, banks' exposure to China tripled over the past three years, but it remained below their exposure to India and well below that to Korea. Banks' exposure to Latin American and Caribbean economies surged in terms of dollars, but it edged down as a share of tier 1 capital.

Developments in Early 2007

U.S. economic activity slowed in the first three months of 2007. Growth in business expenditures stepped down somewhat relative to 2006—spending on fixed investment accelerated, but inventory investment slowed. Although merger and acquisition activity reportedly stayed elevated, corporate profits remained strong, and firms reduced their demand for external financing. Consumer spending picked up, and job growth continued at a solid pace through the first quarter of 2007. However, the financial condition of some households deteriorated as terms reset on variable-rate subprime mortgages and house prices leveled out. Readings on core inflation ticked up in the first two months of the year before coming back down in March. Measures of inflation expectations posted small mixed changes—inflation expectations based on Treasury inflation-protected securities rose a bit, but longer-term survey-based measures edged lower. Against this backdrop, the Federal Open Market Committee maintained its target for the federal funds rate at its first two meetings in 2007. Intermediate-term interest rates declined somewhat over the first three months of the year, and longer-term interest rates held about steady, on balance.

In late February 2007, volatility in global financial markets jumped, and prices of risky assets dropped as investors appeared to reduce their exposure to risk. In particular, concerns about conditions in the U.S. subprime residential mortgage market and possible spillover to the broader economy grew as delinquency rates on such mortgages climbed and potentially high exposures to troubled subprime mortgages surfaced at some financial entities. By the end of the first quarter, measures of implied volatility in Treasury markets and the volatility of the S&P 500 index had retreated somewhat but remained higher than earlier in the year.

Data from the Federal Reserve show that growth of domestic banks' assets stepped down a bit in the first

25. Exposures consist of lending and derivatives exposures for cross-border and local office operations.

3. Exposure of U.S. banks to selected economies at year-end relative to tier 1 capital, 1997–2006

Percent

Year	Asia				Latin America and the Caribbean			Eastern Europe	Total exposure to developing economies
	All	China	India	Korea	All	Mexico	Brazil		
1997	25.4	1.0	1.5	7.4	29.7	5.5	9.7	3.5	77.9
1998	28.2	1.0	2.4	7.1	42.9	9.9	11.3	3.5	100.1
1999	26.1	.8	2.4	6.6	39.0	9.5	10.5	2.9	90.7
2000	24.0	.8	2.6	6.4	37.9	9.1	11.2	4.4	87.9
2001	22.4	.9	2.6	5.8	54.1	26.0	3.0	4.3	100.3
2002	21.9	.9	2.7	5.8	38.9	20.8	8.4	5.5	84.8
2003	22.8	1.3	3.9	5.5	32.9	18.0	6.8	5.4	79.8
2004	32.2	1.4	4.2	15.0	31.8	16.7	6.5	6.1	89.2
2005	30.7	2.4	4.9	12.9	31.8	17.4	6.9	5.9	86.4
2006	34.7	4.1	6.1	13.6	30.8	16.9	5.7	6.5	92.6
MEMO									
Total exposure (billions of dollars)									
1997	87.1	3.5	5.1	25.3	101.7	18.8	33.4	11.9	267.1
1998	69.1	2.3	5.4	17.3	104.7	24.2	27.6	8.5	244.7
1999	67.9	2.0	6.2	17.2	101.6	24.8	27.3	7.4	236.4
2000	68.0	2.2	7.5	18.1	107.3	25.7	31.6	12.3	249.1
2001	67.2	2.7	7.7	17.5	162.4	78.0	39.0	12.9	301.4
2002	69.5	2.7	8.7	18.4	123.5	66.2	26.6	17.6	269.4
2003	79.9	4.4	13.6	19.2	115.2	63.0	23.7	19.1	280.1
2004	125.8	5.3	16.3	58.7	124.4	65.2	25.5	23.8	348.9
2005	134.8	10.4	21.6	56.7	139.7	76.1	30.4	25.7	378.8
2006	190.5	22.7	33.6	74.8	168.9	92.5	31.5	35.5	508.2

NOTE: Exposures consist of lending and derivatives exposures for cross-border and local office operations. Respondents may file information on one bank or on the bank holding company as a whole. For the definition of tier 1 capital, see text note 12.

The year-end 2006 data cover 66 banks with a total of $549.0 billion in tier 1 capital.

SOURCE: Federal Financial Institutions Examination Council (2007), Statistical Release E.16, "Country Exposure Lending Survey" (March 30), www.ffiec.gov/E16.htm.

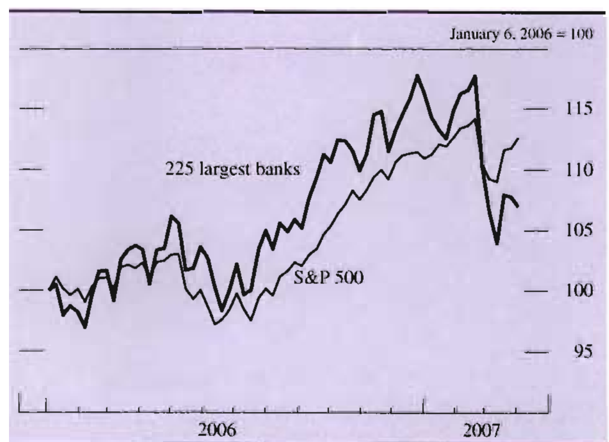
quarter of 2007 relative to 2006.[26] As businesses sought less external financing, C&I loan growth slowed at banks of all sizes. Aside from a sizable bank-to-thrift conversion in the first quarter, loans secured by real estate continued to expand at around the same pace as in 2006. By contrast, loans to consumers picked up a bit, consistent with the rise in consumer spending. With steady growth in core deposits in the first quarter of 2007 and the lower growth in assets, the expansion of managed liabilities dropped back.

Although the tone of first-quarter earnings reports of major bank holding companies was mixed, industry profitability generally appeared to have held up in early 2007. Several banks reported that their profitability was supported by continued strong noninterest income, such as from trading activities. Net interest income rose at some institutions; others indicated that their margins remained under pressure. Decreased demand for new mortgages and write-offs of servicing income on existing mortgages weighed on the profitability of several institutions. Credit quality reportedly generally stayed solid, but some banks noted increased losses in their mortgage portfolios.

26. Board of Governors of the Federal Reserve System, Statistical Release H.8, "Assets and Liabilities of Commercial Banks in the United States" (www.federalreserve.gov/releases/h8). The H.8 includes only domestic assets.

Despite banks' generally strong balance sheets and continued profitability in the first quarter of 2007, an index of the stock prices of the 225 largest banks underperformed the S&P 500 index over the period (figure 29). Investors apparently became concerned about possible implications of the troubles in the subprime mortgage sector for banks' earnings. The bank stock index dropped about 10 percent in late February and early March—about twice as much as the broader market—but some of this decline later reversed in March. Credit default swap premiums on

29. Bank stock prices, by market value of bank, and the S&P 500, 2006–07



NOTE: The data are weekly and extend through March 2007. Stock prices are weighted by market value.

SOURCE: Standard & Poor's and *American Banker*.

banks' subordinated debt moved higher for a time in late February; these premiums subsequently retreated some but remained above their year-end 2006 levels at the end of March. Bank mergers in the first quarter of 2007 occurred at about the same pace as in the first quarter of 2006. □

Appendix tables start on page A61

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006

A. All banks

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	87.15	86.76	87.03	87.13	86.49	86.42	86.08	86.90	86.82	86.85
Loans and leases (net)	58.72	58.33	59.34	60.48	58.95	57.83	56.88	56.98	57.88	58.26
Commercial and industrial	15.77	16.36	17.07	17.16	16.08	14.07	12.18	11.06	11.17	11.43
U.S. addressees	13.17	13.61	14.43	14.67	13.69	12.04	10.48	9.52	9.64	9.73
Foreign addressees	2.60	2.75	2.64	2.49	2.39	2.04	1.70	1.54	1.53	1.70
Consumer	11.50	10.41	9.71	9.38	9.23	9.35	9.06	9.18	9.12	8.53
Credit card	4.62	4.02	3.51	3.52	3.63	3.78	3.55	3.86	4.05	3.73
Installment and other	6.88	6.39	6.20	5.87	5.60	5.57	5.51	5.31	5.06	4.80
Real estate	25.00	24.85	25.44	27.04	27.10	28.39	29.91	30.78	32.40	33.19
In domestic offices	24.39	24.28	24.87	26.49	26.60	27.91	29.45	30.24	31.84	32.61
Construction and land development	1.73	1.86	2.18	2.51	2.85	2.98	2.99	3.26	3.90	4.73
Farmland	.55	.55	.56	.56	.55	.56	.54	.54	.54	.53
One- to four-family residential	14.41	14.25	14.10	14.96	14.67	15.40	16.96	17.42	18.26	18.23
Home equity	1.94	1.89	1.76	1.96	2.18	2.80	3.40	4.34	4.95	4.71
Other	12.47	12.37	12.34	13.00	12.49	12.60	13.57	13.08	13.31	13.52
Multifamily residential	.83	.82	.88	.99	.97	1.02	1.05	1.06	1.08	1.06
Nonfarm nonresidential	6.88	6.80	7.15	7.48	7.56	7.95	7.91	7.97	8.06	8.07
In foreign offices	.61	.57	.57	.54	.50	.48	.46	.53	.56	.58
To depository institutions and acceptances of other banks	1.93	1.91	1.96	1.87	1.83	1.87	1.98	2.11	1.73	1.65
Foreign governments	.18	.15	.16	.12	.10	.09	.08	.08	.06	.04
Agricultural production	.90	.89	.83	.78	.75	.70	.63	.59	.56	.55
Other loans	2.80	2.78	2.75	2.58	2.34	2.06	2.00	2.35	2.09	2.19
Lease-financing receivables	1.87	2.12	2.51	2.63	2.58	2.44	2.11	1.79	1.58	1.43
LESS: Unearned income on loans	−.09	−.07	−.06	−.05	−.04	−.05	−.04	−.04	−.03	−.03
LESS: Loss reserves[1]	−1.13	−1.07	−1.04	−1.02	−1.04	−1.11	−1.04	−.91	−.79	−.71
Securities	20.40	20.37	20.40	20.02	19.53	21.27	21.90	22.57	22.04	21.32
Investment account	17.23	17.48	18.33	17.59	16.82	18.30	18.97	18.99	17.87	16.89
Debt	16.74	16.93	17.73	16.93	16.48	17.99	18.72	18.79	17.71	16.73
U.S. Treasury	3.38	2.71	2.14	1.66	.85	.78	.90	.89	.62	.47
U.S. government agency and corporation obligations	9.73	10.28	10.85	10.31	10.08	11.46	12.26	12.37	11.51	10.65
Government-backed mortgage pools	4.93	5.16	5.24	4.75	5.13	6.09	6.75	7.13	6.78	6.43
Collateralized mortgage obligations	1.93	2.12	2.15	1.92	1.95	2.35	2.34	2.01	1.80	1.58
Other	2.86	2.99	3.46	3.63	2.99	3.02	3.17	3.22	2.93	2.65
State and local government	1.59	1.57	1.62	1.52	1.49	1.49	1.48	1.41	1.36	1.34
Private mortgage-backed securities	.50	.67	.88	.95	1.09	1.25	1.30	1.41	1.76	1.87
Other	1.54	1.70	2.24	2.48	2.98	3.01	2.78	2.72	2.47	2.39
Equity	.50	.55	.61	.66	.34	.31	.25	.20	.16	.16
Trading account	3.16	2.90	2.06	2.43	2.72	2.97	2.93	3.59	4.17	4.43
Gross federal funds sold and reverse RPs	5.18	5.37	4.61	4.12	5.11	4.81	4.85	4.58	4.75	5.29
Interest-bearing balances at depositories	2.86	2.69	2.68	2.52	2.90	2.52	2.45	2.76	2.15	1.97
Non-interest-earning assets	12.85	13.24	12.97	12.87	13.51	13.58	13.92	13.10	13.18	13.15
Revaluation gains held in trading accounts	2.59	2.95	2.57	2.28	2.37	2.42	2.70	2.19	1.82	1.64
Other	10.26	10.29	10.41	10.58	11.15	11.16	11.22	10.91	11.36	11.51
Liabilities	91.57	91.51	91.52	91.58	91.25	90.85	90.96	90.57	89.91	89.84
Core deposits	50.89	49.43	48.60	46.52	47.07	48.98	49.18	48.56	47.52	45.57
Transaction deposits	15.76	14.10	12.58	11.07	10.36	10.06	9.73	9.10	8.46	7.45
Demand deposits	12.15	10.99	9.78	8.61	8.00	7.67	7.26	6.58	6.16	5.41
Other checkable deposits	3.61	3.11	2.81	2.46	2.36	2.39	2.47	2.52	2.30	2.04
Savings deposits (including MMDAs)	19.76	20.87	22.47	22.43	24.53	28.13	30.12	31.19	30.83	29.50
Small time deposits	15.37	14.46	13.55	13.01	12.18	10.80	9.33	8.27	8.23	8.61
Managed liabilities[2]	34.13	34.97	36.59	38.83	37.42	35.05	34.61	35.69	36.25	38.28
Large time deposits	7.25	7.67	7.89	8.77	8.89	8.30	8.09	8.00	9.11	10.08
Deposits booked in foreign offices	10.48	10.59	10.96	11.43	10.66	9.42	9.38	10.25	10.39	11.18
Subordinated notes and debentures	1.15	1.30	1.36	1.37	1.43	1.40	1.33	1.30	1.34	1.40
Gross federal funds purchased and RPs	8.13	7.98	7.97	7.83	7.95	7.77	7.75	7.24	7.05	7.52
Other managed liabilities	7.13	7.43	8.40	9.44	8.49	8.16	8.06	8.91	8.37	8.11
Revaluation losses held in trading accounts	2.64	2.97	2.52	2.29	2.21	2.09	2.30	1.95	1.67	1.51
Other	3.91	4.14	3.81	3.94	4.54	4.73	4.87	4.36	4.47	4.47
Capital account	8.43	8.49	8.48	8.42	8.75	9.15	9.04	9.43	10.09	10.16
MEMO										
Commercial real estate loans[3]	9.98	10.11	10.87	11.58	12.09	12.57	12.47	12.78	13.52	14.35
Other real estate owned[4]	.11	.08	.06	.05	.05	.06	.06	.06	.04	.05
Mortgage-backed securities	7.37	7.96	8.27	7.63	8.17	9.69	10.39	10.56	10.33	9.88
Federal Home Loan Bank advances	n.a.	n.a.	n.a.	n.a.	2.89	3.17	3.19	3.07	3.04	3.07
Average net consolidated assets (billions of dollars)	4,737	5,148	5,439	5,907	6,334	6,635	7,249	7,879	8,592	9,425

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006—*Continued*

A. All banks—*Continued*

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Effective interest rate (percent)[5]									
Rates earned										
Interest-earning assets	8.17	8.01	7.71	8.20	7.37	6.10	5.29	5.09	5.71	6.64
Taxable equivalent	8.23	8.07	7.76	8.26	7.42	6.15	5.34	5.13	5.75	6.68
Loans and leases, gross	9.03	8.85	8.47	9.00	8.15	6.89	6.15	5.91	6.52	7.54
Net of loss provisions	8.50	8.30	7.97	8.33	7.15	5.84	5.47	5.47	6.10	7.18
Securities	6.54	6.45	6.27	6.47	6.04	4.95	3.96	3.86	4.18	4.71
Taxable equivalent	6.73	6.63	6.46	6.65	6.22	5.10	4.10	3.99	4.30	4.83
Investment account	6.50	6.38	6.25	6.45	6.05	5.04	4.00	3.96	4.29	4.85
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	5.76	4.42	3.29	3.11	3.46	4.19
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	6.45	5.44	4.24	4.38	4.60	5.08
Other	n.a.	n.a.	n.a.	n.a.	5.60	4.74	4.08	3.76	4.23	4.80
Trading account	6.75	6.85	6.47	6.63	6.01	4.38	3.71	3.35	3.72	4.16
Gross federal funds sold and reverse RPs	5.45	5.29	4.78	5.56	3.86	1.93	1.40	1.40	2.66	4.31
Interest-bearing balances at depositories	6.23	6.32	5.95	6.48	4.01	2.79	2.09	1.98	3.70	5.09
Rates paid										
Interest-bearing liabilities	4.92	4.88	4.47	5.17	4.15	2.54	1.87	1.77	2.69	3.90
Interest-bearing deposits	4.39	4.31	3.87	4.45	3.61	2.11	1.47	1.36	2.06	3.04
In foreign offices	5.44	5.66	4.91	5.61	3.95	2.38	1.62	1.72	2.77	3.92
In domestic offices	4.16	4.01	3.63	4.17	3.54	2.06	1.44	1.29	1.91	2.85
Other checkable deposits	2.25	2.29	2.08	2.34	1.96	1.06	.75	.77	1.41	1.88
Savings deposits (including MMDAs)	2.93	2.79	2.49	2.86	2.19	1.13	.74	.72	1.24	2.01
Large time deposits[6]	5.45	5.22	4.92	5.78	5.04	3.38	2.59	2.35	3.19	4.38
Other time deposits[6]	5.54	5.48	5.09	5.69	5.43	3.70	2.88	2.56	3.14	4.10
Gross federal funds purchased and RPs	5.17	5.19	4.73	5.77	3.84	1.88	1.30	1.49	3.07	4.57
Other interest-bearing liabilities	6.94	6.89	6.48	6.97	5.92	4.32	3.59	3.26	4.50	6.19
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	7.15	6.98	6.73	7.18	6.38	5.27	4.54	4.44	4.98	5.84
Taxable equivalent	7.21	7.03	6.78	7.22	6.43	5.31	4.58	4.48	5.02	5.88
Loans	5.41	5.27	5.12	5.53	4.92	4.06	3.56	3.42	3.82	4.47
Securities	1.11	1.10	1.14	1.15	1.00	.89	.74	.74	.77	.84
Gross federal funds sold and reverse RPs	.29	.29	.23	.23	.20	.09	.07	.07	.13	.23
Other	.35	.32	.24	.27	.27	.22	.18	.21	.26	.31
Gross interest expense	3.48	3.46	3.22	3.76	2.98	1.79	1.30	1.25	1.89	2.79
Deposits	2.48	2.43	2.20	2.56	2.09	1.23	.86	.81	1.23	1.84
Gross federal funds purchased and RPs	.43	.43	.39	.45	.31	.15	.10	.11	.22	.36
Other	.57	.60	.63	.75	.58	.41	.33	.33	.44	.59
Net interest income	3.68	3.52	3.52	3.41	3.40	3.48	3.24	3.19	3.09	3.05
Taxable equivalent	3.73	3.57	3.56	3.46	3.45	3.52	3.28	3.23	3.12	3.08
Loss provisions[7]	.41	.42	.39	.50	.68	.68	.45	.30	.30	.27
Non-interest income	2.23	2.41	2.66	2.59	2.54	2.54	2.54	2.39	2.33	2.37
Service charges on deposits	.39	.38	.40	.40	.42	.45	.44	.42	.39	.38
Fiduciary activities	.35	.37	.38	.38	.35	.32	.31	.32	.31	.30
Trading revenue	.17	.15	.19	.21	.20	.16	.16	.13	.17	.20
Interest rate exposures	.08	.05	.07	.08	.09	.08	.07	.03	.05	.05
Foreign exchange rate exposures	.08	.09	.09	.08	.07	.07	.07	.07	.07	.08
Other commodity and equity exposures	*	.01	.03	.04	.03	.01	.02	.03	.04	.07
Other	1.32	1.50	1.69	1.61	1.57	1.61	1.63	1.51	1.46	1.48
Non-interest expense	3.61	3.77	3.76	3.66	3.57	3.47	3.36	3.34	3.19	3.13
Salaries, wages, and employee benefits	1.53	1.55	1.58	1.51	1.49	1.51	1.50	1.46	1.44	1.44
Occupancy	.47	.47	.48	.45	.44	.44	.43	.42	.41	.39
Other	1.62	1.76	1.70	1.70	1.64	1.52	1.43	1.46	1.34	1.30
Net non-interest expense	1.38	1.36	1.11	1.07	1.03	.93	.82	.96	.86	.76
Gains on investment account securities	.04	.06	*	−.04	.07	.10	.08	.04	*	−.01
Income before taxes and extraordinary items	1.92	1.81	2.02	1.81	1.77	1.96	2.05	1.97	1.93	2.01
Taxes	.68	.62	.72	.63	.59	.65	.67	.64	.62	.65
Extraordinary items, net of income taxes	*	.01	*	*	−.01	*	.01	*	*	.03
Net income	1.25	1.20	1.31	1.18	1.17	1.31	1.39	1.33	1.31	1.39
Cash dividends declared	.90	.80	.96	.89	.87	1.01	1.07	.76	.75	.87
Retained income	.35	.40	.35	.29	.31	.30	.31	.58	.56	.52
MEMO: Return on equity	14.84	14.07	15.39	13.97	13.40	14.36	15.35	14.14	12.99	13.67

NOTE: Data are as of April 13, 2007.

1. Includes allocated transfer risk reserve.

2. Measured as the sum of large time deposits in domestic offices, deposits booked in foreign offices, subordinated notes and debentures, federal funds purchased and securities sold under repurchase agreements, Federal Home Loan Bank advances, and other borrowed money.

3. Measured as the sum of construction and land development loans secured by real estate; real estate loans secured by nonfarm nonresidential properties or by multifamily residential properties; and loans to finance commercial real estate, construction, and land development activities not secured by real estate.

4. Other real estate owned is a component of other non–interest–earning assets.

5. When possible, based on the average of quarterly balance sheet data reported on schedule RC–K of the quarterly Call Report.

6. Before 1997, large time deposit open accounts were included in other time deposits.

7. Includes provisions for allocated transfer risk.

* In absolute value, less than 0.005 percent.

n.a. Not available.

MMDA Money market deposit account.

RP Repurchase agreement.

MBS Mortgage–backed securities.

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006

B. Ten largest banks by assets

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	81.84	81.25	81.49	82.23	81.74	81.68	81.39	83.54	83.96	84.67
Loans and leases (net)	50.91	50.76	53.37	55.22	53.86	53.61	52.20	51.29	51.35	52.04
Commercial and industrial	16.90	18.07	19.20	19.87	18.82	16.16	12.98	10.54	10.61	11.18
U.S. addressees	10.24	11.76	13.14	13.95	13.42	11.69	9.40	7.49	7.74	8.07
Foreign addressees	6.66	6.31	6.06	5.92	5.41	4.47	3.59	3.06	2.87	3.11
Consumer	6.40	6.04	5.94	5.43	6.17	7.82	7.96	8.49	8.80	8.23
Credit card	1.34	1.30	1.36	1.34	1.64	2.90	2.81	3.19	3.60	3.11
Installment and other	5.06	4.74	4.58	4.09	4.53	4.92	5.15	5.30	5.21	5.12
Real estate	17.42	16.51	16.96	19.82	19.23	20.78	22.68	23.21	24.55	25.48
In domestic offices	15.69	15.08	15.55	18.48	18.05	19.70	21.74	22.21	23.52	24.47
Construction and land development	.68	.77	.90	.98	1.27	1.42	1.36	1.40	1.70	2.01
Farmland	.09	.09	.10	.11	.11	.12	.10	.10	.10	.10
One- to four-family residential	11.02	10.33	10.77	13.37	12.41	13.51	16.03	16.71	17.73	18.28
Home equity	1.70	1.72	1.54	1.61	1.78	2.35	2.96	4.04	5.22	5.40
Other	9.31	8.61	9.22	11.76	10.63	11.17	13.07	12.67	12.52	12.88
Multifamily residential	.39	.38	.43	.60	.51	.55	.47	.45	.44	.44
Nonfarm nonresidential	3.52	3.51	3.35	3.42	3.76	4.09	3.78	3.55	3.55	3.64
In foreign offices	1.73	1.43	1.41	1.34	1.18	1.08	.94	1.00	1.03	1.01
To depository institutions and acceptances of other banks	4.20	4.05	4.34	3.78	3.23	3.20	3.54	4.10	3.15	2.97
Foreign governments	.45	.35	.38	.28	.20	.20	.17	.16	.12	.07
Agricultural production	.31	.28	.26	.23	.28	.23	.19	.22	.20	.20
Other loans	4.15	3.74	3.96	3.75	3.51	2.94	2.87	3.32	2.81	2.88
Lease-financing receivables	2.24	2.81	3.40	3.07	3.43	3.44	2.87	2.08	1.78	1.60
LESS: Unearned income on loans	−.07	−.06	−.05	−.04	−.04	−.08	−.06	−.04	−.04	−.02
LESS: Loss reserves[1]	−1.08	−1.01	−1.03	−.97	−.97	−1.12	−1.02	−.80	−.65	−.56
Securities	20.00	19.72	18.34	18.98	17.81	20.54	21.22	22.95	23.37	23.04
Investment account	10.97	12.12	13.08	13.71	12.14	14.35	15.31	15.99	15.58	15.11
Debt	10.55	11.64	12.57	13.03	11.88	14.13	15.11	15.83	15.44	14.96
U.S. Treasury	1.56	1.70	1.98	1.96	.68	.59	.82	.86	.56	.43
U.S. government agency and corporation obligations	5.34	6.31	6.35	6.59	6.84	8.69	9.20	9.92	9.69	9.47
Government-backed mortgage pools	4.26	5.13	5.03	4.88	4.99	6.38	7.59	8.64	8.65	8.63
Collateralized mortgage obligations	.93	.93	.79	.93	1.11	1.52	.91	.70	.54	.52
Other	.15	.26	.52	.78	.74	.79	.70	.58	.50	.32
State and local government	.51	.47	.45	.51	.55	.59	.59	.57	.58	.64
Private mortgage-backed securities	.32	.60	.57	.51	.58	.92	1.10	.96	1.18	1.06
Other	2.81	2.57	3.22	3.47	3.22	3.34	3.40	3.52	3.43	3.37
Equity	.42	.47	.51	.68	.26	.22	.20	.16	.14	.15
Trading account	9.03	7.60	5.25	5.26	5.67	6.18	5.91	6.96	7.79	7.93
Gross federal funds sold and reverse RPs	7.56	7.81	6.64	5.02	6.38	5.26	5.79	6.37	6.96	7.60
Interest-bearing balances at depositories	3.37	2.96	3.14	3.01	3.69	2.28	2.18	2.93	2.28	1.99
Non-interest-earning assets	18.16	18.75	18.51	17.77	18.26	18.32	18.61	16.46	16.04	15.33
Revaluation gains held in trading accounts	7.36	7.62	6.66	5.66	5.48	5.40	5.79	4.45	3.50	3.07
Other	10.80	11.13	11.85	12.11	12.78	12.93	12.83	12.01	12.54	12.27
Liabilities	92.61	92.58	92.28	92.36	92.14	91.52	91.94	91.64	90.81	91.07
Core deposits	31.66	32.94	33.76	33.28	36.38	40.61	41.07	42.02	40.18	37.99
Transaction deposits	10.19	9.45	8.55	8.01	8.40	8.34	7.74	6.65	6.05	5.40
Demand deposits	8.98	8.46	7.83	7.28	7.50	7.40	6.72	5.43	4.90	4.31
Other checkable deposits	1.21	.99	.72	.74	.90	.95	1.02	1.22	1.15	1.09
Savings deposits (including MMDAs)	15.32	17.07	18.94	19.24	22.21	26.82	28.99	31.54	30.11	28.08
Small time deposits	6.15	6.42	6.26	6.03	5.77	5.44	4.34	3.83	4.02	4.51
Managed liabilities[2]	46.02	44.42	45.49	46.84	43.41	38.89	38.60	39.33	40.83	43.77
Large time deposits	4.17	5.04	5.19	5.55	5.46	5.13	5.53	5.21	6.28	6.84
Deposits booked in foreign offices	23.39	21.23	22.22	22.76	20.28	17.31	16.62	17.20	17.51	18.48
Subordinated notes and debentures	1.80	1.89	1.98	2.10	2.16	2.11	1.92	1.78	1.89	1.99
Gross federal funds purchased and RPs	10.26	9.78	8.84	8.89	9.04	8.83	8.62	7.79	8.39	9.51
Other managed liabilities	6.40	6.49	7.27	7.55	6.47	5.53	5.90	7.35	6.76	6.94
Revaluation losses held in trading accounts	7.53	7.67	6.51	5.69	5.10	4.63	4.88	3.95	3.21	2.83
Other	7.39	7.55	6.52	6.55	7.26	7.39	7.40	6.34	6.60	6.47
Capital account	7.39	7.42	7.72	7.64	7.86	8.48	8.06	8.36	9.19	8.93
MEMO										
Commercial real estate loans[3]	5.45	5.61	5.69	5.87	6.68	6.92	6.31	5.99	6.33	6.73
Other real estate owned[4]	.13	.09	.06	.04	.04	.03	.03	.03	.02	.03
Mortgage-backed securities	5.52	6.65	6.40	6.32	6.68	8.82	9.60	10.30	10.36	10.21
Federal Home Loan Bank advances	n.a.	n.a.	n.a.	n.a.	.82	.82	.84	.79	.63	.75
Average net consolidated assets (billions of dollars)	1,514	1,820	1,935	2,234	2,527	2,785	3,148	3,654	4,232	4,765

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006—*Continued*

B. Ten largest banks by assets—*Continued*

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Effective interest rate (percent)[5]									
Rates earned										
Interest-earning assets	7.57	7.55	7.37	7.76	6.83	5.82	4.99	4.71	5.29	6.25
Taxable equivalent	7.60	7.57	7.39	7.78	6.86	5.85	5.01	4.73	5.31	6.27
Loans and leases, gross	8.25	8.21	7.99	8.46	7.50	6.52	5.76	5.52	6.15	7.26
Net of loss provisions	8.10	7.77	7.65	7.92	6.55	5.30	5.19	5.29	5.84	6.94
Securities	6.78	6.83	6.58	6.48	6.23	5.04	4.15	4.04	4.27	4.67
Taxable equivalent	6.85	6.89	6.65	6.55	6.31	5.11	4.21	4.10	4.32	4.72
Investment account	6.76	6.78	6.59	6.40	6.23	5.30	4.26	4.37	4.63	5.08
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	5.01	3.74	2.62	2.92	3.29	4.15
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	6.42	5.55	4.51	4.83	4.92	5.27
Other	n.a.	n.a.	n.a.	n.a.	6.34	5.30	4.28	3.76	4.26	4.77
Trading account	6.81	6.92	6.56	6.70	6.24	4.46	3.87	3.32	3.57	3.89
Gross federal funds sold and reverse RPs	5.45	5.20	4.52	4.93	3.86	2.20	1.60	1.43	2.46	4.06
Interest-bearing balances at depositories	6.91	7.16	7.22	7.43	3.73	3.40	2.49	1.80	4.06	5.59
Rates paid										
Interest-bearing liabilities	5.41	5.29	4.79	5.37	4.09	2.54	1.85	1.80	2.82	4.10
Interest-bearing deposits	4.54	4.40	3.82	4.40	3.27	1.94	1.34	1.29	2.01	2.96
In foreign offices	5.52	5.83	4.99	5.67	4.02	2.59	1.74	1.81	2.77	3.88
In domestic offices	3.69	3.39	3.04	3.51	2.84	1.67	1.18	1.08	1.70	2.55
Other checkable deposits	1.97	1.67	1.44	1.61	1.67	.93	.80	.97	2.27	2.46
Savings deposits (including MMDAs)	2.68	2.45	2.11	2.43	1.92	1.02	.73	.71	1.15	1.87
Large time deposits[6]	5.17	4.53	4.36	5.32	4.40	3.26	2.36	2.14	3.06	4.31
Other time deposits[6]	5.45	5.21	4.95	5.53	5.11	3.44	2.70	2.61	3.40	4.05
Gross federal funds purchased and RPs	5.02	5.18	4.53	5.47	3.81	2.02	1.39	1.59	3.11	4.62
Other interest-bearing liabilities	9.13	8.85	8.61	8.15	7.01	5.40	4.27	3.69	5.25	7.46
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	6.31	6.21	6.01	6.39	5.55	4.77	4.05	3.94	4.47	5.39
Taxable equivalent	6.33	6.22	6.03	6.41	5.57	4.79	4.07	3.96	4.48	5.41
Loans	4.31	4.27	4.35	4.74	4.13	3.57	3.04	2.86	3.19	3.85
Securities	.73	.81	.85	.88	.72	.73	.63	.69	.72	.79
Gross federal funds sold and reverse RPs	.45	.42	.30	.25	.25	.12	.10	.10	.18	.31
Other	.82	.70	.51	.51	.44	.35	.28	.30	.38	.45
Gross interest expense	3.55	3.48	3.16	3.60	2.69	1.65	1.19	1.20	1.89	2.86
Deposits	2.26	2.20	1.97	2.33	1.74	1.05	.74	.74	1.17	1.72
Gross federal funds purchased and RPs	.54	.54	.40	.49	.35	.18	.13	.13	.27	.47
Other	.75	.74	.79	.78	.59	.41	.33	.33	.45	.67
Net interest income	2.76	2.73	2.84	2.78	2.87	3.12	2.86	2.74	2.58	2.54
Taxable equivalent	2.79	2.75	2.86	2.80	2.89	3.14	2.88	2.76	2.59	2.56
Loss provisions[7]	.16	.31	.26	.38	.59	.73	.35	.16	.20	.21
Non-interest income	2.12	2.15	2.55	2.54	2.26	2.31	2.32	2.21	2.37	2.24
Service charges on deposits	.32	.33	.37	.40	.44	.48	.46	.45	.42	.41
Fiduciary activities	.34	.32	.31	.27	.29	.25	.26	.24	.27	.23
Trading revenue	.43	.33	.46	.48	.43	.32	.30	.23	.31	.36
Interest rate exposures	.23	.10	.17	.20	.20	.15	.12	.07	.11	.09
Foreign exchange rate exposures	.20	.20	.19	.18	.14	.14	.14	.12	.12	.14
Other commodity and equity exposures	*	.03	.09	.11	.08	.03	.04	.04	.07	.13
Other	1.04	1.17	1.41	1.39	1.10	1.26	1.30	1.28	1.38	1.24
Non-interest expense	3.24	3.47	3.45	3.31	3.13	3.16	3.02	3.11	2.99	2.80
Salaries, wages, and employee benefits	1.45	1.45	1.57	1.46	1.38	1.41	1.39	1.34	1.38	1.39
Occupancy	.47	.47	.50	.47	.45	.46	.45	.43	.43	.40
Other	1.33	1.54	1.38	1.39	1.30	1.28	1.18	1.33	1.19	1.01
Net non-interest expense	1.12	1.32	.90	.77	.87	.85	.70	.91	.62	.56
Gains on investment account securities	.08	.11	.03	−.03	.08	.13	.11	.07	*	−.01
Income before taxes and extraordinary items	1.56	1.22	1.71	1.60	1.48	1.67	1.92	1.74	1.75	1.76
Taxes	.58	.44	.66	.60	.49	.56	.63	.56	.57	.57
Extraordinary items, net of income taxes	*	*	*	*	−.01	*	*	*	*	.02
Net income	.98	.78	1.05	1.00	.99	1.11	1.29	1.18	1.18	1.21
Cash dividends declared	.82	.53	.79	.86	.66	1.05	.99	.65	.59	.63
Retained income	.15	.25	.26	.13	.32	.06	.30	.53	.59	.58
MEMO: Return on equity	13.22	10.53	13.58	13.04	12.55	13.14	16.06	14.07	12.86	13.58

NOTE: Data are as of April 13, 2007.

1. Includes allocated transfer risk reserve.

2. Measured as the sum of large time deposits in domestic offices, deposits booked in foreign offices, subordinated notes and debentures, federal funds purchased and securities sold under repurchase agreements, Federal Home Loan Bank advances, and other borrowed money.

3. Measured as the sum of construction and land development loans secured by real estate; real estate loans secured by nonfarm nonresidential properties or by multifamily residential properties; and loans to finance commercial real estate, construction, and land development activities not secured by real estate.

4. Other real estate owned is a component of other non-interest-earning assets.

5. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Report.

6. Before 1997, large time deposit open accounts were included in other time deposits.

7. Includes provisions for allocated transfer risk.

* In absolute value, less than 0.005 percent.

n.a. Not available.

MMDA Money market deposit account.

RP Repurchase agreement.

MBS Mortgage-backed securities.

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006

C. Banks ranked 11 through 100 by assets

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	87.50	87.85	88.40	88.67	88.09	88.34	88.10	88.18	87.87	87.05
Loans and leases (net)	63.89	64.37	64.22	64.88	62.14	60.00	59.48	60.63	63.37	62.80
Commercial and industrial	19.01	18.92	19.40	18.19	15.84	13.27	11.96	11.90	12.18	12.16
U.S. addressees	17.78	17.59	18.18	17.64	15.36	12.94	11.66	11.64	11.91	11.84
Foreign addressees	1.22	1.33	1.22	.55	.48	.33	.30	.26	.27	.32
Consumer	15.62	14.52	13.57	13.79	13.20	12.79	12.57	12.73	12.84	11.83
Credit card	8.50	7.67	6.78	6.97	6.97	6.56	6.35	6.90	7.44	7.00
Installment and other	7.12	6.86	6.79	6.82	6.23	6.22	6.21	5.83	5.39	4.84
Real estate	22.99	24.59	24.80	26.21	27.29	28.94	30.67	32.16	34.89	35.36
In domestic offices	22.85	24.42	24.62	26.12	27.21	28.88	30.54	31.97	34.73	35.15
Construction and land development	1.69	2.03	2.43	3.00	3.31	3.36	3.22	3.51	4.21	5.31
Farmland	.14	.17	.19	.22	.23	.22	.20	.19	.19	.17
One- to four-family residential	13.88	14.86	14.15	14.51	15.51	17.05	18.79	19.52	21.05	20.32
Home equity	2.22	2.17	2.08	2.49	2.90	3.92	4.74	5.90	6.04	5.02
Other	11.65	12.69	12.07	12.02	12.60	13.13	14.05	13.62	15.01	15.30
Multifamily residential	.93	1.00	1.02	1.11	1.16	1.20	1.32	1.34	1.45	1.46
Nonfarm nonresidential	6.21	6.36	6.82	7.28	6.99	7.05	7.00	7.41	7.83	7.89
In foreign offices	.15	.18	.19	.09	.09	.06	.13	.20	.16	.21
To depository institutions and acceptances of other banks	1.30	1.09	.93	1.05	1.40	1.44	1.21	.54	.56	.44
Foreign governments	.09	.06	.06	.03	.03	.02	.02	.01	.02	.01
Agricultural production	.29	.33	.33	.37	.32	.27	.23	.19	.19	.18
Other loans	3.18	3.35	2.99	2.57	2.03	1.80	1.59	1.87	1.62	1.87
Lease-financing receivables	2.70	2.71	3.27	3.82	3.18	2.65	2.35	2.30	2.07	1.83
LESS: Unearned income on loans	−.05	−.04	−.04	−.03	−.02	−.02	−.02	−.02	−.01	−.01
LESS: Loss reserves[1]	−1.24	−1.16	−1.11	−1.12	−1.13	−1.17	−1.10	−1.06	−.97	−.87
Securities	15.80	16.66	17.79	17.32	19.00	20.30	21.16	21.28	19.96	19.19
Investment account	15.07	16.13	17.28	16.10	17.71	19.17	20.09	20.12	18.80	17.69
Debt	14.58	15.58	16.64	15.50	17.32	18.82	19.88	19.96	18.69	17.56
U.S. Treasury	2.81	2.25	1.70	1.12	.67	.74	.95	.89	.60	.44
U.S. government agency and corporation obligations	8.98	9.93	10.57	9.70	10.09	11.45	12.99	12.80	11.62	10.08
Government-backed mortgage pools	5.17	4.98	5.12	4.31	5.19	6.00	6.08	5.74	4.83	4.05
Collateralized mortgage obligations	2.13	2.83	2.89	2.55	2.42	2.79	3.72	3.42	3.39	2.93
Other	1.68	2.12	2.56	2.84	2.48	2.65	3.19	3.64	3.40	3.10
State and local government	.88	.92	.99	.96	.99	.97	.95	.96	.98	1.01
Private mortgage-backed securities	.73	.96	1.35	1.66	2.01	2.13	2.14	2.65	3.58	4.28
Other	1.18	1.53	2.02	2.06	3.56	3.53	2.85	2.66	1.90	1.75
Equity	.49	.55	.65	.60	.39	.34	.21	.16	.11	.12
Trading account	.73	.54	.51	1.22	1.29	1.13	1.07	1.16	1.16	1.51
Gross federal funds sold and reverse RPs	4.38	3.57	3.34	3.76	4.06	4.71	4.20	2.98	2.30	2.86
Interest-bearing balances at depositories	3.43	3.24	3.06	2.71	2.88	3.33	3.26	3.29	2.24	2.20
Non-interest-earning assets	12.50	12.15	11.60	11.33	11.91	11.66	11.90	11.82	12.13	12.95
Revaluation gains held in trading account	.69	.75	.56	.40	.55	.47	.60	.42	.33	.30
Other	11.81	11.40	11.04	10.92	11.37	11.19	11.30	11.40	11.80	12.65
Liabilities	91.85	91.63	91.66	91.57	91.15	90.79	90.65	89.87	88.86	88.12
Core deposits	51.51	49.89	48.35	46.28	46.28	47.07	47.93	46.55	48.18	46.98
Transaction deposits	16.12	14.15	12.12	9.93	8.37	7.49	7.29	7.06	6.64	5.75
Demand deposits	14.17	12.39	10.52	8.61	7.17	6.32	5.96	5.65	5.35	4.55
Other checkable deposits	1.95	1.75	1.60	1.32	1.20	1.17	1.33	1.41	1.29	1.21
Savings deposits (including MMDAs)	21.71	22.51	23.90	24.02	26.62	30.07	32.34	31.75	33.33	32.75
Small time deposits	13.69	13.24	12.32	12.33	11.28	9.51	8.30	7.74	8.21	8.47
Managed liabilities[2]	36.60	38.11	39.83	41.98	40.81	39.48	38.12	39.29	37.05	37.54
Large time deposits	7.37	7.83	8.17	9.54	9.72	8.99	8.20	8.76	10.10	11.47
Deposits booked in foreign offices	8.08	8.37	8.19	7.56	7.05	6.28	6.54	7.21	6.02	6.44
Subordinated notes and debentures	1.48	1.66	1.71	1.54	1.53	1.44	1.38	1.39	1.31	1.33
Gross federal funds purchased and RPs	9.36	9.48	9.77	9.28	9.71	9.66	9.69	8.95	7.17	6.71
Other managed liabilities	10.31	10.77	11.99	14.07	12.79	13.11	12.30	12.97	12.44	11.58
Revaluation losses held in trading accounts	.68	.76	.58	.41	.52	.44	.56	.40	.34	.30
Other	3.05	2.87	2.90	2.91	3.54	3.80	4.05	3.64	3.30	3.31
Capital account	8.15	8.37	8.34	8.43	8.85	9.21	9.35	10.13	11.14	11.88
MEMO										
Commercial real estate loans[3]	9.44	10.11	11.00	12.06	12.06	12.24	12.10	12.85	13.93	15.13
Other real estate owned[4]	.06	.04	.03	.03	.04	.05	.06	.05	.04	.05
Mortgage-backed securities	8.03	8.76	9.36	8.52	9.63	10.93	11.93	11.81	11.81	11.26
Federal Home Loan Bank advances	n.a.	n.a.	n.a.	n.a.	4.07	4.85	4.75	4.65	5.19	5.56
Average net consolidated assets (billions of dollars)	1,604	1,745	1,881	2,031	2,130	2,124	2,287	2,376	2,403	2,575

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006—*Continued*

C. Banks ranked 11 through 100 by assets—*Continued*

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Effective interest rate (percent)[5]									
Rates earned										
Interest-earning assets	8.33	8.12	7.84	8.44	7.54	6.03	5.30	5.26	6.05	7.06
Taxable equivalent	8.36	8.16	7.88	8.48	7.58	6.07	5.33	5.29	6.08	7.09
Loans and leases, gross	9.03	8.81	8.50	9.14	8.26	6.80	6.11	5.98	6.63	7.72
Net of loss provisions	8.27	8.14	7.80	8.25	6.96	5.59	5.11	5.19	5.91	7.17
Securities	6.55	6.31	6.32	6.64	5.96	4.79	3.80	3.63	4.18	5.05
Taxable equivalent	6.70	6.46	6.46	6.77	6.08	4.91	3.90	3.73	4.29	5.16
Investment account	6.57	6.33	6.34	6.66	6.04	4.86	3.87	3.64	4.11	4.90
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	5.83	4.28	3.17	2.94	3.47	4.29
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	6.60	5.34	4.20	4.02	4.34	5.02
Other	n.a.	n.a.	n.a.	n.a.	5.13	4.22	3.61	3.29	4.06	5.18
Trading account	6.05	5.86	5.58	6.25	4.83	3.59	2.56	3.39	5.30	6.86
Gross federal funds sold and reverse RPs	5.45	5.46	5.12	6.06	3.86	1.68	1.14	1.25	3.24	4.98
Interest-bearing balances at depositories	5.76	5.67	4.81	5.49	4.38	2.46	1.93	2.27	3.20	4.21
Rates paid										
Interest-bearing liabilities	4.79	4.77	4.38	5.22	4.16	2.41	1.80	1.71	2.68	3.88
Interest-bearing deposits	4.22	4.15	3.76	4.42	3.60	1.96	1.35	1.29	2.03	3.07
In foreign offices	5.23	5.22	4.70	5.38	3.67	1.70	1.23	1.42	2.76	4.10
In domestic offices	4.04	3.96	3.60	4.26	3.60	1.99	1.36	1.27	1.95	2.95
Other checkable deposits	2.01	2.41	2.03	2.57	2.32	.94	.64	.72	1.29	2.11
Savings deposits (including MMDAs)	2.84	2.76	2.49	2.94	2.30	1.08	.66	.65	1.30	2.14
Large time deposits[6]	5.47	5.32	4.96	5.88	5.11	3.37	2.70	2.49	3.31	4.46
Other time deposits[6]	5.43	5.35	5.03	5.73	5.42	3.68	2.95	2.58	3.03	4.09
Gross federal funds purchased and RPs	5.29	5.22	4.87	6.02	3.86	1.73	1.20	1.37	3.04	4.48
Other interest-bearing liabilities	5.85	5.81	5.41	6.36	5.30	3.54	3.02	2.76	3.87	5.17
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	7.26	7.15	6.98	7.54	6.70	5.31	4.67	4.67	5.34	6.20
Taxable equivalent	7.30	7.19	7.02	7.57	6.73	5.34	4.70	4.70	5.37	6.23
Loans	5.87	5.78	5.56	6.05	5.28	4.15	3.72	3.72	4.27	4.96
Securities	.98	1.00	1.10	1.09	1.06	.90	.75	.73	.77	.88
Gross federal funds sold and reverse RPs	.22	.19	.18	.22	.15	.08	.04	.03	.06	.14
Other	.19	.18	.14	.18	.21	.18	.15	.19	.22	.23
Gross interest expense	3.41	3.45	3.26	3.96	3.14	1.77	1.30	1.26	1.94	2.82
Deposits	2.23	2.23	2.02	2.41	2.01	1.09	.77	.74	1.18	1.85
Gross federal funds purchased and RPs	.51	.51	.51	.56	.38	.17	.12	.13	.23	.30
Other	.68	.71	.74	.99	.75	.51	.41	.40	.53	.67
Net interest income	3.85	3.70	3.72	3.58	3.56	3.54	3.37	3.41	3.40	3.38
Taxable equivalent	3.89	3.73	3.75	3.61	3.59	3.57	3.40	3.44	3.43	3.41
Loss provisions[7]	.60	.53	.55	.68	.91	.80	.67	.55	.52	.42
Non-interest income	2.76	3.09	3.36	3.18	3.35	3.30	3.29	3.05	2.75	3.13
Service charges on deposits	.44	.42	.41	.42	.42	.42	.42	.40	.37	.35
Fiduciary activities	.44	.49	.48	.52	.42	.42	.37	.42	.35	.41
Trading revenue	.08	.09	.08	.07	.08	.08	.09	.07	.06	.07
Interest rate exposures	.02	.03	.02	.02	.04	.04	.04	−.01	−.01	.02
Foreign exchange rate exposures	.05	.06	.05	.04	.03	.04	.04	.05	.04	.05
Other commodity and equity exposures	*	*	*	*	*	*	.01	.03	.02	*
Other	1.79	2.09	2.39	2.18	2.43	2.37	2.41	2.16	1.98	2.30
Non-interest expense	3.85	4.05	4.12	4.00	3.95	3.73	3.64	3.55	3.36	3.51
Salaries, wages, and employee benefits	1.51	1.53	1.53	1.44	1.47	1.49	1.47	1.45	1.37	1.34
Occupancy	.46	.46	.45	.43	.42	.40	.41	.39	.37	.33
Other	1.88	2.06	2.14	2.14	2.07	1.84	1.76	1.70	1.62	1.83
Net non-interest expense	1.10	.95	.76	.82	.60	.43	.35	.50	.61	.38
Gains on investment account securities	.02	.03	−.01	−.05	.09	.10	.06	.03	*	−.03
Income before taxes and extraordinary items	2.18	2.24	2.40	2.02	2.14	2.41	2.42	2.39	2.27	2.56
Taxes	.77	.78	.86	.70	.74	.82	.82	.82	.77	.87
Extraordinary items, net of income taxes	*	*	*	*	*	*	*	*	.01	.07
Net income	1.42	1.45	1.54	1.32	1.39	1.59	1.59	1.57	1.50	1.76
Cash dividends declared	.93	.96	1.16	.94	.96	.99	1.05	.95	1.00	1.38
Retained income	.48	.49	.38	.38	.43	.60	.54	.62	.50	.38
MEMO: Return on equity	17.36	17.37	18.46	15.72	15.74	17.24	17.03	15.54	13.48	14.80

NOTE: Data are as of April 13, 2007.

1. Includes allocated transfer risk reserve.

2. Measured as the sum of large time deposits in domestic offices, deposits booked in foreign offices, subordinated notes and debentures, federal funds purchased and securities sold under repurchase agreements, Federal Home Loan Bank advances, and other borrowed money.

3. Measured as the sum of construction and land development loans secured by real estate; real estate loans secured by nonfarm nonresidential properties or by multifamily residential properties; and loans to finance commercial real estate, construction, and land development activities not secured by real estate.

4. Other real estate owned is a component of other non-interest-earning assets.

5. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Report.

6. Before 1997, large time deposit open accounts were included in other time deposits.

7. Includes provisions for allocated transfer risk.

* In absolute value, less than 0.005 percent.

n.a. Not available.

MMDA Money market deposit account.

RP Repurchase agreement.

MBS Mortgage-backed securities.

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006

D. Banks ranked 101 through 1,000 by assets

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	91.34	91.38	91.68	91.50	91.16	91.36	91.34	91.56	91.32	91.06
Loans and leases (net)	62.34	61.23	61.48	62.15	62.46	61.46	61.32	63.33	65.15	67.05
Commercial and industrial	12.38	12.45	12.64	12.95	13.03	12.38	11.51	11.52	11.78	11.69
U.S. addressees	12.14	12.12	12.32	12.60	12.65	12.06	11.20	11.21	11.48	11.45
Foreign addressees	.23	.32	.32	.36	.38	.31	.31	.31	.30	.23
Consumer	14.36	12.56	10.79	10.19	9.76	8.13	6.79	6.33	5.42	5.50
Credit card	5.87	4.78	3.37	3.27	3.61	2.63	1.82	1.91	1.24	1.63
Installment and other	8.49	7.78	7.41	6.92	6.15	5.50	4.97	4.42	4.18	3.87
Real estate	33.10	33.83	35.90	36.93	37.64	38.92	40.96	43.38	45.86	47.88
In domestic offices	33.08	33.81	35.87	36.91	37.62	38.89	40.91	43.32	45.78	47.78
Construction and land development	2.68	2.87	3.48	4.15	4.90	5.40	5.89	7.01	8.86	10.99
Farmland	.52	.56	.58	.65	.66	.73	.80	.91	.99	1.07
One- to four-family residential	18.08	18.14	18.26	17.17	16.18	15.39	15.71	15.33	15.17	14.75
Home equity	2.29	2.14	1.99	2.10	2.21	2.51	2.92	3.46	3.60	3.24
Other	15.78	16.00	16.26	15.06	13.97	12.88	12.79	11.87	11.57	11.51
Multifamily residential	1.28	1.25	1.44	1.58	1.69	1.83	2.00	2.24	2.37	2.32
Nonfarm nonresidential	10.52	10.99	12.12	13.36	14.18	15.55	16.51	17.82	18.39	18.64
In foreign offices	.02	.02	.02	.02	.02	.03	.05	.06	.08	.10
To depository institutions and acceptances of other banks	.59	.52	.46	.37	.38	.37	.37	.25	.13	.14
Foreign governments	.02	.03	.03	.03	.03	.02	.02	.01	*	*
Agricultural production	.73	.80	.78	.82	.85	.86	.83	.82	.81	.85
Other loans	1.47	1.30	1.25	1.22	1.22	1.18	1.25	1.32	1.36	1.20
Lease-financing receivables	.99	.99	.78	.75	.74	.75	.67	.75	.75	.75
LESS: Unearned income on loans	–.10	–.09	–.08	–.08	–.07	–.06	–.06	–.06	–.06	–.06
LESS: Loss reserves[1]	–1.19	–1.15	–1.06	–1.04	–1.12	–1.10	–1.02	–.98	–.90	–.88
Securities	23.37	24.18	25.17	24.34	22.81	23.86	24.36	23.59	21.57	19.65
Investment account	23.26	24.08	25.09	24.25	22.70	23.80	24.23	23.54	21.50	19.57
Debt	22.65	23.39	24.33	23.46	22.28	23.30	23.79	23.18	21.21	19.30
U.S. Treasury	4.94	3.91	2.53	1.81	1.32	1.22	1.00	1.02	.83	.60
U.S. government agency and corporation obligations	13.91	15.08	16.29	15.56	14.70	15.85	16.96	16.70	15.05	13.61
Government-backed mortgage pools	6.20	6.45	6.72	6.22	6.27	6.55	7.03	6.80	5.73	4.84
Collateralized mortgage obligations	3.00	3.21	3.52	3.04	3.08	3.69	3.69	3.41	3.16	2.85
Other	4.71	5.42	6.05	6.30	5.35	5.60	6.24	6.49	6.16	5.92
State and local government	2.43	2.69	2.91	2.91	2.90	2.89	2.95	2.92	2.78	2.75
Private mortgage-backed securities	.59	.65	1.00	.99	.94	.99	.87	1.08	1.17	1.10
Other	.78	1.06	1.60	2.19	2.42	2.34	2.01	1.46	1.37	1.24
Equity	.61	.69	.77	.79	.43	.50	.43	.36	.29	.27
Trading account	.10	.11	.08	.09	.11	.06	.14	.05	.08	.07
Gross federal funds sold and reverse RPs	3.59	4.16	3.35	3.40	4.20	4.15	3.85	2.95	2.83	2.69
Interest-bearing balances at depositories	2.05	1.80	1.68	1.60	1.68	1.89	1.81	1.69	1.76	1.68
Non-interest-earning assets	8.66	8.62	8.32	8.50	8.84	8.64	8.66	8.44	8.68	8.94
Revaluation gains held in trading accounts	*	*	.01	.02	.01	.01	*	*	*	.03
Other	8.66	8.62	8.31	8.49	8.84	8.64	8.66	8.44	8.68	8.91
Liabilities	90.78	90.55	90.90	90.95	90.32	89.93	89.69	89.18	89.10	89.00
Core deposits	64.06	63.87	62.48	60.80	60.33	61.26	61.31	60.40	59.03	58.03
Transaction deposits	18.05	16.08	13.94	12.29	11.48	11.37	11.50	11.77	11.15	9.83
Demand deposits	13.11	11.87	10.19	8.97	8.23	8.05	7.96	8.13	7.87	7.01
Other checkable deposits	4.94	4.22	3.75	3.32	3.25	3.32	3.54	3.64	3.28	2.83
Savings deposits (including MMDAs)	23.97	26.43	28.55	28.55	29.40	32.34	34.00	34.42	33.75	32.81
Small time deposits	22.05	21.36	19.99	19.96	19.46	17.55	15.81	14.20	14.13	15.39
Managed liabilities[2]	24.89	24.65	26.33	28.01	27.75	26.57	26.40	26.98	28.38	29.32
Large time deposits	9.68	10.09	10.30	11.98	12.60	12.17	11.92	12.12	13.64	15.23
Deposits booked in foreign offices	1.23	1.31	1.20	1.28	1.24	.88	.64	.65	.57	.52
Subordinated notes and debentures	.33	.37	.35	.30	.31	.34	.35	.35	.27	.24
Gross federal funds purchased and RPs	7.06	6.15	6.90	6.30	5.77	5.27	5.35	5.52	5.54	5.40
Other managed liabilities	6.59	6.73	7.57	8.15	7.84	7.90	8.13	8.34	8.35	7.92
Revaluation losses held in trading accounts	.01	.01	.01	*	.01	.01	*	*	*	.01
Other	1.82	2.02	2.10	2.13	2.23	2.08	1.98	1.81	1.69	1.64
Capital account	9.22	9.45	9.10	9.05	9.68	10.07	10.31	10.82	10.90	11.00
MEMO										
Commercial real estate loans[3]	14.72	15.33	17.28	19.32	21.03	23.05	24.62	27.28	29.84	32.21
Other real estate owned[4]	.11	.09	.08	.07	.08	.10	.11	.10	.08	.08
Mortgage-backed securities	9.79	10.30	11.24	10.25	10.29	11.24	11.59	11.29	10.06	8.79
Federal Home Loan Bank advances	n.a.	n.a.	n.a.	n.a.	5.27	5.71	6.29	6.46	6.42	6.10
Average net consolidated assets (billions of dollars)	971	938	972	986	1,002	1,022	1,072	1,080	1,152	1,245

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006—*Continued*

D. Banks ranked 101 through 1,000 by assets—*Continued*

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Effective interest rate (percent)[5]									
Rates earned										
Interest-earning assets	8.54	8.38	7.83	8.48	7.86	6.43	5.60	5.46	6.12	6.98
Taxable equivalent	8.63	8.47	7.92	8.56	7.94	6.51	5.68	5.53	6.19	7.05
Loans and leases, gross	9.53	9.42	8.74	9.42	8.76	7.32	6.57	6.25	6.90	7.76
Net of loss provisions	8.79	8.79	8.26	8.75	7.88	6.56	6.02	5.87	6.64	7.52
Securities	6.43	6.31	6.03	6.45	5.97	4.95	3.81	3.79	4.03	4.50
Taxable equivalent	6.69	6.57	6.29	6.71	6.25	5.21	4.06	4.04	4.28	4.77
Investment account	6.43	6.30	6.03	6.45	5.96	4.93	3.82	3.78	4.02	4.50
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	5.85	4.54	3.42	3.15	3.47	4.16
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	6.33	5.38	3.95	4.01	4.23	4.61
Other	n.a.	n.a.	n.a.	n.a.	5.40	4.51	4.07	4.21	4.42	4.80
Trading account	6.37	6.84	7.33	9.30	6.60	14.05	3.07	10.30	6.59	4.92
Gross federal funds sold and reverse RPs	5.42	5.31	4.98	6.15	3.91	1.73	1.27	1.57	3.31	4.94
Interest-bearing balances at depositories	5.44	5.77	5.07	5.76	3.94	1.79	1.26	1.47	3.29	4.59
Rates paid										
Interest-bearing liabilities	4.67	4.60	4.19	4.93	4.11	2.54	1.88	1.73	2.48	3.55
Interest-bearing deposits	4.34	4.28	3.84	4.46	3.82	2.28	1.61	1.44	2.09	3.09
In foreign offices	5.42	5.55	5.07	6.13	4.45	2.14	1.43	1.43	3.05	4.50
In domestic offices	4.32	4.25	3.82	4.43	3.81	2.28	1.61	1.44	2.08	3.08
Other checkable deposits	2.17	2.15	1.99	2.27	1.81	1.06	.74	.72	1.18	1.73
Savings deposits (including MMDAs)	3.08	2.96	2.65	3.07	2.22	1.17	.76	.74	1.27	2.05
Large time deposits[6]	5.56	5.51	5.17	6.00	5.27	3.34	2.58	2.33	3.21	4.39
Other time deposits[6]	5.57	5.64	5.11	5.74	5.51	3.77	2.86	2.51	3.10	4.16
Gross federal funds purchased and RPs	5.20	5.14	4.82	5.95	3.83	1.83	1.29	1.45	2.94	4.51
Other interest-bearing liabilities	6.08	5.99	5.36	6.45	5.41	4.17	3.60	3.37	4.00	4.74
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	7.79	7.66	7.19	7.79	7.16	5.85	5.08	4.99	5.57	6.37
Taxable equivalent	7.87	7.74	7.27	7.86	7.24	5.93	5.16	5.06	5.64	6.44
Loans	6.05	5.89	5.47	5.96	5.59	4.57	4.08	4.01	4.55	5.27
Securities	1.49	1.50	1.51	1.58	1.33	1.15	.91	.88	.86	.89
Gross federal funds sold and reverse RPs	.19	.22	.17	.21	.16	.07	.05	.05	.09	.13
Other	.06	.06	.04	.04	.08	.06	.05	.05	.07	.09
Gross interest expense	3.47	3.45	3.20	3.79	3.14	1.92	1.41	1.29	1.84	2.66
Deposits	2.69	2.70	2.44	2.87	2.48	1.49	1.04	.92	1.34	2.03
Gross federal funds purchased and RPs	.37	.32	.34	.38	.22	.09	.07	.08	.16	.24
Other	.42	.42	.42	.54	.44	.34	.30	.29	.34	.39
Net interest income	4.32	4.22	3.99	4.00	4.02	3.93	3.68	3.70	3.73	3.72
Taxable equivalent	4.39	4.29	4.07	4.07	4.10	4.00	3.75	3.77	3.79	3.78
Loss provisions[7]	.58	.49	.39	.52	.65	.55	.40	.30	.24	.23
Non-interest income	2.07	2.26	2.31	2.35	2.37	2.37	2.31	2.26	2.02	1.98
Service charges on deposits	.40	.39	.38	.36	.39	.41	.41	.39	.36	.35
Fiduciary activities	.32	.37	.38	.44	.40	.35	.34	.37	.35	.30
Trading revenue	.01	.02	.02	.01	*	*	.01	.01	.01	.01
Interest rate exposures	.01	.01	.01	.01	−.01	*	.01	.01	.01	*
Foreign exchange rate exposures	*	*	*	*	*	*	*	*	*	*
Other commodity and equity exposures	*	*	*	*	*	*	*	*	*	*
Other	1.34	1.49	1.53	1.55	1.58	1.61	1.55	1.49	1.30	1.32
Non-interest expense	3.73	3.86	3.70	3.84	3.88	3.73	3.60	3.54	3.37	3.34
Salaries, wages, and employee benefits	1.50	1.56	1.56	1.59	1.61	1.64	1.64	1.64	1.61	1.58
Occupancy	.46	.47	.47	.47	.46	.45	.43	.43	.41	.40
Other	1.77	1.83	1.68	1.78	1.81	1.64	1.53	1.47	1.36	1.35
Net non-interest expense	1.66	1.60	1.39	1.48	1.52	1.36	1.29	1.29	1.35	1.36
Gains on investment account securities	.02	.04	−.01	−.04	.05	.04	.05	.02	−.01	−.01
Income before taxes and extraordinary items	2.10	2.16	2.20	1.96	1.90	2.06	2.03	2.13	2.13	2.12
Taxes	.73	.74	.74	.67	.66	.67	.66	.68	.68	.69
Extraordinary items, net of income taxes	*	.06	.01	*	.01	*	.03	*	*	*
Net income	1.37	1.47	1.47	1.29	1.25	1.38	1.39	1.45	1.45	1.43
Cash dividends declared	1.10	1.01	1.06	.92	1.33	1.19	1.64	.78	.87	.89
Retained income	.28	.46	.40	.37	−.08	.19	−.25	.68	.58	.54
MEMO: Return on equity	14.89	15.60	16.11	14.21	12.93	13.75	13.53	13.42	13.33	13.02

NOTE: Data are as of April 13, 2007.

1. Includes allocated transfer risk reserve.

2. Measured as the sum of large time deposits in domestic offices, deposits booked in foreign offices, subordinated notes and debentures, federal funds purchased and securities sold under repurchase agreements, Federal Home Loan Bank advances, and other borrowed money.

3. Measured as the sum of construction and land development loans secured by real estate; real estate loans secured by nonfarm nonresidential properties or by multifamily residential properties; and loans to finance commercial real estate, construction, and land development activities not secured by real estate.

4. Other real estate owned is a component of other non-interest-earning assets.

5. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Report.

6. Before 1997, large time deposit open accounts were included in other time deposits.

7. Includes provisions for allocated transfer risk.

* In absolute value, less than 0.005 percent.

n.a. Not available.

MMDA Money market deposit account.

RP Repurchase agreement.

MBS Mortgage-backed securities.

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006

E. Banks not ranked among the 1000 largest by assets

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Balance sheet items as a percentage of average net consolidated assets									
Interest-earning assets	92.45	92.64	92.55	92.52	92.26	92.22	92.14	92.34	92.30	92.37
Loans and leases (net)	58.75	59.11	59.76	62.31	62.67	62.72	62.32	63.80	65.44	66.65
Commercial and industrial	10.16	10.33	10.64	11.09	11.10	10.71	10.42	10.29	10.21	10.17
U.S. addressees	10.08	10.25	10.55	11.02	11.02	10.64	10.37	10.25	10.15	10.13
Foreign addressees	.08	.08	.08	.07	.08	.06	.05	.04	.06	.05
Consumer	8.98	8.46	8.17	7.98	7.42	6.77	6.16	5.45	4.97	4.63
Credit card	.85	.70	.69	.59	.57	.49	.51	.40	.36	.38
Installment and other	8.14	7.76	7.47	7.39	6.85	6.28	5.64	5.05	4.61	4.25
Real estate	35.55	36.04	36.83	39.29	40.30	41.52	42.30	44.75	46.98	48.53
In domestic offices	35.55	36.04	36.83	39.29	40.30	41.52	42.30	44.75	46.98	48.53
Construction and land development	2.82	3.02	3.28	3.70	4.23	4.51	4.99	6.01	7.46	9.10
Farmland	2.69	2.83	2.95	3.06	3.04	3.08	3.13	3.22	3.25	3.26
One- to four-family residential	18.16	18.04	17.66	18.43	18.24	17.91	17.08	17.17	17.12	16.70
Home equity	1.24	1.21	1.17	1.28	1.37	1.62	1.79	2.11	2.20	2.06
Other	16.92	16.83	16.49	17.15	16.87	16.29	15.29	15.06	14.93	14.63
Multifamily residential	.95	.93	.98	1.04	1.06	1.16	1.28	1.41	1.48	1.47
Nonfarm nonresidential	10.93	11.22	11.96	13.06	13.71	14.86	15.82	16.94	17.66	18.01
In foreign offices	*	*	*	*	*	*	*	*	*	*
To depository institutions and acceptances of other banks	.20	.14	.14	.12	.12	.10	.09	.07	.05	.05
Foreign governments	*	*	.01	.01	*	*	*	*	*	*
Agricultural production	4.05	4.27	4.06	3.85	3.76	3.64	3.40	3.26	3.21	3.22
Other loans	.67	.67	.67	.69	.67	.65	.66	.68	.70	.70
Lease-financing receivables	.25	.24	.26	.27	.27	.31	.26	.25	.24	.26
LESS: Unearned income on loans	–.24	–.20	–.15	–.11	–.09	–.07	–.06	–.06	–.05	–.05
LESS: Loss reserves[1]	–.87	–.86	–.87	–.88	–.88	–.90	–.92	–.89	–.87	–.87
Securities	28.24	26.70	26.91	25.40	22.80	23.34	23.47	23.34	21.92	20.55
Investment account	28.21	26.66	26.88	25.38	22.79	23.33	23.43	23.33	21.90	20.53
Debt	27.68	26.12	26.34	24.82	22.49	23.05	23.12	23.07	21.70	20.35
U.S. Treasury	6.70	5.05	3.34	2.12	1.33	1.04	.90	.81	.71	.61
U.S. government agency and corporation obligations	15.58	15.43	16.89	16.95	15.27	16.07	16.23	16.57	15.64	14.73
Government-backed mortgage pools	4.01	3.90	3.95	3.47	3.78	4.54	4.84	4.76	4.23	3.62
Collateralized mortgage obligations	2.19	2.02	2.00	1.70	1.94	2.30	2.20	1.96	1.70	1.50
Other	9.38	9.51	10.93	11.78	9.56	9.23	9.19	9.85	9.70	9.61
State and local government	4.60	4.80	4.96	4.64	4.51	4.56	4.73	4.67	4.49	4.30
Private mortgage-backed securities	.19	.16	.26	.23	.27	.26	.21	.19	.22	.24
Other	.61	.68	.89	.88	1.11	1.12	1.05	.83	.65	.48
Equity	.52	.54	.53	.56	.30	.27	.31	.26	.20	.17
Trading account	.03	.04	.03	.02	.01	.01	.04	.01	.02	.02
Gross federal funds sold and reverse RPs	3.95	5.13	4.17	3.22	5.01	4.26	4.27	3.33	3.24	3.53
Interest-bearing balances at depositories	1.49	1.72	1.71	1.59	1.78	1.90	2.08	1.86	1.70	1.65
Non-interest-earning assets	7.55	7.36	7.45	7.48	7.74	7.78	7.86	7.66	7.70	7.63
Revaluation gains held in trading accounts	*	*	*	*	*	*	*	*	*	*
Other	7.55	7.36	7.45	7.48	7.74	7.78	7.86	7.66	7.70	7.63
Liabilities	89.63	89.54	89.75	89.88	89.59	89.73	89.58	89.55	89.49	89.35
Core deposits	74.58	73.75	72.74	70.87	69.92	70.04	69.97	69.24	67.68	65.74
Transaction deposits	24.48	24.26	23.87	23.20	22.35	22.66	23.18	23.36	22.71	20.81
Demand deposits	13.09	13.08	12.80	12.64	12.16	12.24	12.58	12.77	12.76	11.97
Other checkable deposits	11.39	11.18	11.07	10.57	10.19	10.42	10.60	10.59	9.95	8.84
Savings deposits (including MMDAs)	19.00	19.05	19.77	19.19	19.38	21.32	22.43	23.24	22.98	22.65
Small time deposits	31.10	30.43	29.10	28.48	28.19	26.05	24.36	22.64	21.98	22.27
Managed liabilities[2]	14.02	14.76	16.09	18.08	18.67	18.79	18.78	19.57	21.04	22.77
Large time deposits	10.51	11.11	11.52	12.51	13.55	13.21	13.07	13.16	14.53	16.50
Deposits booked in foreign offices	.10	.07	.08	.05	.06	.07	.06	.07	.06	.06
Subordinated notes and debentures	.01	.01	.01	.02	.02	.04	.03	.04	.03	.03
Gross federal funds purchased and RPs	1.67	1.49	1.79	2.06	1.55	1.51	1.52	1.76	1.74	1.82
Other managed liabilities	1.73	2.08	2.69	3.44	3.49	3.96	4.09	4.54	4.68	4.36
Revaluation losses held in trading accounts	*	*	*	*	*	*	*	*	*	*
Other	1.02	1.03	.92	.93	1.00	.90	.84	.74	.77	.84
Capital account	10.37	10.46	10.25	10.12	10.41	10.27	10.42	10.45	10.51	10.65
MEMO										
Commercial real estate loans[3]	14.80	15.27	16.33	17.91	19.15	20.67	22.23	24.50	26.77	28.80
Other real estate owned[4]	.16	.13	.11	.11	.12	.14	.15	.14	.13	.12
Mortgage-backed securities	6.39	6.07	6.22	5.39	5.99	7.10	7.25	6.91	6.15	5.36
Federal Home Loan Bank advances	n.a.	n.a.	n.a.	n.a.	3.34	3.71	3.87	4.32	4.47	4.14
Average net consolidated assets (billions of dollars)	647	644	652	655	675	704	742	768	805	839

A.1. Portfolio composition, interest rates, and income and expense, U.S. banks, 1997–2006—*Continued*

E. Banks not ranked among the 1000 largest by assets—*Continued*

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
	Effective interest rate (percent)[5]									
Rates earned										
Interest-earning assets	8.50	8.35	8.05	8.44	7.94	6.79	5.94	5.73	6.23	7.01
Taxable equivalent	8.63	8.48	8.18	8.56	8.05	6.91	6.05	5.84	6.33	7.10
Loans and leases, gross	9.80	9.69	9.28	9.51	9.03	7.83	7.08	6.72	7.17	7.95
Net of loss provisions	9.49	9.35	8.89	9.14	8.59	7.39	6.72	6.45	6.94	7.75
Securities	6.26	6.04	5.88	6.15	5.86	5.03	3.87	3.74	3.87	4.28
Taxable equivalent	6.65	6.46	6.29	6.54	6.28	5.43	4.26	4.11	4.24	4.65
Investment account	6.26	6.04	5.89	6.15	5.86	5.02	3.87	3.73	3.87	4.28
U.S. Treasury securities and U.S. government agency obligations (excluding MBS)	n.a.	n.a.	n.a.	n.a.	5.97	4.80	3.74	3.39	3.53	4.12
Mortgage-backed securities	n.a.	n.a.	n.a.	n.a.	6.20	5.47	3.58	3.90	4.17	4.59
Other	n.a.	n.a.	n.a.	n.a.	5.29	4.87	4.43	4.18	4.16	4.25
Trading account	6.33	5.26	3.60	4.01	6.43	15.38	2.89	18.95	7.52	7.19
Gross federal funds sold and reverse RPs	5.51	5.36	4.96	6.24	3.83	1.63	1.08	1.32	3.21	4.95
Interest-bearing balances at depositories	5.62	5.67	5.69	6.38	4.56	2.68	1.97	2.03	3.21	4.65
Rates paid	4.60	4.60	4.28	4.80	4.40	2.92	2.13	1.87	2.43	3.43
Interest-bearing liabilities	4.54	4.53	4.22	4.67	4.32	2.78	2.02	1.75	2.29	3.28
Interest-bearing deposits	4.77	5.08	4.34	5.13	3.97	1.67	.85	1.04	2.86	4.27
In foreign offices	4.53	4.52	4.22	4.67	4.32	2.78	2.02	1.75	2.29	3.28
In domestic offices	2.46	2.44	2.28	2.47	1.97	1.16	.78	.69	1.00	1.45
Other checkable deposits	3.36	3.39	3.21	3.56	2.81	1.72	1.13	1.05	1.53	2.34
Savings deposits (including MMDAs)	5.53	5.53	5.21	5.89	5.53	3.62	2.78	2.47	3.21	4.37
Large time deposits[6]	5.66	5.63	5.25	5.70	5.60	3.88	2.96	2.55	3.04	4.12
Other time deposits[6]	5.22	4.99	4.73	5.69	3.92	1.85	1.31	1.45	2.89	4.37
Gross federal funds purchased and RPs	6.32	6.45	5.64	6.24	5.74	5.31	4.06	3.68	4.02	4.70
Other interest-bearing liabilities										
	Income and expense as a percentage of average net consolidated assets									
Gross interest income	7.90	7.75	7.48	7.83	7.35	6.31	5.46	5.32	5.78	6.50
Taxable equivalent	8.02	7.87	7.61	7.95	7.45	6.41	5.56	5.42	5.88	6.58
Loans	5.86	5.80	5.62	5.99	5.75	5.01	4.47	4.35	4.76	5.35
Securities	1.76	1.59	1.58	1.57	1.32	1.16	.89	.87	.85	.88
Gross federal funds sold and reverse RPs	.24	.29	.22	.21	.20	.07	.05	.05	.11	.18
Other	.04	.06	.06	.05	.08	.06	.06	.05	.06	.08
Gross interest expense	3.48	3.46	3.26	3.64	3.34	2.22	1.60	1.41	1.82	2.56
Deposits	3.28	3.25	3.02	3.30	3.08	1.98	1.42	1.22	1.58	2.27
Gross federal funds purchased and RPs	.08	.07	.08	.12	.06	.03	.02	.02	.05	.08
Other	.11	.13	.15	.21	.20	.21	.17	.17	.19	.21
Net interest income	4.42	4.29	4.23	4.20	4.01	4.08	3.86	3.91	3.96	3.94
Taxable equivalent	4.54	4.41	4.35	4.31	4.12	4.19	3.96	4.00	4.05	4.03
Loss provisions[7]	.27	.29	.31	.32	.36	.35	.29	.23	.21	.20
Non-interest income	1.41	1.52	1.44	1.32	1.31	1.39	1.47	1.38	1.34	1.31
Service charges on deposits	.44	.42	.42	.43	.44	.45	.43	.43	.40	.38
Fiduciary activities	.20	.23	.26	.21	.25	.27	.28	.32	.33	.37
Trading revenue	*	*	*	.01	*	*	*	*	*	*
Interest rate exposures	*	*	*	*	*	*	*	*	*	*
Foreign exchange rate exposures	*	*	*	*	*	*	*	*	*	*
Other commodity and equity exposures	*	*	*	*	*	*	*	*	*	*
Other	.77	.86	.75	.68	.62	.67	.76	.64	.61	.56
Non-interest expense	3.69	3.74	3.73	3.58	3.55	3.57	3.56	3.52	3.49	3.49
Salaries, wages, and employee benefits	1.80	1.82	1.82	1.78	1.79	1.82	1.82	1.81	1.79	1.82
Occupancy	.49	.49	.49	.47	.47	.46	.45	.45	.44	.43
Other	1.40	1.43	1.42	1.32	1.29	1.28	1.28	1.26	1.25	1.24
Net non-interest expense	2.28	2.23	2.29	2.26	2.24	2.18	2.09	2.14	2.15	2.18
Gains on investment account securities	.01	.02	*	-.01	.04	.05	.04	.01	*	-.01
Income before taxes and extraordinary items	1.89	1.79	1.62	1.61	1.45	1.60	1.53	1.55	1.60	1.55
Taxes	.59	.53	.47	.45	.39	.41	.38	.37	.38	.36
Extraordinary items, net of income taxes	*	*	*	*	*	-.01	*	*	*	*
Net income	1.30	1.26	1.15	1.17	1.06	1.18	1.14	1.17	1.21	1.19
Cash dividends declared	.74	.82	.70	.79	.64	.68	.67	.64	.67	.65
Retained income	.56	.44	.45	.38	.42	.49	.47	.54	.54	.54
MEMO: Return on equity	12.53	12.02	11.26	11.52	10.17	11.46	10.97	11.24	11.54	11.17

NOTE: Data are as of April 13, 2007.

1. Includes allocated transfer risk reserve.

2. Measured as the sum of large time deposits in domestic offices, deposits booked in foreign offices, subordinated notes and debentures, federal funds purchased and securities sold under repurchase agreements, Federal Home Loan Bank advances, and other borrowed money.

3. Measured as the sum of construction and land development loans secured by real estate; real estate loans secured by nonfarm nonresidential properties or by multifamily residential properties; and loans to finance commercial real estate, construction, and land development activities not secured by real estate.

4. Other real estate owned is a component of other non-interest-earning assets.

5. When possible, based on the average of quarterly balance sheet data reported on schedule RC-K of the quarterly Call Report.

6. Before 1997, large time deposit open accounts were included in other time deposits.

7. Includes provisions for allocated transfer risk.

* In absolute value, less than 0.005 percent.

n.a. Not available.

MMDA Money market deposit account.

RP Repurchase agreement.

MBS Mortgage-backed securities.

A.2. Report of income, all U.S. banks, 1997–2006

Millions of dollars

Item	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Gross interest income	338,869	359,536	366,144	423,846	404,406	349,731	329,334	349,721	427,976	550,644
Taxable equivalent	341,303	362,000	368,771	426,481	407,093	352,478	332,116	352,705	430,930	553,898
Loans	256,144	271,300	278,539	326,804	311,664	269,519	257,813	269,509	328,296	421,619
Securities	52,660	56,599	62,117	67,667	63,089	59,315	53,317	58,579	65,868	78,848
Gross federal funds sold and reverse repurchase agreements	13,659	15,001	12,331	13,546	12,649	6,223	5,015	5,142	11,045	21,240
Other	16,406	16,637	13,155	15,829	17,006	14,672	13,189	16,490	22,764	28,936
Gross interest expense	164,693	178,162	174,946	222,161	188,799	118,778	94,140	98,544	162,504	263,170
Deposits	117,351	125,218	119,665	151,147	132,352	81,733	62,403	63,642	105,925	173,743
Gross federal funds purchased and repurchase agreements	20,439	22,182	21,130	26,860	19,590	9,920	7,590	8,842	19,161	33,722
Other	26,903	30,760	34,149	44,155	36,854	27,126	24,147	26,059	37,419	55,705
Net interest income	174,176	181,374	191,198	201,685	215,607	230,953	235,194	251,177	265,472	287,474
Taxable equivalent	176,610	183,838	193,825	204,320	218,294	233,700	237,976	254,161	268,426	290,728
Loss provisions	19,402	21,403	21,186	29,386	43,238	45,278	32,766	23,895	25,580	25,249
Non-interest income	105,640	124,051	144,430	153,163	160,925	168,281	183,887	187,988	200,405	223,059
Service charges on deposits	18,558	19,770	21,497	23,720	26,873	29,630	31,693	33,456	33,831	36,161
Fiduciary activities	16,584	19,268	20,502	22,220	21,989	21,404	22,456	25,102	26,387	28,342
Trading revenue	8,018	7,693	10,429	12,235	12,382	10,748	11,605	10,303	14,375	19,172
Other	62,480	77,319	92,001	94,988	99,679	106,501	118,133	119,128	125,810	139,386
Non-interest expense	171,063	194,118	204,634	216,434	226,027	230,293	243,290	263,349	274,142	294,744
Salaries, wages, and employee benefits	72,348	79,548	86,153	89,038	94,209	100,454	108,460	115,271	124,041	135,800
Occupancy	22,080	24,164	25,866	26,766	27,945	29,316	31,317	33,256	35,052	36,366
Other	76,634	90,405	92,616	100,631	103,875	100,521	103,512	114,823	115,049	122,577
Net non-interest expense	65,423	70,067	60,204	63,271	65,102	62,012	59,403	75,361	73,737	71,685
Gains on investment account securities	1,825	3,090	250	−2,280	4,625	6,411	5,633	3,393	−220	−1,232
Income before taxes	91,178	92,995	110,056	106,745	111,891	130,076	148,656	155,317	165,934	189,309
Taxes	32,001	31,957	39,211	37,250	37,284	42,817	48,530	50,267	53,568	61,082
Extraordinary items, net of income taxes	56	506	169	−31	−324	−78	427	59	241	2,652
Net income	**59,232**	**61,542**	**71,013**	**69,464**	**74,284**	**87,181**	**100,554**	**105,108**	**112,606**	**130,880**
Cash dividends declared	42,801	41,205	52,102	52,547	54,844	67,230	77,757	59,539	64,622	82,296
Retained income	16,430	20,337	18,912	16,917	19,438	19,951	22,798	45,568	47,984	48,584

NOTE: Data are as of April 13, 2007.

December 2007

The 2006 HMDA Data

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Since 1975, the Home Mortgage Disclosure Act (HMDA) has required public disclosures from most mortgage lending institutions with offices in metropolitan areas. The release of the information, which includes the geographic location and other characteristics of the home mortgages lenders originate or purchase during a calendar year, is intended to help the public determine whether institutions are adequately serving their communities' housing finance needs; the disclosures are also intended to facilitate enforcement of the nation's fair lending laws and guide investment in both the public and private sectors. Under the 1975 act, the Federal Reserve Board implements the provisions of HMDA through regulation. The Federal Financial Institutions Examination Council (FFIEC) is responsible for facilitating public access to the HMDA data and for aggregating the data by metropolitan statistical area.[1]

For a given calendar year, lenders covered by HMDA publicly release their loan data beginning on March 31 of the subsequent year; in the following September, the FFIEC releases summary tables pertaining to each lender and lending activity in each metropolitan statistical area, along with a file consolidating virtually all the reported information.[2] The nearly 8,900 lenders currently covered by the law account for an estimated 80 percent of all home lending nationwide. Because of its expansive coverage, the HMDA data likely provide a broadly representative picture of home lending in the United States.

After briefly summarizing previously published assessments of the 2004 and 2005 HMDA data and reviewing some prominent issues surrounding pricing in the mortgage market, this article analyzes the 2006 data.[3] As in the analyses of the previous two years, this review focuses primarily on the pricing information included in the HMDA data and differences observed across lending institutions, geographic areas, and population groups. The article concludes with an assessment of factors that account for the variation in rates of serious delinquency on mortgage loans across counties as of March 31, 2007, including information drawn from the HMDA data on the incidence of higher-priced lending and from a data file of credit scores by geographic area.

Increases in market interest rates over the course of 2004 and 2005 were an important contributor to the substantial increase between those years in the reported incidence of higher-priced lending as measured by the HMDA data. For 2006, the relatively subdued increases in market interest rates contributed to a moderation in the growth of higher-priced lending for 2006. The current disturbances in the subprime sector of the mortgage market emerged primarily in the later portions of 2006. The effects of those disturbances and of the associated changes in the regulatory environment will be reflected primarily in the HMDA data for 2007 and subsequent years.

At the outset, HMDA disclosures were limited to summary totals covering loan extensions by type of

NOTE: The authors express their appreciation for the late Edward M. Gramlich, member of the Federal Reserve Board from November 1997 to August 2005. His vision and persistence in seeking what became the 2002 amendments to the Board's HMDA regulations yielded the loan pricing information that has so enriched the value of the HMDA data.

1. The FFIEC (ffiec.gov) was established by federal law in 1979 as an interagency body to prescribe uniform examination procedures, and to promote uniform supervision, among the federal agencies responsible for the examination and supervision of financial institutions. The member agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision. In 1980, federal law gave the FFIEC responsibility for public access to HMDA data and for the aggregation of annual HMDA data, by census tract, for each metropolitan statistical area. In accordance with the 1980 law, the FFIEC established an advisory State Liaison Committee (SLC), composed of representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors. In 2006, the SLC joined the FFIEC as a voting member.

2. Between March and September, the FFIEC member agencies systematically check the data for errors or omissions. To protect the identity of borrowers, the public data exclude the dates of loan applications and the dates of credit decisions.

3. The previously published assessments are Robert B. Avery, Glenn B. Canner, and Robert E. Cook (2005), "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," *Federal Reserve Bulletin*, vol. 91 (Summer), pp. 344–94; and Robert B. Avery, Kenneth P. Brevoort, and Glenn B. Canner (2006), "Higher-Priced Home Lending and the 2005 HMDA Data," *Federal Reserve Bulletin*, vol. 92 (September 8), pp. A123–66.

loan for each census tract but included no information on loan pricing or applications for loans that were denied by the lender. Over the years, the Congress has extended the reach of the law to a broader range of institutions and expanded the types of information that must be reported and disclosed. The most sweeping of the legislative amendments to HMDA, adopted in 1989, required disclosure of the disposition of applications for home loans and the income, sex, and race or ethnicity of the individuals applying for those loans.

Analyses of the new information revealed wide disparities in the rates of approval of loan applications across racial and ethnic lines and prompted widespread public discussion about the fairness of mortgage lending decisions.[4] With the 1989 amendments, the HMDA data thus formed a new basis for public scrutiny of the fairness of mortgage lending and became an important aspect of fair lending enforcement.

In response to significant changes in the mortgage market during the 1990s, particularly the emergence and growth of subprime lending, the Federal Reserve Board in 2002 revised its Regulation C, which implements HMDA (for details, refer to the appendix).[5] The revision substantially increased the type and amount of public information available about home lending in HMDA reports, beginning with data for 2004. The most important change was the requirement that lenders identify and disclose information about mortgages with annual percentage rates (APRs, which encompass interest rates and fees) above designated thresholds, mortgages referred to here as "higher-priced loans."[6] Other new disclosures included lien status of the loan (whether it is a first lien, a junior lien, or unsecured—if the latter, it is a home improvement loan), whether it is secured by a manufactured home, and whether it is subject to the protections of the Home Ownership and Equity Protection Act of 1994.

4. For example, John Goering and Ron Wienk, eds. (1996), *Mortgage Lending, Racial Discrimination, and Federal Policy* (Washington: Urban Institute Press).

5. Home Mortgage Disclosure Act (12 U.S.C. §§2801-11), Regulation C (12 C.F.R. pt. 203), and the staff commentary accompanying Regulation C (12 C.F.R. pt. 203, Supp. I).

6. For loans with spreads above designated thresholds, revised Regulation C requires the reporting of the spread between the APR on a loan and the rate on Treasury securities of comparable maturity. The thresholds for reporting differ by lien status: 3 percentage points for first liens and 5 percentage points for junior, or subordinate, liens. Further details are in note 12, p. A126, of Avery, Brevoort, and Canner, "Higher-Priced Home Lending and the 2005 HMDA Data."

Highlights of the 2004 and 2005 Data

For both the 2004 and 2005 HMDA data, nearly 80 percent of the reporting institutions were depositories (commercial banks, savings associations, and credit unions); accounting for the rest were independent mortgage companies and mortgage companies affiliated with banking institutions or their holding companies. Although mortgage companies represented only 22 percent of the reporting institutions, they submitted information on more than 60 percent of all the reported loans and applications.

Most lenders reported relatively little home lending. The most active lenders (those providing information on at least 5,000 loans or applications) accounted for about 5 percent of the reporting institutions and nearly 90 percent of all the reported loans and applications.

A comparison of the HMDA data for 2004 and 2005 with those from earlier years documented a number of trends, including a growing share of lending to non-owner occupants, the growth of "piggyback" lending (homebuyers simultaneously obtaining two loans—one a first lien and the other a junior lien—to finance the purchase of a home), and a substantial decline in home lending insured by the Federal Housing Administration (FHA) as a share of all home lending.

Because of its importance, the new information on loan pricing was the focus of much of the analyses of the 2004 and 2005 data. The reviews found that the incidence of higher-priced lending increased from about 16 percent of all loans in 2004 to 26 percent in 2005. The substantial narrowing of the difference between short- and long-term interest rates in 2005 explained part of the increase that year in the share of reported loans that exceeded the pricing thresholds established by Regulation C.[7] Estimates suggested that the changes in interest rates accounted for about 15 percent of the increase in reported higher-priced lending for conventional *fixed-rate* home-purchase loans and about 20 percent of the increase for similar

7. Additional research on the possible reasons for the increase in reported higher-priced lending from 2004 to 2005 is in Michael LaCour-Little (2007), "Economic Factors Affecting Home Mortgage Disclosure Act Reporting," paper prepared for the American Real Estate and Urban Economics Association Mid-Year Meeting, Washington, May 29–30. The study finds that, after controlling for the mix of loan types, for credit-risk factors, and for changes in the relationship between short- and long-term interest rates, there was no statistically significant increase in the volume of higher-priced lending for loans originated directly by lenders, but there was an increase for such loans originated through indirect channels.

loans for refinancings. Another portion of the increase in higher-priced lending was attributable to the effects of the narrowing spread between short- and long-term interest rates on *adjustable-rate* lending, but available data limited the ability to quantify this effect. Besides changes in market interest rates, other factors—changes in borrower credit-risk profiles and changes in lender business practices such as an increased willingness to accept higher-risk borrowers—may also have led to increased higher-priced lending from 2004 to 2005; but again, quantifying the influences was impeded by data limitations.

Analysis of the 2004 and 2005 pricing information also found that the incidence of higher-priced lending varied substantially by geography and loan characteristic and across borrower groups. The incidence was found to be elevated for borrowers residing in census tracts characterized by larger proportions of individuals with lower credit scores and lower high-school graduation rates; and in census tracts with larger proportions of lower-income households, minority households, and shares of loan applicants that were denied credit.[8] The incidence of higher-priced lending was also elevated for smaller loans and piggyback loans, for loans made by depository institutions outside their local communities, and for loans originated by independent mortgage companies regardless of location.

Results of an analysis along racial and ethnic lines were consistent with the results by geography: Blacks and Hispanic whites were more likely, and Asians somewhat less likely, to have received higher-priced loans than non-Hispanic whites. Information included in the HMDA data on characteristics of borrowers and loans—such as income, amount borrowed, and property location—does not account fully for the variation in loan pricing across geographies and groups. However, many factors routinely used by lenders to underwrite and price loans—including loan-to-value (LTV) ratios and measures of borrower credit history (for example, a credit history score)—are not included in the HMDA data and, consequently, cannot be included in an analysis of pricing differences that relies on the HMDA data alone.

The expanded HMDA data have both raised concerns about the fairness of the lending process and created new avenues for lenders, regulators, and the public to address fairness. Lenders are responsible for their compliance with fair lending laws, and the HMDA data can both encourage and facilitate the improvement of their compliance efforts. Likewise, the regulatory agencies have been using the expanded data in their fair lending enforcement activities. The expanded data also increase transparency in the marketplace by identifying lenders active in the higher-priced segment of the market and by allowing a wide variety of analyses that more fully describe higher-priced lending.

Loan Pricing in the Mortgage Market

Mortgage markets have changed greatly over the years. Historically, mortgage lenders offered consumers a relatively limited array of loan products. The prices (interest rates, points, and fees) at which they offered their loans varied mainly by

- loan type—for example, conventional or government-backed
- loan type characteristic—including amount borrowed, term to maturity, and LTV ratio
- loan/type of structure securing the loan—traditional "site built" home, factory-manufactured unit, or multifamily units
- ownership status—owner occupied or non-owner occupied

The prices did not, however, vary to any great degree by the creditworthiness of the borrower; effectively, borrowers either did or did not meet the underwriting criteria for a particular loan product, and the borrowers who met the criteria all paid about the same price.

In the past quarter century, advances in technology, improvements in access to the credit histories of individuals, and the emergence of a robust secondary market for loans over the full spectrum of credit risks have helped spur remarkable changes in the mortgage market. The most prominent of those developments has been the explicit risk-based pricing of credit. Over this period, more so than in the past, differences in the creditworthiness of different borrowers led to different prices for the same product.[9] Less-creditworthy applicants, or those either unwilling or unable to document their creditworthiness or income, found it increasingly likely that they would be granted a loan but that it would be offered at a price higher than that for more-creditworthy applicants.

Explicit risk-based pricing has expanded opportunities for homeownership and allowed individuals, including those who otherwise have little access to credit, to more readily purchase homes or borrow

8. The term "minority" as used in this article refers to any racial or ethnic identity other than non-Hispanic white.

9. Refer, for example, to Souphala Chomsisengphet and Anthony Pennington-Cross (2006), "The Evolution of the Subprime Mortgage Market," Federal Reserve Bank of St. Louis, *Review*, vol. 88 (January/February), pp. 31–56.

against the equity they have accumulated in their homes. Recent developments in mortgage markets have caused some lenders to tighten underwriting and charge higher prices to compensate for perceived risk. However, risk-based pricing continues to be a feature of the mortgage market. Although risk-based pricing has broadened opportunities for many consumers, it has been accompanied by growing concerns, some of which are noted below.

Segments of the Market

Broadly, borrowers in the higher-priced mortgage market generally fall into one of two "nonprime" market segments: "subprime" and "near prime." Individuals in the subprime category pay the highest prices because they are considered to pose the greatest risk of default or prepayment.[10] Such borrowers may also impose higher costs of origination, as it can be more difficult and time consuming to assess their credit profiles. Borrowers in the prime market pay the lowest prices for loans, subprime borrowers pay the highest prices, and near-prime borrowers pay prices somewhere in between. In practice, the dividing line between subprime and near prime is amorphous, as is the line between the prime and nonprime markets. The distinctions between all these market segments change over time as market interest rates move, as lenders' appetite for interest rate risk and the risks of prepayment and default changes, and as the ability to price risk more exactly changes.

Industry sources provide some data on the relative sizes of these market segments. For example, in 2006 about 20 percent of mortgages were subprime, and about 13 percent were near prime (often referred to as "alt-A" mortgages).[11]

Nontraditional Loan Products

Over the first half of this decade, home values in many areas of the country rose sharply, as did the competitive pressures on lenders to innovate. Those forces encouraged lenders to develop loan products that were intended to hold down required monthly payments, at least for the first few years of the loan. Among those products were interest-only loans, adjustable-rate loans with discounted ("teaser") initial rates, and payment option loans, which increased the affordability of home purchases and mortgage refinancings, at least in the short term. However, these loan products sometimes are accompanied by minimal down payments (or a piggyback loan), and the limited or zero repayment of principal in the amortization schedule of many of these loan products means that mortgage payments generate little or no additional equity in the first few years. These loans also generally involve an increase in monthly payments at some point later in the life of the loan. Recent evidence indicates, however, that these so-called nontraditional loan products have elevated incidence of default and foreclosure, particularly when extended in combination with other indicators of elevated credit risk, such as a low credit score or no documentation of income. Such loan products have also drawn considerable attention from regulatory authorities, which have provided guidance to banking institutions on the risks posed by those products and the importance of providing clear disclosure of the loan terms and conditions.[12]

The Role of Brokers

Another notable development in the mortgage market was the emergence of brokers as the intermediary through which the majority of individuals obtain a mortgage.[13] Historically, prospective borrowers visited an office of a local banking institution to apply for a loan. Today, a mortgage broker, often working as an independent entity, may take loan applications on behalf of a banking institution or other mortgage lender and may provide the only direct contact with the borrower until closing, when the loan documents are signed and the mortgage is issued. In such cases, the mortgage broker plays an important role in pricing the loan, and frequently the compensation received by the broker is based, in whole or in part, on the interest rate and fees paid by the consumer.

The large role played by brokers in the lending process gained increased attention in the past year or so as delinquencies, defaults, and foreclosures increased, particularly in the subprime portion of the mortgage market. Among the issues that have drawn

10. Prepayment penalties are a common feature of loans in the subprime market and are intended to address the elevated risk of prepayment.

11. Inside Mortgage Finance (2007), *The 2007 Mortgage Market Statistical Annual*, vol. 1: *The Primary Market* (Bethesda, Md.. Inside Mortgage Finance Publications).

12. For example, on September 29, 2006, the federal financial regulatory agencies (Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision) issued the press release "Interagency Guidance on Nontraditional Mortgage Product Risks," www.federalreserve.gov/boarddocs/press/bcreg/2006/20060929/default.htm.

13. Industry sources indicate that mortgage brokers initiated 58 percent of the mortgage originations in 2006, down somewhat from 63 percent in 2005 (Lew Sichelman, 2007, "Broker Market Share Down to 58%," *National Mortgage News*, July 9, p. 1).

increased scrutiny to brokers are whether they provide consumers with sufficient information to make sound choices in selecting a mortgage product and whether fraud has sometimes been involved in the broker's characterization of the borrower's creditworthiness or in the appraisal of the home being purchased. Also, brokers and, many times, the lenders originating the loan do not bear the credit risk of the loans they sell but share in the profits from originating the loan. As a result, the broker or other originating party may not have the incentive to fully pass along to the loan purchasers all relevant information needed to gauge the accuracy and completeness of the information used to underwrite and price the loan.[14]

Concerns about Loan Pricing

As price flexibility has emerged in the mortgage market, so have concerns about the fairness of pricing outcomes. Such concerns generally fall into four broad categories. First are concerns about possible discrimination based on the race or ethnicity of the borrower. Such concerns are heightened because loan prices are not always determined strictly on the basis of credit risk or cost factors but can involve elements of discretion by loan officers or loan brokers, such as seeking prices that differ from the lender's baseline price guidance typically conveyed in the form of rate sheets.

Second are concerns about whether borrowers in the higher-priced segment of the loan market are sufficiently informed and whether they are willing or able to shop effectively for the loan terms most appropriate to their circumstances. For example, it may be difficult for borrowers to determine where they fit along the credit-risk spectrum. Also, some borrowers may fail to shop or negotiate for the best available rates and terms because they need funds immediately; such borrowers tend to focus primarily on the amount they can borrow and the size of the monthly payment. Such borrowers may not fully appreciate the potential longer-run consequences of certain loan terms such as prepayment penalties, adjustable interest rates, negative amortization, and balloon payments. Such borrowers may be more easily exploited by loan officers or brokers. Also, aggressive marketing tactics may confuse such borrowers about the cost and terms of loans.

Third, concerns have been raised about whether competition is adequate to ensure that borrowers in the higher-priced segment of the loan market have access to the full range of credit opportunities. Some believe that prime-market lenders are not present or do not offer or promote their prime products sufficiently in certain geographic markets, including neighborhoods that have larger minority populations. In this view, reduced access to prime lenders and their products limits the opportunities for borrowers in affected communities to access lower-priced loans.

Finally, the elevated default and foreclosure rates currently experienced in the higher-priced portion of the loan market have raised concerns about the sustainability of homeownership, the adverse effects on neighborhoods with higher concentrations of these loans, and the hardship on borrowers who are losing their homes. Recognizing these concerns, the federal and state financial institution regulatory agencies have encouraged lenders and servicers of loans to work with mortgage borrowers facing financial difficulties.[15]

These various concerns about the functioning of the mortgage market raise important public policy issues that are beyond the scope of this article. Nonetheless, the expanded HMDA data provide information that has proven useful in understanding and addressing many of these issues.

General Findings from the 2006 HMDA Data

For 2006, lenders covered by HMDA reported information on 27.5 million applications for home loans. Almost all the applications were for loans to be secured by one- to four-family (so-called single-family) houses, as follows: 10.9 million applications to purchase a home, 2.5 million to make home improvements, and 14.0 million to refinance an existing home loan. The balance (about 0.1 million) was for loans secured by multifamily dwellings—those

14. In some cases, brokers and loan originators are subject to forced repurchase of a loan that was sold if it performs poorly soon after loan origination or if representations and warranties were violated; but in practice, brokers and some of the firms they sometimes work with have limited capacity to fund a repurchase.

15. On April 17, 2007, the federal financial regulatory agencies issued guidance to encourage supervised institutions to work constructively with homeowners who are financially unable to continue meeting their mortgage payments (www.federalreserve.gov/boarddocs/srletters/2007/SR0706). On September 4, 2007, the federal financial regulatory agencies and the Conference of State Bank Supervisors (CSBS) issued a statement encouraging federally regulated financial institutions and state-supervised entities that service securitized residential mortgages to determine the full extent of their authority under pooling and servicing agreements to identify borrowers at risk of default and pursue appropriate loss mitigation strategies designed to preserve homeownership ("Federal Financial Regulatory Agencies and CSBS Issue Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages," www.federalreserve.gov/newsevents/press/bcreg/20070904a.htm).

1. Home loan and reporting activity of home lenders covered under HMDA, 1990–2006

Number

Year	Applications received for home loans on one- to four-family properties, and home loans purchased from other lenders (millions)						Reporters	Disclosure reports[2]
	Applications				Loans purchased	Total[1]		
	Home purchase	Refinance	Home improvement	Total[1]				
1990	3.3	1.1	1.2	5.5	1.2	6.7	9,332	24,041
1991	3.3	2.1	1.2	6.6	1.4	7.9	9,358	25,934
1992	3.5	5.2	1.2	10.0	2.0	12.0	9,073	28,782
1993	4.5	7.7	1.4	13.6	1.8	15.4	9,650	35,976
1994	5.2	3.8	1.7	10.7	1.5	12.2	9,858	38,750
1995	5.5	2.7	1.8	10.0	1.3	11.2	9,539	36,611
1996	6.3	4.5	2.1	13.0	1.8	14.8	9,328	42,946
1997	6.8	5.4	2.2	14.3	2.1	16.4	7,925	47,416
1998	8.0	11.4	2.0	21.4	3.2	24.7	7,836	57,294
1999	8.4	9.4	2.1	19.9	3.0	22.9	7,832	56,966
2000	8.3	6.5	2.0	16.8	2.4	19.2	7,713	52,776
2001	7.7	14.3	1.9	23.8	3.8	27.6	7,631	53,066
2002	7.4	17.5	1.5	26.4	4.8	31.2	7,771	56,506
2003	8.2	24.6	1.5	34.3	7.2	41.5	8,121	65,808
2004	9.8	16.1	2.2	28.1	5.1	33.3	8,853	72,246
2005	11.7	15.9	2.5	30.2	5.9	36.0	8,848	78,193
2006	10.9	14.0	2.5	27.5	6.2	33.7	8,886	78,638

NOTE: Here and in subsequent tables except table 3, applications exclude requests for pre-approval that were denied by the lender or were accepted by the lender but not acted upon by the borrower. In this article, applications are defined as being for a loan on a specific property; they are thus distinct from requests for pre-approval, which are not related to a specific property.

1. Applications for multifamily homes are included only in the total columns; for 2006, these applications numbered nearly 52,380.

2. A report covers the mortgage lending activity of a lender in a single metropolitan statistical area in which it had an office during the year.

SOURCE: Here and in subsequent tables and figures except as noted, Federal Financial Institutions Examination Council, data reported under the Home Mortgage Disclosure Act (www.ffiec.gov/hmda).

for five or more families (table 1). These applications resulted in nearly 14 million loan extensions. Lenders also reported information on 6.2 million loans they had purchased from other institutions and on 411,000 requests for pre-approvals of home-purchase loans; the pre-approval requests either were turned down by the lender or (not shown in table) were granted but not acted on by the applicant.

The total number of reported applications and purchased loans fell 2.3 million, or 6 percent, from 2005; most of the decline was for refinancings. The number of applications for loans to refinance an existing loan fell 1.9 million, or about 12 percent; the number declined most likely because short-term interest rates increased from the end of 2005 through much of 2006 and thereby reduced the number of existing loans that could be refinanced at a lower rate. Slower house-price appreciation and, in some areas, outright declines in property values also likely diminished the attractiveness of refinancing or the borrower's ability to refinance.

For 2006, HMDA reporting requirements covered 8,886 institutions—including 3,900 commercial banks, 946 savings institutions, 2,036 credit unions, and 2,004 mortgage companies (table 2). Of the mortgage companies, two-thirds were independent entities—that is, they were neither subsidiaries of depository institutions nor affiliates of bank holding companies (data derived from table). The total number of reporting institutions was about the same as that in 2005, as was the distribution of reporters by type of institution.

Activity and Size of Lender

As in earlier years, most of the institutions reporting HMDA data are small whether measured by asset size or by some indicator of lending activity such as the number of reported applications or loans (table 3). For 2006, 60 percent of the reporting institutions,

2. Distribution of home lenders covered by HMDA, by type of institution, 2006

Type	Number	Percent
Depository institution		
Commercial bank	3,900	43.9
Savings institution	946	10.6
Credit union	2,036	22.9
All	6,882	77.4
Mortgage company		
Independent	1,328	14.9
Affiliated[1]	676	7.6
All	2,004	22.5
All institutions	**8,886**	**100**

1. Subsidiary of a depository institution or an affiliate of a bank holding company.

each of which provided information on fewer than 250 loans or applications, accounted for just 1.7 percent of all the reported data. At the other extreme, 5 percent of reporting institutions, each of which provided information on 5,000 or more loans or applications, accounted for 87 percent of all the reported data.

Many HMDA reporters are affiliated with each other. If individual HMDA reporters are aggregated to their highest level of corporate organization (such as a holding company), the concentration of mortgage lending nationwide is evident. The twenty-five organizations reporting the largest number of applications and loans accounted for 54 percent of the 2006 data, roughly the same proportions as in the 2004 and 2005 HMDA data (data not shown in tables).

Disposition of Applications, Loan Types, and HOEPA-Related Activities

For purposes of analysis, loan applications and loans can be grouped in many ways; here the analysis focuses on twenty-five distinct product categories characterized by loan and property type, purpose of the loan, and lien and owner-occupancy status. Each product category contains information on the number of total and pre-approval applications, application denials, originated loans, loans with prices above the thresholds, loans covered by the Home Ownership and Equity Protection Act of 1994 (HOEPA), and the mean and median APR spreads for loans priced above the designated reporting thresholds (tables 4 and 5).[16]

Disposition of Applications

HMDA data are the only publicly available source of information on the disposition of individual applications for home loans. The data include information on the race, ethnicity, and sex of applicants as well as the type and purpose of the loan and the location of the property, so the disposition of applications can be assessed along many dimensions.

The HMDA data for 2006, like those from earlier years, indicate that lenders approve most of the applications they receive, although the proportion approved or denied varies by loan purpose, type of loan and property, and lien status. In general, denial rates are higher for refinancings and for home-improvement loans than for home-purchase loans, perhaps because of the prequalification and financial counseling activities that many prospective borrowers go through before purchasing a home (table 4). Denial rates are lower for government-backed loans than for conventional loans but are especially high for loans to purchase manufactured homes. Overall, the denial rate for all home loans in 2006 was 29 percent, compared with 27 percent in 2005.

Conventional and Government-Backed Loans

Consistent with earlier years, most reported home loan activity in 2006 involved conventional loans—that is, non-government-backed loans (table 4). Such loans accounted for about 95 percent of all loans originated in 2006. FHA-insured loans accounted for about three-fourths of the government-backed loans, and most of the rest involved guarantees by the Department of Veterans Affairs (VA) (data not shown in tables). The share of all HMDA-reported loans backed by the FHA has fallen over the past several years, from about 16 percent in 2000 to less than 3 percent in 2005 and 2006 (data not shown in tables).[17] (The FHA share of first-lien home-purchase loans has also been trending down and in 2006 was about 5 percent.) The development in recent years of many conventional loan products that feature more-flexible and quicker underwriting has attracted borrowers who, in the past, might have sought loans with FHA backing. Among the newer conventional loan products are those intended to serve borrowers who are seeking to minimize their down payment or initial monthly payments or who are unable or unwilling to document their incomes. Also, in some areas of the country, high home prices have diminished the attractiveness of the FHA program, as increases in the maximum loan value that the FHA will insure have failed to keep pace with increases in local home values.

For each loan made, the HMDA data show the amount borrowed and the incomes of the borrowers. The analysis that follows immediately in this section considers four loan categories: (1) conventional loans that met the definition of higher-priced loans under HMDA, (2) all other conventional loans, (3) FHA-insured loans, and (4) VA-guaranteed loans. The analysis is limited to site-built, owner-occupied, one-

16. Transition rules governing the reporting of the expanded HMDA data created problems for assessing the data on loan pricing, manufactured-home lending, and pre-approvals. The transition rules had a large influence on the data reported for 2004 and a much smaller effect on the 2005 data. In the 2006 data, transition rules affected only about 6,000 applications and 1,100 loans; the presentation here excludes those applications and loans for analyses that pertain to pricing, manufactured-home lending, and pre-approvals.

17. VA-backed lending has also fallen some in recent years as a share of the overall market, but not to the same extent as FHA-backed lending. For example, VA-guaranteed loans accounted for 3.5 percent of home purchase loans in 2000 and about 2 percent in 2006.

3. Distribution of home lenders covered by HMDA, by type of lender and the number of applications they receive, 2006

Type of lender, and subcategory (asset size in millions of dollars, or affiliation)	1–99		100–249		250–999	
	Percent of lender type[1]	Percent of subcategory[2]	Percent of lender type[1]	Percent of subcategory[2]	Percent of lender type[1]	Percent of subcategory[2]
Depository institution						
Commercial bank						
Less than 250	75.8	60.5	63.1	28.7	25.4	9.9
250–999	19.2	26.9	32.0	25.4	60.5	41.3
1,000 or more	5.0	17.7	5.0	10.0	14.1	24.2
All	100	44.4	100	25.3	100	21.7
Savings institution						
Less than 250	84.4	46.9	64.3	34.9	22.5	16.2
250–999	12.7	8.7	33.6	22.4	66.5	58.8
1,000 or more	2.9	4.7	2.1	3.3	11.1	23.3
All	100	25.8	100	25.2	100	33.4
Credit union						
Less than 250	96.0	62.8	82.3	26.8	34.9	10.3
250–999	3.8	8.4	16.8	18.4	57.9	57.1
1,000 or more	.2	1.7	.8	3.5	7.1	27.0
All	100	47.6	100	23.6	100	21.4
All depository institutions						
Less than 250	83.1	59.9	68.7	28.6	27.4	10.7
250–999	13.6	19.7	27.9	23.4	61.0	47.8
1,000 or more	3.3	12.7	3.4	7.7	11.6	24.4
All	100	42.8	100	24.8	100	23.2
Mortgage company						
Independent	37.7	12.1	63.6	13.2	77.0	30.2
Affiliated	62.3	39.1	36.4	14.8	23.0	17.8
All	100	21.2	100	13.7	100	26.0
All institutions	...	**37.9**	...	**22.3**	...	**23.8**
MEMO						
Percent of all applications, by number reported by lender	...	.5	...	1.2	...	3.8

NOTE: Refer to table 2, note 1. As stated in the general note to table 1, applications in the present table include requests for pre-approval that were denied by the lender or were accepted by the lender but not acted upon by the borrower.

1. Distribution sums vertically. For example, the first column, first row shows that 75.8 percent of commercial banks that received 1–99 applications in 2006 had assets of less than $250 million.

2. Distribution sums horizontally. For example, the second column, first row shows that 60.5 percent of commercial banks with assets of less than $250 million received 1–99 applications in 2006.

Not applicable.

to four-family units, and the four categories are applied separately to home-purchase loans and refinancings.

As noted, distinguishing higher-priced loans from others is one way to differentiate lending activity. A second approach is to distinguish between loans originated for a "conforming" loan amount and those that were larger (jumbo loans).[18] Fannie Mae and Freddie Mac hold some of their purchased loans in their own portfolios, but they convert most of them into securities, which they sell to investors. For 2006 the size limit for conforming loans was $417,000 for a single-family property in the continental United States and 50 percent higher for such a property in Alaska and Hawaii and in Guam and the U.S. Virgin Islands. The size limits for conforming loans are higher for structures accommodating two, three, or four families. However, the HMDA data do not distinguish among properties with fewer than five units, so in this article the discussion of 2006 loans with a conforming size refers to the $417,000 limit for single-family properties in the continental United States, a size that included most home loans extended in 2006.[19]

Indeed, for 2006, about 90 percent of conventional loans for purchase and likewise for refinancing, whether higher-priced or not, were within the single-family conforming loan-size limit (table 6). Higher-priced loans tended to be somewhat smaller than

18. The government-sponsored enterprises Fannie Mae and Freddie Mac are permitted to purchase only those mortgages that are in conformance with annually adjusted size limits and certain other underwriting criteria. The HMDA reports do not provide all the data needed to determine whether a loan is conforming, so a mortgage falling within the "conforming loan amount" limit may not meet the other criteria for conforming loans and thus might not be eligible for purchase by Fannie Mae and Freddie Mac.

19. The 2006 limits, which ranged up to $801,950 for a four-family unit, are given in Fannie Mae (2005), "Fannie Mae Announces 2006 Conforming Loan Limit of $417,000," press release, Nov. 29, www.fanniemae.com/newsreleases/2005/3649.jhtml.

3. Distribution of home lenders covered by HMDA, by type of lender and the number of applications they receive, 2006—*Continued*

Type of lender, and subcategory (asset size in millions of dollars, or affiliation)	1,000–4,999		5,000 or more		Any		MEMO	
	Percent of lender type[1]	Percent of subcategory[2]	Percent of lender type[1]	Percent of subcategory[2]	Percent of lender type[1]	Percent of subcategory[2]	Number of lenders	Percent of applications
Depository institution								
Commercial bank								
Less than 250	6.3	.7	5.0	.2	55.6	100	2,170	1.1
250–999	30.9	6.4	.0	.0	31.7	100	1,238	1.6
1,000 or more	62.9	32.7	95.0	15.5	12.6	100	492	22.0
All	100	6.6	100	2.1	100	100	3,900	24.7
Savings institution								
Less than 250	6.4	1.4	5.6	.7	46.4	100	439	.3
250–999	35.1	9.2	5.6	.8	37.7	100	357	.9
1,000 or more	58.5	36.7	88.9	32.0	15.9	100	150	9.9
All	100	9.9	100	5.7	100	100	946	11.1
Credit union								
Less than 250	1.5	.1	.0	.0	72.7	100	1,480	.6
250–999	51.5	16.1	.0	.0	21.7	100	441	.9
1,000 or more	47.1	56.5	100	11.3	5.7	100	115	1.3
All	100	6.8	100	6	100	100	2,036	2.8
All depository institutions								
Less than 250	4.9	.6	4.8	.2	59.4	100	4,089	2.0
250–999	37.5	9.0	2.0	.2	29.6	100	2,036	3.4
1,000 or more	57.6	37.1	93.2	18.1	11.0	100	757	33.1
All	100	7.1	100	2.1	100	100	6,882	38.5
Mortgage company								
Independent	78.7	28.0	70.7	16.6	66.3	100	1,328	36.7
Affiliated	21.4	14.9	29.3	13.5	33.7	100	676.0	24.7
All	100	23.6	100	15.5	100	100	2,004	61.5
All institutions	**...**	**10.8**	**...**	**5.2**	**...**	**100**	**8,886**	**100**
MEMO								
Percent of all applications, by number reported by lender	...	7.5	...	87.0	...	100	8,886	100

others; for example, among conventional home-purchase loans, the mean size of higher-priced mortgages was $209,000, compared with $246,000 for others (table 6, memo item).

By their nature, government-backed loans tend to be considerably smaller than conventional loans; the difference reflects the relatively low guarantees or insurance limits in the government-backed programs and the focus of the programs on lower- and middle-income borrowers. In 2006, for example, the mean size of FHA-insured home-purchase loans was $133,000, and nearly half of such loans were for less than $125,000, whereas only about one-fourth of the conventional loans were in that size range.

Borrower incomes differ substantially by loan product (table 7). Not surprisingly, the mean income of borrowers with conventional loans was substantially larger than that of borrowers with government-backed loans. Among those obtaining conventional home-purchase mortgages, the mean income of individuals with a loan of conforming size was $82,400, versus a mean income of $258,000 for those with a jumbo loan. And, again among borrowers using conventional loans, those using higher-priced loans either to purchase a home or to refinance had a mean income about 20 percent lower than borrowers not paying higher prices.

Non-Owner-Occupant Lending

Part of the strong performance of housing markets over the first half of this decade can be traced to the growth in sales of homes to investors or individuals purchasing second or vacation homes, units collectively described as "non-owner occupied." HMDA data can document the role of investors and second-home buyers in the housing market because the data indicate whether the subject property is intended as the borrower's principal dwelling (that is, as an owner-occupied unit).[20] A limitation on this type of analysis is that some buyers do not use home mortgages to finance their purchase; rather, they pay cash for the properties or, in some instances, take out commercial loans. After declining in the early 1990s,

20. An investment property is a non-owner-occupied dwelling that is intended to be continuously rented. Non-owner-occupied units—vacation homes and second homes—that are for the primary use of the owner are not considered investment properties. The HMDA data do not, however, distinguish between these two types of non-owner-occupied dwellings.

4. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2006

Type of home and loan	Applications				Loans originated				
	Number submitted	Acted upon by lender			Number	Loans with APR spread above the threshold[1]			
		Number	Number denied	Percent denied		Number	Percent	Distribution, by percentage points of APR spread	
								3–3.99	4–4.99
ONE- TO FOUR-FAMILY									
NONBUSINESS RELATED[2]									
Owner occupied									
Site-built									
Home purchase									
Conventional									
First lien	6,209,040	5,440,857	1,010,083	18.6	3,893,634	983,350	25.3	24.9	13.6
Junior lien	2,092,637	1,858,700	386,435	20.8	1,259,933	575,488	45.7	...	...
Government backed									
First lien	518,564	459,083	55,711	12.1	382,091	6,805	1.8	89.9	4.6
Junior lien	808	611	67	11.0	504	16	3.2	...	...
Refinance									
Conventional									
First lien	10,396,764	7,945,231	2,840,921	35.8	4,262,866	1,320,984	31.0	28.5	16.8
Junior lien	2,073,910	1,759,118	531,231	30.2	1,010,349	281,464	27.9	...	...
Government backed									
First lien	186,746	157,536	34,557	21.9	109,238	3,348	3.1	78.0	12.4
Junior lien	524	424	75	17.7	328	14	4.3	...	...
Home improvement									
Conventional									
First lien	801,434	690,940	280,138	40.5	348,731	103,414	29.7	37.3	19.5
Junior lien	1,120,356	1,017,604	366,647	36.0	545,297	94,234	17.3	...	...
Government backed									
First lien	5,955	5,195	1,326	25.5	3,479	160	4.6	70.6	13.8
Junior lien	4,479	3,674	1,589	43.2	1,723	1,030	59.8	...	...
Unsecured (conventional or government backed)	351,726	343,747	167,873	48.8	149,829	...	...	...	...
Manufactured									
Conventional, first lien									
Home purchase	348,818	335,776	163,799	48.8	100,883	50,927	50.5	30.1	23.8
Refinance	171,666	154,688	77,918	50.4	59,538	31,946	53.7	34.0	26.7
Other	145,212	130,837	52,631	40.2	68,788	15,667	22.8	28.5	11.9
Non-owner occupied[4]									
Conventional, first lien									
Home purchase	1,327,514	1,180,975	225,054	19.1	838,486	239,543	28.6	51.3	15.8
Refinance	1,003,827	852,129	240,862	28.3	523,263	155,057	29.6	41.5	14.6
Other	495,094	434,143	121,602	28.0	262,974	128,449	48.8	4.3	1.8
BUSINESS RELATED[3]									
Conventional, first lien									
Home purchase	21,997	20,062	2,003	10.0	17,239	1,121	6.5	53.1	12.4
Refinance	23,007	21,046	2,625	12.5	17,598	1,011	5.7	53.1	13.4
Other	7,362	6,738	1,104	16.4	5,253	246	4.7	28.0	9.8
MULTIFAMILY[5]									
Conventional, first lien									
Home purchase	65,093	59,320	3,923	6.6	51,710	5,992	11.6	50.5	16.8
Refinance	54,099	47,047	4,477	9.5	38,353	5,148	13.4	59.8	14.2
Other	25,306	21,817	2,849	13.1	16,978	3,692	21.7	3.9	2.1
Total	**27,451,938**	**22,947,298**	**6,575,500**	**28.7**	**13,969,065**	**4,009,106**	**28.7**	**22.4**	**11.6**

NOTE: Excludes transition-period applications (those submitted before 2004) and transition-period loans (those for which the application was submitted before 2004).

1. Annual percentage rate (APR) spread is the difference between the APR on the loan and the yield on a comparable-maturity Treasury security. The threshold for first-lien loans is a spread of 3 percentage points; for junior-lien loans, it is a spread of 5 percentage points.

2. Loans covered by the Home Ownership and Equity Protection Act of 1994, which does not apply to home-purchase loans.

3. Business-related applications and loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are not applicable; all other applications and loans are nonbusiness related.

4. Includes applications and loans for which occupancy status was missing.

5. Includes business-related and nonbusiness-related applications and loans for owner-occupied and non-owner-occupied properties.

... Not applicable.

4. Disposition of applications for home loans, and origination and pricing of loans, by type of home and type of loan, 2006—*Continued*

Loans originated						Memo					
Loans with APR spread above the threshold[1]						Transition-period applications (those submitted before 2004)					
Distribution, by percentage points of APR spread			APR spread (percentage points)		Number of HOEPA-covered loans[2]	Number submitted	Number denied	Percent denied	Loans originated		Number of HOEPA-covered loans[2]
5–6.99	7–8.99	9 or more	Mean	Median					Number	Percent with APR spread above threshold	
51.5	9.6	.5	5.3	5.5	...	1,875	123	11.0	527	3.6	...
58.9	37.2	4.0	6.8	6.7	...	69	4	8.9	23	17.4	...
2.8	2.4	.3	3.5	3.2	...	129	10	20.0	17	17.6	...
75.0	25.0	.0	6.2	6.3	...	0	0	0	0	0	...
44.9	9.7	.1	5.1	5.2	3,894	2,472	84	7.2	93	4.3	0
55.5	37.1	7.5	6.9	6.8	2,655	33	2	10.5	6	0	0
7.8	1.7	.1	3.7	3.2	16	80	12	21.4	11	9.1	0
42.9	42.9	14.3	7.0	7.3	0	0	0	0	0	0	0
34.3	8.0	.7	4.9	4.6	1,578	8	0	0	3	0	0
46.7	35.1	18.2	7.4	7.2	3,720	14	0	0	1	0	0
12.5	2.5	.6	3.9	3.5	1	1	0	0	0	0	0
41.7	33.0	25.3	7.7	7.3	99	0	0	0	0	0	0
...	...	...	...	...	...	0	0	0	0	0	...
30.2	12.0	3.9	5.3	4.8	...	32	1	5.9	6	0	...
28.7	8.6	2.0	4.9	4.6	1,384	50	3	13.0	2	50.0	0
23.8	23.8	12.0	6.1	5.6	1,023	8	1	25.0	2	0	0
25.8	6.3	.7	4.6	3.9	...	369	12	5.6	83	7.2	...
35.0	8.4	.5	4.9	4.5	347	235	5	4.8	18	5.6	0
35.0	34.2	24.6	7.6	7.4	276	16	2	18.2	7	42.9	0
30.4	3.8	.3	4.5	3.9	...	7	0	0	6	0	...
30.7	2.7	.2	4.4	3.9	2	4	0	0	3	0	0
44.3	14.6	3.3	5.4	5.3	1	3	0	0	2	0	0
18.7	12.1	1.9	4.8	4.0	...	175	11	7.1	109	2.8	...
19.7	5.9	.4	4.3	3.7	35	449	2	0.9	191	1.0	0
49.1	31.6	13.3	6.9	6.7	141	40	7	28.0	8	0	0
46.6	**16.7**	**2.7**	**5.6**	**5.7**	**15,172**	**6,069**	**279**	**8.6**	**1,118**	**4.2**	**0**

the share of non-owner-occupant lending among first-lien loans to purchase one- to four-family site-built homes began rising in 1994, and it has risen in every year between 1996 (when it was 6.4 percent) and 2005, when it reached 17.3 percent (table 8). For 2006, the share fell somewhat, to 16.5 percent. Further, in line with the experience for home-purchase loans to owner-occupants, the number of conventional first-lien loans to purchase homes by non-owner-occupants fell about 17 percent from 2005.

5. Home-purchase lending that began with a request for pre-approval: Disposition and pricing, by type of home, 2006

Type of home	Requests for pre-approval			Applications preceded by requests for pre-approval[1]			Loan originations whose applications were preceded by requests for pre-approval		
	Number acted upon by lender	Number denied	Percent denied	Number submitted	Acted upon by lender		Number	Loans with APR spread above the threshold[2]	
					Number	Number denied		Number	Percent
ONE- TO FOUR-FAMILY									
NONBUSINESS RELATED[3]									
Owner occupied									
Site-built									
Conventional									
First lien	782,978	192,997	24.6	478.986	417.401	35,416	344.575	33.668	9.8
Junior lien	158.359	37.834	23.9	103,306	92.200	7.924	72,364	19.054	26.3
Government backed									
First lien	77.970	22,654	29.1	55.250	48.701	3.996	42.201	1.063	2.5
Junior lien	58	8	13.8	54	48	5	42	3	7.1
Manufactured									
Conventional, first lien	40,506	20.489	50.6	37.589	33.069	18.032	8.357	5.793	69.3
Other	5.079	1.533	30.2	3.811	3.117	515	2.452	149	6.1
Non-owner occupied[4]									
Conventional, first lien	89,459	17,789	19.9	67,177	57.720	7,102	44,834	8,890	19.8
Other	16.448	3.246	19.7	13.714	11.573	1.591	8.318	4.352	52.3
BUSINESS RELATED[3]									
Conventional, first lien	2.976	198	6.7	2.813	2,370	126	2.161	84	3.9
Other	388	31	8.0	368	265	23	192	70	36.5
MULTIFAMILY[5]									
Conventional, first lien	295	30	10.2	275	240	18	212	44	20.8
Other	126	5	4.0	125	107	4	99	8	8.1
Total	**1,174,642**	**296,814**	**25.3**	**763,468**	**666,811**	**74,752**	**525,807**	**73,178**	**13.9**

NOTE: Excludes transition-period requests for pre-approval (those submitted before 2004). Refer to general note to table 1

1. These applications are included in the total of 27,451,938 reported in table 4.

2. Refer to table 4, note 1.

3. Business-related applications and loans are those for which the lender reported that the race, ethnicity, and sex of the applicant or co-applicant are "not applicable"; all other applications and loans are nonbusiness related.

4. Includes applications and loans for which occupancy status was missing.

5. Includes business-related and nonbusiness-related applications and loans for owner-occupied and non-owner-occupied properties.

Not applicable.

Piggyback Lending

Many first-time homebuyers have relatively limited assets and thus cannot qualify for other than a mortgage with a high loan-to-value ratio. Other borrowers have the financial capacity to make a large down payment but prefer not to do so. Lenders and secondary-market purchasers often require loans with high LTV ratios to be protected with private mortgage insurance (PMI), carried at the expense of the borrower, to indemnify them, at least in part, against the elevated risk of default on such loans.

In recent years, so-called piggyback loans have emerged as an alternative to PMI. In piggyback lending, borrowers simultaneously receive a first mortgage and a junior-lien (piggyback) loan. The piggyback loan finances the portion of the purchase price not being financed by the first mortgage and sometimes any cash payment that might have been made; the junior loan may amount to as much as 20 percent of the purchase price. Some borrowers have chosen a piggyback loan instead of a loan backed by PMI in part because, until recently, borrower payments for PMI could not be itemized for federal income tax purposes, whereas the interest paid on piggyback loans could be. Also, without the piggyback loan, some home purchases might not have been possible because the underwriting standards applied by PMI companies may have been more conservative than those used by the lender providing the piggyback loan.

The expanded HMDA data document substantial growth in piggyback lending since 2004 and, together with data reported by PMI companies, suggest that such lending played an important role in home sales over the past few years.[21] In 2006, lenders covered by

21. Piggyback loans are not identified explicitly in the HMDA data. However, by matching junior-lien home-purchase loans with first-lien home-purchase loans extended at the same time to borrowers with the

5. Home-purchase lending that began with a request for pre-approval: Disposition and pricing, by type of home, 2006—*Continued*

Loan originations whose applications were preceded by requests for pre-approval							Memo: Applications with transition-period requests for pre-approval (request submitted before 2004)				
Loans with APR spread above the threshold[2]											
Distribution, by percentage points of APR spread					APR spread (percentage points)		Number submitted	Number denied	Percent denied	Loans originated	
3–3.99	4–4.99	5–6.99	7–8.99	9 or more	Mean spread	Median spread				Number	Percent with APR spread above threshold
44.7	17.3	31.0	6.0	.9	4.7	4.3	35	2	8.7	14	0
. . .	. . .	58.1	34.1	7.9	6.9	6.7	3	0	0	2	0
72.2	18.8	5.9	3.0	.1	3.8	3.4	9	1	11.1	7	42.9
. . .	. . .	66.7	33.3	0	6.2	6.4	0	0	0	0	0
20.0	24.4	40.0	13.5	2.1	5.4	5.2	0	0	0	0	0
83.9	.7	3.4	12.1	0	3.8	3.3	0	0	0	0	0
60.0	18.0	16.6	4.3	1.2	4.3	3.7	10	1	16.7	5	0
0	0	22.8	36.1	41.2	8.6	8.5	3	0	0	1	0
60.7	7.1	17.9	11.9	2.4	4.6	3.5	3	0	0	1	0
1.4	1.4	37.1	31.4	28.6	7.8	7.7	0	0	0	0	0
47.7	18.2	27.3	4.5	2.3	4.6	4.2	0	0	0	0	0
12.5	0	62.5	12.5	12.5	7.6	6.2	0	0	0	0	0
30.8	**12.4**	**36.1**	**15.5**	**5.3**	**5.5**	**5.3**	**63**	**4**	**9.1**	**30**	**10.0**

HMDA reported on 1.43 million junior-lien loans to purchase homes; almost all of them were conventional loans, and the quantity was about 4 percent greater than in 2005 (data not shown in tables). Almost 24 percent of the 2006 first-lien conventional home-purchase loans on owner-occupied site-built homes for one to four families involved a piggyback loan as identified here, a proportion that was 2.7 percentage points higher than the comparable figure for 2005. The overall increase from 2005 to 2006 in the number of reported junior-lien loans used to finance a home purchase is notable because the number of reported conventional first-lien home-purchase loans fell nearly 12 percent from 2005 to 2006. Further, in 2006 piggyback lending apparently continued to gain market share at the expense of PMI, as the number of home-purchase loans backed by PMI declined about 6 percent from 2005 to 2006.[22]

An individual whose loan request is too large to meet the conforming size limits also has a reason to take out a piggyback loan: It can be used to divide the total loan amount so that the size of the first lien will be conforming. We estimate that in 2006, 9.6 percent of piggyback loans were used for that purpose (down from 10.1 percent in 2005). Looked at from the borrower perspective, of the individuals in 2006 who borrowed a total exceeding the conforming loan amount, 17.8 percent used a piggyback loan to create a first lien with a conforming size (up from 13.6 percent in 2005).

Manufactured-Home Lending

Manufactured homes, which often sell for less than site-built homes, are an important option for many homebuyers.[23] However, the credit risks associated with manufactured-home lending also tend to be higher than for site-built homes, so loans backed by manufactured units carry relatively high interest rates.

same characteristics and census tract location, an estimate of the incidence of piggyback loans, at least for those originated by the same lender, can be derived. About 85 percent of junior-lien loans reported in the HMDA data can be matched in this manner.

22. Annual PMI data are published by the FFIEC and are available at www.ffiec.gov.

23. Unlike site-built homes, manufactured homes are generally assembled in factories and shipped to a home site.

6. Cumulative distribution of home loans, by loan amount and by purpose, type, and pricing of loan, 2006

Percent

Upper bound of loan amount (thousands of dollars)[1]	Home purchase					Refinance				
	Conventional			FHA	VA	Conventional			FHA	VA
	Not higher priced	Higher priced	Total			Not higher priced	Higher priced	Total		
24	.3	.6	.4	.1	.0	.9	1.3	1.0	.1	.2
49	1.9	3.4	2.3	2.5	.5	3.9	4.7	4.1	2.1	3.3
74	6.6	12.6	8.1	12.9	3.2	9.8	12.9	10.8	9.7	12.2
99	13.6	23.3	16.0	30.1	10.7	17.1	22.8	18.9	23.4	25.6
124	23.7	34.6	26.5	48.4	21.6	26.2	33.6	28.5	40.0	40.0
149	34.5	44.6	37.1	67.4	36.7	34.7	43.5	37.4	57.5	55.3
174	43.9	52.9	46.2	81.3	52.0	43.4	52.5	46.2	71.4	67.0
199	51.9	59.9	54.0	90.0	64.7	50.7	60.0	53.6	81.4	76.2
224	59.5	66.2	61.2	94.4	74.0	58.0	66.7	60.7	88.4	83.2
249	65.2	71.3	66.7	96.8	81.8	63.5	71.8	66.1	92.3	88.5
274	70.3	75.5	71.6	98.1	87.3	68.8	76.3	71.1	94.9	92.4
299	74.4	79.3	75.6	98.8	91.3	72.9	79.9	75.0	96.5	94.9
324	78.4	82.7	79.5	99.2	94.2	77.0	83.3	79.0	97.6	96.8
349	81.3	85.3	82.3	99.5	96.2	80.0	85.9	81.8	98.4	97.9
374	84.0	87.7	84.9	99.8	97.6	83.0	88.2	84.6	99.6	98.8
399	86.1	89.6	87.0	99.8	98.7	85.3	90.0	86.7	99.7	99.4
417	89.1	91.0	89.6	99.9	99.6	88.5	91.4	89.4	99.8	99.9
449	90.2	92.8	90.9	99.9	99.7	89.8	93.1	90.8	99.9	99.9
499	92.2	95.1	92.9	100	99.8	92.1	95.2	93.1	100	99.9
549	94.0	96.7	94.7	100	99.9	94.0	96.7	94.9	100	100
599	95.2	97.7	95.8	100	100	95.3	97.6	96.0	100	100
649	96.3	98.4	96.8	100	100	96.4	98.3	97.0	100	100
699	97.0	98.8	97.5	100	100	97.2	98.8	97.7	100	100
749	97.5	99.1	97.9	100	100	97.6	99.0	98.1	100	100
799	97.9	99.3	98.3	100	100	98.0	99.3	98.4	100	100
More than 799	100	100	100	100	100	100	100	100	100	100
MEMO *Loan amount (thousands of dollars)*										
Mean	245.8	208.7	236.4	133.0	184.6	245.6	207.5	233.8	150.2	154.1
Median[1]	192	165	185	127	171	196	167	186	138	141

1. Loan amounts are reported under HMDA to the nearest $1,000.
FHA Federal Housing Administration.
VA Department of Veterans Affairs.

Beginning with the 2004 data, HMDA rules require lenders to include a code to identify applications and loans involving manufactured homes.[24] The 2006 data indicate that 4,477 lenders extended about 256,000 manufactured-home loans, a loan volume little changed from 2005 (data not shown in tables). Despite the large number of lenders extending at least one mortgage for a manufactured home, such lending is relatively concentrated: 83 percent of the reported manufactured home loans were reported by just ten lenders. About three-fifths of reported manufactured-home loans were used to purchase homes, and a relatively large portion of those mortgages were FHA-insured (18 percent, versus about 5 percent on the purchase of site-built homes).

Delinquency rates on manufactured homes tend to be higher than for other types of home loans, and the resulting lender caution is reflected in very high rates of denial for home-purchase applications on such properties (table 4). (The elevated credit risk also is reflected in elevated loan prices, as discussed below.) Because the use of manufactured homes varies greatly across populations and geographies, analyses of denial-rate differences across groups should differentiate between site-built and manufactured housing.

Loans Covered by HOEPA

Under the Home Ownership Equity Protection Act of 1994, certain types of mortgage loans that have rates or fees above specified levels require additional disclosures to consumers and are subject to certain restrictions on loan terms.[25] Under the 2002 revisions to Regulation C, the expanded HMDA data include a code to identify whether a loan is subject to the protections of HOEPA.

24. In the years preceding 2004, the Department of Housing and Urban Development (HUD) helped users of the HMDA data identify, albeit imperfectly, applications and loans related to manufactured homes by producing each year a list of reporting institutions (typically about twenty) that it believed were primarily in the business of extending such credit (www.huduser.org/datasets/manu.html).

25. HOEPA is implemented by the Federal Reserve Board's Regulation Z (www.federalreserve.gov/regulations/default.htm).

7. Cumulative distribution of home loans, by borrower income and by purpose, type, and pricing of loan, 2006

Percent

Upper bound of borrower income (thousands of dollars)[1]	Home purchase					Refinance				
	Conventional			FHA	VA	Conventional			FHA	VA
	Not higher priced	Higher priced	Total			Not higher priced	Higher priced	Total		
24	2.9	3.6	3.1	5.9	1.0	2.9	4.6	3.5	4.6	3.0
49	22.5	29.3	24.2	50.6	31.0	23.1	33.0	26.2	39.5	31.4
74	46.3	56.1	48.8	83.2	69.2	48.8	62.3	53.0	76.3	69.4
99	64.8	73.9	67.1	94.5	89.2	68.1	79.8	71.8	93.1	88.5
124	76.8	84.3	78.7	97.7	96.6	80.0	88.6	82.7	98.0	96.0
149	83.8	89.9	85.4	98.7	98.8	86.5	92.8	88.5	99.3	98.6
199	91.6	95.7	92.6	99.5	99.8	93.2	96.8	94.3	99.8	99.8
249	94.9	97.6	95.6	99.7	99.9	96.0	98.2	96.6	99.9	100
299	96.5	98.4	97.0	99.8	100	97.2	98.7	97.7	99.9	100
More than 299	100	100	100	100	100	100	100	100	100	100
MEMO Borrower income, by selected loan type (thousands of dollars)[2]										
All										
Mean	105.3	86.1	100.5	55.2	66.0	98.6	78.1	92.1	60.1	65.8
Median[1]	79	68	76	49	60	76	63	72	56	60
Conforming										
Mean	85.3	74.0	82.4	...	...	80.9	67.8	76.7	...	...
Median[1]	72	64	70	...	...	70	60	66	...	...
Jumbo										
Mean	271.6	212.1	258.8	...	...	234.7	191.0	223.7	...	...
Median[1]	199	168	190	...	...	175	150	168	...	...

NOTE: For loans with two or more applicants, HMDA-covered lenders report data on only two. Income for two applicants is reported jointly.

1. Income amounts are reported under HMDA to the nearest $1,000.
2. By size, all loans backed by the FHA or VA are conforming.

... Not applicable.
FHA Federal Housing Administration.
VA Department of Veterans Affairs.

Coverage under HOEPA is determined by a two-part test that considers both the APR and the dollar amount of points and fees. The APR portion of the coverage test is similar to that used to determine which loans are higher priced under HMDA. In the case of HMDA, identifying higher-priced loans requires using the yield on the Treasury security of comparable maturity for the fifteenth day of the month preceding *the date on which the loan rate was set*. For HOEPA, however, the APR portion of the coverage test requires using the yield on the Treasury security of comparable maturity for the fifteenth day of the month preceding *the month in which the application was received*. Another difference is that the APR spreads for determining HOEPA coverage are higher than for determining which loans must be reported as higher-priced under HMDA. HOEPA coverage is based on spreads that exceed 8 percentage points and 10 percentage points for first- and junior-lien loans, respectively, versus minimum spreads of 3 percentage points and 5 percentage points, respectively, in HMDA higher-priced loans.

8. Non-owner-occupied lending as a share of all first liens to purchase one- to four-family site-built homes, by number and dollar amount of loans, 1990–2006

Percent

Year	Number	Dollar amount
1990	6.6	5.9
1991	5.6	4.5
1992	5.2	4.0
1993	5.1	3.8
1994	5.7	4.3
1995	6.4	5.0
1996	6.4	5.1
1997	7.0	5.8
1998	7.1	6.0
1999	7.4	6.4
2000	8.0	7.2
2001	8.6	7.6
2002	10.5	9.2
2003	11.9	10.6
2004	14.9	13.1
2005	17.3	15.7
2006	16.5	14.8

Before the release of the 2004 data, little information was publicly available about the extent of HOEPA-related lending or the number or type of institutions involved in that activity. Although the expanded HMDA data provide important new information, the data fail to capture all HOEPA-related lending. Some HOEPA loans are extended by institutions not covered by HMDA, and some HOEPA loans made by HMDA-covered institutions are not reported under Regulation C, which implements HMDA. Most notably, if the proceeds of a home-secured loan are not used to refinance an existing home loan or to finance home improvements, then the loan may be covered by HOEPA but is not reportable under Regulation C. The extent of HOEPA-related lending not reported under HMDA is unknown.

For 2006, roughly 1,200 lenders reported extending about 15,200 loans covered by HOEPA (table 4). Only 17 lenders made 100 or more HOEPA loans, and most lenders did not report any such loans (data not shown in tables). A majority of the HOEPA loans involved a refinancing, and about two-thirds of these were first-lien loans. In the aggregate, HOEPA-related lending accounts for a very small proportion of the loan market: HOEPA loans accounted for less than 0.1 percent of all the originations of home-secured refinancings and home-improvement loans reported for 2006 (data derived from table 4).

The 2006 HMDA Data on Loan Pricing

The sections that follow analyze the loan-pricing information in the 2006 HMDA data by lender, loan product, geography, and characteristics of borrowers and their neighborhoods.

Incidence of Higher-Priced Lending

As with most loans reported in 2004 and 2005, most loans reported in 2006 were not higher-priced as defined under the Board's Regulation C.[26] Among all the HMDA-reported loans, 28.7 percent were higher-priced in 2006, up from 26.2 percent in 2005 (table 4). Later sections of this article focus on the changes in the incidence of higher-priced lending from 2005 to 2006; this section focuses on 2006 pricing patterns across loan products.

The incidence of higher-priced lending in 2006 differed by loan product (table 4). For example,

- Loans backed by the government—either insured by the FHA or guaranteed by the VA—had a much lower incidence of higher-priced lending than did conventional loans used for the same purpose.
- First-lien home-purchase loans had a lower incidence of higher-priced lending than did junior-lien loans used for that purpose.
- Manufactured-home loans exhibited the greatest incidence of higher pricing regardless of purpose.
- First-lien home-purchase loans extended to non-owner occupants had a higher incidence of higher-priced lending than did comparable loans to owner occupants.

Rate Spreads for Higher-Priced Lending

The 2006 variation in APR spreads between home-purchase loans and loans used in refinancings was much smaller than the variations in incidence noted above. For example, for higher-priced conventional first-lien loans for an owner-occupied site-built home, the mean APR spreads were about 5 percentage points above the yields on comparable Treasury securities both for purchase loans and refinancings (table 4). A similar pattern is found for conventional junior-lien loans: They show a mean spread of about 7 percentage points whether they were used for home purchase or refinancing.

As noted, loans backed by manufactured homes were substantially more likely to be higher-priced than loans backed by site-built properties. However, for each of those two products, the mean spreads paid by those with higher-priced loans were roughly the same whether the loan was for home purchase or refinancing.

As in 2004 and 2005, only a relatively small proportion (about 10 percent) of first-lien loans in 2006 had very large spreads—7 percentage points or more. Similarly, only a relatively small proportion of junior-lien loans had spreads of 9 percentage points or more.

Lenders and Higher-Priced Lending

The concentration of higher-priced lending among institutions covered by HMDA fell somewhat in 2006, although it remained fairly high. About 5,000 of the nearly 8,900 lenders covered by HMDA in 2006 reported extending fewer than 10 higher-priced loans (data not shown in tables). At the other end of the spectrum, the roughly 1,250 lenders that reported making at least 100 higher-priced loans in 2006 accounted for 97 percent of all such loans. The share of such lending attributable to the 10 lenders with the largest volume of higher-priced loans dropped from 59 percent in 2005 to 35 percent in 2006.

Another aspect of concentration is the extent to which institutions that extend higher-priced loans may be considered to be "specialists" in that activity, that is, to have a large proportion of their loans in the higher-priced category. Such specialized institutions

26. Refer to notes 5 and 6 and the appendix.

9. Higher-priced lending: Distribution by type of lender, and incidence at each type of lender, 2004–06

Percent

Type of lender	2004			2005			2006		
	Higher-priced loans		MEMO: All loans, distribution	Higher-priced loans		MEMO: All loans, distribution	Higher-priced loans		MEMO: All loans, distribution
	Distribution	Incidence		Distribution	Incidence		Distribution	Incidence	
Independent mortgage company	50.6	25.5	27.8	52.0	41.4	31.0	45.7	41.5	31.2
Depository	25.9	8.0	45.2	22.8	12.8	43.8	28.5	18.7	43.4
Subsidiary of depository	11.5	9.0	17.9	13.0	20.7	15.5	12.4	22.9	15.4
Affiliate of depository	12.0	18.6	9.1	12.2	30.9	9.7	13.4	37.9	10.1
Total	**100**	**14.0**	**100**	**100**	**24.7**	**100**	**100**	**28.4**	**100**

NOTE: Conventional, first-lien mortgages for site-built properties.

can have a business orientation that is quite different from that of other lenders.[27] Taking 60 percent of loans as the criterion for defining higher-priced specialists, about 25 percent of the roughly 1,250 lenders reporting at least 100 higher-priced loans were specialists, or about 4 percent of *all* reporting institutions. The HMDA data on pricing can only approximately indicate the extent to which a lender specializes in *subprime* loans because some prime loans are higher-priced, and some subprime loans are not.

Higher-priced lending activity may also be described by type of lender. Four groupings are provided here—depository institutions and three types of mortgage company, namely, independents, direct subsidiaries of depository institutions, and affiliates of depository institutions. Regarding conventional first-lien loans for site-built homes in both 2004 and 2005, independent mortgage companies originated about 50 percent of the higher-priced loans and about 30 percent of all such loans; in contrast, depository institutions originated about 25 percent of the higher-priced loans and about 45 percent of all such loans (table 9).

The market shares for all types of home lending were virtually unchanged from 2005 to 2006 across the four categories of lender. However, some changes in market shares of higher-priced lending appeared across the four groups. Depository institutions increased their share of the higher-priced loan market about 6 percentage points, while the market share of independent mortgage companies fell about the same number of percentage points. Notably, the incidence of higher-priced lending for independent mortgage companies was unchanged from 2005, which suggests that the increase in market share for depositories was not caused by independent mortgage companies abandoning that segment of the market.

The recent turmoil in the subprime sector has caused a number of lenders, primarily independent mortgage companies, to cease operations, curtail their activities, or transfer or sell their business to others. As a consequence, the 2007 HMDA data may reveal a notable change in the sources of higher-priced lending, likely with a diminished share coming from independent mortgage companies.

Factors that Influence Higher-Priced Lending

As described in our assessment of the 2005 data, three basic factors may cause the higher-priced share of lending that is reported under HMDA to change from year to year: (1) changes in the interest rate environment, particularly increases in short-term interest rates; (2) changes in the business practices of lenders, particularly in the products offered and the willingness or ability of lenders to bear credit risk; and (3) changes in the borrowing practices or credit-risk profiles of consumers. Among the borrowing practices at issue are the relative preference for adjustable-rate versus fixed-rate loans and for interest rate reduction versus cash-out equity when refinancing; a change in credit-risk profiles would include changes in the distribution of credit scores among borrowers, in the down payments they make, and in their levels of monthly mortgage payment relative to income. Our previous analysis suggested that all three factors were likely responsible for the very large increase from 2004 to 2005 in the reported incidence of higher-priced lending. Quantifying the precise contribution of each of these factors to the change in higher-priced lending proved difficult, however, largely because of a lack of available information within the HMDA data.[28]

27. For example, specialists in higher-priced lending may use different marketing practices and may rely more heavily on the ability to sell loans to secondary-market purchasers.

28. LaCour-Little, "Economic Factors Affecting Home Mortgage Disclosure Act Reporting."

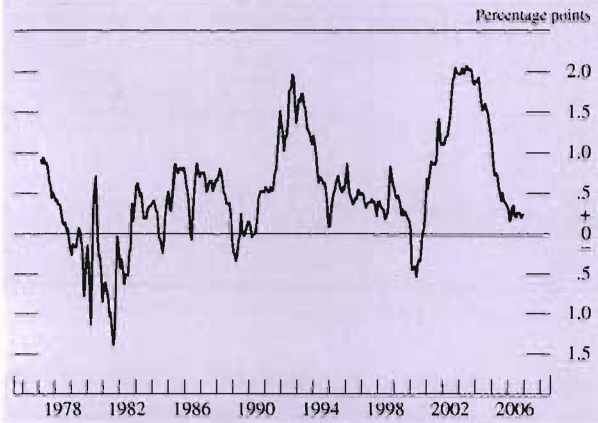
As noted, the incidence of higher-priced lending increased about 2.5 percentage points overall from 2005 to 2006, but, by loan product, changes in the incidence differed considerably over the two years. The most notable changes were increases in the incidence of higher-priced lending for conventional first-lien refinancings on owner-occupied properties, for home-improvement lending, and for lending on non-owner-occupied homes.[29] The following sections analyze those increases in the incidence of higher-priced lending from 2005 to 2006 in terms of the three factors listed above.

The Changing Interest Rate Situation

Regulation C directs lenders to determine whether a loan is higher priced by comparing its APR with the yield on a Treasury security that matches the stated maturity of the loan (refer to notes 5 and 6). Thus, the regulation effectively requires lenders to use *longer-term* interest rates to determine whether to report a loan as higher priced because the stated maturity of most home loans, particularly first-lien loans, typically exceeds twenty years. In contrast, because a mortgage tends to be paid off before its stated maturity, lenders use relatively *shorter-term* interest rates to help set mortgage rates.[30] Thus, a mismatch exists between the longer-term yields used to determine higher-priced lending under HMDA and the shorter-term yields used to set mortgage prices.

A yield curve shows the relationship between the yield on a debt instrument and its term to maturity (figure 1, and box "The Yield Curve"). A consequence of the mismatch just described is that a change from one year to the next in the relationship between short- and long-term rates—a change in the slope of the yield curve—can cause a change in the proportion of loans that are reported as higher priced, all other things being equal. Most notably, if shorter-term interest rates increase in a given year relative to longer-term rates, both the number and proportion of loans that exceed the HMDA price-reporting thresholds in that year will be higher than they would have been in the absence of the change in rates even if lender business practices and borrower behavior remain the same.

1. Spread between interest rates on thirty-year and five-year Treasury bonds, 1977–2006



NOTE: The data are monthly. After March 2002, the spread is between twenty-year and five-year Treasury bonds.

SOURCE: Federal Financial Institutions Examination Council, "FFIEC Rate Spread Calculator," www.ffiec.gov/ratespread/default.aspx.

Fixed-rate lending and the incidence of higher-priced lending. The changing interest rate environment from 2005 through 2006 likely explains part of the increase from 2005 in the share of reported loans that exceeded the pricing thresholds established by Regulation C. Throughout 2004 and 2005, long-term rates exceeded short-term rates (the yield curve was upward sloping), but the difference narrowed over this period as shorter-term rates increased rather steadily (the slope of the yield curve flattened). The yield curve continued to flatten over much of 2006 as shorter-term rates increased, further narrowing the gap between short- and long-term rates.

Using the methodology similar to that described in our analysis of the 2005 data, we estimate that, if all loans were thirty-year fixed-rate loans, the flattening of the yield curve would have made the 2005–06 rise in the incidence of reported higher-priced lending *higher* than it would have been in the absence of the yield-curve flattening, as follows (data not shown in tables): The flattening would have increased the rise in higher-priced lending for conventional first-lien home-purchase loans by 1.9 percentage points, and it would have increased the rise for similar loans for refinancings by about 2.3 percentage points.[31] The actual increase in incidence from 2005 to 2006 was 0.7 percentage point for those home-purchase loans and 5.3 percentage points for those refinancings. Those actual figures imply that if all of the loans reported in HMDA were fixed-rate loans, the change

29. The increase from 2005 to 2006 in the incidence of higher-priced lending for home-purchase loans on non-owner-occupied properties was notable—from 20.3 percent to 28.6 percent. In contrast, the incidence for the purchase of owner-occupied properties increased only slightly over the period, from 24.6 percent to 25.3 percent.

30. Most mortgages are paid off in a relatively short period (typically well before the stated term of the loan is reached) because the individual moves and prepays the loan, or refinances, or defaults.

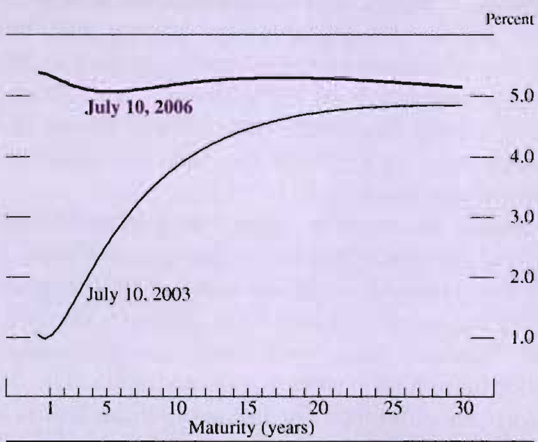
31. The methodology is described on pp. A147–50 in Avery, Brevoort, and Canner, "Higher-Priced Home Lending and the 2005 HMDA Data." Although the maturities of fixed-rate home loans vary somewhat, the overwhelming majority of them are thirty-year loans.

The Yield Curve

The yield curve describes the relationship between interest rates on financial instruments of different maturities (figure A).

The yield curve is typically upward sloping because longer-term investments ordinarily involve greater risk (credit risk, market interest rate risk, and inflation premium), and consequently investors require a higher return to be willing to invest their funds for longer periods. Over the past twenty years, longer-term interest rates (for example, as represented by the annual yield on thirty-year Treasury securities) have almost always exceeded shorter-term interest rates (for example, as represented by the yield on five-year Treasury securities). Figure 1, in the main text, portrays this relationship with the spread, or difference, between the yields on thirty-year and five-year Treasuries. As shown in figure 1 (and as illustrated by the selected dates shown in figure A), the yield curve was especially steep in the 2002–04 period—when short-term rates were quite low by historical standards—but has become much flatter since then and has in fact inverted for short periods.

A. Yield curves on Treasury securities, July 10, 2003 and 2006



NOTE: Smoothed yield curves estimated from off-the-run Treasury coupon securities. Yields shown are those on notional par Treasury securities with semiannual coupons.

between 2005 and 2006 in the incidence of higher-priced lending for first-lien home-purchase loans would have been a modest decline of about 1.2 percentage points (0.7 less 1.9), as opposed to a modest increase. The increase in the incidence for similar refinancing loans would have been about half of the actual reported increase in higher-priced lending (5.3 less 2.3). Overall, our estimate of the roughly 2 percentage point effect on fixed-rate loans between 2005 and 2006 is similar to our estimate of the corresponding effect between 2004 and 2005.

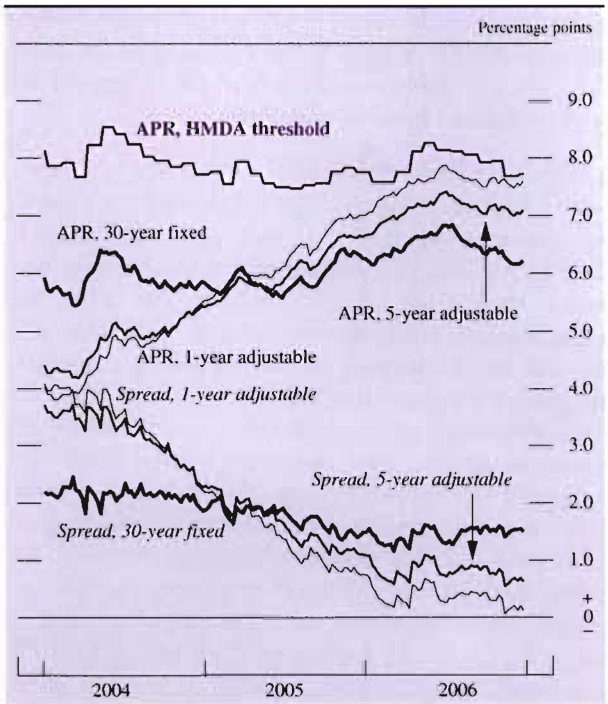
Additional analysis suggests that another portion of the increase in higher-priced lending arises from the effects of the flattening of the yield curve on *adjustable-rate* lending. Evidence provided below suggests that the effects of the flattening of the yield curve on adjustable-rate lending might be larger than on the effect on fixed-rate lending.

Adjustable-rate lending and the incidence of higher-priced lending. A steeply upward sloping yield curve suggests that the market expects short-term interest rates to rise. Yet the method of calculation specified under Regulation Z for deriving the APR for adjustable-rate loans assumes that interest rates will stay the same. Because of this regulatory construct, an upward-sloping yield curve causes the APRs for adjustable-rate loans to be below those for fixed-rate loans of similar term and credit risk. Thus, the flattening of the yield curve can have two effects. First, it can narrow the gap between the longer-term rates used for the HMDA reporting threshold for higher-priced loans and the shorter-term rates used to price loans in the marketplace. Second, a flattening of the yield curve can narrow or even invert the APR gap between adjustable- and fixed-rate loans because, as short-term interest rates increase, the flattening reduces the effect of the comparatively low APR calculations for adjustable-rate loans. The APR gap can be inverted because the expected durations of adjustable- versus fixed-rate loans differ—adjustable-rate loans are expected to be outstanding for shorter periods of time. The APR calculations assume that the durations are the same for both adjustable- and fixed-rate loans and thus underweight the value to the consumer of low teaser rates offered on many adjustable-rate loans. For these reasons, a likely result of a flattening (or inversion) of the yield curve is an increase in the proportion of adjustable-rate loans that exceed the HMDA price-reporting thresholds.

Figure 2 illustrates these effects of a flattening yield curve. The bottom three lines of the figure represent the differences (spreads) between the APRs of three loan types (the top three lines) and the HMDA reporting threshold. The APRs in the figure are the average rates being offered for prime (best credit-quality) loans for those periods as reported by Freddie Mac.[32] The three loan types are all thirty-year

32. The rates are from Freddie Mac's *Primary Mortgage Market Survey* for 2004–06. The Freddie Mac series for five-year adjustable rates did not begin until January 1, 2005. For 2004, we estimated five-year adjustable rates from a statistical model using the one-year adjustable rate and thirty-year fixed rate reported by Freddie Mac and the one- and five-year rates for Treasury securities.

2. APRs of three selected loan types, and the spread between them and the HMDA price-reporting threshold, 2004–06



NOTE: The data are weekly. Threshold and annual percentage rates (APRs) are for prime, conventional, first-lien mortgages amortized on thirty years. For explanation of threshold, refer to text.

SOURCE: APRs are estimated from Freddie Mac, *Primary Mortgage Market Survey*.

loans, but for one of them the interest rate is fixed for the life of the loan whereas the rates for the other two reset after one and five years respectively. As thirty-year first-lien loans, they each have the same HMDA higher-priced reporting threshold—3 percentage points above the yield on the thirty-year Treasury security. The gap between the APR of the typical prime thirty-year fixed-rate loan and the reporting threshold narrowed from 215 basis points at the beginning of 2004 to 144 basis points at the beginning of 2006 and oscillated over the remainder of the year. For prime one-year adjustable-rate loans, the gap narrowed much more, from about 400 basis points at the beginning of 2004 to 52 basis points at the beginning of 2006, then declined further to end the year at only 20 basis points. Thus, at the end of 2006, a one-year adjustable-rate mortgage with a contract rate only 20 basis points above the rate for prime loans as reported by Freddie Mac would have been reported as higher-priced under the HMDA reporting rules.

The differences between the APRs and the reporting threshold decreased for both the fixed-rate and adjustable-rate loans, but the decrease for adjustable-rate loans was much larger. Thus, the gap between the APRs on fixed- and adjustable-rate loans, which was substantial at the beginning of 2004, had been virtually eliminated by early 2005; then the relationship between the two loan types inverted, with APRs on adjustable-rate loans somewhat higher than those on thirty-year fixed-rate loans during most of 2005 and all of 2006. The finding suggests that, as an artifact of regulation, geographic areas may have shown differing incidences of higher-priced lending over the past three years merely because they had differing shares of fixed-rate versus adjustable-rate loans. That is, areas with larger shares of adjustable-rate loans likely had fewer higher-priced loans than areas with larger shares of fixed-rate loans in 2004. This effect should have reversed over the course of 2005 and throughout 2006 as APRs on adjustable-rate loans moved above those on fixed-rate loans.

In the analysis of the 2005 HMDA data, we used information on the mix of adjustable- and fixed-rate loans for each state to derive a rough approximation of the differential effect of the flattening of the yield curve on the proportion of adjustable-rate and fixed-rate loans that exceeded the HMDA price-reporting thresholds.[33] The analysis indicated that states with higher levels of adjustable-rate lending had both relatively low levels of higher-priced lending in 2004 and larger increases in such lending from 2004 to 2005, a pattern that would have been predicted from the narrowing of the APR gap between adjustable- and fixed-rate loans.

The data illustrated in figure 2 suggest that the mix of adjustable- and fixed-rate mortgages should be related to changes in the incidence of higher-priced lending between 2005 and 2006, although the differences between these two years are substantially smaller than those between 2004 and 2005. The data support that inference for home-purchase loans, although the effects are very mild. States with the highest proportion of adjustable-rate mortgages showed a greater increase in the incidence of higher-priced home-purchase lending than other states (table 10). The pattern for refinancings was not consistent: The states with the largest share of adjustable-rate mortgages showed about an average increase in the incidence of higher-priced lending for refinancings, which suggests that other factors, such as opportunities to extract equity, played a more dominant role in explaining differences between 2005

33. The mix of adjustable- and fixed-rate loans was derived from data obtained from First American LoanPerformance, www.loanperformance.com.

10. Incidence of higher-priced lending in states grouped by share of originated loans that had an adjustable rate, and the change in incidence, by quintile and type of loan, 2006

Quintile of states	Home purchase		Refinance	
	2006 (percent)	Change, 2005–06 (percentage points)	2006 (percent)	Change, 2005–06 (percentage points)
Lowest	19.0	.8	38.3	6.7
Second lowest	20.6	1.4	33.6	5.8
Middle	23.6	1.6	31.8	5.0
Second highest	21.6	−.1	29.0	5.3
Highest	26.4	4.6	31.2	5.3
MEMO: California[1]	30.2	1.4	23.3	4.6
Total	**24.1**	**1.9**	**30.2**	**5.3**

NOTE: Spreads are unadjusted. Quintiles based on share of loans originated in 2006 that had an adjustable rate. For definition of higher-priced lending, refer to text.

1. California is shown separately because it accounts for a large number of loans and has a high incidence of adjustable-rate lending.

and 2006 in the incidence of higher-priced lending for refinancings. The role of these factors is discussed below.

Above, we estimated that if all loans were fixed rate, then the effects of the flattening of the yield curve would have been to add approximately 2 percentage points to the reported incidence of higher-priced lending for first-lien loans in the 2006 HMDA data. However, adjustable-rate first-lien mortgages are not as homogenous as fixed-rate loans; substantial proportions of the adjustable-rate loans have variously, for example, one-year, five-year, and seven-year introductory (fixed-rate) periods. We estimate that, if all loans had adjustable rates, the yield-curve effect would have added on the order of 4 or 5 percentage points—depending on the mix of adjustment terms—to the reported incidence of higher-priced lending. Thus, depending on the overall mix of fixed- and adjustable-rate loans and the mix of types among loans with adjustable rates, the effect of the yield curve flattening on the incidence of higher-priced loans would have been to increase the incidence by an amount somewhere between that for the all-fixed-rate assumption and that for the all-adjustable-rate assumption—that is, on the order of 3 or 4 percentage points. That estimate implies that had there been no yield-curve changes, the incidence of higher-priced home-purchase loans would have fallen and the incidence for refinancings would have shown only a modest increase.

Real Effects on the Incidence of Higher-Priced Lending

To the extent that changes in the incidence of higher-priced lending are caused by yield-curve effects, they are not a result of changes in the business practices of lenders nor in the credit-risk profiles of consumers.[34] The importance of the latter two factors in explaining changes in the "real" incidence of higher-priced lending is difficult to gauge.

The housing market, and economic conditions more generally, were favorable in the 2004–05 period. Sales of both new and existing homes in 2005 eclipsed the historic highs reached in 2004. Housing market conditions began moderating in 2006: For the year, home prices rose more slowly in many areas and declined in some others. Nationally, the median price for existing homes increased throughout 2005, reached a high in July 2006, and then declined over the remainder of the year. Nonetheless, the overall median price of existing homes was higher at year-end 2006 than at year-end 2005. In addition, a steady climb in short-term interest rates pushed up monthly payments for some existing borrowers with adjustable-rate loans and for those taking out new such loans.[35] Thus, nationally, housing affordability fell from 2005 to 2006, which suggests that more borrowers may have had to stretch financially to purchase or refinance the mortgages on their homes.[36]

Moreover, higher interest rates altered the mix of individuals seeking to refinance their loans. Historically, individuals have refinanced their loans for one

34. As discussed in the preceding section, the yield-curve effects are an artifact of the Regulation C definition of a higher-priced loan and the specification in Regulation Z of the method of calculating APRs (particularly for adjustable-rate loans).

35. Because many adjustable-rate loans have an initial period at a fixed rate (often two or three years from loan origination), some borrowers with such loans do not experience an immediate change in their payments if interest rates increase. For new borrowers, an increase in short-term rates generally results in a corresponding increase in the initial rate on the loan.

36. Information on the sales, prices, and affordability of homes is in U.S. Department of Housing and Urban Affairs, *U.S. Housing Market Conditions*, www.huduser.org/periodicals/ushmc.html.

or both of the following reasons: to lower the interest rate on the debt or to extract some of the accumulated equity in their home. The latter purpose (sometimes referred to as cash-out refinancing) is accomplished by borrowing more than is needed to cover the closing costs of the new loan plus the existing balance of the old loan. Increases in interest rates during 2005 and the first part of 2006 reduced the opportunities for individuals to benefit from rate-reduction refinancings, so the proportion of borrowers in the refinance market who were seeking equity extraction likely rose in 2006.[37]

The less-favorable conditions in the housing market and in the interest rate environment in 2006 relative to 2005 undoubtedly account for much of the decline in the number of mortgage originations reported in the HMDA data for 2006, particularly with regard to the sharp decline in refinancings (about 15 percent). It also likely explains the increase from 2005, apart from the effects of the yield-curve flattening, in the proportion of borrowers who obtained higher-priced loans in the market for refinancings. The rise in the incidence of higher-priced lending in the refinance market (particularly when compared with the home-purchase market) seems to have come primarily from the aforementioned rise in the proportion of borrowers in the refinance market who were seeking to raise cash—and equity extraction is a major reason for borrowers in the higher-priced segment market to refinance.[38] In short, the increase in the incidence of higher-priced lending in the refinance market, at least relative to the home-purchase market, appears to have been driven mainly by a decrease in the number of prime borrowers in this market rather than by an increase in borrowers with weaker credit profiles.

Industry data provide additional support for the view that real credit quality declined from 2005 to 2006, albeit modestly. However, most of the change in credit quality seems to have taken place in the near-prime, or "alt-A," portion of the market. For example, estimates show that from 2005 to 2006, the subprime share of all mortgage originations held steady at about 20 percent, whereas, over the same period, the alt-A portion of the market rose from 12.2 percent to 13.4 percent.[39]

Differences in Lending Outcomes by Race, Ethnicity, and Sex of Borrower

One purpose of the HMDA data is to allow comparisons of lending outcomes across borrowers grouped by their race, ethnicity, or sex. Three types of outcomes often assessed are the incidence of higher-priced lending (that is, the percentage of loans that were higher priced), the price spreads on the higher-priced loans (that is, the amount by which the APRs on those loans were above the HMDA reporting threshold), and denial rates. Analysis of the 2004 and 2005 HMDA data found that differences across groups in mean spreads paid by those with higher-priced loans were generally small. However, the analysis revealed substantial differences across racial and ethnic lines in the incidence of higher-priced lending and in denial rates; further, it showed that such differences could not be fully explained by factors included in the HMDA data.

In examining 2006 lending outcomes by the race, ethnicity, and sex of borrowers, the present analysis focuses on home-purchase and refinancing loans that are conventional first liens on owner-occupied, one- to four-family, site-built homes. Those types of home-purchase and refinancing loans together represent, by far, the largest number of reported mortgages in the HMDA data: For 2006, the home-purchase category comprised 6.2 million applications and 3.9 million loans; the refinancing category comprised 10.4 million applications and 4.3 million loans (table 4).

The HMDA data include only some of the many factors directly considered by lenders in the process of credit underwriting and pricing. Among the borrower-related items in the HMDA data that are likely related to the loan underwriting and pricing process are property location, income relied on in underwriting, loan amount, time of year when the loan was made, and presence of a co-applicant. Because of the focus here on specific loan product categories, the analysis already accounts in broad

37. Data published by Freddie Mac indicate that the share of refinancings involving a cash-out rose steadily over the course of 2005 and through the third quarter of 2006 (www.freddiemac.com/news/finance/refi_archives.htm).

38. This conclusion follows from the belief that the credit profiles of those extracting equity are, in general, worse than those that refinance purely to benefit from interest rate reductions. Empirical evidence on delinquency rates for refinancings involving equity extraction is generally consistent with this belief. However, in areas that have experienced exceptional increases in home values, the expected credit profiles of those extracting equity may not be worse than others because such borrowers may benefit from relatively low loan-to-value ratios. That condition may explain, for example, the relatively low incidence of higher-priced lending for refinancings in California (table 10), a state with a high incidence of higher-priced lending for home purchases. California was among the states with the largest increases in home values in recent years.

39. Estimate derived from Inside Mortgage Finance, *The 2007 Mortgage Market Statistical Annual.*

terms for loan type and purpose, type of property securing the loan, lien status, and owner-occupancy status.

In comparing lending outcomes across racial and ethnic groups, one can match for the sex of the applicant and co-applicant. Accounting for sex in the analysis is intended to better distinguish pricing issues related purely to the race or ethnicity of the borrower from those that could be related to sex. In assessing lending outcomes by sex, one can match for race and ethnicity, once again to make comparisons as precise as possible.

The pricing analysis here focuses on both the incidence of higher-priced lending and the mean APR spreads paid by borrowers with higher-priced loans. Comparisons of these outcomes are made across eleven groups—nine racial or ethnic groups and the two sexes. Comparisons of average outcomes for each group are made both before and after modifying the results for (1) differences in the borrower-related factors cited earlier and (2) differences in the borrower-related factors *plus* the specific lending institution used by the borrower.[40] The method of controlling for these factors is to gather borrower data into cells or groupings; in each cell, borrowers are similar along the dimensions considered. The methodology used here is the same as that described in the previously cited articles in the *Federal Reserve Bulletin* assessing the 2004 and 2005 HMDA data.

Comparisons for lending outcomes across groups are of three types: gross ("unmodified"), modified to account for borrower-related factors ("borrower modified"), and modified for borrower-related factors plus lender ("borrower-plus-lender modified"). For purposes of presentation, the borrower-modified and borrower-plus-lender-modified outcomes shown in the tables are normalized so that, *for the base comparison group* (non-Hispanic whites in the case of comparison by race and ethnicity, and males in the case of comparison by sex), the mean at each modification level is the same as the gross mean. Consequently, the borrower-modified and borrower-plus-lender-modified outcomes for any other group represent the expected average outcome if the members of that group had the same distribution of control factors as that of the base comparison group.

40. To recall, the borrower-related factors are income, loan amount, metropolitan statistical area (MSA) of the property, presence of a co-applicant, and (in the comparisons by race and ethnicity) sex. Excluded from the pricing analysis are applicants residing outside the fifty states and the District of Columbia and applications deemed to be business related.

Incidence of Higher-Priced Lending by Race and Ethnicity

The 2006 HMDA data, like the 2004 and 2005 data, indicate that black and Hispanic borrowers are more likely, and Asians borrowers less likely, to obtain loans with prices above the HMDA pricing reporting thresholds than are non-Hispanic white borrowers. These relationships are found for both home-purchase loans and refinancings (table 11).[41] Gross differences in the incidence of higher-priced lending between non-Hispanic whites, on the one hand, and blacks or Hispanic whites, on the other, are large, but borrower-plus-lender-modified differences are substantially reduced. Most of the reduction in the difference in the incidence across groups comes from adding the control for lender to the control for borrower-related factors, an indication that the pricing differences in a given lender's underwriting are typically smaller than the differences among loans across lenders.

For home-purchase loans in 2006, the gross mean incidence of higher-priced lending was 53.7 percent for blacks and 17.7 percent for non-Hispanic whites, a difference of 36.0 percentage points (table 11, top panel). Borrower-related factors included in the HMDA data accounted for about one-sixth of the unmodified difference. Controlling further for lender reduces the remaining gap to 12.6 percentage points. In comparison, in 2005, the unmodified mean incidence of higher-priced lending for such loans was 54.7 percent for blacks and 17.2 percent for non-Hispanic whites, a difference of 37.5 percentage points. For 2005, borrower-related factors accounted for about one-fifth of the unmodified difference, and controlling further for borrower and lender reduced the remaining gap to 10 percentage points, a somewhat smaller "unexplained" difference than that found in the 2006 data.

For refinancings in 2006, the difference between blacks and non-Hispanic whites in the unmodified mean incidence of higher-priced lending was 27.1 percentage points, and the borrower-plus-lender-related difference was 7.3 percentage points; once again, most of the reduction in differences came from the addition of the control for lender (table 11, bottom

41. Applicants are placed under only one category for race and ethnicity, generally according to the race and ethnicity of the person listed first on the application. However, under race, the application is designated as *joint* if one applicant reported the single designation of white and the other reported one or more minority races. If the application is not joint but more than one race is reported, the following designations are made: If at least two minority races are reported, the application is designated as *two or more minority races*; if the first person listed on an application reports two races, and one is white, the application is categorized under the minority race.

11. Incidence of higher-priced lending, unmodified and modified for borrower- and lender-related factors, for conventional first liens on owner-occupied one- to four-family site-built homes, by type of loan and by race, ethnicity, and sex of borrower, 2005 and 2006

Percent except as noted

Race, ethnicity, and sex[1]	2005				2006			
	Number of loans	Unmodified incidence	Modified incidence, by modification factor: Borrower-related	Modified incidence, by modification factor: Borrower-related plus lender	Number of loans	Unmodified incidence	Modified incidence, by modification factor: Borrower-related	Modified incidence, by modification factor: Borrower-related plus lender
	Home purchase							
Race other than white only								
American Indian or Alaska Native	27,766	35.3	29.5	21.8	21,615	34.2	30.5	24.5
Asian	237,383	16.6	15.8	16.6	187,187	16.8	15.3	16.8
Black or African American	312,451	54.7	47.0	27.2	318,650	53.7	47.6	30.3
Native Hawaiian or other Pacific Islander	23,450	34.8	30.4	21.0	18,773	34.0	29.2	22.9
Two or more minority races	2,112	30.4	28.7	20.8	2,112	27.6	28.6	20.7
Joint	51,881	18.2	23.0	19.0	44,666	17.5	23.8	19.8
Not available	431,159	32.4	33.6	21.6	377,985	29.2	31.8	23.3
White, by ethnicity								
Hispanic white	464,634	46.1	34.2	21.9	464,291	46.6	35.1	24.0
Non-Hispanic white	2,789,265	17.2	17.2	17.2	2,406,570	17.7	17.7	17.7
Sex								
One male	1,392,947	31.7	31.7	31.7	1,255,567	32.3	32.3	32.3
One female	1,021,006	30.8	29.8	30.8	925,029	30.9	30.2	31.2
Two males	44,278	23.1	23.1	23.1	36,405	23.9	23.9	23.9
Two females	36,140	24.7	22.4	23.9	31,062	26.2	22.5	23.4
	Refinance							
Race other than white only								
American Indian or Alaska Native	37,213	28.9	32.1	24.1	27,748	32.8	36.1	29.5
Asian	165,011	15.2	18.9	21.1	127,873	19.6	23.7	25.3
Black or African American	441,299	49.3	45.0	27.2	397,452	52.8	50.0	33.0
Native Hawaiian or other Pacific Islander	31,453	28.4	32.2	24.3	24,078	33.6	37.5	30.0
Two or more minority races	3,650	28.6	29.5	24.2	2,913	28.0	28.9	30.8
Joint	61,200	19.3	26.2	22.4	41,875	26.2	33.3	26.9
Not available	752,573	32.2	38.0	24.5	570,431	38.2	43.7	30.6
White, by ethnicity								
Hispanic white	478,381	33.8	31.5	23.6	437,163	37.7	37.0	29.7
Non-Hispanic white	3,496,425	21.0	21.0	21.0	2,596,873	25.7	25.7	25.7
Sex								
One male	1,424,721	30.3	30.3	30.3	1,197,165	34.6	34.6	34.6
One female	1,229,138	31.1	30.0	30.4	1,033,700	35.3	34.3	34.5
Two males	37,442	21.2	21.2	21.2	27,336	26.6	26.6	26.6
Two females	41,572	27.0	23.5	22.5	31,179	34.1	29.9	26.6

NOTE: Excludes transition-period loans (those for which the application was submitted before 2004). For definition of higher-priced lending and explanations of spread adjustment and of modification factors, refer to text.

1. Categories for race and ethnicity reflect the revised standards established in 1997 by the Office of Management and Budget. For method of allocation into racial and ethnic categories and definitions of categories, refer to text note 41. Loans taken out jointly by a male and female are not tabulated here because they would not be directly comparable with loans taken out by one borrower or by two borrowers of the same sex.

panel). In comparison, in 2005, the unmodified difference in incidence between blacks and non-Hispanic whites was 28.3 percentage points, and the borrower-plus-lender-related difference was 6.2 percentage points. As in 2006, most of the reduction in 2005 came from the addition of the control for lender. Relationships are similar for comparisons made between Hispanic whites and non-Hispanic whites, but the unmodified difference in incidence between these two groups (12 percentage points in 2006) is notably smaller than that between blacks and non-Hispanic whites, and much of the difference is attributable to borrower-related factors and lender.

The situation for Asians differs greatly from that for blacks or Hispanic whites: Compared with non-Hispanic whites, Asians had a *lower* unmodified mean incidence of higher-priced lending in 2006 for home-purchase and refinance loans. Borrower-related factors plus lender do not alter the gap in incidence but narrow it for refinancings.

Rate Spreads by Race and Ethnicity

The 2006 data indicate that among borrowers with higher-priced loans, the unmodified mean spread of prices paid by black borrowers are moderately higher,

12. Mean APR spreads, unmodified and modified for borrower- and lender-related factors, for higher-priced conventional first liens on owner-occupied one- to four-family site-built homes, by type of loan and by race, ethnicity, and sex of borrower, 2005 and 2006

Percentage points except as noted

Race, ethnicity, and sex	2005				2006			
	Number of higher-priced loans	Unmodified mean spread	Modified mean spread, by modification factor		Number of higher-priced loans	Unmodified mean spread	Modified mean spread, by modification factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
	Home purchase							
Race other than white only								
American Indian or Alaska Native	9,799	4.6	4.8	4.8	7,388	5.2	5.2	5.2
Asian	39,471	4.6	4.7	4.7	31,395	5.0	5.1	5.1
Black or African American	171,009	5.0	4.9	4.9	171,238	5.7	5.6	5.3
Native Hawaiian or other Pacific Islander	8,162	4.6	4.8	4.8	6,376	5.2	5.2	5.1
Two or more minority races	641	4.8	4.9	4.8	583	5.4	5.4	5.3
Joint	9,468	4.6	4.8	4.8	7,802	5.3	5.3	5.2
Not available	139,740	4.9	4.9	4.8	110,527	5.5	5.5	5.3
White, by ethnicity								
Hispanic white	214,415	4.6	4.7	4.8	216,422	5.3	5.2	5.2
Non-Hispanic white	479,338	4.7	4.7	4.7	426,138	5.1	5.1	5.1
Sex								
One male	441,919	4.8	4.8	4.8	405,414	5.3	5.3	5.3
One female	313,959	4.8	4.8	4.8	285,937	5.3	5.3	5.3
Two males	10,213	4.5	4.5	4.5	8,716	5.2	5.2	5.2
Two females	8,943	4.7	4.6	4.5	8,142	5.4	5.3	5.2
	Refinance							
Race other than white only								
American Indian or Alaska Native	10,770	4.8	4.8	4.8	9,096	5.1	5.1	5.1
Asian	25,119	4.7	4.8	4.8	25,096	4.9	5.0	5.1
Black or African American	217,351	5.0	5.0	4.9	209,910	5.4	5.3	5.2
Native Hawaiian or other Pacific Islander	8,945	4.8	4.8	4.8	8,102	5.1	5.1	5.1
Two or more minority races	1043	4.9	4.9	4.8	815	5.2	5.3	5.2
Joint	11,815	4.7	4.8	4.8	10,958	5.0	5.1	5.1
Not available	242,666	5.0	5.0	4.8	217,915	5.3	5.3	5.1
White, by ethnicity								
Hispanic white	161,713	4.8	4.8	4.8	164,748	5.1	5.1	5.1
Non-Hispanic white	733,290	4.8	4.8	4.8	668,337	5.1	5.1	5.1
Sex								
One male	432,386	4.9	4.9	4.9	414,387	5.2	5.2	5.2
One female	382,071	4.9	4.9	4.9	365,368	5.2	5.2	5.2
Two males	7,937	4.8	4.8	4.8	7,276	5.0	5.0	5.0
Two females	11,208	4.8	4.8	4.8	10,646	5.1	5.1	5.0

NOTE: Spread-unadjusted APR is the difference between the APR on the loan and the yield on a comparable-maturity Treasury security. Spread-adjusted APR is the difference between the APR on the loan and the estimated APR reported by Freddie Mac for a thirty-year fixed-rate loan in their Primary Mortgage Market Survey. Excludes transition-period loans (those for which the application was submitted before 2004). Refer also to note 1, table 11.

and those paid by Hispanic white borrowers are slightly higher, than those paid by non-Hispanic white borrowers (table 12). The spread of prices paid by Asian borrowers with higher-priced loans was about the same, on average, as that by non-Hispanic whites with higher-priced loans. These relationships are generally consistent for both types of loan and are little influenced by borrower-related factors or the specific lender used by the borrowers.

Pricing Differences by Sex

The HMDA data for 2006, like those for previous years, reveal little difference in pricing outcomes by sex. For example, sole female borrowers generally have a slightly lower incidence of higher-priced lending than sole male borrowers for home-purchase loans both before and after accounting for borrower-related factors plus lender (table 11). Similarly, the average spreads on prices paid by females with higher-priced loans are virtually the same as those paid by males after accounting for the presence or absence of a co-borrower (table 12).

Denial Rates by Race, Ethnicity, and Sex

Analyses of the HMDA data from earlier years has consistently found that denial rates vary by applicant race and ethnicity. For the 2006 home-purchase and refinance loans examined here on an unmodified

13. Denial rates on applications, unmodified and modified for borrower- and lender-related factors, for conventional first liens on owner-occupied, one- to four-family, site-built homes, by type of loan and by race, ethnicity, and sex of applicant, 2006

Percent except as noted

Race, ethnicity, and sex	Home purchase				Refinance			
	Number of applications acted upon by lender	Unmodified denial rate	Modified denial rate, by modification factor		Number of applications acted upon by lender	Unmodified denial rate	Modified denial rate, by modification factor	
			Borrower-related	Borrower-related plus lender			Borrower-related	Borrower-related plus lender
Race other than white only								
American Indian or Alaska Native	34,646	25.9	22.2	18.2	63,757	44.7	44.8	37.7
Asian	264,397	17.0	14.5	14.8	215,172	27.7	33.2	34.6
Black or African American	553,168	31.6	27.7	21.5	883,842	44.9	46.2	38.7
Native Hawaiian or other Pacific Islander	29,104	23.4	20.3	17.4	47,437	36.4	41.8	37.5
Two or more minority races	3,139	20.2	18.0	17.2	5,878	40.5	42.9	37.3
Joint	57,781	13.6	17.0	14.9	74,030	34.0	40.3	34.4
Not available	611,069	24.2	23.7	18.1	1,448,614	48.0	49.6	38.3
White, by ethnicity								
Hispanic white	719,166	25.4	20.3	17.5	801,813	33.5	36.6	35.8
Non-Hispanic white	3,063,436	13.1	13.1	13.1	4,343,279	30.6	30.6	30.6
Sex								
One male	1,833,621	21.7	21.7	21.7	2,324,086	37.6	37.6	37.6
One female	1,334,498	21.0	20.5	20.9	1,926,089	36.1	35.0	35.9
Two males	50,505	19.2	19.2	19.2	50,870	36.5	36.5	36.5
Two females	43,322	19.5	17.4	17.7	60,185	39.5	36.8	36.1

NOTE: Includes transition-period applications (those submitted before 2004). For explanation of modification factors, refer to text. Refer also to note 1, table 11.

basis, American Indians, blacks, and Hispanic whites had higher denial rates than non-Hispanic whites; blacks had the highest rates; and Hispanic whites had rates between those for blacks and those for non-Hispanic whites. The pattern was less consistent for Asians, who had higher denial rates than non-Hispanic whites for home purchase but lower rates for refinancings (table 13).

For home-purchase lending, controlling for borrower-related factors in the HMDA data reduces the differences in denial rates among racial and ethnic groups. Accounting for the specific lender used by the applicant almost always reduces differences further, although unexplained differences remain between non-Hispanic whites and other racial and ethnic groups. For example, for home-purchase loans, the gross mean denial rate was 31.6 percent for blacks and 13.1 percent for non-Hispanic whites, a difference of 18.5 percentage points (table 13). Borrower-related factors reduce the difference to 14.6 percentage points, and lender adjustment further reduces it to 8.4 percentage points. The borrower-plus-lender-modified differences for refinance loans are similar to those for home purchase, although unmodified differences in denial rates tend to be smaller. The gross difference between denial rates for blacks and non-Hispanic whites for refinancings is 14.3 percentage points, a difference cut about in half by borrower-plus-lender adjustment.

With regard to the sex of applicants, sole male applicants have nearly the same denial rate as sole females. For home-purchase loans, co-applicants, whether male or female, have somewhat lower denial rates than single individuals.

Limitations of the Data on Differences across Groups

The 2006 HMDA data, like those for 2004 and 2005, show that the incidence of higher-priced lending for blacks and Hispanic white borrowers is notably greater than for non-Hispanic whites and, for Asians, that the incidence is fairly close to that for non-Hispanic whites. The borrower-plus-lender adjustment, discussed above, is insufficient to account fully for racial or ethnic differences in the incidence of higher-priced lending; significant differences remain unexplained. Similar patterns are shown in racial and ethnic differences in denial rates. By contrast, only small differences across groups were found in the mean spreads paid by those receiving higher-priced loans. Regarding the sex of borrowers, only small differences were found in lending outcomes.

In our analysis of the 2005 HMDA data regarding differences by race, ethnicity, and sex in the incidence of higher-priced lending and in the spreads paid by those with higher-priced loans, we presented differences both before and after adjusting the APRs to remove the effects of the flattening of the yield curve. Here, for 2006, we present only the differences before making the APR adjustment; they are similar to the differences remaining after that adjustment. But the changes in group differences between 2005 and 2006 are narrowed by the APR adjustment. For example, controlling for borrower-related factors plus lender, the gap in the incidence of higher-priced lending between black and non-Hispanic white home-purchase borrowers rose from 10.0 percentage points to 12.6 percentage points between 2005 and 2006; the comparable differences are 9.0 percentage points and 10.5 percentage points when adjusted APRs are used. Thus, the APR adjustment narrowed the 2005–06 rise in the gap from 2.6 percentage points to 1.5 percentage points. For refinancings, the unadjusted difference in the incidence of higher-priced lending between blacks and non-Hispanic whites rose from 6.2 to 7.3 percentage points, whereas the gap after the APR adjustment was 5.6 percentage points in both years. These results suggest that at least a portion of the apparent widening of gaps in the incidence of higher-priced lending across racial groups for home-purchase lending was due to the further flattening of the yield curve during 2006. For refinancings, the yield-curve effects may explain all of the changes.

The unexplained differences in the incidence of higher-priced lending and in denial rates stem, at least in part, from credit-related factors not available in the HMDA data, such as measures of credit history (including credit scores), LTV ratios, debt-to-income (DTI) ratios, and differences in choice of loan product. Differential costs of loan origination and the competitive environment also likely bear on the differences in pricing; so may differences in financial literacy, which can lead to differences in credit-shopping activities and negotiating. Differences in pricing and underwriting outcomes may also reflect discriminatory treatment of minorities or other actions by lenders, including marketing practices. Further research is needed to assess the extent to which credit- or cost-related factors account for the unexplained differences in loan pricing and denial rates.

Credit Scores by Area and Higher-Priced Lending

For some time, the staff of the Federal Reserve Board has been using information on the credit experiences of consumers as reflected in their credit records and by their credit history scores to research related public policy issues. Some of that research has focused on the utility of credit scoring and its effects on credit availability and affordability for different populations.[42] Other staff research has considered the relationship between the accuracy of credit reporting and access to credit.[43] Most of this research has been undertaken using nationally representative samples of the credit records of individuals (with no personally identifiable information in the data). These data include the full range of information contained in the credit records of these individuals as assembled by TransUnion, one of the three national credit-reporting agencies.[44]

A second type of credit-record-related information has also been used in the Board staff's research: summary statistics about the credit scores of individuals aggregated at the census-tract level.[45] These data, also provided by TransUnion, include, for each census tract, information on the mean credit scores and the distribution of credit scores for individuals with an outstanding mortgage and for other individuals for whom TransUnion could calculate a credit score. The statistics were constructed by TransUnion using their TransRisk Account Management Score (TransRisk Score).[46] The data also include the percentage of individuals who have a credit record but could not be scored at the time the data were assembled, most often because their credit accounts were not sufficiently numerous or did not show enough recent activity to calculate a TransRisk Score. The thresholds selected for the different segments of the credit score distribution correspond roughly to the cutoffs that, based on credit scores alone, would place individuals in the prime, near-prime, and subprime price ranges. The census-tract credit-score data are constructed from the credit records of approximately

42. Board of Governors of the Federal Reserve System (2007), *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit* (Washington: Board of Governors, August), www.federalreserve.gov/boarddocs/RptCongress/creditscore/creditscore.pdf.

43. For a discussion of credit-reporting accuracy and access to credit and for references to research on this subject, refer to two 2004 articles by Robert B. Avery, Paul S. Calem, and Glenn B. Canner: "Credit Report Accuracy and Access to Credit," *Federal Reserve Bulletin*, vol. 90 (Summer), pp. 297–322; and "Consumer Credit Scoring: Do Situational Circumstances Matter," *Journal of Banking and Finance*, vol. 28 (April), pp. 835–56.

44. TransUnion LLC, www.transunion.com. The other two national credit-reporting agencies are Equifax, www.equifax.com; and Experian, www.experian.com.

45. Refer to Avery, Brevoort, and Canner, "Higher-Priced Home Lending and the 2005 HMDA Data."

46. The TransRisk Scores were generated by TransUnion using their proprietary model for assessing the credit risk of existing credit accounts. TransRisk Account Management Score is a registered trademark of TransUnion LLC; other trademarks, service marks, and brands referred to in this article are the property of their respective owners.

14. Distribution of individuals, by characteristic of census tract and by type of credit record, borrower status, and credit score range, 2005

Percent

Census tract category and subcategory	Scorable							
	Mortgage borrowers							
	Low		Middle		High		Total	MEMO: Percent of census tract population with a credit record[3]
	Percent of census tract sub-category[1]	Percent of census tract category[2]	Percent of census tract sub-category[1]	Percent of census tract category[2]	Percent of census tract sub-category[1]	Percent of census tract category[2]		
Income ratio (percent of area median)[4]								
Less than 50	24.9	2.9	16.4	2.0	58.7	0.9	100	4.7
50–79	18.1	21.1	14.4	17.3	67.5	10.0	100	10.7
80–119	11.2	56.7	10.8	56.0	78.1	50.4	100	20.6
120 or more	5.5	19.3	7.0	24.8	87.5	38.7	100	28.9
Total	...	100	...	100	...	100	...	...
Racial or ethnic composition (minorities as a percentage of population)								
Less than 10	8.5	34.1	8.9	36.6	82.6	42.3	100	25.9
10–49	9.4	42.2	9.6	44.0	81.0	46.2	100	20.3
50–79	15.3	12.4	13.1	10.9	71.6	7.4	100	12.5
80–100	21.9	11.3	15.9	8.4	62.1	4.1	100	8.7
Total	...	100	...	100	...	100	...	...
MEMO: Census tract unknown	11.1	...	10.7	...	78.2	...	100	10.2
Total	**10.2**	...	**9.9**	...	**79.9**	...	**100**	**19.2**

NOTE. The credit score ranges are based on the TransRisk Account Management Score (TransRisk Score) as of December 31, 2005. TransRisk Account Management Score is a registered trademark of TransUnion LLC.

1. Distribution sums horizontally. For example, the first column, first row shows that 24.9 percent of scorable mortgage borrowers in census tracts with an income ratio of less than 50 percent had credit scores in the low range.

2. Distribution sums vertically. For example, the second column, first row shows that 2.9 percent of scorable mortgage borrowers with credit scores in the low range lived in a census tract with an income ratio of less than 50 percent.

3. Memo items sum horizontally.

4. The income ratio of a census tract is the median family income of the tract relative to that of the area (MSA or statewide non-MSA) in which the tract is located.

... Not applicable.

27 million anonymous individuals drawn from stratified, nationally representative random samples of all the credit records maintained by TransUnion.[47]

With the geographic identifiers included in each data file, the census-tract credit score can be combined with the HMDA data and with information from the 2000 decennial census. For the analysis here, credit scores by census tract (not scores of individuals separately) were obtained for two specific dates: December 31, 2004, and December 31, 2005.[48] Given the large proportion of all outstanding mortgages originated in just the past few years, the census-tract credit-score data for mortgage holders are likely quite representative of the individuals who received a mortgage over this period.[49]

National Distribution of Credit Scores

The analysis here uses the 2005 file of credit scores by census tract because its information is the nearest in time to the 2006 HMDA data and because it is likely a reasonable approximation of the credit scores of individuals taking out mortgages during 2006. Nationally, about 15 percent of individuals with a credit record were unscorable; about 19 percent of individuals had a mortgage, and 66 percent did not (table 14, memo items).[50] The distribution of credit

47. Information on census tract was not available for all individuals.

48. The census-tract credit scores do not provide information about the specific credit score that may have been used to assess the credit risk of any individual mortgage borrower included in the HMDA data; that information is proprietary to the lender and is not reported under HMDA. Also, the samples of credit records drawn in 2004 and 2005 were chosen randomly and do not necessarily include the same individuals.

49. As of December 2006, according to data from First American LoanPerformance, about 80 percent of outstanding first-lien mortgages had been originated in 2003 or later (www.loanperformance.com).

50. One difficulty reconciling these shares with other data sources is that credit records are for individuals, whereas the household or family is the unit of analysis typically used in statistics on homeownership and mortgage holding. Virtually everyone in the database who

14. Distribution of individuals, by characteristic of census tract and by type of credit record, borrower status, and credit score range, 2005—*Continued*

Percent

Scorable								Unscorable		
Others								MEMO: Percent of census tract population with a credit record[3]	Percent of census tract category[2]	Incidence of higher-priced lending
Low		Middle		High		Total	MEMO: Percent of census tract population with a credit record[3]			
Percent of census tract sub-category[1]	Percent of census tract category[2]	Percent of census tract sub-category[1]	Percent of census tract category[2]	Percent of census tract sub-category[1]	Percent of census tract category[2]					
49.8	6.9	14.8	4.7	35.4	2.2	100	67.1	28.1	9.6	46.5
38.8	28.3	14.3	23.9	46.8	15.4	100	68.1	21.2	31.5	38.8
26.4	49.7	12.0	51.8	61.6	52.3	100	66.4	13.0	43.8	27.7
16.6	15.1	9.5	19.6	73.9	30.2	100	61.9	9.2	15.1	18.3
...	100	...	100	...	100	...	...	...	100	...
19.9	24.1	10.1	28.1	70.0	28.1	100	64.4	9.7	20.7	21.7
26.2	43.0	11.9	44.6	61.9	44.6	100	65.8	13.9	42.2	24.8
37.1	16.1	14.2	14.1	48.7	14.1	100	67.1	20.4	18.2	36.3
45.2	16.8	15.6	13.2	39.2	13.2	100	67.7	23.6	19.0	46.6
...	100	...	100	...	100	...	...	...	100	...
32.7	...	13.0	...	54.3	...	100	66.7	23.2	...	26.9
27.5	**...**	**12.0**	**...**	**60.5**	**...**	**100**	**65.8**	**15.0**	**...**	**27.0**

scores differs for mortgage borrowers and others: Overall, about 80 percent of individuals with a mortgage, but only about 61 percent of other individuals with a credit score, had relatively high credit scores, that is, scores that (everything else being equal) would make them eligible for the most attractive interest rates available for home loans. At the other end of the spectrum, about 10 percent of mortgage borrowers and 28 percent of other individuals who could be scored had relatively low credit scores, that is, scores that (everything else being equal) would be consistent with placement in the subprime-loan market.

Distribution of Credit Scores across Census Tracts

The broad differences in the distribution of credit scores for mortgage borrowers and other individuals, noted above, hold across census tracts grouped along a variety of socioeconomic dimensions.[51] However, the distributions of scores differ across census tracts grouped by relative income and racial or ethnic composition. Individuals in higher-income census tracts (in which the median family income is 120 percent or more of the median for the broader area) tend to have higher credit scores than individuals in other areas. These patterns hold both for the population of individuals with a mortgage and for others. For example, on average, 88 percent of scorable individuals with a mortgage who resided in higher-income census tracts had relatively high credit scores, as did 74 percent of other individuals. By comparison, 59 percent of the mortgage borrowers who could be scored and who resided in low-income census tracts had relatively high credit scores, as did 35 percent of other scorable individuals in low-income census tracts. Also, the proportion of individuals in higher-income census tracts who were unscorable was notably smaller than that of individuals in low-income areas—9 percent and 28 percent respectively.

The distribution of credit scores also differs across census tracts sorted by the proportion of census-tract population that is minority. In predominantly nonminority census tracts (less than 10 percent minority

had a record of an outstanding mortgage had a credit score. However, although some individuals with credit scores were likely unscorable at the time they received their mortgage loan, they became scorable as their credit records "thickened" with the reports of their periodic payments on the debt. The proportion of individuals that are unscorable depends on the credit-scoring model. Model builders differ on the criteria used to determine scorability.

51. Census tracts differ along a range of socioeconomic metrics. In part, these differences are by design, as one of the objectives in defining census-tract boundaries is to group smaller geographic areas that have similar population and economic circumstances. According to the Census Bureau, census tracts usually have a population of between 2,500 and 8,000 and, when first delineated, are designed to be homogeneous with respect to population characteristics, economic status, and living conditions (www.census.gov).

population), about 83 percent of the mortgage borrowers and 70 percent of others with a credit score had relatively high credit scores. In census tracts with a minority population exceeding 80 percent, 62 percent of the mortgage borrowers and 39 percent of others with a credit score had relatively high credit scores. Once again, the percentage of individuals without a credit score differs greatly across census-tract groupings. In predominantly nonminority areas, 10 percent of the individuals could not be assigned a credit score; in contrast, 24 percent of the individuals in census tracts with more than 80 percent minority individuals were unscorable.

Note that in considering differences in credit scores across census tracts grouped by racial or ethnic makeup, differences in score arise solely from differences in the content of *credit records*; so, for example, two individuals with identical credit records will receive identical credit scores regardless of any difference between them in racial or ethnic identity. No information on location, race or ethnicity, sex, or other personal demographic characteristic is used in calculating generic credit history scores, such as the TransRisk Score.[52]

Distribution of Credit Scores across Counties

The data on credit scores by census tract can be aggregated to broader geographic areas, including counties, metropolitan statistical areas (MSAs), and states. The South and Southwestern sections of the country and portions of the Midwest stand out because they have relatively low mean credit scores (figure 3). By contrast, mean scores for mortgage borrowers in the Northeast, in the upper Great Plains, and on the West Coast have relatively high mean scores.

Credit Scores and the Incidence of Higher-Priced Lending

Individuals with lower credit scores are more likely to receive higher-priced loans.[53] Likewise, the HMDA data show that census tracts with larger shares of individuals who have relatively low credit scores and a mortgage also have larger shares of individuals who received higher-priced loans (table 15). For example, in census tracts in which more than 20 percent of the mortgage borrowers had low credit scores as of the end of 2005, 45 percent of the homebuyers in 2006 using conventional first liens to purchase site-built homes or to refinance such liens had higher-priced loans; in census tracts in which the share of mortgage borrowers with low credit scores was less than 3 percent, the incidence of higher-priced lending was only 14 percent.

Both the relative income of a census tract and the minority percentage are associated with the incidence of higher-priced lending (table 14). Further analysis (not shown in tables) indicates that the incidence of higher-priced lending across census tracts (after accounting for the income and racial or ethnic composition of the census tract) can be further explained by census-tract data on mean credit scores and on the proportion of individuals with credit scores in the categories roughly corresponding to the near-prime and subprime markets. For example, consider census tracts arrayed into quintiles ranked by relative income and, within each quintile, further subdivided by mean credit score: The census tracts with lower mean credit scores have a higher incidence of higher-priced lending in the 2006 data (by about 4 percentage points) than census tracts with the same income level but higher mean credit scores. A similar relationship is found when census tracts are grouped by minority percentage or when the analysis is restricted to non-Hispanic whites.

Loan Performance and the HMDA Data

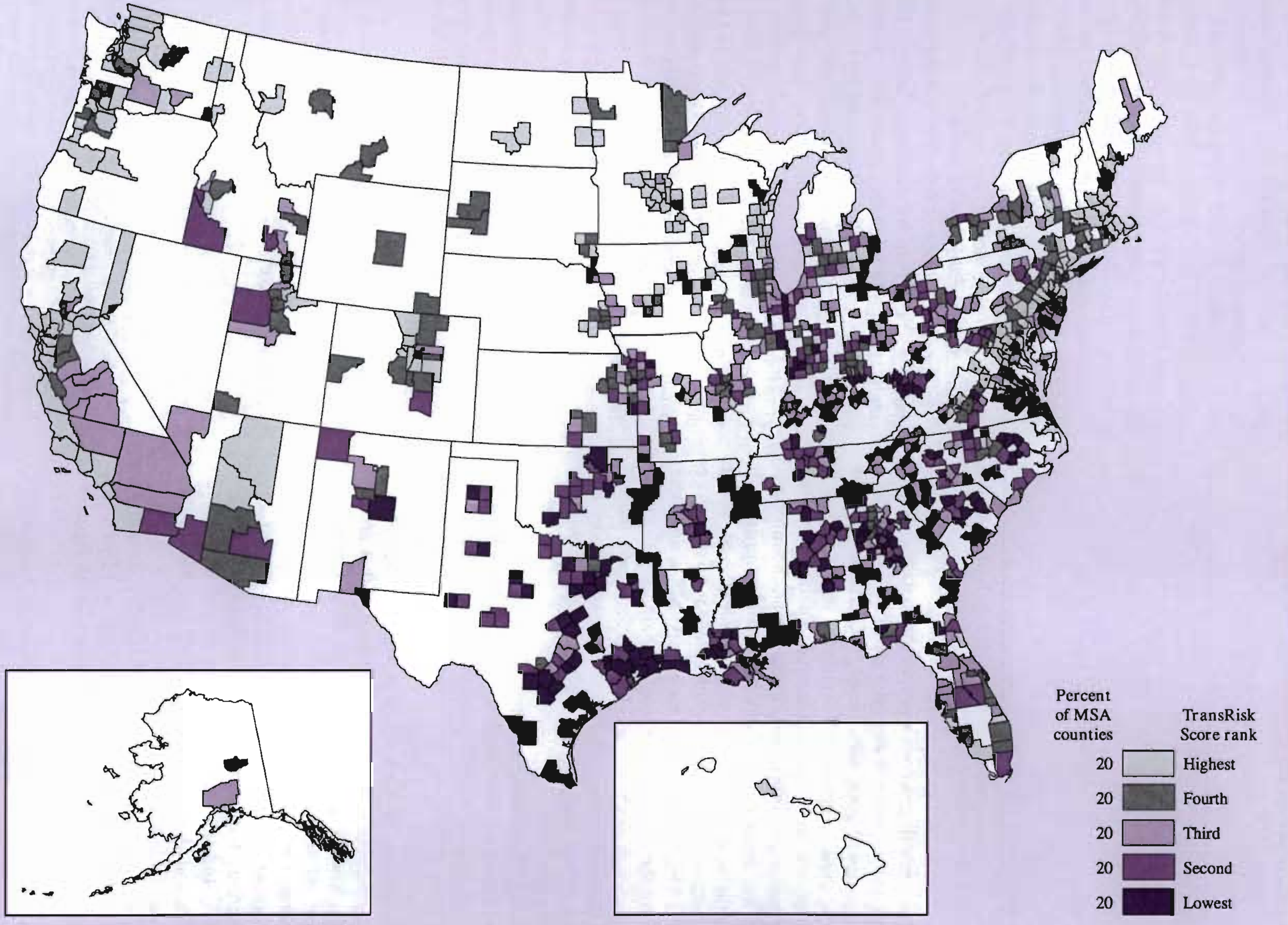
As of this writing, conditions in the mortgage market are the subject of considerable concern. Delinquency and foreclosure rates have risen substantially, particularly in the higher-priced segment of the market, and lax underwriting is widely believed to have contributed to the rise in defaults. Also, a significant share of the higher-priced loans apparently involve adjustable rates; such loans carry the potential to significantly increase monthly payments and, hence, to place greater burdens on many mortgage borrowers.

Although the HMDA data are limited, they can be combined with other data to better understand the linkages between loan pricing, economic factors, and mortgage loan performance. We pursue such an analysis here, focusing on variations in rates of serious delinquency (payment overdue for ninety days or more) on mortgages across MSA counties. Specifically, we examine the relationship between the rates of serious delinquency on mortgages as of March 31, 2007, and (1) the incidence of higher-priced lending (from the HMDA data) for 2005 and 2006 and (2) county-level economic indicators measured over the 2002–06 period.

52. Board of Governors of the Federal Reserve System, *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit*.

53. For example, refer to Board of Governors of the Federal Reserve System, *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit*.

3. Mean TransRisk Score quintiles of mortgage borrowers, by metropolitan statistical area county, December 31, 2005



Source: TransRisk Account Management Score (TransRisk Score), from TransUnion LLC.

15. Credit scores and the incidence of higher-priced lending, 2006

Percent

Share of mortgage borrowers in census tract who have low credit scores	Share of mortgage loans in census tract that are higher priced
0–2.9	13.9
3–6.9	19.8
7–9.9	25.3
10–14.9	27.4
15–19.9	34.7
20 or more	45.4
All tracts	27.0

NOTE: Lending covers first-lien purchase or refinancing loans for site-built homes. Refer also to general note to table 14.

The analysis employs a proprietary database, TrenData, that measures loan performance at a reasonably disaggregated geographic level.[54] TrenData is based on the credit records of individuals, which makes it one of the most comprehensive databases on the performance of mortgages. In particular, the information has been drawn from the credit records of a geographically stratified random sample of about 30 million individuals for each calendar quarter since 1992. The data (available by county, MSA, and state and for the nation as a whole) include more than 200 measures of credit use and loan performance, including the proportion of mortgage borrowers in a county who are at least ninety days delinquent on their mortgages.[55]

Using TrenData, we created a map of the fifty states showing mortgage delinquency rates by MSA county (figure 4). MSA counties are grouped into quintiles ranked by their rate of serious mortgage delinquency as of March 31, 2007. The counties vary considerably in the level of problem loans, but most areas had rates of serious delinquency that are relatively low. About 35 percent of the MSA counties had a serious delinquency rate below 1 percent, and only 5 percent had a serious delinquency rate greater than 3 percent. Areas of the country with the highest levels of serious delinquency were in western Pennsylvania, Ohio, Indiana, and Michigan; in the southeastern states and along the rest of the Gulf Coast area; and in Texas, Oklahoma, and Colorado.

We also mapped the 2006 HMDA data on the incidence of higher-priced lending by MSA county (figure 5). A comparison of figure 4 with figure 5 is revealing. For the most part, MSA counties with elevated rates of higher-priced lending also had elevated rates of serious mortgage delinquency. Notable exceptions in one direction are some MSA counties in Florida, California, New York, Pennsylvania, and New Jersey that were in the top quintile of the incidence of higher-priced lending but that had relatively moderate levels of serious delinquency.[56] Notable exceptions in the other direction are many of the MSA counties in Michigan, Indiana, Ohio, Colorado, western Pennsylvania, and the southeastern states, which had high levels of mortgage delinquency but were not in the highest quintile of the incidence of higher-priced lending.[57]

In general, we expect both loan pricing and delinquency to be driven by economic factors. Unfortunately, few high-frequency measures of economic conditions are available at the county level. Available items include the unemployment rate, per capita income, house-price appreciation, and population growth; credit scores and other information drawn from credit records are also available. Each of these factors may influence loan performance and the incidence of higher-priced lending, but no single factor stands out. Consequently, for our analysis, we construct a composite of economic factors (by regressing the TrenData delinquency measure of loan performance against several county-level indicators) as a representative measure of economic circumstances.[58]

The coefficient weights from this regression are used to form the composite economic variable used here. That variable can also be viewed as a predictor—based only on the economic factors described above—of the rate of serious mortgage delinquency

54. TrenData is a registered trademark of TransUnion LLC (products.trendatatu.com/faqs.asp).

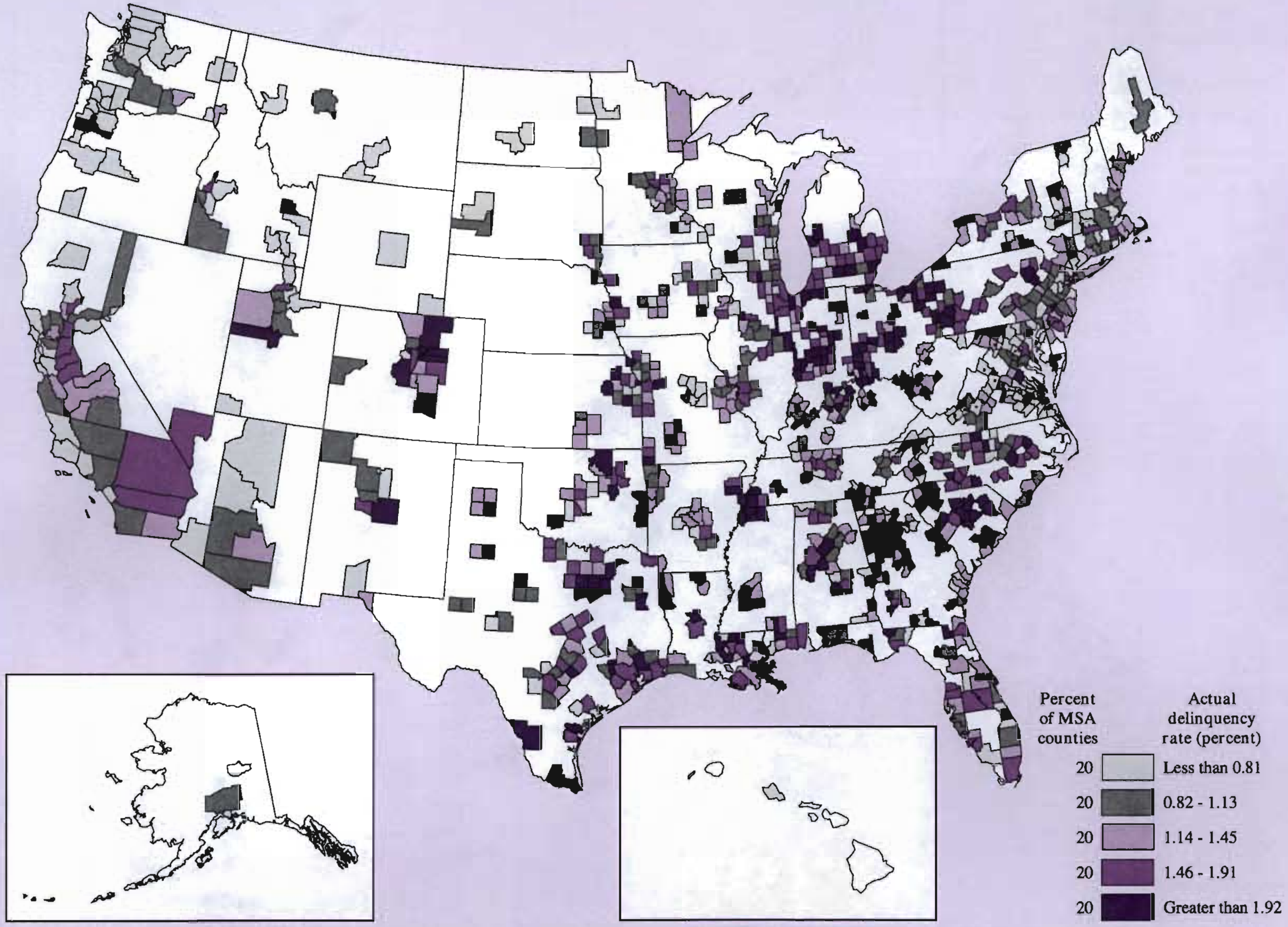
55. All lenders selling their loans to Fannie Mae or Freddie Mac must report loan performance to the three national credit-reporting agencies. Virtually all banking institutions also report loan performance on the loans they service or hold in portfolio. Other loans, such as those from smaller lenders or seller financings, are less likely to be reported.

56. Although these areas have average or lower levels of serious delinquency, they are all in the top quintile when measured by the increase in rates of serious delinquency from the last quarter of 2004 through the first quarter of 2007.

57. The delinquency rates presented here are as of only a single date—March 31, 2007; some areas of the country that have had relatively low rates of serious delinquency have been experiencing sharp increases in those rates more recently.

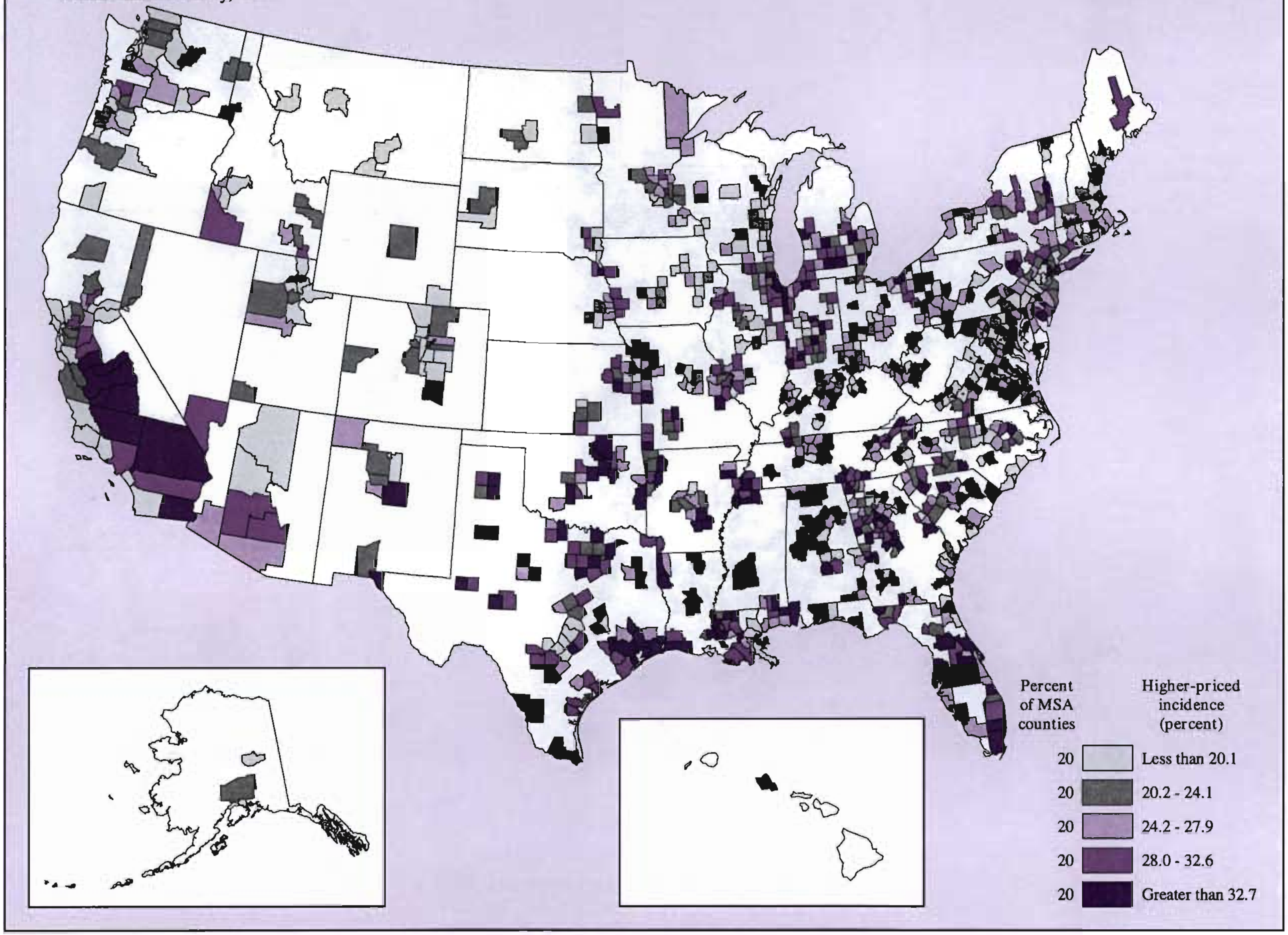
58. The composite measure is constructed by regressing the TrenData delinquency measure of loan performance against the following county-level economic factors: the unemployment rates in 2005 and 2006 and the change in the unemployment rate from 2002 to 2005; the rates of house price appreciation from 2001 to 2004 and from 2004 to 2006; the level of per capita income in 2005 and the change in per capita income from 2002 to 2005; the population growth rate from 2002 to 2005; and, as of the end of 2004, the mean credit score of mortgage holders and the percentage of mortgage holders in the two lowest score groupings as described earlier. We also include the average share of HMDA loans secured by non-owner-occupied houses in each county in 2005 and 2006 as a measure of the importance of investor activity. Data on house-price appreciation are from the Office of Federal Housing Enterprise Oversight (www.ofheo.gov); unemployment rates, from the Bureau of Labor Statistics (www.bls.gov); and per capita income and population growth, from the Bureau of Economic Analysis (www.bea.gov).

4. Quintiles of mortgages delinquent 90 days or more, by metropolitan statistical area county, March 31, 2007



Source: TrenData, from TransUnion LLC.

5. Quintiles of incidence of higher-priced lending for first-lien, home-purchase or refinance loans on owner-occupied, site-built homes, by metropolitan statistical area county, 2006



for the first quarter of 2007. As expected, each of the factors included in the regression played a role in predicting future mortgage loan performance. The most important factor, however, was house-price appreciation, particularly from 2004 to 2006.[59]

Figure 6 shows counties grouped by our composite economic variable. The MSA counties are grouped by their expected level of delinquency, applying the same cutoffs used for the actual delinquency rates in figure 4. Not surprisingly, the patterns in figures 4 and 6 show a high degree of correlation. Notable divergences appear in Colorado, where most MSA counties had higher levels of actual serious mortgage delinquency (figure 4) than would be expected on the basis of economic factors as measured here (figure 6); and in Florida, where the MSA counties generally had expected rates of delinquency higher than the actual rates.

Further Analysis Relating Higher-Priced Lending to Loan Performance

The analysis in the previous section does not explicitly link the HMDA data on the incidence of higher-priced lending to mortgage loan performance. The figures show similar patterns for the incidence of higher-priced lending; the comparison of the results from the economic composite variable and the mortgage delinquency rates are suggestive, but it does not identify whether loan pricing data have additional power in predicting delinquency once economic factors are taken into account. To focus on this issue, we estimated a regression similar to that used to create the economic composite described above. But we added to the regression a variable reflecting the average incidence of higher-priced lending for mortgage loans reported in the 2005 and 2006 HMDA data for each MSA county. Other variables were added to reflect, for each state, the percentage of subprime and prime loans that had adjustable interest rates (as derived from First American LoanPerformance data on mortgages).

Results suggest that the incidence of higher-priced lending has independent predictive value for loan performance beyond that of the economic factors. All else being equal, an increase in the incidence of higher-priced lending of 1 percentage point implies an increase in the March 2007 rate of serious mortgage delinquency of 0.03 percentage point in an MSA county. Although the effect may seem small, it is, in fact, fairly large given the relatively low level of mortgage delinquency. For example, consider an MSA county with the median level of serious delinquency (1.27 percent): Holding economic factors constant, an increase in the incidence of higher-priced lending of 10 percentage points in that county would raise its rate of serious mortgage delinquency 0.3 percentage point, to 1.57 percent—enough to move that county into the next highest quintile of counties ordered by serious loan delinquency (refer to rates of actual serious delinquency by quintiles of counties, shown in figure 4).

The relationship between the incidence of higher-priced lending and the rate of serious delinquency just described (a 1 percentage point increase in the incidence of higher-priced lending implies an increase of 0.03 percentage point in the delinquency rate) is robust and of a similar magnitude when the prediction changes from the level of serious delinquency as of March 2007 to the change in delinquency rates between 2004 and 2007. Finally, some evidence indicates that higher numbers of adjustable-rate mortgages are associated with higher rates of future serious loan delinquency, but the effect is small and is found only for prime mortgages. However, the data available here cannot identify which types of mortgages within an area are delinquent. Adjustable-rate mortgages may be more prone to delinquency, but their delinquency status is not reflected in the aggregated data used in this study. Also, some evidence indicates that delinquencies in adjustable-rate mortgages are a growing problem that may not be fully reflected in the delinquency rates for March 2007.

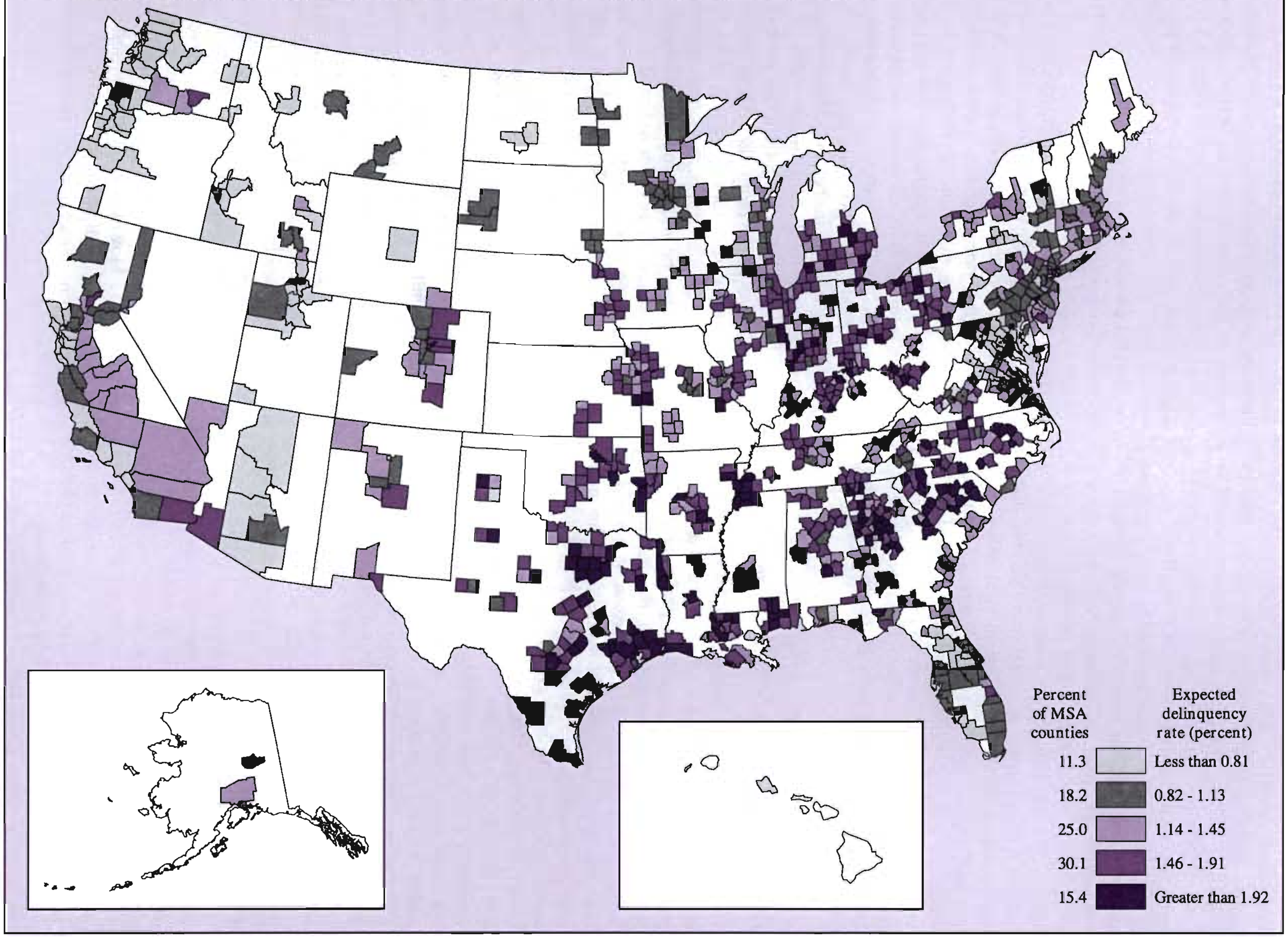
The statistical relationship between the incidence of higher-priced lending and future loan performance could be caused by several factors. The relationship may be direct: Perhaps the higher monthly payments associated with higher-priced lending are a greater burden on borrowers and lead to greater delinquency. However, the statistical associations we measure may also reflect the effects of other economic factors, which we were not able to include in our model and that are related both to higher rates of delinquency and to higher-priced lending.[60] Such factors may include expected changes in home prices, foreclosure laws, the specific types of loans used to buy homes or refinance, and other factors used in underwriting and pricing loans.

Our analysis is largely suggestive and is relatively parsimonious. However, it does suggest that the pricing data in HMDA may be a useful source of information in understanding and predicting loan performance.

59. The R-squared value for the regression was 0.40.

60. Additional analysis shows that the economic factors and the incidence of higher-priced lending are highly correlated. A regression relating the incidence of higher-priced lending in 2005 and 2006 with the economic factors included in the economic composite variables had an R-squared value of about 0.67.

6. Expected delinquency based on economic factors, by metropolitan statistical area county, March 31, 2007



APPENDIX: REQUIREMENTS OF REGULATION C

Under the Home Mortgage Disclosure Act (HMDA), lenders use a "loan/application register" (HMDA/LAR) to report information annually to their federal supervisory agencies for each application and loan acted on during the calendar year. Lenders must make their HMDA/LARs available to the public by March 31 following the year to which the data relate, and they must remove the two date-related fields (date of the loan application and date of the credit decision) to help preserve applicants' privacy. Lenders must make their date-modified register available to the public for a period of three years.

Only lenders that have offices (or, for nondepository institutions, are deemed to have offices) in metropolitan areas are required to report under HMDA. However, if a lender is required to report, it must report information on all of its home loan applications and loans in all locations, including nonmetropolitan areas.

The Federal Reserve Board's Regulation C requires lenders to report the following information on home-purchase and home-improvement loans and on the refinancing of such loans:

For each application or loan

- application date and the date an action was taken on the application
- action taken on the application
  - — approved and originated
  - — approved but not accepted by the applicant
  - — denied (with the reasons for denial—voluntary for some lenders)
  - — withdrawn by the applicant
  - — file closed for incompleteness
- pre-approval program used (for home-purchase loans only)
- amount
- type
  - — conventional
  - — insured by the Federal Housing Administration
  - — guaranteed by the Veterans Administration
  - — backed by the Farm Service Agency or Rural Housing Service
- pre-approval status
- status
  - — first lien
  - — junior lien
  - — unsecured
- purpose
  - — home purchase
  - — refinance
  - — home improvement
- of purchaser (if the lender subsequently sold the loan)

For each applicant or co-applicant

- ethnicity
- income relied on in credit decision

For each property

- location, by state, county, and census tract
- of structure
  - — one-to four-family dwelling
  - — manufactured home
  - — multifamily property (dwelling with five or more units)
- occupancy status (owner occupied or non-owner occupied)

For loans subject to price reporting

- spread above comparable Treasury security

For loans subject to HOEPA

- indicator of whether loan is subject to HOEPA

Institutions also report information on home loans they purchased during the calendar year.

Reports on the Condition of the U.S. Banking Industry

April 2007

Report on the Condition of the U.S. Banking Industry: First Quarter, 2006

CHANGE IN REPORTING PANEL

This report presents aggregate time-series data drawn primarily from the FR Y-9C (Consolidated Financial Statements for Bank Holding Companies) and the FR Y-9LP (Parent Company Only Financial Statements for Large Bank Holding Companies) regulatory report forms submitted to the Federal Reserve each quarter by large bank holding companies (defined within this report as "all reporting bank holding companies"). Beginning with the quarter ended March 31, 2006, the Federal Reserve updated the filing requirements for these reports. Most notably, it raised the asset threshold at which bank holding companies are required to file reports to $500 million from $150 million.[1] The changes to the filing requirements mitigated regulatory reporting burden because it substantially reduced the number of required respondents. Compared with those that filed as of December 31, 2005, the number of top-tier bank holding companies that filed these reports as of March 31, 2006, fell by more than 1,200 companies.[2]

Despite the large drop in the number of filers, reporting bank holding companies still represented a substantial majority of all bank holding company assets. At quarter-end, 5,129 top-tier bank holding companies held roughly $11.9 trillion in consolidated assets.[3] Among these companies, 1,003 with aggregate consolidated assets of $11.4 trillion filed the FR Y-9C, representing more than 95 percent of total bank holding company assets.[4]

Although the effect of the reporting change on the volume of bank holding company assets included in this report was relatively modest, the substantial reduction in the number of filers enhanced, on the aggregate, the already significant influence of the largest companies, moving some measures included on table 1, "Financial characteristics of all reporting bank holding companies in the United States," closer to the levels for the same measures at the fifty large bank holding companies summarized in table 2. For example, the capital ratios for all reporting bank holding companies are slightly lower than they were before the change in the reporting requirements, and the loan to deposit ratio is higher. In addition, by trimming the number of companies covered in the reports by more than half, the numbers shown for both domestic financial holding companies and bank holding companies engaged in nonbanking activities were reduced. (See table 4, "Nonfinancial characteristics of reporting bank holding companies.") Also, the fifty large bank holding companies now account for 79 percent of all reporting companies' assets, an increase of nearly 3 percentage points.

The quarterly comparisons below focus on the subset of bank holding companies that filed the FR Y-9C as of March 31, 2006, and the accompanying tables (except for the fifty large companies) append a column of modified year-end financial statistics for these first-quarter FR Y-9C respondents. It should be noted that the December 31, 2005, data include the results for a small number of top-tier FR Y-9C filers that subsequently merged into top-tier bank holding companies included in the March 31, 2006, fixed panel. Including these companies in the December 2005 data improves the comparability of data for these periods.

SUMMARY OF CURRENT DEVELOPMENTS FOR THE FIXED PANEL OF REPORTERS

Assets of reporting bank holding companies increased 4.1 percent ($446 billion) over the first quarter, to $11.4 trillion, mainly in money market assets and loans. Net income rose sharply from the fourth quarter of 2005, owing to robust capital markets revenues and exceptional credit quality, which allowed a sizable reduction in provisions for loan losses.

1. In addition, certain lower tier bank holding companies that formerly filed the FR Y-9C are no longer required to file this report.

2. Some bank holding companies with consolidated assets less than the reporting threshold of $500 million continue to file the FR Y-9C and the FR Y-9LP reports voluntarily or for supervisory purposes.

3. Consolidated assets for bank holding companies that do not file the FR Y-9C are approximated using financial data for bank subsidiaries reported on the Call Report.

4. The remaining bank holding companies submit a semiannual FR Y-9SP (Parent Company Only Financial Statements for Small Bank Holding Companies) regulatory report.

Growth in securities and money market assets generated more than half of the asset expansion, as balances rose 7.0 percent ($280 billion), to $4.3 trillion, from year-end 2005. A $155 billion buildup in federal funds sold and securities purchased under agreements to resell, which was accompanied by a corresponding rise in money market liabilities ($179 billion), contributed to most of this increase. Investment securities expanded 4.0 percent ($71 billion), to $1.8 trillion.

Aggregate loans grew at a slower pace, rising 2.4 percent ($130 billion), to $5.6 trillion. Increases in home equity loans and construction, land development, and other land loans were relatively strong. Commercial and industrial loans also advanced substantially, increasing 4.4 percent ($43 billion). Unused commitments to lend expanded 2.4 percent ($127 billion), to $5.5 trillion.

Deposits grew 2.3 percent (or $126 billion) at the same time that customer sensitivity to the increased yields available on time deposits caused a shift away from transaction deposits. The growth in deposits largely kept pace with loan expansion, but nondeposit borrowings (including the $179 billion increase in federal funds purchased and securities sold under agreements to repurchase noted above) funded most of the asset growth over the quarter, rising 7.2 percent ($257 billion), to $3.8 trillion.

Shareholders' equity at all reporting bank holding companies rose 3.6 percent, to $930 billion. Merger adjustments (related, in particular, to the combination of Bank of America Corporation and MBNA Corporation) and, to a lesser extent, retained earnings enlarged the equity base. Risk-based capital ratios, which exclude goodwill from the capital base, remained largely stable. Compared with year-end 2005, the total risk-based capital ratio edged down 1 basis point, to 11.75 percent and the tier one capital ratio decreased 2 basis points, to 8.96 percent. The leverage ratio dropped 5 basis points, to 6.33 percent.

First-quarter net income for reporting bank holding companies climbed 7.0 percent, or $2.2 billion, from the fourth quarter of 2005 to $34.3 billion in the first quarter of 2006. The strong earnings growth boosted returns on assets (up 4 basis points, to 1.21 percent) and equity (up 34 basis points, to 14.88 percent). Higher non-interest income (particularly trading revenues and net servicing fees) and lower provisions (down 28 percent, or $2.6 billion) bolstered earnings growth. In addition, reflecting significant realized losses booked in the last quarter of 2005 in conjunction with efforts to restructure interest rate risk positions, lower realized securities losses contributed almost $700 million of the improvement in quarterly net income. However, elevated non-interest expenses, related to incentive-based compensation, weighed on earnings growth. Moreover, a still flatter term structure and growth in higher-cost certificates of deposit exerted downward pressure on the aggregate net interest margin (down 9 basis points, to 2.96 percent).

Nonperforming assets edged down 2 basis points, to 0.67 percent of total loans and related assets. Nonaccrual loans contracted 3.9 percent, or $1.2 billion (mostly in first-lien residential mortgages and consumer loans), as inflows of nonperforming loans fell considerably. The ratio of net charge-offs to average loans improved markedly, shrinking to a historically low 0.45 percent from 0.74 percent in the fourth quarter of 2005 when credit losses were elevated by an increase in personal bankruptcy filings related to a change in the bankruptcy law.

1. Financial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio[1, 2]	2001	2002	2003	2004	2005	2004	2005				2005[r]	2006
						Q4	Q1	Q2	Q3	Q4	Q4	Q1
Balance sheet												
Total assets	**7,487,107**	**7,989,910**	**8,880,558**	**10,339,801**	**11,333,100**	**10,339,801**	**10,710,570**	**10,956,171**	**11,257,415**	**11,333,100**	**10,906,559**	**11,352,835**
Loans	3,835,237	4,083,169	4,435,653	5,109,493	5,659,808	5,109,493	5,192,276	5,363,646	5,525,962	5,659,808	5,431,492	5,561,703
Securities and money market	2,563,779	2,858,856	3,297,932	3,804,003	4,157,256	3,804.003	4,114,628	4,143,955	4,246,546	4,157,256	4,025,401	4,305.752
Allowance for loan losses	–68,829	–74,782	–73,817	–74,589	–73,031	–74.589	–73,378	–72,949	–74,097	–73,031	–70,146	–70,544
Other	1,156,920	1.122,668	1,220,790	1,500,894	1.589,068	1,500.894	1,477,045	1,521.520	1,559,005	1,589,068	1,519.813	1,555,924
Total liabilities	**6,900,721**	**7,347,694**	**8,176,868**	**9.452,623**	**10,393,243**	**9,452,623**	**9,819,629**	**10,034,472**	**10,327,938**	**10,393,243**	**10,008,645**	**10,422,650**
Deposits	4,026,460	4,356,585	4,705,045	5,249,494	5,700,850	5,249,494	5,349,427	5,448,059	5,563,636	5,700,850	5,427,593	5,553,762
Borrowings	2,072,505	2,242,717	2,629,293	3,157,578	3,586,922	3,157,578	3,424,013	3,525,137	3,667,710	3,586,922	3,568,417	3,825,102
Other[3]	801,756	748,392	842,531	1,045,552	1,105,471	1,045.552	1,046,189	1,061,277	1,096.593	1,105,471	1,012,636	1,043,787
Total equity	**586,386**	**642,216**	**703,690**	**887,178**	**939,857**	**887,178**	**890,941**	**921,699**	**929,477**	**939,857**	**897,914**	**930,185**
Off-balance-sheet												
Unused commitments to lend[4]	3,482,236	3,651,209	4,097,531	4,823,332	5,437,902	4,823,332	4,929,516	5,064,198	5,245,819	5,437,902	5,393,260	5,520,728
Securitizations outstanding[5]	276,717	295,001	298,348	353,978	389,726	353,978	366,430	367,887	375,142	389,726	387,875	394,600
Derivatives (notional value, billions)[6]	48,261	57,866	72,883	89,115	99,077	89,115	92,621	96,653	98,281	99,077	99,060	109.261
Income statement												
Net income[7]	67,208	86,013	107,885	113.317	133,047	28,653	32,598	33,072	34,543	32,837	32,036	34.266
Net interest income	224,127	245,251	256,562	278,075	295,789	70,822	72,434	73,153	74,848	75,363	72,678	72,726
Provisions for loan losses	40,665	45,089	33,052	28,608	32,618	7,793	6,580	6,824	9,972	9,243	9,292	6,662
Non-interest income	220,516	222,815	251,496	270,485	294,938	68,192	73,442	72,542	77,067	71,883	71,358	78,427
Non-interest expense	302,202	297,015	316,339	355,698	370.814	90,007	91,505	91,435	94,057	93.817	91,564	95,119
MEMO												
Realized securities gains or losses	4,348	4,594	5,771	5,043	1,332	81	417	1,478	484	–1,047	–1.141	–474
Ratios (percent)												
Return on average equity	11.98	14.14	16.24	14.35	14.68	13.27	14.71	14.73	15.04	14.23	14.54	14.88
Return on average assets	.92	1.12	1.26	1.16	1.21	1.11	1.22	1.21	1.24	1.15	1.17	1.21
Net interest margin[8]	3.61	3.74	3.51	3.37	3.09	3.29	3.16	3.08	3.07	3.05	3.05	2.96
Efficiency ratio[7]	66.71	62.24	61.65	63.40	61.70	64.13	61.12	61.47	61.74	63.92	63.77	61.93
Nonperforming assets to loans and related assets	1.44	1.44	1.15	.82	.69	.82	.76	.71	.70	.69	.69	.67
Net charge-offs to average loans	.91	1.04	.84	.67	.62	.71	.57	.52	.65	.72	.74	.45
Loans to deposits	95.25	93.72	94.27	97.33	99.28	97.33	97.06	98.45	99.32	99.28	100.07	100.14
Regulatory capital ratios												
Tier 1 risk-based	8.94	9.24	9.59	9.35	9.14	9.35	9.28	9.27	9.17	9.14	8.98	8.96
Total risk-based	11.93	12.30	12.61	12.22	11.87	12.22	12.15	12.03	11.91	11.87	11.76	11.75
Leverage	6.69	6.73	6.88	6.59	6.50	6.59	6.49	6.53	6.54	6.50	6.38	6.33
Number of bank holding companies	1,842	1,979	2,134	2,254	2,268	2.254	2,282	2,296	2,290	2,268	1,016	1,003

Footnotes appear on p. B6.

2. Financial characteristics of fifty large bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio[2, 9]	2001	2002	2003	2004	2005	2004	2005				2006
						Q4	Q1	Q2	Q3	Q4	Q1
Balance sheet											
Total assets	**5,896,783**	**6,256,824**	**6,926,108**	**7,963,241**	**8,645,888**	**7,963,241**	**8,226,990**	**8,440,266**	**8,515,432**	**8,645,888**	**8,970,662**
Loans	2,968,905	3,153,028	3,404,117	3,945,799	4,351,995	3,945,799	4,001,893	4,121,526	4,241,636	4,351,995	4,456,423
Securities and money market	2,050,129	2,276,872	2,628,112	2,913,583	3,188,236	2,913,583	3,147,849	3,210,407	3,200,593	3,188,236	3,378,174
Allowance for loan losses	−56,737	−61,324	−59,548	−59,656	−57,219	−59,656	−58,287	−57,595	−58,368	−57,219	−57,413
Other	934,487	888,248	953,428	1,163,516	1,162,877	1,163,516	1,135,535	1,165,928	1,131,572	1,162,877	1,193,478
Total liabilities	**5,446,449**	**5,767,409**	**6,393,247**	**7,271,689**	**7,918,171**	**7,271,689**	**7,531,639**	**7,725,734**	**7,797,427**	**7,918,171**	**8,212,994**
Deposits	3,036,830	3,273,801	3,531,832	3,967,576	4,297,653	3,967,576	4,038,580	4,102,410	4,172,538	4,297,653	4,402,954
Borrowings	1,875,435	2,037,450	2,358,631	2,712,748	3,077,129	2,712,748	2,896,505	3,024,117	3,097,466	3,077,129	3,248,232
Other[3]	534,184	456,158	502,784	591,365	543,390	591,365	596,555	599,207	527,423	543,390	561,808
Total equity	**450,334**	**489,415**	**532,862**	**691,552**	**727,717**	**691,552**	**695,351**	**714,532**	**718,005**	**727,717**	**757,668**
Off-balance-sheet											
Unused commitments to lend[4]	3,242,175	3,391,837	3,807,849	4,490,684	5,050,405	4,490,684	4,582,671	4,702,953	4,867,314	5,050,405	5,166,727
Securitizations outstanding[5]	271,825	289,905	293,046	348,986	384,996	348,986	361,524	363,221	370,518	384,996	391,756
Derivatives (notional value, billions)[6]	48,144	57,746	72,692	88,671	98,749	88,671	92,136	96,300	97,994	98,749	108,963
Income statement											
Net income[7]	53,411	68,756	87,858	90,408	106,132	23,455	26,168	25,326	27,761	26,881	29,074
Net interest income	166,848	183,553	192,195	206,579	215,352	52,844	53,289	53,668	54,200	54,204	55,423
Provisions for loan losses	35,767	39,400	28,573	25,197	29,128	6,748	5,765	6,035	9,031	8,297	6,034
Non-interest income	176,226	174,233	196,967	210,812	230,868	55,061	57,860	55,123	59,997	57,884	64,299
Non-interest expense	225,124	216,533	230,158	259,732	266,747	66,870	66,560	65,694	66,693	67,799	71,902
MEMO											
Realized security gains or losses	4,330	5,022	5,217	4,174	1,702	133	227	1,426	469	−420	−117
Ratios (percent)											
Return on average equity	12.38	14.74	17.43	14.83	15.05	13.90	15.10	14.46	15.57	15.04	15.51
Return on average assets	.93	1.13	1.31	1.19	1.25	1.18	1.28	1.20	1.30	1.24	1.30
Net interest margin[8]	3.39	3.56	3.36	3.21	2.92	3.17	3.01	2.91	2.89	2.86	2.83
Efficiency ratio[7]	64.36	59.40	58.63	60.57	58.70	61.39	58.03	58.81	58.28	61.29	59.28
Nonperforming assets to loans and related assets	1.56	1.55	1.21	.84	.70	.84	.78	.72	.71	.70	.68
Net charge-offs to average loans	1.03	1.20	.97	.79	.74	.83	.69	.62	.78	.86	.53
Loans to deposits	97.76	96.31	96.38	99.45	101.26	99.45	99.09	100.47	101.66	101.26	101.21
Regulatory capital ratios											
Tier 1 risk-based	8.26	8.55	8.83	8.59	8.45	8.59	8.54	8.48	8.48	8.45	8.43
Total risk-based	11.61	11.98	12.21	11.86	11.56	11.86	11.81	11.61	11.62	11.56	11.55
Leverage	6.26	6.28	6.38	6.18	6.16	6.18	6.10	6.08	6.17	6.16	6.10

Footnotes appear on p. B6.

3. Financial characteristics of all other reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account[1, 10]	2001	2002	2003	2004	2005	2004	2005				2005[r]	2006
						Q4	Q1	Q2	Q3	Q4	Q4	Q1
Balance sheet												
Total assets	**1,277,090**	**1,401,227**	**1,527,308**	**1,686,798**	**1,846,496**	**1,686,798**	**1,717,675**	**1,767,744**	**1,816,198**	**1,846,496**	**1,512,393**	**1,533,908**
Loans	812,179	875,986	952,217	1,081,393	1,222,260	1,081,393	1,108,765	1,155,948	1,194,967	1,222,260	996,041	1,015,838
Securities and money market	357,366	406,771	446,237	470,040	465,922	470,040	468,314	463,460	467,758	465,922	383,635	386,457
Allowance for loan losses	−11,727	−13,021	−13,852	−14,533	−15,343	−14,533	−14,654	−14,901	−15,253	−15,343	−12,526	−12,704
Other	119,273	131,491	142,706	149,898	173,656	149,898	155,251	163,236	168,725	173,656	145,242	144,318
Total liabilities	**1,162,232**	**1,271,919**	**1,387,290**	**1,531,062**	**1,678,565**	**1,531,062**	**1,562,077**	**1,606,086**	**1,651,157**	**1,678,565**	**1,374,465**	**1,393,756**
Deposits	975,514	1,064,802	1,150,648	1,262,006	1,396,880	1,262,006	1,291,162	1,325,494	1,370,318	1,396,880	1,124,004	1,143,429
Borrowings	161,450	176,225	202,893	228,755	235,401	228,755	228,424	238,313	234,934	235,401	210,170	206,535
Other[3]	25,267	30,892	33,748	40,302	46,284	40,302	42,491	42,280	45,905	46,284	40,291	43,792
Total equity	**114,859**	**129,308**	**140,018**	**155,737**	**167,930**	**155,737**	**155,597**	**161,658**	**165,040**	**167,930**	**137,928**	**140,152**
Off-balance-sheet												
Unused commitments to lend[4]	229,887	247,466	276,769	319,277	367,264	319,277	332,445	345,663	359,746	367,264	323,206	329,823
Securitizations outstanding[5]	4,567	4,358	4,159	2,877	2,885	2,877	2,792	2,667	2,697	2,885	2,878	2,844
Derivatives (notional value, billions)[6]	89	88	94	144	103	144	98	99	100	103	101	86
Income statement												
Net income[7]	13,659	16,469	17,626	19,244	21,306	4,831	5,154	5,433	5,617	5,102	4,426	4,472
Net interest income	45,676	50,475	52,266	56,545	62,698	14,723	15,049	15,484	16,116	16,049	13,897	13,294
Provisions for loan losses	4,461	5,058	4,262	3,179	3,191	763	684	735	892	881	947	578
Non-interest income	22,118	24,282	27,311	25,934	26,410	6,299	6,569	6,646	6,930	6,264	5,972	6,063
Non-interest expense	43,828	46,390	50,672	52,661	56,323	13,681	13,783	13,845	14,325	14,369	12,680	12,252
MEMO												
Realized security gains or losses	727	651	962	531	35	−3	98	61	66	−190	−177	22
Ratios (percent)												
Return on average equity	12.54	13.55	13.08	13.16	13.24	12.60	13.25	13.70	13.74	12.29	12.99	12.91
Return on average assets	1.13	1.25	1.20	1.20	1.21	1.16	1.22	1.25	1.26	1.12	1.19	1.19
Net interest margin[8]	4.20	4.25	3.97	3.93	3.97	3.94	3.97	3.98	4.00	3.93	4.16	3.94
Efficiency ratio[7]	63.75	61.05	62.93	62.68	61.89	64.01	62.59	61.76	61.54	62.74	62.20	61.98
Nonperforming assets to loans and related assets	.99	1.04	.99	.77	.69	.77	.75	.71	.69	.69	.67	.67
Net charge-offs to average loans	.44	.46	.39	.25	.20	.30	.17	.19	.21	.24	.27	.15
Loans to deposits	83.26	82.27	82.75	85.69	87.50	85.69	85.87	87.21	87.20	87.50	88.62	88.84
Regulatory capital ratios												
Tier 1 risk-based	12.24	12.47	12.61	12.45	12.17	12.45	12.32	12.16	12.12	12.17	11.92	11.93
Total risk-based	13.80	14.08	14.30	14.07	13.72	14.07	13.92	13.72	13.67	13.72	13.51	13.50
Leverage	8.78	8.91	9.07	9.15	9.19	9.15	9.12	9.12	9.15	9.19	9.09	9.17
Number of other reporting bank holding companies	1,777	1.914	2,069	2,197	2,213	2,197	2,225	2,239	2,233	2.213	962	950

Footnotes appear on p. B6.

4. Nonfinancial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account	2001	2002	2003	2004	2005	2004	2005				2005[r]	2006
						Q4	Q1	Q2	Q3	Q4	Q4	Q1
Bank holding companies that qualify as financial holding companies[11, 12]												
Domestic												
Number	388	434	451	472	461	472	470	468	471	461	288	289
Total assets	5,436,743	5,917,109	6,605,686	7,456,569	8,184,677	7,456,569	7,643,649	7,898,330	8,068,742	8,184,677	8,136,643	8,468,806
Foreign-owned[13]												
Number	10	11	12	14	14	14	15	15	15	14	13	14
Total assets	621,442	616,254	710,441	1,376,333	1,561,580	1,376,333	1,526,168	1,516,408	1,625,281	1,561,580	1,460,245	1,689,001
Total U.S. commercial bank assets[14]	**6,416,080**	**6,897,215**	**7,397,903**	**8,207,714**	**8,994,064**	**8,207,714**	**8,544,414**	**8,676,294**	**8,857,369**	**8,994,066**	**8,994,059**	**9,286,846**
By ownership												
Reporting bank holding companies	5,942,670	6,429,231	6,941,106	7,785,988	8,439,788	7,785,988	8,011,264	8,138,007	8,312,461	8,439,915	8,416,815	8,341,350
Other bank holding companies	230,467	227,016	219,222	209,115	220,133	209,115	204,891	206,367	211,840	220,140	243,101	602,912
Independent banks	242,944	240,968	237,575	212,611	334,143	212,611	328,259	331,920	333,067	334,011	334,142	342,584
Assets associated with nonbanking activities[12, 15]												
Insurance	426,462	372,405	437,503	579,111	602,258	579,111	587,000	598,669	601,076	602,258	512,058	527,193
Securities broker–dealers	n.a.	630,851	656,775	892,571	1,170,659	892,571	1,168,482	1,165,688	1,231,410	1,170,659	1,170,639	1,314,092
Thrift institutions	91,170	107,422	133,056	191,201	220,819	191,201	194,267	201,317	210,811	220,819	220,709	231,207
Foreign nonbank institutions	138,977	145,344	170,630	216,758	242,408	216,758	219,829	231,566	242,333	242,408	236,225	268,848
Other nonbank institutions	1,674,267	561,710	678,086	954,845	969,255	954,845	886,022	910,770	954,085	969,255	962,883	927,934
Number of bank holding companies engaged in nonbanking activities[12, 15]												
Insurance	143	96	102	97	97	97	97	99	98	97	83	81
Securities broker–dealers	n.a.	47	50	44	46	44	43	45	46	46	43	41
Thrift institutions	38	32	27	27	26	27	27	27	25	26	23	22
Foreign nonbank institutions	32	37	42	39	35	39	38	37	38	35	33	33
Other nonbank institutions	743	880	1,042	1,026	845	1,026	926	885	875	845	515	509
Foreign-owned bank holding companies[13]												
Number	23	26	27	29	29	29	29	30	30	29	28	24
Total assets	764,411	762,901	934,085	1,537,208	1,747,797	1,537,208	1,690,119	1,698,197	1,811,451	1,747,797	1,646,462	1,822,367
Employees of reporting bank holding companies (full-time equivalent)	1,985,981	1,992,559	2,034,358	2,162,179	2,241,112	2,162,179	2,168,165	2,199,910	2,221,004	2,241,112	2,122,810	2,150,153
Assets of fifty large bank holding companies[9, 16]												
Fixed panel (from table 2)	5,896,783	6,256,824	6,926,108	7,963,241	8,645,888	7,963,241	8,226,990	8,440,266	8,515,432	8,645,888	8,645,879	8,970,662
Fifty large as of reporting date	5,732,621	6,032,000	6,666,488	7,940,955	8,631,229	7,940,955	8,206,462	8,417,847	8,489,633	8,631,229	8,631,229	8,970,662
Percent of all reporting bank holding companies	76.60	75.50	75.10	76.80	76.20	76.80	76.60	76.80	75.40	76.20	79.10	79.00

NOTE: All data are as of the most recent period shown. The historical figures may not match those in earlier versions of this table because of mergers, significant acquisitions or divestitures, or revisions or restatements to bank holding company financial reports. Data for the most recent period may not include all late-filing institutions.

1. For quarters beginning on or after March 31, 2006, this report covers top-tier bank holding companies with consolidated assets of at least $500 million and some smaller top-tier firms that filed the FR Y-9C as required by Federal Reserve Banks for supervisory purposes or on a voluntary basis. Before March 31, 2006, aggregate data refer to top-tier bank holding companies with consolidated assets of at least $150 million and smaller multibank holding companies with debt outstanding to the general public or engaged in certain nonbanking activities.

2. Data for all reporting bank holding companies and the fifty large bank holding companies reflect merger adjustments to the fifty large bank holding companies. Merger adjustments account for mergers, acquisitions, other business combinations, and large divestitures that occurred during the time period covered in the tables so that the historical information on each of the fifty underlying institutions depicts, to the greatest extent possible, the institutions as they exist in the most recent period. In general, adjustments for mergers among bank holding companies reflect the combination of historical data from predecessor bank holding companies. The data for the fifty large bank holding companies have also been adjusted as necessary to match the historical figures in each company's most recently available financial statement. In general, the data are not adjusted for changes in generally accepted accounting principles.

3. Includes minority interests in consolidated subsidiaries.

4. Includes credit card lines of credit as well as commercial lines of credit.

5. Includes loans sold to securitization vehicles in which bank holding companies retain some interest, whether through recourse or seller-provided credit enhancements or by servicing the underlying assets. Securitization data were first collected on the FR Y-9C report for June 2001.

6. The notional value of a derivative is the reference amount of an asset on which an interest rate or price differential is applied when calculating the contractual payments. The total notional value of a bank holding company's derivatives holdings is the sum of the notional values of each derivative contract regardless of whether the bank holding company is a payor or recipient of payments under the contract. The actual cash flows and fair market values associated with these derivative contracts are generally only a small fraction of the contract's notional value.

7. Income statement subtotals for all reporting bank holding companies and the fifty large bank holding companies exclude extraordinary items, the cumulative effects of changes in accounting principles, and discontinued operations at the fifty large institutions and therefore will not sum to Net income. The efficiency ratio is calculated excluding nonrecurring income and expenses.

8. Calculated on a fully-taxable-equivalent basis.

9. In general, the fifty large bank holding companies are the fifty largest bank holding companies as measured by total consolidated assets for the latest period shown. Excludes a few large bank holding companies whose commercial banking operations account for only a small portion of assets and earnings.

10. Excludes predecessor bank holding companies that were subsequently merged into other bank holding companies in the panel of fifty large bank holding companies. Also excludes those bank holding companies excluded from the panel of fifty large bank holding companies, because commercial banking operations represent only a small part of their consolidated operations.

11. Excludes qualifying institutions that are not reporting bank holding companies.

12. No data related to financial holding companies and only some data on nonbanking activities were collected on the FR Y-9C report before implementation of the Gramm–Leach–Bliley Act in 2000.

13. A bank holding company is considered "foreign-owned" if it is majority-owned by a foreign entity. Data for foreign-owned companies do not include data for branches and agencies of foreign banks operating in the United States.

14. Total assets of insured commercial banks in the United States as reported in the commercial bank Call Report (FFIEC 031 or 041, Reports of Condition and Income). Excludes data for a small number of commercial banks owned by other commercial banks that file separate call reports yet are also covered by the reports filed by their parent banks. Also excludes data for mutual savings banks.

15. Data for thrift, foreign nonbank, and other nonbank institutions are total assets of each type of subsidiary as reported in the FR Y-9LP report. Data cover those subsidiaries in which the top-tier bank holding company directly or indirectly owns or controls more than 50 percent of the outstanding voting stock and that has been consolidated using generally accepted accounting principles. Data for securities broker–dealers are net assets (that is, total assets, excluding intercompany transactions) of broker–dealer subsidiaries engaged in activities pursuant to the Gramm–Leach–Bliley Act, as reported on schedule HC-M of the FR Y-9C report. Data for insurance activities are all insurance-related assets held by the bank holding company as reported on schedule HC-I of the FR Y-9C report.

Beginning in 2002:Q1, insurance totals exclude intercompany transactions and subsidiaries engaged in credit-related insurance or those engaged principally in insurance agency activities. Beginning in 2002:Q2, insurance totals include only newly authorized insurance activities under the Gramm–Leach–Bliley Act.

16. Changes over time in the total assets of the time-varying panel of fifty large bank holding companies are attributable to (1) changes in the companies that make up the panel and (2) to a small extent, restatements of financial reports between periods.

n.a. Not available

SOURCE: Federal Reserve Reports FRY-9C and FR Y-9LP, Federal Reserve National Information Center, and published financial reports.

June 2007

Report on the Condition of the U.S. Banking Industry: Second Quarter, 2006

Total assets of reporting bank holding companies rose 2.7 percent ($304 billion) over the second quarter, to $11.7 trillion.[1] Robust loan growth, concentrated in real estate, generated most of the increase. Earnings were dampened by continued pressure on net interest margins and modest growth in fee income, but benefited from loan expansion, reduced operating expenses, and securities gains. Credit quality remained excellent.

Loans expanded at a vigorous pace, rising 3.1 percent ($172 billion) for the quarter. Lending activity was particularly strong in the residential mortgage segment, which grew 3.7 percent ($71 billion) and accounted for more than 40 percent of loan growth. On balance sheet, commercial real estate loans—primarily loans secured by nonfarm, nonresidential properties and construction, land development, and other land loans—also continued to grow rapidly, rising 3.4 percent ($39 billion). Unused commitments to lend expanded 4.2 percent, to $5.8 trillion, with more than half of the increase driven by credit card lines.

Securities and money market assets (up 1.7 percent, or $73 billion) increased more slowly than loans. Growth was constrained by a substantial reduction ($48 billion) in money market holdings—with a fully offsetting decline in money market liabilities—at one bank holding company in which operations are predominantly concentrated at its securities broker-dealer subsidiary. Excluding this company, securities and money market assets increased 3 percent, slightly outpacing asset growth overall. Aggregate trading assets jumped 8.2 percent ($91 billion), mainly among the largest companies.

Deposit growth at 2.8 percent ($153 billion) kept pace with balance sheet expansion. Most growth was concentrated in foreign and time deposits, rates on which moved up. Core deposits—which exclude time deposits in denominations higher than $100,000, brokered deposits, and deposits booked in foreign offices—stayed roughly flat, with a rise in small time deposits partly offset by further declines in transaction accounts. While deposits funded more than half of asset growth, borrowings also advanced 2.6 percent ($98 billion).

Higher dividend payouts by larger companies and increases in unrealized losses in available-for-sale investment account securities that reduced the accumulated other comprehensive income component restrained equity growth for the quarter. Equity was up just 1 percent (roughly $9 billion). Given the more rapid advance in bank holding company assets, the equity to assets ratio dropped slightly from 8.19 percent to 8.06 percent. The tier 1 leverage, tier 1 risk-based, and total risk-based capital ratios, which do not reflect the unrealized losses on available-for-sale securities, also declined slightly, but remained sound at 6.28 percent, 8.94 percent, and 11.73 percent respectively.

Profitability remained strong in the quarter. Return on equity increased 26 basis points from the first quarter, to 15.17 percent, while the return on assets leveled off (up one basis point) to 1.22 percent. Net income improved 2.6 percent, to $35 billion. Reduced noninterest expenses, due to lower incentive-based compensation at the largest companies, and increased realized gains on securities sales (from a $474 million loss in the first quarter) bolstered earnings. Fee income also contributed to growth in earnings, benefiting from stronger mortgage-related and investment banking businesses, but was held back by declines in equity trading at the largest institutions. Despite further margin compression, net interest income grew 1.4 percent ($1 billion) on a larger average earning assets base. The net interest margin fell 7 basis points, to 2.89 percent, owing to a higher

1. This report presents aggregate time-series data drawn primarily from the FR Y-9C and FR Y-9LP regulatory report forms submitted to the Federal Reserve each quarter by large bank holding companies (defined within the report as "all reporting bank holding companies"). Beginning with the quarter ended March 31, 2006, the Federal Reserve updated the filing requirements for these reports. Most notably, it raised the asset threshold requiring the filing of the reports to $500 million from $150 million. The changes to the filing requirements mitigated regulatory reporting burden by reducing the number of required respondents substantially. Despite the large drop in the number of filers, reporting bank holding companies still represent a substantial majority of all bank holding company assets (when assets of nonreporting bank holding companies are approximated using data for bank subsidiary assets).

cost of deposit funding, a competitive lending environment, and a flattened yield curve. Although 60 percent of the companies reduced provisioning, aggregate provisions for loan losses increased $144 million (2.2 percent).

Nonperforming assets inched up from a low level, but the ratio of nonperforming assets to loans and related assets dropped slightly from 0.67 percent to 0.65 percent as loans expanded briskly. Net charge-offs increased as the moderating effect of last year's reform of the bankruptcy code on credit card losses continued to wane, but remained near historic lows at 0.48 percent of average loans. □

1. Financial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio[1, 2]	2001	2002	2003	2004	2005	2004	2005				2006	
						Q4	Q1	Q2	Q3	Q4	Q1	Q2
Balance sheet												
Total assets	**7,487,107**	**7,989,910**	**8,880,558**	**10,339,801**	**11,333,100**	**10,339,801**	**10,710,570**	**10,956,171**	**11,257,415**	**11,333,100**	**11,352,835**	**11,656,441**
Loans	3,835,237	4,083,169	4,435,653	5,109,493	5,659,808	5,109,493	5,192,276	5,363,646	5,525,962	5,659,808	5,561,703	5,733,310
Securities and money market	2,563,779	2,858,856	3,297,932	3,804,003	4,157,256	3,804,003	4,114,628	4,143,955	4,246,546	4,157,256	4,305,752	4,378,775
Allowance for loan losses	−68,829	−74,782	−73,817	−74,589	−73,031	−74,589	−73,378	−72,949	−74,097	−73,031	−70,544	−70,759
Other	1,156,920	1,122,668	1,220,790	1,500,894	1,589,068	1,500,894	1,477,045	1,521,520	1,559,005	1,589,068	1,555,924	1,615,116
Total liabilities	**6,900,721**	**7,347,694**	**8,176,868**	**9,452,623**	**10,393,243**	**9,452,623**	**9,819,629**	**10,034,472**	**10,327,938**	**10,393,243**	**10,422,650**	**10,717,404**
Deposits	4,026,460	4,356,585	4,705,045	5,249,494	5,700,850	5,249,494	5,349,427	5,448,059	5,563,636	5,700,850	5,553,762	5,707,211
Borrowings	2,072,505	2,242,717	2,629,293	3,157,578	3,586,922	3,157,578	3,424,013	3,525,137	3,667,710	3,586,922	3,825,102	3,922,825
Other[3]	801,756	748,392	842,531	1,045,552	1,105,471	1,045,552	1,046,189	1,061,277	1,096,593	1,105,471	1,043,787	1,087,367
Total equity	**586,386**	**642,216**	**703,690**	**887,178**	**939,857**	**887,178**	**890,941**	**921,699**	**929,477**	**939,857**	**930,185**	**939,037**
Off-balance-sheet												
Unused commitments to lend[4]	3,482,236	3,651,209	4,097,531	4,823,332	5,437,902	4,823,332	4,929,516	5,064,198	5,245,819	5,437,902	5,520,728	5,754,362
Securitizations outstanding[5]	276,717	295,001	298,348	353,978	389,726	353,978	366,430	367,887	375,142	389,726	394,600	388,744
Derivatives (notional value, billions)[6]	48,261	57,866	72,883	89,115	99,077	89,115	92,621	96,653	98,281	99,077	109,261	117,992
Income statement												
Net income[7]	67,208	86,013	107,885	113,317	133,047	28,653	32,598	33,072	34,543	32,837	34,266	35,148
Net interest income	224,127	245,251	256,562	278,075	295,789	70,822	72,434	73,153	74,848	75,363	72,726	73,737
Provisions for loan losses	40,665	45,089	33,052	28,608	32,618	7,793	6,580	6,824	9,972	9,243	6,662	6,806
Non-interest income	220,516	222,815	251,496	270,485	294,938	68,192	73,442	72,542	77,067	71,883	78,427	79,409
Non-interest expense	302,202	297,015	316,339	355,698	370,814	90,007	91,505	91,435	94,057	93,817	95,119	94,182
MEMO												
Realized securities gains or losses	4,348	4,594	5,771	5,043	1,332	81	417	1,478	484	−1,047	−474	49
Ratios (percent)												
Return on average equity	11.98	14.14	16.24	14.35	14.68	13.27	14.71	14.73	15.04	14.23	14.91	15.17
Return on average assets	.92	1.12	1.26	1.16	1.21	1.11	1.22	1.21	1.24	1.15	1.21	1.22
Net interest margin[8]	3.61	3.74	3.51	3.37	3.09	3.29	3.16	3.08	3.07	3.05	2.96	2.89
Efficiency ratio[7]	66.71	62.24	61.65	63.40	61.70	64.13	61.12	61.47	61.74	63.92	61.93	61.37
Nonperforming assets to loans and related assets	1.44	1.44	1.15	.82	.69	.82	.76	.71	.70	.69	.67	.65
Net charge-offs to average loans	.91	1.04	.84	.67	.62	.71	.57	.52	.65	.72	.45	.48
Loans to deposits	95.25	93.72	94.27	97.33	99.28	97.33	97.06	98.45	99.32	99.28	100.14	100.46
Regulatory capital ratios												
Tier 1 risk-based	8.94	9.24	9.59	9.35	9.14	9.35	9.28	9.27	9.17	9.14	8.96	8.94
Total risk-based	11.93	12.30	12.61	12.22	11.87	12.22	12.15	12.03	11.91	11.87	11.75	11.73
Leverage	6.69	6.73	6.88	6.59	6.50	6.59	6.49	6.53	6.54	6.50	6.33	6.28
Number of bank holding companies	1,842	1,979	2,134	2,254	2,268	2,254	2,282	2,296	2,290	2,268	1,003	995

Footnotes appear on p. B12.

2. Financial characteristics of fifty large bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account or ratio [2, 9]	2001	2002	2003	2004	2005	2004	2005				2006	
						Q4	Q1	Q2	Q3	Q4	Q1	Q2
Balance sheet												
Total assets	**5,896,783**	**6,256,824**	**6,926,108**	**7,963,241**	**8,645,888**	**7,963,241**	**8,226,990**	**8,440,266**	**8,515,432**	**8,645,888**	**8,970,662**	**9,282,941**
Loans	2,968,905	3,153,028	3,404,117	3,945,799	4,351,995	3,945,799	4,001,893	4,121,526	4,241,636	4,351,995	4,456,423	4,598,577
Securities and money market	2,050,129	2,276,872	2,628,112	2,913,583	3,188,236	2,913,583	3,147,849	3,210,407	3,200,593	3,188,236	3,378,174	3,505,834
Allowance for loan losses	−56,737	−61,324	−59,548	−59,656	−57,219	−59,656	−58,287	−57,595	−58,368	−57,219	−57,413	−57,432
Other	934,487	888,248	953,428	1,163,516	1,162,877	1,163,516	1,135,535	1,165,928	1,131,572	1,162,877	1,193,478	1,235,963
Total liabilities	**5,446,449**	**5,767,409**	**6,393,247**	**7,271,689**	**7,918,171**	**7,271,689**	**7,531,639**	**7,725,734**	**7,797,427**	**7,918,171**	**8,212,994**	**8,518,106**
Deposits	3,036,830	3,273,801	3,531,832	3,967,576	4,297,653	3,967,576	4,038,580	4,102,410	4,172,538	4,297,653	4,402,954	4,540,867
Borrowings	1,875,435	2,037,450	2,358,631	2,712,748	3,077,129	2,712,748	2,896,505	3,024,117	3,097,466	3,077,129	3,248,232	3,379,098
Other [3]	534,184	456,158	502,784	591,365	543,390	591,365	596,555	599,207	527,423	543,390	561,808	598,141
Total equity	**450,334**	**489,415**	**532,862**	**691,552**	**727,717**	**691,552**	**695,351**	**714,532**	**718,005**	**727,717**	**757,668**	**764,835**
Off-balance-sheet												
Unused commitments to lend [4]	3,242,175	3,391,837	3,807,849	4,490,684	5,050,405	4,490,684	4,582,671	4,702,953	4,867,314	5,050,405	5,166,727	5,387,508
Securitizations outstanding [5]	271,825	289,905	293,046	348,986	384,996	348,986	361,524	363,221	370,518	384,996	391,756	385,937
Derivatives (notional value, billions) [6]	48,144	57,746	72,692	88,671	98,749	88,671	92,136	96,300	97,994	98,749	108,963	117,631
Income statement												
Net income [7]	53,411	68,756	87,858	90,408	106,132	23,455	26,168	25,326	27,761	26,881	29,074	29,689
Net interest income	166,848	183,553	192,195	206,579	215,352	52,844	53,289	53,668	54,200	54,204	55,423	56,645
Provisions for loan losses	35,767	39,400	28,573	25,197	29,128	6,748	5,765	6,035	9,031	8,297	6,034	6,141
Non-interest income	176,226	174,233	196,967	210,812	230,868	55,061	57,860	55,123	59,997	57,884	64,299	65,147
Non-interest expense	225,124	216,533	230,158	259,732	266,747	66,870	66,560	65,694	66,693	67,799	71,902	71,201
MEMO												
Realized securities gains or losses	4,330	5,022	5,217	4,174	1,702	133	227	1,426	469	−420	−117	374
Ratios (percent)												
Return on average equity	12.38	14.74	17.43	14.83	15.05	13.90	15.10	14.46	15.57	15.04	15.51	15.60
Return on average assets	.93	1.13	1.31	1.19	1.25	1.18	1.28	1.20	1.30	1.24	1.30	1.27
Net interest margin [8]	3.39	3.56	3.36	3.21	2.92	3.17	3.01	2.91	2.89	2.86	2.83	2.76
Efficiency ratio [7]	64.36	59.40	58.63	60.57	58.70	61.39	58.03	58.81	58.28	61.29	59.28	58.55
Nonperforming assets to loans and related assets	1.56	1.55	1.21	.84	.70	.84	.78	.72	.71	.70	.68	.66
Net charge-offs to average loans	1.03	1.20	.97	.79	.74	.83	.69	.62	.78	.86	.53	.56
Loans to deposits	97.76	96.31	96.38	99.45	101.26	99.45	99.09	100.47	101.66	101.26	101.21	101.27
Regulatory capital ratios												
Tier 1 risk-based	8.26	8.55	8.83	8.59	8.45	8.59	8.54	8.48	8.48	8.45	8.43	8.42
Total risk-based	11.61	11.98	12.21	11.86	11.56	11.86	11.81	11.61	11.62	11.56	11.55	11.56
Leverage	6.26	6.28	6.38	6.18	6.16	6.18	6.10	6.08	6.17	6.16	6.10	6.03

Footnotes appear on p. B12.

3. Financial characteristics of all other reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account[1, 10]	2001	2002	2003	2004	2005	2004	2005				2006	
						Q4	Q1	Q2	Q3	Q4	Q1	Q2
Balance sheet												
Total assets	**1,277,090**	**1,401,227**	**1,527,308**	**1,686,798**	**1,846,496**	**1,686,798**	**1,717,675**	**1,767,744**	**1,816,198**	**1,846,496**	**1,533,908**	**1,559,106**
Loans	812,179	875,986	952,217	1,081,393	1,222,260	1,081,393	1,108,765	1,155,948	1,194,967	1,222,260	1,015,838	1,044,850
Securities and money market	357,366	406,771	446,237	470,040	465,922	470,040	468,314	463,460	467,758	465,922	386,457	375,857
Allowance for loan losses	−11,727	−13,021	−13,852	−14,533	−15,343	−14,533	−14,654	−14,901	−15,253	−15,343	−12,704	−12,897
Other	119,273	131,491	142,706	149,898	173,656	149,898	155,251	163,236	168,725	173,656	144,318	151,296
Total liabilities	**1,162,232**	**1,271,919**	**1,387,290**	**1,531,062**	**1,678,565**	**1,531,062**	**1,562,077**	**1,606,086**	**1,651,157**	**1,678,565**	**1,393,756**	**1,416,917**
Deposits	975,514	1,064,802	1,150,648	1,262,006	1,396,880	1,262,006	1,291,162	1,325,494	1,370,318	1,396,880	1,143,429	1,158,982
Borrowings	161,450	176,225	202,893	228,755	235,401	228,755	228,424	238,313	234,934	235,401	206,535	213,895
Other[3]	25,267	30,892	33,748	40,302	46,284	40,302	42,491	42,280	45,905	46,284	43,792	44,040
Total equity	**114,859**	**129,308**	**140,018**	**155,737**	**167,930**	**155,737**	**155,597**	**161,658**	**165,040**	**167,930**	**140,152**	**142,189**
Off-balance-sheet												
Unused commitments to lend[4]	229,887	247,466	276,769	319,277	367,264	319,277	332,445	345,663	359,746	367,264	329,823	336,227
Securitizations outstanding[5]	4,567	4,358	4,159	2,877	2,885	2,877	2,792	2,667	2,697	2,885	2,844	2,806
Derivatives (notional value, billions)[6]	89	88	94	144	103	144	98	99	100	103	86	88
Income statement												
Net income[7]	13,659	16,469	17,626	19,244	21,306	4,831	5,154	5,433	5,617	5,102	4,472	4,774
Net interest income	45,676	50,475	52,266	56,545	62,698	14,723	15,049	15,484	16,116	16,049	13,294	13,443
Provisions for loan losses	4,461	5,058	4,262	3,179	3,191	763	684	735	892	881	578	631
Non-interest income	22,118	24,282	27,311	25,934	26,410	6,299	6,569	6,646	6,930	6,264	6,063	6,224
Non-interest expense	43,828	46,390	50,672	52,661	56,323	13,681	13,783	13,845	14,325	14,369	12,252	12,241
MEMO												
Realized securities gains or losses	727	651	962	531	35	−3	98	61	66	−190	22	32
Ratios (percent)												
Return on average equity	12.54	13.55	13.08	13.16	13.24	12.60	13.25	13.70	13.74	12.29	12.91	13.52
Return on average assets	1.13	1.25	1.20	1.20	1.21	1.16	1.22	1.25	1.26	1.12	1.19	1.24
Net interest margin[8]	4.20	4.25	3.97	3.93	3.97	3.94	3.97	3.98	4.00	3.93	3.94	3.89
Efficiency ratio[7]	63.75	61.05	62.93	62.68	61.89	64.01	62.59	61.76	61.54	62.74	61.98	61.54
Nonperforming assets to loans and related assets	.99	1.04	.99	.77	.69	.77	.75	.71	.69	.69	.67	.65
Net charge-offs to average loans	.44	.46	.39	.25	.20	.30	.17	.19	.21	.24	.15	.18
Loans to deposits	83.26	82.27	82.75	85.69	87.50	85.69	85.87	87.21	87.20	87.50	88.84	90.15
Regulatory capital ratios												
Tier 1 risk-based	12.24	12.47	12.61	12.45	12.17	12.45	12.32	12.16	12.12	12.17	11.93	11.83
Total risk-based	13.80	14.08	14.30	14.07	13.72	14.07	13.92	13.72	13.67	13.72	13.50	13.42
Leverage	8.78	8.91	9.07	9.15	9.19	9.15	9.12	9.12	9.15	9.19	9.17	9.16
Number of other reporting bank holding companies	1,777	1,914	2,069	2,197	2,213	2,197	2,225	2,239	2,233	2,213	950	942

Footnotes appear on p. B12.

4. Nonfinancial characteristics of all reporting bank holding companies in the United States

Millions of dollars except as noted, not seasonally adjusted

Account	2001	2002	2003	2004	2005	2004	2005				2006	
						Q4	Q1	Q2	Q3	Q4	Q1	Q2
Bank holding companies that qualify as financial holding companies [11, 12]												
Domestic												
Number	388	434	451	472	461	472	470	468	471	461	289	288
Total assets	5,436,743	5,917,109	6,605,686	7,456,569	8,184,677	7,456,569	7,643,649	7,898,330	8,068,742	8,184,677	8,468,806	8,721,000
Foreign-owned [13]												
Number	10	11	12	14	14	14	15	15	15	14	14	14
Total assets	621,442	616,254	710,441	1,376,333	1,561,580	1,376,333	1,526,168	1,516,408	1,625,281	1,561,580	1,689,001	1,710,637
Total U.S. commercial bank assets [14]	**6,416,080**	**6,897,215**	**7,397,903**	**8,207,714**	**8,994,064**	**8,207,714**	**8,544,414**	**8,676,294**	**8,857,369**	**8,994,071**	**9,286,848**	**9,554,923**
By ownership												
Reporting bank holding companies	5,942,670	6,429,231	6,941,106	7,785,988	8,439,788	7,785,988	8,011,264	8,138,007	8,312,461	8,439,915	8,203,720	8,595,385
Other bank holding companies	230,467	227,016	219,222	209,115	220,133	209,115	204,891	206,367	211,840	220,143	740,544	609,203
Independent banks	242,944	240,968	237,575	212,611	334,143	212,611	328,259	331,920	333,067	334,013	342,584	350,335
Assets associated with nonbanking activities [12, 15]												
Insurance	426,462	372,405	437,503	579,111	602,258	579,111	587,000	598,669	601,076	602,258	527,193	528,828
Securities broker–dealers	n.a.	630,851	656,775	892,571	1,170,659	892,571	1,168,482	1,165,688	1,231,410	1,170,659	1,314,092	1,298,790
Thrift institutions	91,170	107,422	133,056	191,201	220,819	191,201	194,267	201,317	210,811	220,819	231,207	243,863
Foreign nonbank institutions	138,977	145,344	170,630	216,758	242,408	216,758	219,829	231,566	242,333	242,408	268,848	267,345
Other nonbank institutions	1,674,267	561,710	678,086	954,845	969,255	954,845	886,022	910,770	954,085	969,255	927,934	1,018,219
Number of bank holding companies engaged in nonbanking activities [12, 15]												
Insurance	143	96	102	97	97	97	97	99	98	97	81	82
Securities broker–dealers	n.a.	47	50	44	46	44	43	45	46	46	41	41
Thrift institutions	38	32	27	27	26	27	27	27	25	26	22	24
Foreign nonbank institutions	32	37	42	39	35	39	38	37	38	35	33	34
Other nonbank institutions	743	880	1,042	1,026	845	1,026	926	885	875	845	509	496
Foreign-owned bank holding companies [13]												
Number	23	26	27	29	29	29	29	30	30	29	24	24
Total assets	764,411	762,901	934,085	1,537,208	1,747,797	1,537,208	1,690,119	1,698,197	1,811,451	1,747,797	1,822,367	1,847,094
Employees of reporting bank holding companies (full-time equivalent)	1,985,981	1,992,559	2,034,358	2,162,179	2,241,112	2,162,179	2,168,165	2,199,910	2,221,004	2,241,112	2,150,153	2,173,503
Assets of fifty large bank holding companies [9, 16]												
Fixed panel (from table 2)	5,896,783	6,256,824	6,926,108	7,963,241	8,645,888	7,963,241	8,226,990	8,440,266	8,515,432	8,645,888	8,970,662	9,282,941
Fifty large as of reporting date	5,732,621	6,032,000	6,666,488	7,940,955	8,631,229	7,940,955	8,206,462	8,417,847	8,489,633	8,631,229	8,970,662	9,282,941
Percent of all reporting bank holding companies	77	75	75	77	76	77	77	77	75	76	79	80

NOTE: All data are as of the most recent period shown. The historical figures may not match those in earlier versions of this table because of mergers, significant acquisitions or divestitures, or revisions or restatements to bank holding company financial reports. Data for the most recent period may not include all late-filing institutions.

1. For quarters beginning on or after March 31, 2006, this report covers top-tier bank holding companies with consolidated assets of at least $500 million and some smaller top-tier firms that filed the FR Y-9C as required by Federal Reserve Banks for supervisory purposes or on a voluntary basis. Before March 31, 2006, aggregate data refer to top-tier bank holding companies with consolidated assets of at least $150 million and smaller multibank holding companies with debt outstanding to the general public or engaged in certain nonbanking activities.

2. Data for all reporting bank holding companies and the fifty large bank holding companies reflect merger adjustments to the fifty large bank holding companies. Merger adjustments account for mergers, acquisitions, other business combinations, and large divestitures that occurred during the time period covered in the tables so that the historical information on each of the fifty underlying institutions depicts, to the greatest extent possible, the institutions as they exist in the most recent period. In general, adjustments for mergers among bank holding companies reflect the combination of historical data from predecessor bank holding companies. The data for the fifty large bank holding companies have also been adjusted as necessary to match the historical figures in each company's most recently available financial statement. In general, the data are not adjusted for changes in generally accepted accounting principles.

3. Includes minority interests in consolidated subsidiaries.

4. Includes credit card lines of credit as well as commercial lines of credit.

5. Includes loans sold to securitization vehicles in which bank holding companies retain some interest, whether through recourse or seller-provided credit enhancements or by servicing the underlying assets. Securitization data were first collected on the FR Y-9C report for June 2001.

6. The notional value of a derivative is the reference amount of an asset on which an interest rate or price differential is applied when calculating the contractual payments. The total notional value of a bank holding company's derivatives holdings is the sum of the notional values of each derivative contract regardless of whether the bank holding company is a payor or recipient of payments under the contract. The actual cash flows and fair market values associated with these derivative contracts are generally only a small fraction of the contract's notional value.

7. Income statement subtotals for all reporting bank holding companies and the fifty large bank holding companies exclude extraordinary items, the cumulative effects of changes in accounting principles, and discontinued operations at the fifty large institutions and therefore will not sum to Net income. The efficiency ratio is calculated excluding nonrecurring income and expenses.

8. Calculated on a fully-taxable-equivalent basis.

9. In general, the fifty large bank holding companies are the fifty largest bank holding companies as measured by total consolidated assets for the latest period shown. Excludes a few large bank holding companies whose commercial banking operations account for only a small portion of assets and earnings.

10. Excludes predecessor bank holding companies that were subsequently merged into other bank holding companies in the panel of fifty large bank holding companies. Also excludes those bank holding companies excluded from the panel of fifty large bank holding companies, because commercial banking operations represent only a small part of their consolidated operations.

11. Excludes qualifying institutions that are not reporting bank holding companies.

12. No data related to financial holding companies and only some data on nonbanking activities were collected on the FR Y-9C report before implementation of the Gramm–Leach-Bliley Act in 2000.

13. A bank holding company is considered "foreign-owned" if it is majority-owned by a foreign entity. Data for foreign-owned companies do not include data for branches and agencies of foreign banks operating in the United States.

14. Total assets of insured commercial banks in the United States as reported in the commercial bank Call Report (FFIEC 031 or 041, Reports of Condition and Income). Excludes data for a small number of commercial banks owned by other commercial banks that file separate call reports yet are also covered by the reports filed by their parent banks. Also excludes data for mutual savings banks.

15. Data for thrift, foreign nonbank, and other nonbank institutions are total assets of each type of subsidiary as reported in the FR Y-9LP report. Data cover those subsidiaries in which the top-tier bank holding company directly or indirectly owns or controls more than 50 percent of the outstanding voting stock and that has been consolidated using generally accepted accounting principles. Data for securities broker–dealers are net assets (that is, total assets, excluding intercompany transactions) of broker–dealer subsidiaries engaged in activities pursuant to the Gramm–Leach–Bliley Act, as reported on schedule HC-M of the FR Y-9C report. Data for insurance activities are all insurance-related assets held by the bank holding company as reported on schedule HC-I of the FR Y-9C report.

Beginning in 2002:Q1, insurance totals exclude intercompany transactions and subsidiaries engaged in credit-related insurance or those engaged principally in insurance agency activities. Beginning in 2002:Q2, insurance totals include only newly authorized insurance activities under the Gramm–Leach–Bliley Act.

16. Changes over time in the total assets of the time-varying panel of fifty large bank holding companies are attributable to (1) changes in the companies that make up the panel and (2) to a small extent, restatements of financial reports between periods.

n.a. Not available

SOURCE: Federal Reserve Reports FRY-9C and FR Y-9LP, Federal Reserve National Information Center, and published financial reports.

Legal Developments

March 2007

Legal Developments: Fourth Quarter, 2006

ORDERS ISSUED UNDER BANK HOLDING COMPANY ACT

ORDERS ISSUED UNDER SECTION 3 OF THE BANK HOLDING COMPANY ACT

AFNB Holdings, Inc.
Houston, Texas

Order Approving the Formation of a Bank Holding Company

AFNB Holdings, Inc. ("Holdings") has requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[1] to become a bank holding company and acquire all the voting shares of American First National Bank ("AFNB"), also of Houston.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (71 *Federal Register* 57,511 (2006)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

Holdings is a newly organized corporation formed to acquire AFNB. AFNB, with total assets of approximately $355 million, is the 102nd largest insured depository institution in Texas, controlling deposits of approximately $313 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.[2]

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving any proposal that would result in a monopoly or that would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[3]

Holdings does not currently control a depository institution. Based on all the facts of record, the Board concludes that consummation of the proposal would have no significantly adverse effect on competition or on the concentration of banking resources in any relevant market and that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of companies and depository institutions involved in a proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other confidential supervisory information from the Office of the Comptroller of the Currency ("OCC"), the primary federal supervisor of AFNB, publicly reported and other financial information, information provided by Holdings, and public comments received on the proposal.

In evaluating financial factors in proposals involving newly formed bank holding companies, the Board reviews the financial condition of both the applicant and the target depository institution. The Board also evaluates the financial condition of the pro forma organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors of the proposal. AFNB currently is well capitalized and would remain so on consummation of the proposal. The proposed transaction is structured as a share exchange. Based on its review of the record, the Board finds that Holdings has sufficient financial resources to effect the proposal.

The Board also has considered the managerial resources of the organizations involved.[4] The Board has reviewed the

1. 12 U.S.C. § 1842.

2. Asset data are as of September 30, 2006. Deposit data and state rankings are as of June 20, 2006, and reflect merger activity through December 6, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

3. *See* 12 U.S.C. § 1842(c)(1).

4. Three commenters, including two minority shareholders of AFNB, questioned the competence and integrity of the current chairman of the board of AFNB, who also would serve as chairman of Holdings on consummation of the proposal. These commenters alleged that the chairman previously demonstrated poor performance and breached fiduciary duties while serving as chairman and chief executive officer of Texas First National Bank ("TFNB"), Houston. The Board has carefully reviewed publicly available information as well as

examination record of AFNB, including assessments of its management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the OCC with AFNB and its record of compliance with applicable banking laws and anti-money-laundering laws. The Board has also considered the supervisory experiences of the OCC with TFNB, which was previously headed by members of the current management of AFNB. In addition, the Board has considered Holdings' plans for implementing the proposal, including the proposed management after consummation.[5]

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on proposals under section 3 of the BHC Act, the Board must also consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[6] The Board has considered carefully all the facts of record, including reports of examination of the CRA record of AFNB, information provided by Holdings, and confidential supervisory information. AFNB received a "Satisfactory" rating at its most recent CRA performance evaluation by the OCC, as of January 20, 2004. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance record of AFNB are consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Holdings with the conditions in this order and the commitments made to the Board in connection with the application. For purposes of this transaction, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Dallas, acting pursuant to delegated authority.

By order of the Board of Governors, effective December 18, 2006.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

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confidential supervisory information about AFNB and TFNB in assessing the financial and managerial resources of AFNB and Holdings. In addition, the Board has consulted with the OCC, also the primary federal supervisor of TFNB, about the record of the current chairman of AFNB, including his service as chairman and chief executive officer of TFNB.

5. Two commenters expressed concern that the bylaws of Holdings would not permit cumulative voting and would thereby reduce the ability of AFNB's minority shareholders to elect directors and exert influence on the management or policies of AFNB. The Board notes that changes in the powers of common stock are not within the limited statutory factors the Board may consider when reviewing an application under the BHC Act. *See Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

6. 12 U.S.C. §2901 et seq.

Capital One Financial Corporation McLean, Virginia

Order Approving the Merger of Bank Holding Companies

Capital One Financial Corporation ("Capital One"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to merge with North Fork Bancorporation, Inc. ("North Fork"), Melville, New York, and acquire its subsidiary banks, North Fork Bank ("NF Bank"), Mattituck, New York, and Superior Savings of New England, National Association ("Superior Savings"), Branford, Connecticut.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (71 *Federal Register* 29,627 (2006)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.[3]

Capital One, with total consolidated assets of approximately $89.5 billion, is the 36th largest depository organization in the United States,[4] controlling deposits of approximately $32.6 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. Capital One owns three subsid-

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1. 12 U.S.C. §1842. Capital One and North Fork also have requested the Board's approval to hold and exercise options to purchase up to 19.9 percent of each other's common stock. Both options would expire on consummation of the proposal.

2. North Fork engages in asset management, securities brokerage, and the sale of investment products through its nonbank subsidiaries. Capital One proposes to acquire those nonbank subsidiaries in accordance with section 4(k) of the BHC Act.

3. The Board received four comments expressing concerns about various aspects of the proposal.

4. Asset and national ranking and deposit data are as of June 30, 2006.

iary depository institutions that operate in Louisiana, Texas, and Virginia[5] and engages in numerous nonbanking activities that are permissible under the BHC Act.

North Fork, with total consolidated assets of approximately $59.4 billion, is the 41st largest depository organization in the United States, controlling deposits of $37.2 billion. North Fork owns two subsidiary depository institutions that operate in New York, New Jersey, and Connecticut. In New York, North Fork is the fifth largest depository organization, controlling deposits of $33.2 billion. North Fork is the 15th largest depository organization in Connecticut, controlling deposits of $799.9 million, and the 13th largest depository organization in New Jersey, controlling deposits of $3.2 billion.[6]

On consummation of this proposal, Capital One would become the 24th largest depository organization in the United States, with total consolidated assets of approximately $154 billion (including pro forma accounting adjustments). Capital One would control deposits of approximately $69.8 billion, which represent less than 2 percent of the total amount of deposits of insured depository institutions in the United States.

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met. For purposes of the BHC Act, the home state of Capital One is Virginia,[7] and North Fork is located in New York, New Jersey, and Connecticut.[8]

Based on a review of all the facts of record, including a review of relevant state statutes, the Board finds that all conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[9] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[10]

Capital One and North Fork do not compete directly in any relevant banking market. Based on all the facts of record, the Board concludes that consummation of the proposal would have no significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market. Accordingly, the Board has determined that competitive factors are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, information provided by Capital One, and public comments received on the proposal.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations.[11] In this evaluation, the Board

5. Capital One owns Capital One Bank, Glen Allen, and Capital One, F.S.B. ("Capital One FSB"), McLean, both in Virginia. Capital One also owns Capital One, National Association ("CONA"), New Orleans, Louisiana, formerly known as Hibernia National Bank, which Capital One acquired in connection with its merger with Hibernia Corporation in 2005 ("Hibernia Proposal"). *See Capital One Financial Corporation*, 91 *Federal Reserve Bulletin* 512 (2005) ("Hibernia Order").

6. State ranking and deposit data are as of June 30, 2006, and reflect merger activity through July 7, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

7. A bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

8. For purposes of section 3(d), the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch (12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B)).

9. 12 U.S.C. §§ 1842(d)(1)(A) and (B), 1842(d)(2)(A) and (B). Capital One is adequately capitalized and adequately managed, as defined by applicable law. NF Bank and Superior Savings have been in existence and operated for the minimum period of time required by applicable state law (five years). On consummation of the proposal, Capital One would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States and less than 30 percent of the total amount of deposits of insured depository institutions in New York, New Jersey, and Connecticut. All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

10. 12 U.S.C. § 1842(c)(1).

11. Two commenters criticized the relationships of Capital One and North Fork with unaffiliated nontraditional providers of financial services. As a general matter, these businesses are licensed by the states where they operate and are subject to applicable state law. The Board considered the relationships of Capital One and Hibernia National Bank (now CONA) with these types of providers in the Hibernia Order and hereby readopts and reaffirms those findings and decisions herein. Capital One represented that it has made no significant changes to the manner in which Capital One and its affiliates

considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors of the proposal. Capital One, all its subsidiary depository institutions, and all the subsidiary depository institutions of North Fork currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that Capital One has sufficient financial resources to effect the proposal.[12] The proposed transaction is structured as a partial share exchange and partial cash purchase of shares. Capital One will use existing resources and the proceeds of long-term debt to fund the cash purchase of shares.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of Capital One, North Fork, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws.[13] The Board also has considered Capital One's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board must also consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[14] The CRA requires the federal financial supervisory agencies to encourage financial institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[15]

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of the subsidiary-insured depository institutions of Capital One and North Fork, data reported by Capital One and North Fork under the Home Mortgage Disclosure Act ("HMDA"),[16] other information provided by Capital One, confidential supervisory information, and public comments received on the proposal.

Two commenters opposed the proposal or expressed concern based on the levels of lending by the subsidiary depository institutions of Capital One and North Fork to LMI communities and the institutions' records of serving those communities through community development grants and loans. One of these commenters was particularly concerned that the acquisition of North Fork would adversely affect LMI residents in New York City if North Fork's current CRA programs were altered.[17] The com-

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conduct their lending relationships with such providers since the Hibernia Proposal. According to Capital One, NF Bank's Middle-Market Lending Group provides banking services to licensed check-cashing businesses in New York and New Jersey, and NF Bank's Small Business Financial Services Group extends a small number of loans to nontraditional providers of financial services. Capital One represented that NF Bank does not play any role in the lending practices or credit-review processes of these firms. In addition, North Fork owns a check-cashing business licensed by and operated exclusively in New York. The Board has consulted with the New York State Banking Department on this check-cashing business.

12. A commenter requested that, in light of the compensation to be received by certain North Fork executives in connection with the proposal, the Board consider whether it has authority to evaluate the appropriateness of compensation arrangements for executive officers in connection with merger and acquisition transactions subject to the BHC Act. The Board has taken the compensation arrangements for North Fork's executives into account in evaluating this proposal under the financial and managerial factors. As noted, Capital One and North Fork would remain well capitalized on consummation of the proposal. In addition, information about these arrangements was disclosed to the shareholders of Capital One and North Fork, and they approved the proposed transactions.

13. One commenter opposed the proposal in part based on a lawsuit and investigations undertaken by the Attorneys General of Minnesota and West Virginia in their respective states relating to Capital One's marketing of its credit cards. The Board considered this matter in the Hibernia Order and has reviewed additional information with respect to these actions, including information provided by Capital One and confidential supervisory information. The Board notes that in February 2006, Capital One and the state of Minnesota entered into a Consent Judgment, which by its terms constituted a full and final resolution of all claims brought by the state and was not deemed an admission of liability by Capital One. According to the terms of the Consent Judgment, Capital One agreed not to distribute certain advertisements in Minnesota for a period of 18 months after the date of the Consent Judgment and to pay a total of $749,999, to be divided equally among Minnesota-based chapters of the Legal Aid Society, the Minnesota Association of Community Organizations for Reform Now, and the state of Minnesota. The Board will continue to monitor the investigation by the Attorney General of West Virginia and notes that neither Board action on this proposal nor any supervisory action by the Board under the BHC Act would interfere with the Attorney General's review or with the ability of a court to resolve any litigation pertaining to this matter.

14. 12 U.S.C. § 2901 et seq.

15. 12 U.S.C. § 2903.

16. 12 U.S.C. § 2801 et seq.

17. The commenter made specific recommendations for community development programs for Capital One and its subsidiary bank after consummation of this merger that were modeled on pledges previously made by North Fork. Another commenter expressed concern that Capital One had not made community development lending commit-

menters also alleged, based primarily on 2004 and 2005 HMDA data, that Capital One and North Fork engaged in discriminatory treatment of minority individuals in the home mortgage lending operations of their subsidiary depository institutions.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions of both organizations. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[18]

CONA, Capital One's largest subsidiary depository institution as measured by total deposits, received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency ("OCC"), as of January 12, 2004. Capital One FSB and Capital One Bank both received "outstanding" ratings at their most recent CRA performance evaluations.[19] NF Bank received an "outstanding" rating from the Federal Deposit Insurance Corporation ("FDIC"), as of August 19, 2002, and Superior Savings received a "satisfactory" rating from the OCC, as of August 1, 2005. Capital One has indicated that it does not expect the proposed merger to result in the discontinuation of any products or services offered by North Fork, except to the extent that Capital One offers a comparable product or service.[20]

ments specific to New Jersey and to specific types of organizations. The Board notes that the CRA does not require depository institutions to engage in particular kinds of lending or in lending to specific types of organizations. Moreover, the Board views the enforceability of third-party pledges, initiatives, and agreements as matters outside the CRA. The Board has explained that an applicant must demonstrate a satisfactory record of performance under the CRA without reliance on plans or commitments for future action. In addition, the Board has consistently found that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization. *See, e.g., Wachovia Corporation*, 91 *Federal Reserve Bulletin* 77 (2005). Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the needs of its CRA assessment areas at the time the Board reviews a proposal under the convenience and needs factor.

18. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,640 (2001).

19. Capital One FSB's and Capital One Bank's most recent evaluations were both as of July 18, 2005, by the Office of Thrift Supervision ("OTS") and the Federal Reserve Bank of Richmond ("Reserve Bank"), respectively.

20. A commenter expressed concern that Capital One has limited experience in branch services and mortgage lending. As noted above, Capital One intends to maintain the current services provided by North Fork. In addition, Capital One stated that it intends to retain key management personnel at North Fork's branches.

B. CRA Performance of Capital One

1. *CONA*. CONA received an overall "satisfactory" CRA performance rating at its January 2004 evaluation.[21] The Board previously considered the CRA performance of CONA in the Hibernia Order and hereby reaffirms and readopts its findings and decisions herein. Capital One represented that it has retained or expanded all CRA programs in place at CONA since it acquired the bank. As noted in the Hibernia Order, examiners commended CONA's responsiveness to the credit needs of its assessment areas, particularly in providing loan products to small businesses. Examiners noted CONA's good overall distribution of loans to borrowers of different income levels, adequate levels of community development lending and investment, and accessible service-delivery systems in its assessment areas. Examiners also commended its excellent community development services.

Since the 2004 CRA evaluation, Capital One represented that CONA has originated more than $300 million in community development loans, made or committed to make qualified investments totaling $34 million, and provided $1.8 million in community development grants.[22]

2. *Capital One FSB*. As noted, Capital One FSB received an overall "outstanding" CRA performance rating at its July 2005 evaluation.[23] The institution received a "high satisfactory" rating under the lending and services tests and an "outstanding" rating under the investment test in this evaluation.

Examiners noted that Capital One FSB's geographic distribution of consumer loans was reasonable in relation to the demographic characteristics of its assessment area and that the geographic distribution of mortgage loans and small loans to businesses was commensurate with both demographic and peer lending data. According to examiners, the percentage of consumer installment loans made to LMI borrowers in the institution's assessment area exceeded the percentage of LMI families residing in that area. Capital One FSB's distribution of consumer credit cards to borrowers of different income levels also was reasonable compared with the demographic data. In addition, examiners noted favorably the institution's special installment-loan product that was primarily used by LMI borrowers.[24]

21. The evaluation period was from October 18, 1999, through January 12, 2004, except for the lending test, which was evaluated from January 1, 2000, through December 31, 2002.

22. These amounts were provided from January 31, 2004, through March 31, 2006. In addition, CONA provided special assistance to the communities affected by Hurricane Katrina through charitable donations, fundraising coordination, grants of payment deferrals for business and individual customers, and extensions of lines of credit on favorable terms.

23. The evaluation period was from April 1, 2003, through June 30, 2005, except for the review of retail lending, which was evaluated from January 1, 2003, through March 31, 2005. Capital One FSB is a nationwide provider of consumer and commercial lending and offers consumer deposit products.

24. This product featured a low minimum loan amount of $1,000 and flexible underwriting requirements.

Examiners commended Capital One FSB for increasing its community development lending, which totaled approximately $15.8 million during the most recent evaluation period. Examiners also noted the innovative nature of Capital One FSB's lending arrangements with community development fund initiatives, affordable housing organizations, and other nonprofit organizations that served LMI individuals.

During the evaluation period, Capital One FSB's qualified investments totaled approximately $119.4 million and included purchases of qualified mortgage-backed securities and low-income-housing tax credits, investments in small business investment corporations, and deposits in community development fund initiatives. In addition, examiners noted that Capital One FSB provided approximately $8.6 million in financial grants during the assessment period.

Although Capital One FSB has no public offices, examiners noted that it provided customer-service call centers with extended hours and issued ATM cards to customers to allow them access to their money market accounts. Examiners also commended Capital One FSB for the technical assistance and financial advice it provided to a variety of nonprofit organizations in its assessment area and other communities in which Capital One FSB operated.

3. *Capital One Bank.* Capital One Bank is engaged primarily in credit card operations and has been designated as a limited-purpose bank, which is evaluated under the community development test for CRA performance.[25] In assigning a rating to a limited-purpose bank, examiners may consider the bank's community development loans, investments, and services nationwide rather than only in the bank's assessment area. In rating Capital One Bank "outstanding" at its July 2005 evaluation, Reserve Bank examiners noted that Capital One Bank's nationwide qualified investments increased from $82 million to $128 million during the evaluation period.[26] These investments included investments in low-income-housing tax credit projects, entities that support microenterprise development, and bonds issued by the Virginia Housing Development Authority.

During the evaluation period, Capital One Bank contributed more than $6.5 million to a variety of organizations that primarily assist LMI individuals or areas or support microenterprise development. Examiners also noted that Capital One Bank provided technical assistance and financial expertise to organizations dedicated to community development, including affordable housing, social services, and small business development.

C. CRA Performance of North Fork

1. *NF Bank.* As noted, NF Bank received an overall "outstanding" rating in its August 2002 CRA evaluation.[27] Under the lending test, NF Bank received a rating of "outstanding," and examiners commended the bank's level of lending activity as reflecting an excellent responsiveness to the credit needs of its assessment area. Examiners found NF Bank's overall distribution of loans to borrowers of different income levels to be very good, particularly its home purchase loans. During the evaluation period, NF Bank's percentages of home purchase loans exceeded the percentages for lenders in the aggregate ("aggregate lenders").[28] Similarly, the percentage of its home purchase loans to LMI geographies exceeded the percentages for aggregate lenders during the evaluation period. Examiners also noted that the geographic distribution of the bank's loans to small businesses was excellent.[29]

Since its most recent evaluation, NF Bank has remained an active mortgage lender in its assessment area. For example, Capital One represented that NF Bank and its mortgage subsidiary, GreenPoint Mortgage Funding, Inc. ("GreenPoint"), Novato, California, closed more than $525 million of multifamily housing loans in its assessment area in 2004 and $534 million of such loans in 2005. Capital One also represented that NF Bank's percentages of home purchase loans and refinance loans originated in LMI geographies in New Jersey exceeded the percentages for aggregate lenders in 2004 and 2005. In addition, Capital One stated that NF Bank and GreenPoint, on a combined basis, made more than $1.3 billion in small business loans in the New York and New Jersey assessment area in 2004.

Examiners commended NF Bank's leadership role in making community development loans that respond to the credit needs of economically disadvantaged areas, individuals, and small businesses through its community investment efforts and innovative and flexible loan practices. During the evaluation period, NF Bank made community development loans totaling $83.4 million to affordable housing projects, nursing homes serving elderly residents in LMI neighborhoods, and other community development groups. NF Bank also originated or purchased $345 million in affordable multifamily housing loans for properties in LMI neighborhoods.

NF Bank has continued its community development lending since its most recent evaluation.[30] Capital One

25. *See* 12 CFR 228.25(a).

26. The evaluation period was from April 28, 2003, through June 30, 2005.

27. The evaluation period was October 1, 1999, through June 30, 2002, with the exception of the lending test, for which the evaluation period was January 1, 2000, through June 30, 2002.

28. The lending data of the aggregate lenders represent the cumulative lending for all financial institutions that reported HMDA data in a given market.

29. For purposes of the evaluation, small businesses are businesses with gross annual revenues of $1 million or less.

30. One commenter expressed concern about NF Bank's CRA programs in New Jersey. NF Bank entered the New Jersey market by acquiring The Trust Company of New Jersey ("Trust Company") in May 2004. NF Bank's CRA performance has not been evaluated since

stated that NF Bank provided $650 million in general community development loans and $450 million in affordable multifamily housing loans in 2004 and 2005. Capital One also represented that NF Bank has approved more than $6.8 million in financing for affordable housing in New Jersey since 2004.

In the 2002 CRA evaluation, NF Bank received an "outstanding" rating under the investment test, and examiners commended NF Bank for taking a leadership role in investing in innovative and complex qualified investments in its assessment area. Examiners reported that during the evaluation period, NF Bank made community development investments in its New York assessment area totaling $66.1 million, primarily in affordable housing initiatives. NF Bank also donated $1.2 million to numerous community development organizations engaged in affordable housing development, social services, and neighborhood revitalization efforts in its assessment area.

Capital One represented that NF Bank made $86.3 million in qualified community development investments, and that NF Bank and GreenPoint also made approximately $5 million in community development grants on a combined basis, in 2004 and 2005.[31] These community development investments and grants aided a broad range of community and housing development groups in its assessment area, including a $10 million investment in housing revenue bonds issued by the New Jersey State Housing Mortgage Finance Agency for development of affordable housing for LMI families in the state.

In the 2002 CRA evaluation, NF Bank also received an "outstanding" rating for the service test. Examiners noted that NF Bank's service-delivery systems were accessible to geographies and individuals of different income levels throughout its assessment areas and that its branch network was well-dispersed geographically and conducive to banking by LMI individuals.[32] In addition, examiners commended the bank for having an "excellent" level of innovative community development services. Examiners also noted that the bank's outreach efforts included extensive financial literacy programs in LMI areas and small business seminars providing financial and technical assistance.

2. *Superior Savings.* Superior Savings received an overall "satisfactory" rating in its August 2005 evaluation.[33] Examiners concluded that the bank had an adequate level of community development lending, services, and qualified investments in its assessment areas and an adequate responsiveness to the credit and community development needs in its assessment areas.

During the 2002 evaluation period, Superior Savings extended $13.7 million in community development loans and $14.7 million in qualified community investments that were primarily related to affordable housing and neighborhood revitalization initiatives in LMI areas. Superior Savings engaged in various community development programs in its assessment areas, particularly in the Bronx borough of New York City, including financial literacy seminars provided by Superior Savings' staff at local charitable institutions and schools. Although Superior Savings employed a telemarketing business strategy, examiners noted that it maintained one of its two branches in the East Tremont neighborhood, an underserved LMI area of the Bronx.

D. HMDA and Fair Lending Record

The Board has carefully considered the lending records of Capital One and North Fork in light of public comment received on the proposal. A commenter alleged, based on 2004 HMDA data, that Capital One FSB had made higher-cost loans[34] more frequently to African Americans and Hispanics than to nonminority borrowers nationwide.[35] Another commenter asserted, based on 2005 HMDA data, that a relatively high percentage of Capital One FSB's home mortgage loans to African Americans were higher-cost loans. In addition, the commenter alleged that GreenPoint, a mortgage subsidiary of North Fork, made higher-cost loans nationwide more frequently to African Americans than to nonminorities.[36] Further, the commenter asserted that on a combined basis in the New York City Metropolitan Statistical Area ("MSA"), GreenPoint and NF Bank made higher-cost loans more frequently to African Ameri-

the acquisition. Capital One represented that since North Fork acquired Trust Company, North Fork has assigned employees familiar with community development lending to identify and underwrite those types of loans in New Jersey, and North Fork staff has participated in outreach efforts designed to promote homeownership opportunities for LMI borrowers and in LMI communities.

31. A commenter expressed concern that NF Bank engaged in less philanthropic activities than other local financial institutions and that such activities were not focused on community priorities. The Board notes that neither the CRA nor the federal banking agencies' implementing rules require that institutions make charitable donations.

32. Capital One also stated that North Fork has hired New Jersey-based employees and senior executive officers with substantial experience in the New Jersey market to manage the bank's retail and lending operations in the state and that, based on reviews conducted by independent companies of customer service in those branches, NF Bank's New Jersey branches consistently have received excellent reports for branch service.

33. The evaluation period was from September 30, 2002, through July 31, 2005. Superior Savings focuses on offering its services primarily through telemarketing and has been designated a wholesale institution by the OCC for CRA purposes. Superior Savings does not originate small business loans.

34. Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate (APR) exceeds the yield for U.S. Treasury securities of comparable maturity 3 or more percentage points for first-lien mortgages and 5 or more percentage points for second-lien mortgages (12 CFR 203.4).

35. The commenter also alleged, on the basis of 2005 HMDA data, that GreenPoint made a high percentage of higher-cost loans to African-American borrowers in Newark, New Jersey.

36. The commenter also contended that NF Bank extended an insufficient number of home mortgage loans to African-American and Hispanic borrowers in light of the demographic profile of its lending areas.

cans than to nonminorities.[37] The Board has reviewed HMDA data reported by Capital One FSB, NF Bank, and GreenPoint.[38]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial and ethnic groups in certain local areas, HDMA data provide an insufficient basis by themselves on which to conclude whether or not Capital One's subsidiary depository institutions, NF Bank, or GreenPoint are excluding or imposing higher credit costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[39] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide an on-site evaluation of compliance with fair lending laws by Capital One, North Fork, and their subsidiaries. The Board also has consulted with the Reserve Bank, the OTS, the OCC, and the FDIC about the fair-lending compliance records of Capital One Bank, Capital One FSB, CONA, and NF Bank, respectively.

The record, including confidential supervisory information, indicates that Capital One and North Fork have taken steps to help ensure compliance with fair lending laws and other consumer protection laws. CONA, NF Bank, and GreenPoint each has a fair lending compliance program that includes a second review of all loans marked for denial and an annual fair-lending review of its mortgage portfolio to determine whether there are any race- or ethnicity-related disparities in loan underwriting. Throughout both the Capital One and North Fork organizations, employees are required to attend annual fair-lending training sessions. In addition, Capital One stated that it intends to assimilate North Fork's consumer compliance operations into its consolidated compliance function and that the resultant organization will use best practices from both Capital One and North Fork to ensure that it maintains sound internal controls to promote compliance. As part of this integration, Capital One intends to provide ongoing role-based training to all its employees to ensure that they are well prepared to carry out their individual responsibilities in accordance with applicable consumer protection laws and regulations.

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance records of the subsidiary banks of Capital One and North Fork under the CRA. These established efforts demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

E. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by the applicant, comments received on the proposal, and confidential supervisory information. Capital One represented that its national presence and financial and managerial resources will enhance the ability of NF Bank and Superior Savings to serve their customers and broaden their geographic reach and that the branch networks of NF Bank and Superior Savings will allow Capital One to offer a broader variety of products and services to its customers.[40] Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved.[41] In reaching its conclusion, the Board

37. The Board notes that NF Bank reported no higher-cost loans in 2005.

38. The Board has focused its analysis on the 2005 HMDA data reported nationwide by Capital One FSB, NF Bank, and GreenPoint and by GreenPoint in the New York City and Newark, New Jersey MSAs.

39. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

40. One commenter expressed concern that Capital One would reduce or change the products and services it currently offers to customers in New Jersey. Capital One represented that it intends to continue offering NF Bank's current products and services to New Jersey customers and that it may offer additional products not currently offered by NF Bank.

41. A commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for any of the banks to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from any supervisory authority. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to provide an opportunity for testimony or other presentations (12 CFR 225.16(e), 262.3(i)(2), 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit comments on the proposal and, in fact, submitted written comments that the Board has

has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Capital One with the conditions in this order and the commitments made to the Board in connection with the application. For purposes of this action, the commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order unless such period is extended for good cause by the Board or by the Reserve Bank, acting pursuant to delegated authority.

By order of the Board of Governors, effective November 8, 2006.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Citizens Banking Corporation Flint, Michigan

Order Approving the Acquisition of a Bank Holding Company

Citizens Banking Corporation ("Citizens"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Republic Bancorp Inc. ("Republic"), Owosso, and its subsidiary bank, Republic Bank, Lansing, both of Michigan.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 54,992 (2006)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

Citizens, with total consolidated assets of approximately $7.8 billion, operates two subsidiary-insured depository institutions with branches in Iowa, Michigan, and Wisconsin. Citizens' subsidiary banks are Citizens Bank, Flint, Michigan, and F&M Bank—Iowa, Marshalltown, Iowa. Citizens is the ninth largest depository organization in Michigan, controlling deposits of $4.3 billion, which represent 2.8 percent of total deposits of insured depository institutions in Michigan ("state deposits").[2]

Republic, with total consolidated assets of approximately $6.2 billion, operates one insured depository institution with branches in Michigan and Ohio. Republic is the 12th largest depository organization in Michigan, controlling deposits of approximately $2.7 billion, which represent 1.8 percent of state deposits.

On consummation of this proposal, and after accounting for the proposed divestiture, Citizens would become the seventh largest depository organization in Michigan, controlling deposits of approximately $6.8 billion, which represent 4.6 percent of state deposits.

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met.[3] For purposes of section 3(d) of the BHC Act, the home state of Citizens is Michigan,[4] and Republic Bank is located in Michigan and Ohio.[5]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that all conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[6] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the

considered carefully in acting on the proposal. The request fails to demonstrate why written comments do not present its views adequately or why a hearing or meeting otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the request for a public hearing or meeting is denied.

1. 12 U.S.C. § 1842.

2. Asset data are as of September 30, 2006; statewide deposit and ranking data are as of June 30, 2006, and reflect merger activity through October 18, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

3. 12 U.S.C. § 1842.

4. Under section 3(d) of the BHC Act, a bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

5. For purposes of section 3(d), the Board considers a bank to be located in states in which the bank is chartered, headquartered, or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7), 1842(d)(1)(A), and 1842 (d)(2)(B).

6. *See* 12 U.S.C. §§ 1842(d)(1)(A)–(B), (d)(2)(A)–(B). Citizens is adequately capitalized and adequately managed, as defined by applicable law. Ohio does not require a bank to be in existence for a minimum period of time before its acquisition. On consummation of the proposal, Citizens would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States and less than 30 percent of total deposits held in Ohio by insured depository institutions. *See* Ohio Rev. Code 1115.05(B)(1)(a) (30 percent limit on statewide deposits). All other requirements pursuant to section 3(d) of the BHC Act would be met on consummation of the proposal.

business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[7]

Citizens and Republic have subsidiary depository institutions that compete directly in six markets in Michigan: Ann Arbor, Detroit, Flint, Jackson, Lansing, and Traverse City. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by Citizens and Republic,[8] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[9] other characteristics of the markets, and commitments by Citizens to divest certain branches of Republic in the Flint banking market.

A. Two Banking Markets Warranting Special Scrutiny

Citizens and Republic compete directly in two banking markets that warrant a detailed review: Flint and Jackson. As discussed below, the post-consummation concentration levels in the Flint market (after accounting for the proposed divestiture) would exceed the thresholds of the DOJ Guidelines, and Citizens' resulting market share in the market would exceed 35 percent. The post-consummation concentration level in the Jackson market would exceed the DOJ Guidelines' thresholds.

The Board has considered carefully whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in each market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase and the resulting level of concentration in a banking market.[10] In both markets, the record indicates that the proposal would not have a significantly adverse affect on competition.

Flint Banking Market. In the Flint banking market,[11] Citizens' subsidiary, Citizens Bank ("Citizens Bank"), Flint, is the largest depository institution in the market, controlling deposits of approximately $1.5 billion, which represent approximately 35 percent of market deposits. Republic Bank is the third largest depository institution in the market, controlling deposits of approximately $436.9 million, which represent approximately 10 percent of market deposits.

To reduce the potential adverse effects on competition in the Flint banking market, Citizens has committed to divest seven branches of Republic, with at least $210 million in deposits, to an out-of-market insured depository organization.[12] On consummation of the proposed merger, and after accounting for the proposed divestiture, Citizens would remain the largest depository institution in the market, controlling deposits of approximately $1.8 billion, which would represent 41 percent of market deposits. The HHI would increase 350 points to 2502.

Several factors indicate that the increase in concentration in the Flint banking market, as measured by the HHI and Citizens' market share, overstates the potential adverse competitive effects of the proposal in the market. After consummation, and taking into account the proposed divestiture, at least 17 other insured depository institutions would continue to operate in the market. In addition, community credit unions exert an important competitive influence in the Flint banking market.[13] Eight community

7. 12 U.S.C. § 1842(c)(1).

8. Deposit and market-share data are as of June 30, 2006, adjusted to reflect subsequent mergers and acquisitions through October 18, 2006, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market-share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

9. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

10. *See NationsBank Corp.*, 84 *Federal Reserve Bulletin* 129 (1998).

11. The Flint banking market is defined as Genesee County; Hazelton, Venice, Vernon, and Burns townships in Shiawassee County; Maple Grove, Taymouth, and Birch Run townships in Saginaw County; and Arbela and Millington townships in Tuscola County, all in Michigan.

12. Citizens has committed that, before consummation of the proposed merger, it will execute an agreement for the proposed divestiture in the Flint banking market with a purchaser that the Board determines to be competitively suitable. Citizens also has committed to complete the divestiture within 180 days after consummation of the proposed merger. In addition, Citizens has committed that, if it is unsuccessful in completing the proposed divestiture within that time period, it will transfer the unsold branch(es) to an independent trustee who will be instructed to sell the branch(es) to an alternate purchaser or purchasers in accordance with the terms of this order and without regard to price. Both the trustee and any alternate purchaser must be acceptable by the Board. *See BankAmerica Corporation*, 78 *Federal Reserve Bulletin* 338 (1992); *United New Mexico Financial Corporation*, 77 *Federal Reserve Bulletin* 484 (1991).

13. The Board previously has considered the competitiveness of certain active credit unions as a mitigating factor. *See, e.g., Regions Financial Corporation*, 93 *Federal Reserve Bulletin* C16 (2007); *Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006); *F.N.B. Corporation*, 90 *Federal Reserve Bulletin* 481 (2004); *Gateway*

credit unions control approximately $887.5 million in deposits in the market, which represent approximately 9 percent of market deposits on a 50 percent weighted basis. Accounting for the revised weightings of these deposits, Citizens would control approximately 37 percent of market deposits on consummation of the proposal, and the HHI would increase 288 points to 2077.[14]

Moreover, the record of recent entry into the Flint banking market evidences the market's attractiveness for entry. Within the past five years, six de novo bank branches and one credit union have opened in the Flint market, and all remain operational. Other factors indicate that the Flint banking market remains attractive for entry. For example, from 2002 to 2005, the market's average annualized deposit growth exceeded the average annualized deposit growth for all metropolitan areas in Michigan.

Jackson Banking Market. In the Jackson banking market,[15] Citizens Bank is the third largest depository institution, controlling deposits of $275.7 million, which represent 19 percent of market deposits. Republic Bank is the fourth largest depository institution in the market, controlling deposits of $172 million, which represent 12 percent of market deposits. On consummation of the proposal, Citizens Bank would become the largest depository institution in the market, controlling deposits of approximately $447.8 million. The HHI in this market would increase 459 points to 1974, and the pro forma market share of the combined entity would be 31 percent.

Several factors indicate that the proposal would not have a significantly adverse effect on concentration in the Jackson banking market. On consummation of the proposal, at least 12 other insured depository institutions would continue to operate in the market. The Board also has evaluated the competitive influence of five active community credit unions in this market. These credit unions control approximately $192.4 million in deposits in the market, which represent approximately 6 percent of market deposits on a 50 percent weighted basis. Accounting for the revised weightings of these deposits, Citizens would control approximately 29 percent of market deposits on consummation of the proposal, and the HHI would increase 403 points to 1747.[16]

In addition, the record of recent entry into the Jackson banking market evidences the market's attractiveness for entry. Within the past five years, three de novo bank branches have opened in the Jackson market, and all remain operational. Other factors indicate that the Jackson banking market continues to be attractive for entry. From 2002 to 2005, the market's annualized population growth exceeded the average annualized population growth for all metropolitan areas and nonmetropolitan counties in Michigan. Furthermore, the market's annualized income growth exceeded the average annualized income growth for all metropolitan areas in Michigan during the same period.

B. Banking Markets within Established Guidelines

Consummation of the proposal without divestitures would be consistent with Board precedent and within the thresholds of the DOJ Guidelines in the other four banking markets: Ann Arbor, Detroit, Lansing, and Traverse City.[17] On consummation of the proposal, the Ann Arbor banking market would remain unconcentrated, the Detroit and Traverse City banking markets would remain moderately concentrated, and the Lansing banking market would become moderately concentrated, as measured by the HHI. Numerous competitors would remain in each of the four banking markets.

C. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ also conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the competitive effects of the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in the six banking markets where Citizens and Republic compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the

Bank & Trust Co., 90 *Federal Reserve Bulletin* 547 (2004). In the Flint and Jackson banking markets, several credit unions offer a wide range of consumer products, operate street-level branches, and have memberships open to almost all the residents in the applicable market. The Board has concluded that the activities of such credit unions in these two markets exert sufficient competitive influence to mitigate, in part, the potential adverse competitive effects of the proposal.

14. With the deposits of these credit unions weighted at 50 percent, Citizens would be the largest depository institution in the market, with approximately 32 percent of market deposits, and Republic would be the third largest depository institution in the market, controlling approximately 9 percent of market deposits.

15. The Jackson banking market is defined as Jackson County and the eastern two tiers of townships in Calhoun County, including Lee, Clarence, Marengo, Sheridan, Eckford, Albion, Clarendon, and Homer townships, all in Michigan.

16. With the deposits of these credit unions weighted at 50 percent, Citizens would be the third largest depository institution in the market, with approximately 18 percent of market deposits, and Republic would be the fourth largest depository institution in the market, controlling approximately 11 percent of market deposits.

17. The effects of the proposal on the concentration of banking resources in these markets are described in the appendix.

proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by Citizens.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-only and on a consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. Citizens, all its subsidiary depository institutions, and Republic Bank currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that Citizens has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange and cash payment. The cash portion would be funded from the proceeds of an issuance of trust preferred securities and cash on hand.

The Board also has considered the managerial resources of Citizens, Republic, and their subsidiary banks. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws and with anti-money-laundering laws. Citizens, Republic, and their subsidiary depository institutions are considered well managed. The Board also has considered Citizens' plans for implementing the proposal, including the proposed management after consummation, and has consulted with the other relevant supervisory agencies for Republic Bank concerning those plans.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[18] Citizens Bank and F&M Bank-Iowa received "outstanding" and "satisfactory" ratings at their most recent CRA performance evaluations by the Federal Reserve Bank of Chicago, as of July 18, 2005, and July 17, 2006, respectively. Republic Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Insurance Deposit Corporation, as of August 12, 2002. After consummation of the proposal, Citizens plans to implement its CRA policies at Republic Bank. Citizens has represented that the proposal will provide greater convenience to customers through a larger network of branches and ATMs and a broader range of financial products and services over an expanded geographic area. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the community to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by Citizens with the conditions imposed in this order and the commitments made to the Board in connection with the application, including the divestiture commitment discussed above. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Chicago, acting pursuant to delegated authority.

By order of the Board of Governors, effective December 12, 2006.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

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18. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

Appendix

CITIZENS AND REPUBLIC BANKING MARKETS IN MICHIGAN CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Ann Arbor—Washtenaw County, excluding Salem township; and Putnam, Hamburg, and Unadilla townships in Livingston County						
Citizens Pre-Consummation	13	137.5 mil.	2.7	905	16	20
Republic	11	154.7 mil.	3.0	905	16	20
Citizens Post-Consummation	7	292.1 mil.	5.7	905	16	20
Detroit—Oakland, Macomb, and Wayne Counties; Hadley, Metamora, Dryden, and Almont townships in Lapeer County; Berlin, Riley, Columbus, Saint Clair, Casco, China, East China, Ira, Cottrellville, and Clay townships in Saint Clair County; Tyrone, Howell, Oceola, Hartland, Iosco, Marion, Genoa, Brighton, and Green Oak townships in Livingston County; Salem township in Washtenaw County; and Ash and Berlin townships in Monroe County						
Citizens Pre-Consummation	16	423.5 mil.	.5	1,562	1	49
Republic	12	530.1 mil.	.7	1,562	1	49
Citizens Post-Consummation	9	953.6 mil.	1.2	1,562	1	49
Lansing—Clinton, Eaton, and Ingham Counties; Portland and Danby townships in Ionia County; Handy, Conway, Cohoctah, and Deerfield townships in Livingston County; and Woodland and Castleton townships in Barry County						
Citizens Pre-Consummation	5	362.6 mil.	6.7	1,090	200	25
Republic	2	823.7 mil.	15.1	1,090	200	25
Citizens Post-Consummation	1	1.2 bil.	21.8	1,090	200	25
Traverse City—Antrim County, excluding Banks township; and Benzie, Grand Traverse, Kalkaska, and Leelanau Counties						
Citizens Pre-Consummation	11	45.7 mil.	2.0	1,428	4	15
Republic	12	24.7 mil.	1.1	1,428	4	15
Citizens Post-Consummation	11	70.4 mil.	3.1	1,428	4	15

NOTE: Data are as of June 30, 2006. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

Grupo Financiero Banorte, S.A. de C.V.
Monterrey, Nuevo León, Mexico

Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte
Monterrey, Nuevo León, Mexico

Banorte USA Corporation
Wilmington, Delaware

Order Approving the Formation of Bank Holding Companies and Acquisition of a Bank

Grupo Financiero Banorte, S.A. de C.V. ("GF Norte"), Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte ("Banorte"), and Banorte USA Corporation ("Banorte USA")[1] (collectively, "Applicants") have requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[2] to become bank holding companies and to acquire 70 percent of the voting securities of INB Financial Corporation ("INB Financial"), McAllen, Texas, and thereby acquire control of its subsidiaries, INB Delaware Corporation ("INB Delaware"), Wilmington, Delaware, and Inter National Bank, McAllen, Texas.[3] GF Norte, Banorte, Banorte USA, INB Financial, and INB Delaware (jointly, "FHC electors") have also filed with the Board elections to become financial holding companies on consummation of the proposal pursuant to section 4(k) and (l) of the BHC Act and section 225.82 of the Board's Regulation Y.[4]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 14,894 (2006)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

1. GF Norte has represented that Banorte USA would be formed before consummation of the transaction.

2. 12 U.S.C. § 1842.

3. Banorte USA will have an option to acquire the remaining 30 percent of INB Financial's voting securities at specified intervals during the next five years.

4. *See* 12 U.S.C. § 1843(k) and (l); 12 CFR 225.82. FHC electors have certified that Inter National Bank is well capitalized and well managed and have provided all the information required under Regulation Y. Based on all the facts of record, the Board has determined that these elections to become financial holding companies will become effective on consummation of the proposal, if on that date Inter National Bank remains well capitalized and well managed, and if it has received a rating of at least "satisfactory" at its most recent performance evaluation under the Community Reinvestment Act ("CRA") (12 U.S.C. § 2901 et seq).

Banorte, with total consolidated assets of approximately $15.1 billion, is the fifth largest bank in Mexico.[5] Banorte is a subsidiary of and represents more than 90 percent of the assets of GF Norte, a financial services holding company that owns 96 percent of the shares of Banorte. GF Norte currently has no banking operations in the United States; however, it engages through subsidiaries in investment advisory and securities brokerage activities in the United States.

INB Financial, with total consolidated assets of approximately $1.2 billion, controls one insured depository institution, Inter National Bank, in Texas. INB Financial is the 41st largest insured depository organization in the state, controlling deposits of approximately $862 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.[6]

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has carefully considered these factors in light of all the facts of record, including confidential supervisory and examination information from the various U.S. banking supervisors of the institutions involved, publicly reported and other financial information, and information provided by the Applicants. The Board also has consulted with the National Banking and Securities Commission ("CNBV"), an agency of the Mexican Ministry of Finance and Public Credit that is responsible for the supervision and regulation of Mexican banks and financial services holding companies, such as GF Norte.

In evaluating the financial factors in proposals involving the formation of new bank holding companies, the Board reviews the financial condition of the Applicants and the target depository institutions. The Board also evaluates the financial condition of the pro forma organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors of the proposal. Mexico's risk-based capital standards are consistent with those established by the Basel Capital Accord. The capital ratios of Banorte would continue to exceed the minimum levels that would be required under the Accord and are considered equivalent to the capital levels that would be required of a U.S. banking organization. Furthermore, INB Financial and Inter National Bank are well capitalized and would remain so on consummation

5. Mexican asset and ranking data are as of December 31, 2004, and are based on the exchange rate then in effect. Domestic assets are as of June 30, 2006, and deposit data and rankings are as of June 30, 2005.

6. In this context, depository institutions include commercial banks, savings banks, and savings associations.

of the proposal. The Board also has considered the financial resources of GF Norte and Banorte USA. Based on its review of these factors, the Board finds that Applicants have sufficient financial resources to effect the proposal. The proposed transaction is structured as a share purchase to be funded with available cash resources.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of INB Financial and Inter National Bank, including assessments of their management, risk-management systems, and operations. In addition, the Board has consulted with the CNBV about Applicants' managerial resources to implement the proposal, including compliance of GF Norte and Banorte with applicable laws and regulations. The Board also has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the U.S. organizations and their records of compliance with applicable banking laws and with anti-money-laundering laws. INB Financial and Inter National Bank are considered to be well managed. The Board also has considered Applicants' plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval.

Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the bank's home country.[7] As noted, the CNBV is the primary supervisor of Mexican banks, including Banorte. The Board has previously determined, in an application under the International Banking Act involving BBVA Bancomer, S.A. ("Bancomer"), Mexico City, Mexico, that Bancomer was subject to home country supervision on a consolidated basis.[8] In this case, the Board has determined that Banorte is supervised on substantially the same terms and conditions as Bancomer. Based on all the facts of record, the Board has concluded that Banorte is subject to comprehensive supervision and regulation on a consolidated basis by its home country supervisor.[9]

In addition, section 3 of the BHC Act requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act.[10] The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which GF Norte and Banorte operate and has communicated with relevant government authorities concerning access to information.

In addition, GF Norte and Banorte have committed that, to the extent not prohibited by applicable law, each will make available to the Board such information on the operations of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act and other applicable federal law. GF Norte and Banorte also have committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable their affiliates to make any such information available to the Board. In light of these commitments, the Board has concluded that GF Norte and Banorte have provided adequate assurances of access to any appropriate information the Board may request. For these reasons, and based on all the facts of record, the Board has concluded that the supervisory factors it is required to consider under section 3(c)(3) of the BHC Act are consistent with approval.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. In addition, section 3 of the BHC Act prohibits the Board from approving a proposed bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[11] Applicants do not currently engage in banking activities in the United States and, therefore, do not compete with Inter National Bank in any relevant banking market. Accordingly, the Board concludes, based on all the facts of record, that consummation of the proposal would not have a significant adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive considerations are consistent with approval.

7. *See* 12 U.S.C. § 1842(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home country supervision under the standards set forth in Regulation K. *See* 12 CFR 225.13(a)(4). Regulation K provides that a foreign bank will be considered subject to comprehensive supervision or regulation on a consolidated basis if the Board determines that the bank is supervised or regulated in such a manner that its home country supervisor receives sufficient information on the worldwide operations of the bank, including its relationship to any affiliates, to assess the bank's overall financial condition and its compliance with laws and regulations. *See* 12 CFR 211.24(c)(1).

8. *See BBVA Bancomer*, 89 *Federal Reserve Bulletin* 146 (2003); *Grupo Financiero Banamex Accival*, 82 *Federal Reserve Bulletin* 1047 (1996).

9. The CNBV has supervisory authority over GF Norte. In addition, the CNBV has supervisory authority, with other agencies of the Mexican Ministry of Finance and Public Credit, over the nonbanking subsidiaries of GF Norte. The CNBV has the authority to require GF Norte to submit reports about its operations on a consolidated basis and to conduct inspections of GF Norte's primary nonbanking subsidiaries. The CNBV also has authority to impose restrictions on transactions between Banorte and related parties, including GF Norte and its subsidiaries.

10. *See* 12 U.S.C. § 1842 (c)(3)(A).

11. 12 U.S.C. § 1842(c)(1).

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the CRA. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[12]

The Board has carefully considered the convenience and needs factor and the CRA performance record of Inter National Bank in light of all the facts of record. As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisor of the CRA performance record of Inter National Bank. The bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of April 14, 2003.

Applicants have represented that they intend to maintain Inter National Bank's CRA program. Applicants expect that the proposal will enhance the ability of Inter National Bank's customers to conduct cross-border financial transactions and business.

In light of all the facts of record, the Board has concluded that considerations relating to the convenience and needs factor, including the performance record of Inter National Bank, are consistent with approval of this proposal.

CONCLUSION

Based on the foregoing and in light of all the facts of record, the Board has determined that the proposal should be, and hereby is, approved. In reaching this conclusion, the Board has considered all the facts of record in light of the factors it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Applicants with the conditions in this order and all the commitments made to the Board in connection with the proposal. For purposes of this action, the commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposed transaction shall not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Dallas, acting pursuant to delegated authority.

By order of the Board of Governors, effective October 13, 2006.

12. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620, 36,640 (2001).

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Kroszner and Mishkin. Absent and not voting: Governors Bies and Warsh.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Regions Financial Corporation Birmingham, Alabama

Regions Bank Birmingham, Alabama

Order Approving the Merger of Bank Holding Companies, the Merger of Banks, and the Establishment of Branches

Regions Financial Corporation ("Regions"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to merge with AmSouth Bancorporation ("Amsouth") and acquire its subsidiary bank, AmSouth Bank, both of Birmingham.[2] In addition, Regions' subsidiary state member bank, Regions Bank, also of Birmingham, has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act[3] ("Bank Merger Act") to merge with AmSouth Bank, with Regions Bank as the surviving entity. Regions Bank also has applied under section 9 of the Federal Reserve Act ("FRA") to retain and operate branches at the locations of AmSouth Bank's main office and branches.[4] In addition, Regions has provided notice under section 25 of the Federal Reserve Act and section 211.5 of the Board's Regulation K[5] of its intention to acquire Cahaba International, Inc., also of Birmingham, an agreement corporation subsidiary of AmSouth Bank.[6]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 47,812 (2006)) and in local publications in accordance with the relevant statutes and the Board's Rules of Procedure.[7] As required by the Bank Merger Act, reports on the competitive effects of the mergers were requested from the United States Attorney General and the appropriate banking agencies. The

1. 12 U.S.C. § 1842.
2. In addition, Regions and AmSouth each has requested the Board's approval to exercise an option to purchase up to 19.9 percent of the other institution's stock on the occurrence of certain circumstances. The options would terminate on consummation of Regions' merger with AmSouth.
3. 12 U.S.C. § 1828(c).
4. 12 U.S.C. § 321.
5. 12 U.S.C. § 601 et seq.; 12 CFR 211.5.
6. Regions proposes to acquire the shares of the nonbanking subsidiaries of AmSouth in accordance with section 4(k) of the BHC Act and the post-transaction notice procedures in section 225.87 of Regulation Y (12 U.S.C. § 1843(k); 12 CFR 225.87).
7. 12 CFR 262.3(b).

time for filing comments has expired, and the Board has considered the applications, notice, and all comments received in light of the factors set forth in section 3 of the BHC Act, the Bank Merger Act, and the FRA.[8]

Regions, with total consolidated assets of approximately $86.1 billion, is the 21st largest depository organization in the United States, controlling domestic deposits of approximately $57.2 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States.[9] Regions operates one subsidiary depository institution, Regions Bank, with branches in 16 states,[10] and engages in numerous nonbanking activities that are permissible under the BHC Act.

AmSouth, with total consolidated assets of approximately $53.9 billion, is the 27th largest depository organization in the United States, controlling domestic deposits of approximately $35.8 billion. AmSouth operates one subsidiary depository institution, AmSouth Bank, with branches in seven states.[11]

On consummation of this proposal, and after accounting for all proposed divestitures, Regions would become the 13th largest depository organization in the United States, with total consolidated assets of approximately $142.4 billion. Regions would control domestic deposits of approximately $90.6 billion, which represent less than 2 percent of the total amount of deposits of insured depository institutions in the United States.

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met.[12] For purposes of section 3(d) of the BHC Act, the home state of Regions is Alabama,[13] and AmSouth Bank is located in Alabama, Florida, Georgia, Louisiana, Mississippi, Tennessee, and Virginia.[14]

Based on a review of all the facts of record, including a review of relevant state statutes, the Board finds that all conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[15] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

The BHC Act and the Bank Merger Act prohibit the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. Both acts also prohibit the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[16]

Regions and AmSouth have subsidiary depository institutions that compete directly in 67 banking markets in Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, and Tennessee. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record and public comments on the proposal.[17] In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions ("market deposits") controlled by Regions and AmSouth in those markets,[18] the concentration levels of market deposits and the increases in these levels,

8. The Board received 132 comments that supported the transaction and 18 comments that either opposed or expressed concern about various aspects of the proposal.

9. Nationwide asset data are as of June 30, 2006. Nationwide deposit and ranking data are as of, and reflect merger activity through, June 30, 2006. In this context, insured depository institutions include insured commercial banks, savings banks, and savings associations.

10. Regions Bank operates branches in Alabama, Arkansas, Florida, Georgia, Illinois, Indiana, Iowa, Kentucky, Louisiana, Mississippi, Missouri, North Carolina, South Carolina, Tennessee, Texas, and Virginia.

11. AmSouth Bank operates branches in Alabama, Florida, Georgia, Louisiana, Mississippi, Tennessee, and Virginia.

12. 12 U.S.C. § 1842.

13. Under section 3(d) of the BHC Act, a bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

14. For purposes of section 3(d), the Board considers a bank to be located in states in which the bank is chartered, headquartered, or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7), 1842(d)(1)(A), and 1842(d)(2)(B).

15. *See* 12 U.S.C. § 1842(d)(1)(A)–(B), (d)(2)(A)–(B). Regions is adequately capitalized and adequately managed, as defined by applicable law. AmSouth Bank has been in existence and operated for the minimum period of time required by applicable law. *See* Fla. Stat. Ann. § 658.2953 (three years); Ga. Code § 7-1-622(b)(1) (three years); La. Rev. Stat. Ann. § 538 (five years); Miss. Code. Ann. § 81-23-9 (five years); Tenn. Code. Ann. § 45-2-1403 (three years); and Va. Code Ann. § 6.1–44.20 (no minimum period). On consummation of the proposal, Regions would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States and, after accounting for all proposed divestitures, less than 30 percent, or the applicable percentage established by state law, of total deposits held in each relevant state by insured depository institutions. All other requirements pursuant to section 3(d) of the BHC Act would be met on consummation of the proposal.

16. 12 U.S.C. § 1842(c)(1); 12 U.S.C. § 1828(c)(5).

17. Several commenters expressed general concerns about the competitive effects of this proposal, including that consummation of the proposal would violate antitrust law. These concerns were carefully considered as part of the analysis described above.

18. Deposit and market share data are based on data reported by insured depository institutions in the summary of deposits data as of June 30, 2005, adjusted to reflect mergers and acquisitions through August 3, 2006, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market-share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[19] and other characteristics of the markets. In addition, the Board has considered commitments made by Regions to the Board to reduce the potential that the proposal would have adverse effects on competition by divesting 52 AmSouth branches (the "divestiture branches"), which account for approximately $2.7 billion in deposits,[20] in 17 banking markets (the "divestiture markets").[21] Regions has proposed to transfer all but one of the branches to be divested to out-of-market competitors.[22]

A. Banking Markets within Established Guidelines

Consummation of the proposal without divestitures would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in 42 banking markets.[23] On consummation of the proposal, two of these banking markets would remain unconcentrated; 32 banking markets would remain moderately concentrated; and eight banking markets would remain highly concentrated, with only moderate increases in market concentration, as measured by the HHI. Numerous competitors would remain in each of the 42 banking markets.

19. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is less than 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI is more than 1800. The Department of Justice has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The Department of Justice has stated that the higher-than-normal HHI thresholds for screening bank mergers for anticompetitive effects implicitly recognize the competitive effects of limited-purpose lenders and other nondepository financial entities.

20. Regions proposes to divest 39 AmSouth branches with approximately $2 billion in deposits in Alabama, six AmSouth branches with approximately $304.6 million in deposits in Mississippi, and seven AmSouth branches with approximately $408.3 million in deposits in Tennessee.

21. Regions has committed that, before consummating the proposed merger, it will execute an agreement for the proposed divestures in each divestiture market with a purchaser that the Board determines to be competitively suitable. Regions also has committed to divest total deposits in each divestiture market of at least the amount specified in the commitment and discussed in this order and to complete divestitures within 180 days of consummation of the proposed merger. In addition, Regions has committed that, if it is unsuccessful in completing the proposed divestiture within this time period, it will transfer the unsold branches to an independent trustee that will be instructed to sell such branches to an alternate purchaser or purchasers, without regard to price. Both the trustee and any alternate purchaser must be acceptable to the Board. *See BankAmerica Corp.*, 78 *Federal Reserve Bulletin* 338 (1992); *United New Mexico Financial Corp.*, 77 *Federal Reserve Bulletin* 484 (1991).

22. Regions proposes to sell the only AmSouth branch in the Paris, Tennessee, banking market to a commercial banking organization that currently operates in that banking market. Regions may divest not less than $46.9 million in deposit liabilities to an in-market depository institution with no more than 8 percent of market deposits.

23. These markets, and the effects of the proposal on the concentration of banking resources in these markets, are described in Appendix A.

B. Certain Banking Markets with Divestitures

After accounting for the divestitures Regions has proposed, consummation of the merger would be consistent with the DOJ Guidelines and Board precedent in 12 banking markets.[24] In nine of these markets, Regions proposes to divest all branches to be acquired from AmSouth and, therefore, the levels of concentration as measured by the HHI would not materially increase on consummation of the merger and the proposed divestitures.[25] In the other three markets, the HHI would not exceed the DOJ Guidelines and Board precedent on consummation of the merger and the proposed divestitures.[26] Numerous competitors would remain in these three banking markets. After accounting for the proposed divestitures, two banking markets would remain moderately concentrated, and ten banking markets would remain highly concentrated on consummation of the proposal.

C. Thirteen Banking Markets Warranting Special Scrutiny

Regions and AmSouth compete directly in 13 banking markets that warrant a detailed review: Anniston Area, Decatur Area, Etowah County, Gulf Shores Area, Mobile Area, Montgomery Area, and Tuscaloosa Area, all of Alabama; Panama City Area, Florida; Shreveport-Bossier City, Louisiana; Jackson Area, Lauderdale County, and Starkville, all of Mississippi; and McComb Area, of Mississippi and Louisiana. In each of these markets, including five with proposed divestitures and eight without proposed divestitures, the concentration levels on consummation of the proposal would exceed the threshold levels in the DOJ Guidelines, or the resulting market share of Regions would exceed 35 percent.

For each of these markets, the Board has carefully considered whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase in and resulting level of concentration in a banking market.[27] In each of these markets, the Board has identified factors that indicate the proposal would not have a significantly adverse impact on competition, despite the post-consummation increase in the HHI and market share.

24. These markets, and the effects of the proposal on the concentration of banking resources in these markets, are described in Appendix B.

25. The nine markets are: Dallas County, Alabama; Clarksdale and Greenwood, both of Mississippi; and Bedford County, Cannon County, DeKalb County, Fayetteville, Paris, and Rhea County, all of Tennessee.

26. The three markets are: Huntsville Area, Alabama; Cumberland County, Tennessee; and Greenville, Mississippi.

27. *See NationsBank Corporation*, 84 *Federal Reserve Bulletin* 129 (1998).

Among the factors reviewed, the Board has considered the competitive influence of community credit unions in these banking markets. In 11 of the markets, certain credit unions offer a wide range of consumer products, operate street-level branches, and have membership open to almost all the residents in the applicable market. The Board has concluded that the activities of such credit unions in those 11 markets exert competitive influence that mitigates, in part, the potential competitive effects of the proposal.[28]

1. Banking Markets in Alabama

Anniston Area. In the Anniston Area banking market,[29] Regions is the fourth largest depository organization, controlling deposits of approximately $199.5 million, which represent approximately 13 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $267.1 million, which represent approximately 18 percent of market deposits. On consummation of the proposal, Regions would become the largest depository organization in the market, controlling deposits of approximately $466.7 million, which represent approximately 31 percent of market deposits. The HHI would increase 478 points to 1960.

Several factors indicate that the increase in concentration in the Anniston Area banking market, as measured by the HHI, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the proposal, nine other commercial banking competitors would remain in the market, some with a significant presence in the market. The second and third largest bank competitors in the market would control approximately 21 and 17 percent, respectively, of market deposits.

In addition, the Board has evaluated the competitive influence of five active community credit unions in this market. These credit unions control approximately $137.6 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 4 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 30 percent of market deposits, and the HHI would increase 437 points to 1795.[30]

Furthermore, the record of recent entry into the Anniston Area banking market evidences the market's attractiveness for entry. Three depository institutions have entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. From 2001 to 2004, the market's annualized income growth exceeded the average annualized income growth for metropolitan counties in Alabama.

Decatur Area. In the Decatur Area banking market,[31] Regions is the largest depository organization in the market, controlling deposits of approximately $332.3 million, which represent approximately 24 percent of market deposits. AmSouth is the fourth largest depository organization in the market, controlling deposits of approximately $183 million, which represent 13 percent of market deposits. To reduce the potential for adverse effects on competition in the Decatur Area banking market, Regions has proposed to divest one of AmSouth's branches with at least $45.3 million in deposits to an out-of-market depository organization. On consummation of the merger and after accounting for the proposed divestiture, Regions would remain the largest depository organization in the market, controlling deposits of approximately $470 million, which represent 33 percent of market deposits. The HHI would increase not more than 401 points and would not exceed 1853.

Several factors indicate that the proposal is not likely to have a significantly adverse effect on competition in the Decatur Area market. After consummation of the merger and taking into account the proposed divestiture, 11 other commercial banking competitors would remain in the market, some with a significant presence in the market. Four bank competitors in the market each would control more than 10 percent of market deposits.

Furthermore, the Board has evaluated the competitive influence of one active community credit union in this market. This credit union controls approximately $102.9 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 4 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 32 percent of market deposits, and the HHI would increase 373 points to 1737.[32]

In addition, the record of recent entry into the Decatur Area banking market evidences the market's attractiveness for entry. The Board notes that three depository institutions have entered the market de novo since 2001.

Etowah County. In the Etowah County banking market,[33] Regions is the fifth largest depository organization in the market, controlling deposits of approximately $110.6 million, which represent 11 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $191.8 million, which represent 18 percent of market

28. The Board previously has considered the competitiveness of certain active credit unions as a mitigating factor. *See, e.g., Wachovia*, C183 (2006); *F.N.B. Corporation*, 90 *Federal Reserve Bulletin* 481 (2004); *Gateway Bank & Trust Co.*, 90 *Federal Reserve Bulletin* 547 (2004).

29. The Anniston Area banking market in Alabama is defined as Calhoun County and the city of Heflin in Cleburne County.

30. With the deposits of these credit unions weighted at 50 percent, Regions would be the fourth largest depository organization in the market, with approximately 13 percent of market deposits, and AmSouth would be the second largest depository institution in the market, controlling approximately 17 percent of market deposits.

31. The Decatur Area banking market in Alabama is defined as Morgan County and the portion of the city of Decatur in Limestone County.

32. With the deposits of this credit union weighted at 50 percent, Regions would be the largest depository organization in the market, with approximately 23 percent of market deposits, and AmSouth would be the fourth largest depository organization in the market, with approximately 13 percent of market deposits.

33. The Etowah County banking market is defined as Etowah County, Alabama.

deposits. On consummation of the proposal, Regions would become the largest depository organization in the market, controlling deposits of approximately $302.4 million, which represent approximately 29 percent of market deposits. The HHI would increase 385 points to 1997.

Several factors indicate that the increase in concentration in the Etowah County banking market, as measured by the HHI, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the proposal, eight other commercial banking competitors would remain in the market, some with a significant presence in the market. The second largest bank competitor in the market would control 24 percent of market deposits, and two other bank competitors in the market each would control more than 10 percent of market deposits.

In addition, the Board has evaluated the competitive influence of three active community credit unions in this market. These credit unions control approximately $145 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 7 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 27 percent of market deposits, and the HHI would increase 337 points to 1764.[34]

Moreover, the record of recent entry into the Etowah County banking market evidences the market's attractiveness for entry. The Board notes that one depository institution has entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. From 2001 to 2004, the market's annualized income growth exceeded the average annualized income growth for metropolitan counties in Alabama.

Gulf Shores Area. In the Gulf Shores Area banking market,[35] Regions is the largest depository organization in the market, controlling deposits of approximately $309.7 million, which represent approximately 21 percent of market deposits. AmSouth is the fifth largest depository organization in the market, controlling deposits of approximately $147.9 million, which represent approximately 10 percent of market deposits. On consummation of the merger, Regions would remain the largest depository organization in the market, controlling approximately $457.7 million in deposits, which represent 31 percent of market deposits. The HHI would increase 409 points to 1849.

Several factors indicate that the increase in concentration in the Gulf Shores Area banking market, as measured by the HHI, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the proposal, 11 other commercial banking and thrift competitors would remain in the market. The Board notes that there are other competitors with a significant presence in the market. The second largest bank competitor in the market would control approximately 19 percent of market deposits, and two other bank competitors in the market each would control more than 10 percent of market deposits.

In addition, the Board has evaluated the competitive influence of two active community credit unions in this market. These credit unions control approximately $48.4 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 2 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 30 percent of market deposits, and the HHI would increase 396 points to 1792.[36]

Furthermore, the record of recent entry into the Gulf Shores Area banking market evidences the market's attractiveness for entry. The Board notes that two depository institutions have entered the market de novo since 2001. Other factors indicate that the Gulf Shores Area banking market remains attractive for entry. From 2002 to 2004, the market's annualized deposit growth was more than four times the average annualized deposit growth for nonmetropolitan counties in Alabama. From 2001 to 2004, the market's annualized population growth and income growth exceeded the average annualized population and income growth for nonmetropolitan counties in Alabama.

Mobile Area. In the Mobile Area banking market,[37] Regions is the largest depository organization in the market, controlling deposits of approximately $2.5 billion, which represent approximately 36 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $1.4 billion, which represent approximately 20 percent of market deposits. To reduce the potential for adverse effects on competition in the Mobile Area banking market, Regions has proposed to divest 22 of AmSouth's branches, with at least $887.6 million in deposits, to an out-of-market depository organization. On consummation of the merger and after accounting for the proposed divestiture, Regions would remain the largest depository organization in the market, controlling deposits of approximately $3 billion, which represent 44 percent of market deposits. The HHI would increase not more than 343 points and would not exceed 2440.

One thrift institution operating in the market serves as a significant source of commercial loans and provides a broad range of consumer, mortgage, and other banking products. Competition from this thrift institution closely approximates competition from a commercial bank. Accord-

34. With the deposits of these credit unions weighted at 50 percent, Regions would be the fifth largest depository organization in the market, with approximately 10 percent of market deposits, and AmSouth would be the second largest depository organization in the market, with approximately 17 percent of market deposits.

35. The Gulf Shores Area banking market in Alabama is defined as the towns of Elberta, Foley, Gulf Shores, Lillian, Magnolia Springs, and Orange Beach in Baldwin County.

36. With the deposits of these credit unions weighted at 50 percent, Regions would be the largest depository organization in the market, with approximately 20 percent of market deposits, and AmSouth would be the fifth largest depository organization in the market, with approximately 10 percent of market deposits.

37. The Mobile Area banking market in Alabama is defined as Mobile County, and the towns of Bay Minette, Daphne, Fairhope, Loxley, Point Clear, Robertsdale, Silverhill, Spanish Fort, and Summerdale in Baldwin County.

ingly, the Board has concluded that deposits controlled by this institution should be weighted at 100 percent in market-share calculations.[38] Accounting for the revised weighting of these deposits, Regions would control approximately 44 percent of market deposits on consummation of the proposal, and the HHI would increase 342 points to 2434.

Several factors indicate that the increase in concentration in the Mobile Area banking market, as measured by the HHI and Regions' market share, overstates the potential competitive effects of the proposal in the market. After consummation of the proposal, 17 other commercial banking and thrift competitors would remain in the market. The Board notes that there are other competitors with a significant presence in the market. Two bank competitors each would control approximately 12 percent of the market.

In addition, the Board has evaluated the competitive influence of one active community credit union in this market. This credit union controls approximately $66.4 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 1 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 44 percent of market deposits, and the HHI would increase 339 points to 2410.[39]

In addition, the record of recent entry into the Mobile Area banking market evidences the market's attractiveness for entry. The Board notes that two depository institutions have entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. From 2002 to 2005, the market's annualized deposit growth was more than twice the average annualized deposit growth for metropolitan counties in Alabama. From 2001 to 2004, the market's annualized population growth exceeded the average annualized population growth for metropolitan counties in Alabama.

Montgomery Area. In the Montgomery Area banking market,[40] Regions is the largest depository organization in the market, controlling deposits of approximately $1.5 billion, which represent approximately 27 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $750.1 million, which represent approximately 14 percent of market deposits. To reduce the potential for adverse effects on competition in the Montgomery Area banking market, Regions has proposed to divest six of AmSouth's branches, with at least $183.9 million in deposits, to an out-of-market depository organization. On consummation of the merger and after accounting for the proposed divestiture, Regions would remain the largest depository organization in the market, controlling deposits of approximately $2 billion, which represent approximately 38 percent of market deposits. The HHI would increase not more than 508 points and would not exceed 1886.

Several factors indicate that the increase in concentration in the Montgomery Area banking market, as measured by the HHI and Regions' market share, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the proposal, 19 other commercial banking competitors would remain in the market.

The Board also has evaluated the competitive influence of five active community credit unions in this market. These credit unions control approximately $408.1 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 7 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control less than 35 percent of market deposits, and the HHI would increase 438 points to 1652.[41]

In addition, the record of recent entry into the Montgomery Area banking market evidences the market's attractiveness for entry. The Board notes that three depository institutions have entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. From 2002 to 2005, the market's annualized deposit growth substantially exceeded the average annualized deposit growth for metropolitan counties in Alabama.

Tuscaloosa Area. In the Tuscaloosa Area banking market,[42] Regions is the largest depository organization in the market, controlling deposits of approximately $766.5 million, which represent approximately 34 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $466 million, which represent approximately 20.8 percent of market deposits. To reduce the potential for adverse effects on competition in the Tuscaloosa Area banking market, Regions proposed to divest four of AmSouth's branches, with at least $361.3 million in deposits, to an out-of-market depository organization. On consummation of the merger and after accounting for the proposed divestiture, Regions would remain the largest depository organization in the market, controlling deposits of approximately $871 million, which represent approximately 39 percent of market deposits. The HHI would increase not more than 168 points and would not exceed 2069.

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38. The Board previously has indicated that it may consider the competitiveness of a thrift institution at a level greater than 50 percent of its deposits when appropriate. *See, e.g., Banknorth Group, Inc.*, 75 *Federal Reserve Bulletin* 703 (1989). The thrift in the Mobile Area banking market has a ratio of commercial and industrial loans to assets of approximately 10 percent, which is comparable to the national average for all commercial banks. *See First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998).

39. With the deposits of this credit union weighted at 50 percent, Regions would be the largest depository organization in the market, with approximately 36 percent of market deposits, and AmSouth would be the second largest depository organization in the market, controlling approximately 20 percent of market deposits.

40. The Montgomery Area banking market in Alabama is defined as Autauga, Elmore, Lowndes, and Montgomery counties, and the towns of Tallassee and East Tallassee in Tallapoosa County.

41. With the deposits of these credit unions weighted at 50 percent, Regions would be the largest depository organization in the market, with approximately 25 percent of market deposits, and AmSouth would be the eighth largest depository organization in the market, controlling approximately 10 percent of market deposits.

42. The Tuscaloosa Area banking market in Alabama is defined as Tuscaloosa County, and the city of Moundville in Hale County.

One thrift institution operating in the market serves as a significant source of commercial loans and provides a broad range of consumer, mortgage, and other banking products. Competition from this thrift institution closely approximates competition from a commercial bank. Accordingly, the Board has concluded that deposits controlled by this institution should be weighted at 100 percent in market-share calculations.[43] Accounting for the revised weighting of these deposits, Regions would control 38 percent of market deposits on consummation of the proposal, and the HHI would increase 164 points to 2020.

Several factors indicate that the proposal would not have a significantly adverse effect on concentration in the Tuscaloosa Area banking market. After consummation of the proposal, 14 other commercial banking and thrift competitors would remain in the market.

In addition, the Board has evaluated the competitive influence of five active community credit unions in this market. These credit unions control approximately $216.5 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 9 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control less than 35 percent of market deposits, and the HHI would increase 137 points to 1714.[44]

In addition, the record of recent entry into the Tuscaloosa Area banking market evidences the market's attractiveness for entry. The Board notes that two depository institutions have entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. For example, from 2000 through 2005, the market's annualized deposit growth exceeded the average annualized deposit growth for metropolitan counties in Alabama.

2. Banking Market in Florida

Panama City Area. In the Panama City Area banking market,[45] Regions is the largest depository organization in the market, controlling deposits of approximately $500.1 million, which represent 22 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $327.4 million, which represent 14 percent of market deposits. On consummation of the merger, Regions would remain the largest depository organization in the market, controlling deposits of approximately $827.5 million, which represent 36 percent of market deposits. The HHI would increase 614 points to 1792.

Several factors indicate that the increase in Region's market share in the Panama City Area banking market would not have a significant adverse effect on competition in the market. On consummation of the proposal, 15 other commercial banking and thrift competitors would remain in the market, some with a significant presence in the market. The second largest bank competitor in the market would control 11 percent of market deposits, and two other bank competitors in the market each would control slightly less than 10 percent of market deposits.

Furthermore, the Board has evaluated the competitive influence of four active community credit unions in this market. These credit unions control approximately $568.4 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 11 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 32 percent of market deposits, and the HHI would increase 486 points to 1475.[46]

In addition, the record of extensive recent entry into the Panama City Area banking market evidences the market's attractiveness for entry. The Board notes that six depository institutions have entered the market de novo since 2001. Other factors indicate that the Panama City Area banking market remains attractive for entry. From 2002 through 2005, the market's annualized deposit growth substantially exceeded the average annualized deposit growth for metropolitan counties in Florida. In addition, the market's annualized income growth from 2001 through 2004 exceeded the average annualized income growth for metropolitan counties in Florida.

3. Banking Market in Louisiana

Shreveport-Bossier City. In the Shreveport-Bossier City banking market,[47] Regions is the fourth largest depository organization in the market, controlling deposits of approximately $491.5 million, which represent 11 percent of market deposits. AmSouth is the third largest depository organization in the market, controlling deposits of approximately $768 million, which represent 17 percent of market deposits. On consummation of the proposal, Regions would become the largest depository organization in the market, controlling deposits of approximately $1.3 billion, which represent 28 percent of market deposits. The HHI would increase 379 points to 1952.

In addition, one thrift institution operating in the market serves as a significant source of commercial loans and provides a broad range of consumer, mortgage, and other

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43. This thrift institution has a ratio of commercial and industrial loans to assets of approximately 16 percent, which is comparable to the national average for all commercial banks. *See First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998).

44. With the deposits of these credit unions weighted at 50 percent, Regions would be the largest depository organization in the market, with approximately 31 percent of market deposits, and AmSouth would be the second largest depository organization in the market, controlling approximately 17 percent of market deposits.

45. The Panama City Area banking market in Florida is defined as Bay County and the southern half of Washington County, including the towns of Vernon and Wausau.

46. With the deposits of these credit unions weighted at 50 percent, Regions would be the largest depository organization in the market, with approximately 19 percent of market deposits, and AmSouth would be the second largest depository organization in the market, controlling approximately 13 percent of market deposits.

47. The Shreveport-Bossier City banking market in Louisiana is defined as Bossier, Caddo, DeSoto, and Webster Parishes.

banking products. Competition from this thrift institution closely approximates competition from a commercial bank. Accordingly, the Board has concluded that deposits controlled by this institution should be weighted at 100 percent in market-share calculations.[48] Accounting for the revised weighting of these deposits, Regions would control approximately 27 percent of market deposits on consummation of the proposal, and the HHI would increase 353 points to 1914.

Several factors indicate that the increase in concentration in the Shreveport-Bossier City banking market, as measured by the HHI, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the proposal, 21 other commercial banking and thrift competitors would remain in the market. The Board notes that there are other competitors with a significant presence in the market. The second and third largest bank competitors in the market would control 25 percent and 18 percent, respectively, of market deposits.

In addition, the Board has evaluated the competitive influence of five active community credit unions in this market. These credit unions control approximately $505.9 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 5 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 27 percent of market deposits, and the HHI would increase 334 points to 1736.[49]

Furthermore, the record of recent entry into the Shreveport-Bossier City banking market evidences the market's attractiveness for entry. The Board notes that three depository institutions have entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. From 2001 to 2004, the market's annualized income growth exceeded the average annualized income growth for metropolitan counties in Louisiana.

4. Banking Markets in Mississippi

Jackson Area. In the Jackson Area banking market,[50] Regions is the fifth largest depository organization in the market, controlling deposits of $440.5 million, which represent approximately 6 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $1.5 billion, which represent approximately 20 percent of market deposits. On consummation of the proposal, Regions would become the second largest depository organization in the market, controlling deposits of approximately $1.9 billion, which represent 26 percent of market deposits. The HHI would increase 246 points to 2240.

A number of factors indicate that the increase in concentration in the Jackson Area banking market, as measured by the HHI, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the proposal, 21 other commercial banking and thrift competitors would remain in the market. The Board notes that there are other competitors with a significant presence in the market. The largest depository organization in the market would control 37 percent of market deposits, and two other bank competitors in the market each would control slightly more than 5 percent of market deposits.

In addition, the Board has evaluated the competitive influence of three active community credit unions in this market. These credit unions control approximately $117.2 million in deposits in the market, which, on a 50 percent weighted basis, represent less than 1 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 26 percent of market deposits, and the HHI would increase 242 points to 2205.[51]

In addition, the record of significant recent entry into the Jackson Area banking market evidences the market's attractiveness for entry. The Board notes that five depository institutions have entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. For example, the market's annualized deposit growth from 2002 to 2005 exceeded the average annualized deposit growth for metropolitan counties in Mississippi, and in 2004 the market's per capita income exceeded the per capita income for metropolitan counties in Mississippi.

Lauderdale County. In the Lauderdale County banking market,[52] Regions is the sixth largest depository organization in the market, controlling deposits of approximately $76.3 million, which represent approximately 8 percent of market deposits. AmSouth is the fourth largest depository organization in the market, controlling deposits of approximately $120.3 million, which represent approximately 13 percent of market deposits. On consummation of the merger, Regions would become the second largest depository organization in the market, controlling deposits of approximately $196.7 million, which represent approximately 21 percent of market deposits. The HHI would increase 208 points to 1959.

Several factors indicate that the increase in concentration in the Lauderdale County banking market, as measured by the HHI, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the

48. This thrift institution has a ratio of commercial and industrial loans to assets of approximately 9 percent, which is comparable to the national average for all commercial banks. *See First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998).

49. With the deposits of these credit unions weighted at 50 percent, Regions would be the fourth largest depository organization in the market, with approximately 10 percent of market deposits, and AmSouth would be the third largest depository organization in the market, controlling approximately 16 percent of market deposits.

50. The Jackson Area banking market in Mississippi is defined as Hinds, Madison, and Rankin counties; Copiah County, excluding the town of Wesson; and the town of Mendenhall in Simpson County.

51. With the deposits of these credit unions weighted at 50 percent, Regions would be the fifth largest depository organization in the market, with approximately 6 percent of market deposits, and AmSouth would be the second largest depository organization in the market, controlling approximately 20 percent of market deposits.

52. The Lauderdale County banking market is defined as Lauderdale County, Mississippi.

proposal, seven other commercial banking competitors would remain in the market. The Board notes that there are other competitors with a significant presence in the market. The largest depository organization in the market would control 30 percent of market deposits, and two other bank competitors in the market each would control more than 10 percent of market deposits.

In addition, the Board has evaluated the competitive influence of three active community credit unions in this market. These credit unions control approximately $62.7 million in deposits in the market, which, on a 50 percent weighted basis, represent approximately 3 percent of market deposits. Accounting for the revised weightings of these deposits, Regions would control approximately 20 percent of market deposits, and the HHI would increase 195 points to 1838.[53]

Furthermore, the record of recent entry into the Lauderdale County banking market evidences the market's attractiveness for entry. The Board notes that one depository institution has entered the market de novo since 2001. Other factors indicate that the market remains attractive for entry. From 2002 to 2005, the market's annualized deposit growth exceeded the average annualized deposit growth for nonmetropolitan counties in Mississippi, and in 2004 the market area's per capita income exceeded the per capita income for nonmetropolitan counties in Mississippi. Furthermore, from 1999 to 2004, the market's annualized population growth exceeded the average annualized population growth for nonmetropolitan counties in Mississippi.

Starkville. In the Starkville banking market,[54] Regions is the fourth largest depository organization in the market, controlling deposits of approximately $115.4 million, which represent 14 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $180 million, which represent 22 percent of market deposits. To reduce the potential for adverse effects on competition in the Starkville banking market, Regions has proposed to divest three of AmSouth's branches, with at least $50 million in deposits, to an out-of-market depository organization. On consummation of the merger and after accounting for the proposed divestiture, Regions would become the second largest depository organization in the market, controlling deposits of approximately $245.4 million, which represent 30 percent of market deposits. The HHI would increase not more than 249 points and would not exceed 2231.

Several factors indicate that the proposal would not have significantly adverse competitive effects in the Starkville banking market. After consummation of the proposal, six other commercial banking and thrift competitors would remain in the market. The Board notes that there are other competitors with a significant presence in the market. The largest bank competitor in the market would control 30 percent of market deposits, and two other bank competitors in the market each would control 9 percent or more of market deposits.

In addition, the market appears to be attractive for entry. From 2002 to 2005, the market's annualized deposit growth exceeded the average annualized deposit growth for nonmetropolitan counties in Mississippi. For example, the market's annualized income growth from 1999 to 2004 exceeded the average annualized income growth for nonmetropolitan counties in Mississippi.

5. Banking Market in Mississippi and Louisiana

McComb Area. In the McComb Area banking market,[55] the HHI would slightly exceed the DOJ Guidelines on consummation of the proposal. Regions is the fifth largest depository organization in the market, controlling deposits of approximately $30.2 million, which represent 5 percent of market deposits. AmSouth is the second largest depository organization in the market, controlling deposits of approximately $141.3 million, which represent approximately 22 percent of market deposits. On consummation of the merger, Regions would become the second largest depository organization in the market, controlling deposits of $171.5 million, which represent approximately 27 percent of market deposits. The HHI would increase 201 points to 1934.

Several factors indicate that the increase in concentration in the McComb Area banking market, as measured by the HHI, overstates the potential anticompetitive effects of the proposal in the market. After consummation of the proposal, nine other commercial banking competitors would remain in the market. The Board notes that there are other competitors with a significant presence in the market. The largest bank competitor in the market would control 27 percent of market deposits, and two other bank competitors in the market each would control 15 percent of market deposits. In addition, the market appears to be moderately attractive for entry. For example, from 2001 to 2004, the market's annualized population growth exceeded the average annualized population growth for nonmetropolitan counties in Mississippi.

D. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that, in light of the proposed divestitures, consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have

53. With the deposits of these credit unions weighted at 50 percent, Regions would be the sixth largest depository organization in the market, with approximately 8 percent of market deposits, and AmSouth would be the fourth largest depository organization in the market, controlling approximately 12 percent of market deposits.

54. The Starkville banking market in Mississippi is defined as Choctaw, Oktibbeha, and Webster counties.

55. The McComb Area banking market is defined as Pike County and the portion of Amite County east of the West Fork of the Amite River, all in Mississippi, and the town of Kentwood in Tangipahoa Parish, Louisiana.

been afforded an opportunity to comment and have not objected to the proposal.

Based on these and all other facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the 67 banking markets where Regions and AmSouth compete directly or in any other relevant banking market. Accordingly, based on all the facts of record and subject to completion of the proposed divestitures, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act and the Bank Merger Act require the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, information provided by Regions and AmSouth, and public comments on the proposal.[56]

In evaluating financial resources in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and the organizations' nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors of the proposal. Regions, AmSouth, and their subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that Regions has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange.[57]

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization.[58] The Board has reviewed the examination records of Regions, AmSouth, and their subsidiary depository institutions, including assessments of their management,[59] risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws and with anti-money-laundering laws.[60] Regions, AmSouth, and their subsidiary depository institutions are considered to be well managed.[61] The Board also has considered Regions' plans for

56. Two commenters expressed concern about Regions' and AmSouth's relationships with unaffiliated retail check cashers, pawn shops, and other nontraditional providers of financial services. In approving Regions' application to acquire Union Planters Corporation, Memphis, Tennessee, the Board considered this concern and reviewed Regions' relationships with nontraditional providers of financial services. *Regions Financial Corporation*, 90 *Federal Reserve Bulletin* 389 (2004) ("Union Planters Order"). Regions represented that there have been no material changes in the way Regions conducts such relationships since it acquired Union Planters. With regard to AmSouth, Regions represented that AmSouth plays no role in the lending practices or credit review processes of such firms. As noted in the Union Planters Order, the activities of the consumer finance businesses identified by the commenters are permissible, and the businesses are licensed by the states where they operate.

57. Regions will use existing resources to fund the cash purchase of fractional shares.

58. One commenter expressed generalized concerns about the management and customer service at a branch of AmSouth Bank. Another commenter expressed concern about a press report that Regions and the Internal Revenue Service ("IRS") are currently litigating the extent of the IRS's ability to access the tax accrual working papers of Regions' outside accounting firm. The federal courts, and not the Board, have jurisdiction to adjudicate disputes between the IRS and Regions.

59. Several commenters asserted that the boards of directors and management of Regions, AmSouth, and their subsidiary banks lack ethnic diversity. One commenter suggested that both Regions and AmSouth should implement supplier diversity programs. The Board notes that the racial, ethnic, or gender composition of a banking organization's management and suppliers are not factors the Board is permitted to consider under the BHC Act. *See Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973); *Deutsche Bank AG*, 86 *Federal Reserve Bulletin* 509, 513 (1999).

60. Two commenters expressed concern about AmSouth's record of compliance with anti-money-laundering laws in light of past enforcement actions taken against the organization. In October 2004, AmSouth and AmSouth Bank consented to a cease and desist order issued by the Board and the Alabama Department of Banking to address deficiencies in the bank's anti-money-laundering program (the "C&D Order"). Simultaneous with the C&D Order, AmSouth and AmSouth Bank: (1) consented to an order issued by the Board, and the bank consented to an order issued by the U.S. Department of the Treasury's Financial Crimes Enforcement Network, that assessed concurrent $10 million civil money penalties (the "CMP Orders"); and (2) entered into a deferred-prosecution agreement (the "Agreement") with the U.S. Attorney for the Southern District of Mississippi that included a $40 million penalty to be paid to the U.S. Department of the Treasury. AmSouth and AmSouth Bank have fully complied with the requirements of the C&D Order, the CMP Orders, and the Agreement. The C&D Order was terminated as of April 2006, and the criminal complaint filed against AmSouth and AmSouth Bank as part of the Agreement was dismissed in October 2005.

61. One commenter expressed concern about investigations by regulatory agencies of Morgan Keegan & Company, Inc. ("Morgan Keegan"), Memphis, Tennessee, a subsidiary of Regions that engages in securities brokerage and investment banking activities. The commenter also expressed concern about an investigation by the Securities and Exchange Commission ("SEC") of AmSouth's mutual fund unit in connection with its investigation of an unaffiliated third party provider of administrative support to AmSouth funds. The Board is aware of public settlements entered into by Morgan Keegan and the SEC on February 8 and May 31, 2006, respectively, relating to late trades in mutual funds and to inadequate disclosure to investors of certain auction-rate securities practices. The Board also is aware that Morgan Keegan has publicly disclosed that it may be under investigation by

implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors the Board must consider under the BHC Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on proposals under section 3 of the BHC Act and the Bank Merger Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[62] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[63]

In response to the Board's request for public comment on this proposal, several commenters expressed concern about Regions' and AmSouth's records of lending to LMI or minority individuals or in LMI communities and to small businesses. Some commenters who opposed the proposal criticized the adequacy and enforceability of a lending and investment plan announced in July by Regions and AmSouth in connection with the proposal. In addition, several commenters questioned the sufficiency of assistance that Regions and AmSouth provided to individuals and communities affected by Hurricanes Katrina and Rita. Some commenters also expressed concern that the proposal would result in possible branch closings. A significant number of commenters also expressed support for the services of Regions and AmSouth and for the merger.

The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of Regions Bank and AmSouth Bank, data reported under the Home Mortgage Disclosure Act ("HMDA")[64] by the subsidiaries of Regions and AmSouth that engage in home mortgage lending, other information provided by Regions, confidential supervisory information, and public comments received on the proposal.

A. CRA Performance Evaluations

As provided in the CRA, the Board has reviewed the proposal in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[65]

Regions Bank received a "satisfactory" rating from the Federal Reserve Bank of Atlanta ("Reserve Bank") at its most recent CRA performance evaluation, as of October 20, 2003. AmSouth Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Reserve Bank, as of July 12, 2004.[66] Regions expects to continue the existing CRA programs of Regions Bank and AmSouth Bank, but the combined institution's community development program would be modeled on AmSouth's program.

CRA Performance of Regions Bank. In addition to the overall "satisfactory" rating that Regions Bank received at its most recent CRA performance evaluation,[67] the bank received separate overall "outstanding" or "satisfactory" ratings[68] in all but one of the MSAs and states reviewed.[69]

various state and federal regulators. The Board has consulted with the SEC about these matters and notes that AmSouth sold its mutual fund services unit, as of September 2005. As part of its ongoing supervision of Regions and AmSouth, the Board monitors the status of publicly disclosed investigations and consults as needed with relevant regulatory authorities.

62. 12 U.S.C. § 2901 et seq.

63. 12 U.S.C. § 2903.

64. 12 U.S.C. § 2801 et seq.

65. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 at 36,640 (2001).

66. One commenter requested that the Board postpone consideration of the proposal until after completion of a new CRA performance evaluation for AmSouth Bank. The Board must take into account the actual records of the relevant insured depository institutions under the CRA as of the time of the proposal in acting on proposals under section 3 of the BHC Act and the Bank Merger Act. Neither these acts nor the CRA require the initiation of new performance evaluations in connection with such proposals. Moreover, the BHC Act, the Bank Merger Act, and Regulation Y require the Board to act on proposals submitted under those provisions within certain time periods.

67. The evaluation period was July 1, 2001, through June 30, 2003, and the review included data from Regions Mortgage, Inc., Montgomery, Alabama, and EquiFirst Corporation ("EquiFirst"), Charlotte, North Carolina, which were both wholly owned subsidiaries of Regions Bank during the evaluation period.

68. Full-scope evaluations were conducted in Regions Bank's assessment areas in the Augusta-Aiken (GA-SC), Chattanooga (TN-GA), Columbus (GA-AL), Memphis (TN-AR-MS), Texarkana (TX-AR) multistate metropolitan statistical areas ("MSAs"). Full-scope evaluations were also conducted in other select MSAs in Alabama, Arkansas, Florida, Georgia, Louisiana, North Carolina, South Carolina, Tennessee, and Texas. Limited-scope evaluations were conducted in other relevant MSAs in those states.

69. Several commenters expressed concern about the less-than-satisfactory ratings the bank received for its CRA performance in some of its assessment areas. The bank received an overall rating of "needs to improve" in the Chattanooga multistate metropolitan area, and received "low satisfactory" ratings under the lending test for Louisiana and the Augusta and Texarkana multistate metropolitan areas. In each of these assessment areas, examiners noted that there are a relatively high proportion of families below the poverty level and that these families may not qualify for residential real estate loans because of their lower capacity for debt repayment. Examiners indicated that these conditions may have hindered the bank's efforts to lend to LMI individuals in these assessment areas. The bank received higher ratings under the lending and other tests in other areas, and examiners con-

Examiners reported that the bank's lending levels reflected excellent responsiveness to community credit needs and that the bank had an excellent level of qualified community development investments and grants.

Examiners rated Regions Bank's performance under the lending test as "outstanding," "high satisfactory," or "low satisfactory" in all MSAs and states reviewed, based on a review of the bank's housing-related loans reported under HMDA, small loans to businesses,[70] and qualified community development loans. Examiners stated that the bank's distribution of loans to geographies and borrowers of different income levels was good.[71] They noted that Regions Bank offered affordable housing loan programs, and made more than 357 loans totaling $10.6 million during the evaluation period using flexible lending products.

Examiners generally characterized Regions Bank's distribution of small loans to businesses in each of the MSAs or states reviewed as good or adequate. They reported that the bank made 72,657 small loans to businesses during the evaluation period, totaling $7.6 billion, and that 18 percent of those loans by dollar volume were to businesses located in LMI census tracts. Examiners also concluded that Regions Bank's distribution of loans to businesses of different sizes was good. In addition, examiners reported that the bank's community development lending total of $294.7 million during the review period was a relatively high level of community development lending.

Examiners rated Regions Bank's performance under the investment test as "outstanding" or "high satisfactory" in most of the MSAs and states reviewed. They reported that the bank often exercised leadership by making investments and grants not routinely provided by private investors. During the evaluation period, the bank's qualified investments totaled more than $161 million, and it contributed more than $1.9 million to charities with community development purposes.

Examiners rated Regions Bank's performance under the service test as "high satisfactory" or "low satisfactory" in most of the MSAs and states reviewed. They concluded that the bank's distribution of branch offices and ATMs generally was accessible to all portions of the bank's assessment areas and that services offered generally did not vary in any way that inconvenienced any portion of the bank's assessment areas. In addition, examiners concluded that the bank's community development services were responsive to affordable housing needs in the bank's assessment areas, and that the bank exhibited a reasonable level of community development services to assist small business owners.

In 2005, Regions originated housing-related loans reported under HMDA in its assessment areas totaling more than $6.7 billion. Of this amount, 10.2 percent by dollar volume was loaned to borrowers in LMI census tracts, and 18.6 percent to LMI borrowers. In addition, Regions represented that, in 2005, Regions Bank made approximately $316 million in qualified community development loans and approximately $232 million in qualified investments and grants in its assessment areas.

CRA Performance of AmSouth Bank. In addition to the overall "outstanding" rating that AmSouth Bank received at its most recent CRA performance evaluation,[72] the bank received separate overall "outstanding" or "satisfactory" ratings in all the MSAs and states reviewed.[73] Examiners reported that the bank's levels of lending demonstrated excellent responsiveness to community credit needs. They also concluded that the bank had an excellent level of qualified community development investments and grants.

Examiners rated AmSouth Bank "outstanding" or "high satisfactory" under the lending test in all MSAs and states reviewed, based on a review of the bank's housing-related loans reported under HMDA, small loans to businesses, and qualified community development loans. They reported that the bank's overall distribution of lending within geographies of different income levels was adequate, and its distribution of loans to borrowers of different income levels was good. In addition, examiners reported that AmSouth Bank made use of flexible lending practices to serve community credit needs and made more than 2,300 loans, totaling approximately $188 million, under these programs during the evaluation period. Examiners also reported that AmSouth Bank made $1.7 billion of community development loans during the evaluation period, a level which the examiners characterized as relatively high.

Examiners generally characterized AmSouth Bank's distribution of small loans to businesses among geographies of differing income levels and to businesses in LMI areas as good in the MSAs and states reviewed.[74] They reported that

cluded that the bank's record of CRA performance during the review period, when viewed as whole, merited a rating of "satisfactory."

70. "Small loans to businesses" are loans with original amounts of $1 million or less that are either secured by nonfarm, nonresidential properties or classified as commercial and industrial loans.

71. Several commenters specifically criticized Regions Bank's levels of lending to small businesses in LMI areas in the Birmingham, Alabama, and Jackson, Tennessee MSAs. In the most recent CRA performance evaluation for Regions Bank, examiners stated that the bank had an adequate distribution of small business loans to businesses in LMI areas in the Birmingham assessment area. In addition, Regions made 1,589 small loans to businesses in the Birmingham MSA in 2005, and more than 25 percent of those loans by number were to businesses located in LMI census tracts. Regions entered the Jackson MSA in July 2004, on consummation of its acquisition of Union Planters Corporation. In 2005, Regions made 97 small loans to businesses in the Jackson MSA, and more than 15 percent of those loans by number were to businesses in LMI census tracts.

72. The evaluation period was January 1, 2002, through December 31, 2003.

73. Full-scope evaluations were conducted in AmSouth Bank's assessment areas in the Chattanooga (TN-GA), Johnson City-Kingsport-Bristol (TN-VA), and Memphis (TN-AR-MS) MSAs. Full-scope evaluations were conducted in other select MSAs in Alabama, Florida, Louisiana, Mississippi, and Tennessee, and limited-scope evaluations were conducted in other relevant MSAs in those states. In addition, a full-scope evaluation was conducted in the bank's assessment areas in Georgia.

74. One commenter criticized the levels of participation of both AmSouth Bank and Regions Bank in Small Business Administration ("SBA") loan programs. Regions represented that Regions Bank is an

the bank made more than 84,000 small loans to businesses, totaling approximately $7.4 billion, during the evaluation period. Examiners also concluded that the bank's distribution of loans to businesses of different sizes was good or excellent in the MSAs and states reviewed.

Under the investment test, examiners rated AmSouth Bank "outstanding" for all the MSAs and states reviewed. They stated the bank was often in a leadership position with regard to investments and grants not routinely provided by private investors. During the evaluation period, the bank's qualified community development investments totaled more than $234 million, and the bank contributed approximately $7.4 million to organizations with community development purposes.

Examiners rated AmSouth Bank "outstanding" or "high satisfactory" under the service test for all the MSAs and states reviewed.[75] They concluded that the bank's ATMs and branch locations were readily accessible to all portions of the bank's assessment areas and that services offered generally did not vary in any way that inconvenienced any portion of the bank's assessment areas. Examiners commended the bank for being a leader in providing community development services, and noted that the services provided are responsive to affordable housing needs and assist small business owners in the bank's assessment areas.

B. Assistance to Communities Affected by Hurricane Katrina

Several commenters asserted that Regions and AmSouth should demonstrate greater support for recovery and reconstruction efforts in areas affected by Hurricane Katrina, and should detail plans for financing the rebuilding efforts and working with borrowers with mortgage loans at risk of default due to the hurricane.

Regions represented that it and AmSouth originated more than 23,000 HMDA-reportable mortgage loans, totaling approximately $3.8 billion, in 2005 in portions of their assessment areas affected by Hurricane Katrina. The banks also originated approximately $2.3 billion in small loans to businesses in 2005 in those areas. Moreover, Regions is involved in programs created under the Gulf Opportunity Zone Act ("GO Zone") to support housing and small business lending in areas affected by Hurricane Katrina and has represented that it has closed on $26.6 million of those loans, as of July 31, 2006.[76]

Regions also indicated that it expects to have made approximately $70 million in community development loans in parts of Mississippi in the GO Zone by the end of 2006. For example, Regions stated that it is providing construction and permanent financing to a low-income housing tax credit project in New Orleans that will result in the construction of 29 housing units. AmSouth indicated that it has provided $3.5 million of financing in the parts of Mississippi affected by Hurricane Katrina to rebuild a senior citizens complex and to build 71 new affordable homes, and that it has committed more than $25 million to purchase and rehabilitate a 307-unit senior citizens apartment complex in New Orleans.

Regions also represented that it and AmSouth continue to work with affected residential mortgage loan customers, and that assistance provided to these borrowers has included modifying mortgages, providing forbearance relief, and suspending credit bureau reporting. Regions represented that Regions Mortgage has modified more than 2,800 of the approximately 54,000 residential mortgage loans it serviced in FEMA-declared disaster areas at the time of Katrina's landfall, and has itself absorbed the $800,000 cost of these modifications. AmSouth indicated that only ten of the nearly 3,300 mortgage loans it held in the affected areas at the time of landfall are currently in foreclosure, six of which were delinquent before Hurricane Katrina. In addition, Regions has stated that it is involved with state programs in Louisiana and Mississippi to provide grants to homeowners in affected areas.

C. Branch Closings

Two commenters expressed concern about the proposal's possible effect on branch closings. Regions has represented that it and AmSouth have identified specific branches in overlapping markets as candidates for closure, relocation, or consolidation, but they have not made final decisions on closures. Regions has stated that, on consummation of the proposal, it expects that the combined institution's branch closing policy would likely closely resemble AmSouth's current branch closing policy.

The Board has considered carefully Regions' and AmSouth's branch closing policies and the banks' records of opening and closing branches. AmSouth's branch closing policy requires the bank to make every effort to minimize the customer impact within the local market and to provide a reasonable alternative for customers to acquire similar

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SBA Preferred Lender and currently offers several SBA loan programs, including SBAExpress loans. The bank also offers other loan programs targeted to small businesses, including the Right Business Line of Credit, which provides revolving lines of credit of up to $250,000 to small businesses. Regions also represented that AmSouth Bank also offers other loan programs targeted to small businesses, such as the Flexline product, under which small businesses may borrow up to $100,000 on an unsecured basis and can apply on a one-page application.

75. Several commenters criticized the levels of service of both AmSouth Bank and Regions Bank to LMI individuals.

76. One commenter criticized the level of Region Bank's investments in nonprofit organizations involved in microenterprise lending and providing affordable housing in the Gulf Coast region. As noted, Regions Bank represented that it has made a number of investments to construct or rehabilitate affordable housing in the region. The CRA does not require banks to provide any particular type of qualified CRA investments in its efforts to meet the credit needs of their communities.

services. The policy requires that, before a final decision is made to close a branch, management consult with members of the community in an effort to minimize the impact of the closing. In the most recent CRA performance examinations, examiners found that the banks' records of opening or closing branches had not adversely affected the accessibility of delivery systems, particularly to LMI geographies and to LMI individuals.

The Board also has considered that federal banking law provides a specific mechanism for addressing branch closings.[77] Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory agency before closing a branch. In addition, the Board notes that the Reserve Bank will continue to review the branch closing record of Regions Bank in the course of conducting CRA performance evaluations.

D. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of Regions and AmSouth Bank in light of public comments received on the proposal. Commenters alleged, based on 2004 and 2005 HMDA data, that Regions made higher-cost loans[78] in various states more frequently to African-American borrowers than to nonminority borrowers, and made a disproportionate share of its subprime loans in certain MSAs to African Americans.[79] Commenters also alleged that Regions denied the home mortgage loan applications of African-American borrowers more frequently than those of nonminority applicants in various states and MSAs, and that the amount of Regions' and AmSouth's mortgage lending to African Americans in the Birmingham MSA lagged behind the performance of the aggregate of lenders.[80] The Board focused its analysis on the 2005 HMDA data reported by Regions Bank, EquiFirst, and AmSouth Bank.[81]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Regions or AmSouth Bank are excluding or imposing higher costs on any racial or ethnic group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[82] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity.[83] Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance by Regions and AmSouth Bank with fair lending laws.

In the fair lending review conducted in conjunction with the most recent CRA performance evaluation of AmSouth Bank, examiners found no substantive violations of applicable fair lending laws. Moreover, the record indicates that both Regions and AmSouth have taken steps to ensure compliance with fair lending and other consumer protection laws. Regions monitors Regions Bank's and EquiFirst's compliance with fair lending laws through internal audits that include comparative file analyses, and through self-assessments that include pricing, underwriting, and regression analysis of HMDA data.[84] In addition, Regions

77. Section 42 of the Federal Deposit Insurance Act (12 U.S.C. § 1831r–1), as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34,844 (1999)), requires that a bank provide the public with at least 30 days' notice and the appropriate federal supervisory agency and customers of the branch with at least 90 days' notice before the date of the proposed branch closing. The bank also is required to provide reasons and other supporting data for the closure, consistent with the institution's written policy for branch closings.

78. Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate exceeds the yield for U.S. Treasury securities of comparable maturity 3 or more percentage points for first-lien mortgages and 5 or more percentage points for second-lien mortgages (12 CFR 203.4).

79. As the Board previously has noted, subprime lending is a permissible activity that provides needed credit to consumers who have difficulty meeting conventional underwriting criteria. *See Royal Bank of Canada*, 88 *Federal Reserve Bulletin* 385, 388 n. 18 (2002). The Board continues to expect all bank holding companies and their affiliates to conduct their subprime lending operations without any abusive lending practices and in compliance with all applicable laws.

80. The lending data of the aggregate of lenders represent the cumulative lending for all financial institutions that have reported HMDA data in a given market.

81. The Board reviewed the HMDA data for Regions and AmSouth Bank in various markets of concern to the commenters, in the combined CRA assessment areas for each bank, and on a nationwide basis.

82. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

83. One commenter complained that AmSouth provided HMDA data of AmSouth Bank on paper rather than electronically in the format requested by the commenter. The Board notes that neither HMDA nor the CRA require financial institutions to provide HMDA data in an electronic format on written request. *See* 12 CFR 203.5. Moreover, HMDA data may be obtained electronically via the HMDA web site maintained by the Federal Financial Institutions Examination Council.

84. In the fair lending review conducted in conjunction with Regions Bank's 2003 CRA performance evaluation, examiners cited failures to comply with the Board's Regulation B (Equal Credit

employs a second-review process under which applications that have been preliminarily denied are reviewed by a second credit officer. Regions also requires all new employees to complete fair lending training during the first six months of their tenure and to take annual refresher courses. AmSouth employs similar compliance techniques, such as self-assessments, a second-review process, and annual fair lending training. AmSouth also employs an independent consultant to conduct internal audits that include comparative file reviews. Regions represented that it is reviewing the compliance programs of both organizations and that the combined organization will adopt the best practices of both Regions and AmSouth.

The Board also has considered the HMDA data in light of other information, including the CRA performance records of Regions Bank and AmSouth Bank discussed above.[85] Based on all the facts of record, the Board concludes that Regions' and AmSouth's established efforts and record demonstrate that they are active in helping to meet the credit needs of their entire communities.[86]

E. Community Development Plan

In connection with the proposed transaction, Regions and AmSouth announced a plan to invest at least $100 billion over seven years across the Southeast, Midwest, and Texas to support community development, small business lending, and mortgage lending for low-income communities and borrowers. Several commenters expressed concerns about the plan, arguing that it lacked sufficient detail or did not represent increases over the organizations' current lending levels.[87] Commenters also requested that the plan's goals be made enforceable by the Board, or that the plan be embodied in an agreement with one or more community groups.[88]

The Board views the enforceability of pledges, initiatives, and agreements with third parties as matters outside the scope of the CRA.[89] As the Board previously has explained, an applicant must demonstrate a satisfactory record of performance under the CRA without reliance on plans or commitments for future action.[90] Moreover, the Board has consistently found that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization.

In this case, as in past cases, the Board instead has focused on the demonstrated CRA performance record of the applicant and the programs that the applicant has in place to serve the credit needs of its CRA assessment areas.

F. Conclusion on Convenience and Needs Factor

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Regions, comments received on the proposal, and confidential supervisory information.[91] Regions represented that the proposal would provide customers of both organizations with increased credit availability and expanded access to products and services. Based on a review of the entire record and for the reasons discussed above, the Board has concluded that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

ESTABLISHMENT OF BRANCHES

As previously noted, Regions Bank has also applied under section 9 of the FRA to establish branches at the locations of AmSouth Bank's main office and branches. The Board has assessed the factors it is required to consider when reviewing an application under section 9 of the FRA and

Opportunity Act) in a nonmortgage lending program. The Board has considered that the failure was discovered by the bank and the bank took immediate corrective action. The Board also notes that the compliance failure was limited to one product line and the bank no longer offers that product line.

85. One commenter speculated about the Board's analysis of 2004 HMDA data for Regions and AmSouth Bank. The Board uses HMDA data as a screen to identify institutions with application denial rates or pricing patterns that appear to differ significantly based on borrower ethnicity or sex. Examiners typically review loan files and other information from institutions identified by the screen, and an array of supervisory actions can be taken if no credible nondiscriminatory explanation can be found for the disparities. *See* Robert B. Avery, et al., "New Information Reported under HMDA and Its Application in Fair Lending Enforcement," 91 *Federal Reserve Bulletin* 344 (2005). Such matters are handled in the regular course of the examination and supervision process.

86. One commenter noted press reports about litigation against Regions by several immigrant chicken farmers who alleged that Regions Bank made loans to them knowing that they could not afford repayment. Because these matters are unresolved, they do not provide a factual basis for Board consideration. The courts, and not the Board, have jurisdiction to adjudicate the legal claims of these plaintiffs against Regions. Board action on the proposal would not interfere with the ability of the courts to resolve any litigation pertaining to these matters.

87. One commenter specifically alleged that the small business component of the pledge does not represent any increase over the two organizations' current small business lending levels.

88. One commenter expressed concern that Regions' acquisition of Union Planters Corporation in 2004 did not include a community development plan that was the subject of an agreement between Regions and one or more community groups.

89. *See, e.g., Bank of America Corporation*, 90 *Federal Reserve Bulletin* 217, 233 (2004); *Citigroup Inc.*, 88 *Federal Reserve Bulletin* 485, 488 n.18 (2002).

90. *See Wachovia Corporation*, 91 *Federal Reserve Bulletin* 77 (2005); *J.P. Morgan Chase & Co.*, 90 *Federal Reserve Bulletin* 352 (2004); *Bank of America Corporation*, 90 *Federal Reserve Bulletin* 217 (2004); *NationsBank Corporation*, 84 *Federal Reserve Bulletin* 858 (1998).

91. One commenter expressed concern about possible job losses resulting from this proposal. The effect of a proposed acquisition on employment in a community is not among the limited factors the Board is authorized to consider under the BHC Act, and the convenience and needs factor has been interpreted consistently by the federal banking agencies, the courts, and the Congress to relate to the effect of a proposal on the availability and quality of banking services in the community. *See, e.g., Wells Fargo & Company*, 82 *Federal Reserve Bulletin* 445, 457 (1996).

the Board's Regulation H and finds those factors to be consistent with approval.[92]

FOREIGN ACTIVITIES

As noted above, Regions also proposes to acquire Cahaba International, Inc., the agreement corporation subsidiary of AmSouth Bank. The Board has concluded that all the factors required to be considered under section 25 of the Federal Reserve Act and section 211.5 of Regulation K are consistent with approval.[93]

CONCLUSION

Based on the foregoing and all facts of record, the Board has determined that the applications should be, and hereby are, approved.[94] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act, the Bank Merger Act, and the FRA.[95] The Board's approval is specifically conditioned on compliance by Regions and Regions Bank with the conditions imposed in this order, the commitments made to the Board in connection with the applications, and receipt of all other regulatory approvals. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed banking acquisitions may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Atlanta, acting pursuant to delegated authority.

By order of the Board of Governors, effective October 20, 2006.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

JENNIFER J. JOHNSON
Secretary of the Board

92. 12 U.S.C. §322; 12 CFR 208.6(b).

93. 12 CFR 211.5.

94. Several commenters requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authority. The Bank Merger Act and the FRA do not require the Board to hold a public meeting or hearing. Under its rules, the Board may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to provide an opportunity for testimony or other presentations (12 CFR 262.3(i)(2), 262.25(d)). The Board has considered carefully the commenters' requests in light of all the facts of record. In the Board's view, the commenters had ample opportunity to submit comments on the proposal and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. Moreover, the commenters' requests fail to demonstrate why their written comments do not present their views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the requests for a public hearing or meeting on the proposal are denied.

95. Several commenters also requested that the Board extend the comment period or delay action on the proposal. As previously noted, the Board has accumulated a significant record in this case, including reports of examination, confidential supervisory information, public reports and information, and public comments. As noted, the commenters have had ample opportunity to submit their views and, in fact, have provided multiple written submissions that the Board has considered carefully in acting on the proposal. Based on a review of all the facts of record, the Board has concluded that the record in this case is sufficient to warrant action at this time and that neither an extension of the comment period nor further delay in considering the proposal is necessary.

Appendix A

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
ALABAMA BANKING MARKETS						
Auburn and Opelika—Lee County, excluding that portion of the county that is within 12 road miles of Phenix City, Alabama or Columbus, Georgia						
Regions Pre-Consummation	8	63.9 mil.	4.7	1,695	72	10
AmSouth	4	104.5 mil.	7.7	1,695	72	10
Regions Post-Consummation	3	168.4 mil.	12.4	1,695	72	10
Birmingham—Bibb, Blount, Chilton, Jefferson, St. Clair, Shelby, and Walker Counties						
Regions Pre-Consummation	4	2.5 bil.	12.8	1,600	517	40
AmSouth	1	3.9 bil.	20.3	1,600	517	40
Regions Post-Consummation	1	6.3 bil.	33.0	1,600	517	40
Cullman—Cullman County						
Regions Pre-Consummation	5	123.9 mil.	11.6	1,207	169	9
AmSouth	7	78.0 mil.	7.3	1,207	169	9
Regions Post-Consummation	1	201.9 mil.	18.9	1,207	169	9
DeKalb—DeKalb County						
Regions Pre-Consummation	8	32.2 mil.	5.2	1,394	222	10
AmSouth	1	134.3 mil.	21.6	1,394	222	10
Regions Post-Consummation	1	166.5 mil.	26.7	1,394	222	10
Dothan—Houston and Henry Counties; Midland City and Newton in Dale County; and Hartford and Slocomb in Geneva County						
Regions Pre-Consummation	2	347.1 mil.	17.7	1,462	269	15
AmSouth	3	149.1 mil.	7.6	1,462	269	15
Regions Post-Consummation	1	496.2 mil.	25.3	1,462	269	15
Florence—Colbert and Lauderdale Counties						
Regions Pre-Consummation	5	139.9 mil.	7.1	1,554	93	10
AmSouth	8	129.3 mil.	6.6	1,554	93	10
Regions Post-Consummation	3	269.2 mil.	13.6	1,554	93	10
Marshall—Marshall County						
Regions Pre-Consummation	4	151.7 mil.	11.6	1,506	382	12
AmSouth	1	214.7 mil.	16.4	1,506	382	12
Regions Post-Consummation	1	366.4 mil.	28.0	1,506	382	12
FLORIDA BANKING MARKETS						
Beverly Hills—Citrus County, excluding the city of Citrus Springs						
Regions Pre-Consummation	5	175.3 mil.	8.7	1,478	125	11
AmSouth	7	144.0 mil.	7.2	1,478	125	11
Regions Post-Consummation	4	319.3 mil.	15.9	1,478	125	11

Appendix A—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Brevard—Brevard County						
Regions Pre-Consummation	14	89.2 mil.	1.4	1,559	7	19
AmSouth	8	172.5 mil.	2.6	1,559	7	19
Regions Post-Consummation	7	261.7 mil.	4.0	1,559	7	19
Daytona Beach—Flagler County; the towns of Allandale, Daytona Beach, Daytona Beach Shores, Edgewater, Holly Hill, New Smyrna Beach, Ormond Beach, Ormond-by-the-Sea, Pierson, Port Orange, and South Daytona in Volusia County; and the town of Astor in Lake County						
Regions Pre-Consummation	5	398.7 mil.	5.7	1,667	[1]	22
AmSouth	19	n.a.[1]	n.a.[1]	1,667	[1]	22
Regions Post-Consummation	5	398.7 mil.	5.7	1,667	[1]	22
Fort Walton Beach—Okaloosa and Walton Counties, and the city of Ponce de Leon in Holmes County						
Regions Pre-Consummation	4	334.4 mil.	7.8	999	214	22
AmSouth	1	595.9 mil.	13.8	999	214	22
Regions Post-Consummation	1	930.4 mil.	21.6	999	214	22
Ocala—Marion County, and the town of Citrus Springs in Citrus County						
Regions Pre-Consummation	13	62.2 mil.	1.4	1,463	39	20
AmSouth	4	574.5 mil.	13.4	1,463	39	20
Regions Post-Consummation	4	636.6 mil.	14.8	1,463	39	20
Orlando—Orange, Osceola, and Seminole Counties; the western half of Volusia County; and Clermont and Groveland in Lake County						
Regions Pre-Consummation	17	291.9 mil.	1.1	1,354	7	47
AmSouth	6	926.5 mil.	3.4	1,354	7	47
Regions Post-Consummation	5	1.2 bil.	4.5	1,354	7	47
Pensacola—Escambia and Santa Rosa Counties						
Regions Pre-Consummation	6	405.9 mil.	7.8	1,359	292	18
AmSouth	1	978.2 mil.	18.8	1,359	292	18
Regions Post-Consummation	1	1.4 bil.	26.5	1,359	292	18

Appendix A—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Sarasota—Manatee and Sarasota Counties, excluding that portion of Sarasota County that is both east of the Myakka River and south of Interstate 75 (currently the towns of Northport and Port Charlotte); the peninsular portion of Charlotte County west of the Myakka River (currently the towns of Englewood, Englewood Beach, New Point Comfort, Grove City, Cape Haze, Rotonda, Rotonda West, and Placida); and Gasparilla Island (the town of Boca Grande) in Lee County						
Regions Pre-Consummation	17	162.3 mil.	1.0	1,305	3	43
AmSouth	11	261.2 mil.	1.6	1,305	3	43
Regions Post-Consummation	8	423.5 mil.	2.7	1,305	3	43
Tallahassee—Leon County, and the towns of Quincy and Havana in the eastern half of Gadsden County						
Regions Pre-Consummation	14	6.7 mil.	.2	1,221	3	12
AmSouth	5	360.1 mil.	9.1	1,221	3	12
Regions Post-Consummation	5	366.8 mil.	9.2	1,221	3	12
Tampa Bay—Hernando, Hillsborough, Pinellas, and Pasco Counties						
Regions Pre-Consummation	15	325.0 mil.	.8	1,540	13	64
AmSouth	4	3.2 bil.	7.9	1,540	13	64
Regions Post-Consummation	4	3.5 bil.	8.7	1,540	13	64
GEORGIA BANKING MARKETS						
Dalton—Murray and Whitfield Counties						
Regions Pre-Consummation	4	164.4 mil.	9.5	1,512	22	12
AmSouth	12	19.4 mil.	1.1	1,512	22	12
Regions Post-Consummation	3	183.8 mil.	10.7	1,512	22	12
Gordon—Gordon County						
Regions Pre-Consummation	7	10.0 mil.	1.6	2,948	21	5
AmSouth	5	44.6 mil.	6.9	2,948	21	5
Regions Post-Consummation	5	54.6 mil.	8.5	2,948	21	5
Rome—Floyd and Polk Counties						
Regions Pre-Consummation	3	192.4 mil.	12.4	1,411	119	11
AmSouth	8	73.7 mil.	4.8	1,411	119	11
Regions Post-Consummation	2	266.1 mil.	17.2	1,411	119	11

Appendix A—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
LOUISIANA BANKING MARKETS						
Baton Rouge—Ascension, East Baton Rouge, Iberville, Livingston, and West Baton Rouge Parishes; the northern half of Assumption Parish, including the towns of Napoleonville, Pierre Part, and Plattenville; and the town of Union in St. James Parish						
Regions Pre-Consummation	3	1.0 bil.	11.9	1,852	62	37
AmSouth	6	228.1 mil.	2.6	1,852	62	37
Regions Post-Consummation	3	1.3 bil.	14.5	1,852	62	37
Monroe—Caldwell, Ouachita, and Union Parishes						
Regions Pre-Consummation	4	211.8 mil.	9.8	1,134	92	15
AmSouth	9	102.8 mil.	4.7	1,134	92	15
Regions Post-Consummation	2	314.6 mil.	14.5	1,134	92	15
New Orleans—Jefferson, Orleans, Plaquemines, Saint Bernard, Saint Charles, Saint John the Baptist, and Saint Tammany Parishes; and Saint James Parish excluding the town of Union						
Regions Pre-Consummation	4	1.5 bil.	7.6	1,577	40	40
AmSouth	5	516.6 mil.	2.7	1,577	40	40
Regions Post-Consummation	4	2.0 bil.	10.3	1,577	40	40
MISSISSIPPI BANKING MARKETS						
Biloxi—Hancock County, Harrison County, and the City of Ocean Springs in Jackson County						
Regions Pre-Consummation	6	158.5 mil.	5.2	2,965	11	11
AmSouth	9	31.5 mil.	1.0	2,965	11	11
Regions Post-Consummation	4	190.0 mil.	6.2	2,965	11	11
Columbus—Lowndes County						
Regions Pre-Consummation	7	21.8 mil.	3.2	2,245	110	6
AmSouth	3	117.5 mil.	17.2	2,245	110	6
Regions Post-Consummation	2	139.4 mil.	20.4	2,245	110	6
Hattiesburg—Lamar and Forrest Counties						
Regions Pre-Consummation	2	245.6 mil.	15.1	1,780	218	13
AmSouth	5	117.9 mil.	7.2	1,780	218	13
Regions Post-Consummation	2	363.5 mil.	22.3	1,780	218	13
Jones—Jones County						
Regions Pre-Consummation	8	39.4 mil.	4.5	1,738	77	7
AmSouth	5	76.1 mil.	8.6	1,738	77	7
Regions Post-Consummation	4	115.5 mil.	13.1	1,738	77	7

Appendix A—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Oxford—Lafayette and Yalobusha Counties						
Regions Pre-Consummation	2	120.2 mil.	15.3	1,547	2	9
AmSouth	10	n.a.2	n.a.2	1,547	2	9
Regions Post-Consummation	2	120.2 mil.	15.3	1,547	2	9
Tupelo—Chickasaw, Itawamba, Lee, Pontotoc, Prentiss, and Union Counties in Mississippi; and the portion of Monroe County, Mississippi, north of U.S. Highway 278 and State Route 41, including the cities of Amory, Quincy, and Greenwood Springs						
Regions Pre-Consummation	4	212.0 mil.	6.7	1,908	49	13
AmSouth	8	116.4 mil.	3.7	1,908	49	13
Regions Post-Consummation	3	328.4 mil.	10.4	1,908	49	13
TENNESSEE BANKING MARKETS						
Athens—McMinn, Meigs, and Monroe Counties plus the town of Delano in Polk County						
Regions Pre-Consummation	8	51.9 mil.	4.3	1,479	81	13
AmSouth	3	114.5 mil.	9.5	1,479	81	13
Regions Post-Consummation	3	166.4 mil.	13.7	1,479	81	13
Cleveland—Bradley County plus the towns of Benton and Ocoee in Polk County						
Regions Pre-Consummation	9	15.5 mil.	1.2	1,650	34	8
AmSouth	3	193.1 mil.	14.4	1,650	34	8
Regions Post-Consummation	3	208.6 mil.	15.6	1,650	34	8
Cookeville—Jackson, Overton, and Putnam Counties						
Regions Pre-Consummation	5	145.1 mil.	9.7	1,315	215	12
AmSouth	4	164.7 mil.	11.1	1,315	215	12
Regions Post-Consummation	1	309.8 mil.	20.8	1,315	215	12
Dickson—Dickson County						
Regions Pre-Consummation	9	16.3 mil.	3.3	1,710	102	7
AmSouth	3	74.7 mil.	15.3	1,710	102	7
Regions Post-Consummation	2	91.0 mil.	18.6	1,710	102	7
Jackson—includes all of Crockett and Madison Counties; Chester County, excluding the city of Enville; Henderson County, excluding the Sardis census county division; and the Humboldt, Gibson, Medina, and Milan census county divisions in southern Gibson County						
Regions Pre-Consummation	2	445.6 mil.	18.4	1,663	411	18
AmSouth	4	270.1 mil.	11.2	1,663	411	18
Regions Post-Consummation	1	715.8 mil.	29.6	1,663	411	18

Appendix A—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Knoxville—Anderson, Knox, Loudon, Roane, and Union Counties; the portion of Blount County northwest of Chilhowee Mountain; the towns of Chestnut Hill, Danridge, Dumplin, Friends Station, Hodges, New Market, and Strawberry Plains in Jefferson County; the towns of Harriman and Oliver Springs in Morgan County; the towns of Seymour and Kodak in Sevier County; and the towns of Blaine, Buffalo Springs, Joppa, Lea Springs, and Powder Springs in Grainger County						
Regions Pre-Consummation	6	462.4 mil.	4.9	1,441	167	35
AmSouth	3	1.6 bil.	17.0	1,441	167	35
Regions Post-Consummation	2	2.1 bil.	21.9	1,441	167	35
Maury—Maury County						
Regions Pre-Consummation	5	46.8 mil.	4.4	2,496	132	9
AmSouth	3	163.4 mil.	15.2	2,496	132	9
Regions Post-Consummation	3	210.2 mil.	19.5	2,496	132	9
McMinnville—Warren County, and the town of Altamont in Grundy County						
Regions Pre-Consummation	2	139.6 mil.	24.7	2,708	188	6
AmSouth	6	21.5 mil.	3.8	2,708	188	6
Regions Post-Consummation	2	161.1 mil.	28.5	2,708	188	6
Morristown-Newport Area—Cocke, Grainger, and Hamblen Counties, excluding the towns of Blaine, Buffalo Springs, Joppa, Lea Springs, and Powder Spring in Grainger County; the towns of Baneberry, Jefferson City, Jefferson Estates, Leadvale, Talbot, and White Pine in Jefferson County						
Regions Pre-Consummation	5	110.1 mil.	7.9	1,008	93	15
AmSouth	8	83.2 mil.	5.9	1,008	93	15
Regions Post-Consummation	2	193.3 mil.	13.8	1,008	93	15
Nashville—Cheatham, Davidson, Robertson, Rutherford, Sumner, Williamson, and Wilson Counties						
Regions Pre-Consummation	4	1.6 bil.	6.7	1,404	243	45
AmSouth	2	4.3 bil.	18.2	1,404	243	45
Regions Post-Consummation	1	5.8 bil.	24.9	1,404	243	45

Appendix A—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
BANKING MARKET IN ARKANSAS, MISSISSIPPI, AND TENNESSEE						
Memphis Area—Fayette, Shelby, and Tipton Counties in Tennessee; the city of Grand Junction in Tennessee; Crittenden County in Arkansas; Benton, De Soto, Marshall, Tate, and Tunica Counties in Mississippi; the northern part of Coahoma County, Mississippi, including the cities of Friars Point, Coahoma, Lula, and Jonestown; the portion of Panola County, Mississippi, north of State Route 315 east to Sardis Lake, including the city of Sardis; and the portion of Quitman County, Mississippi, north of State Route 315, including the cities of Birdie and Sledge						
Regions Pre-Consummation	2	2.9 bil.	10.6	3,351	52	57
AmSouth	6	647.5 mil.	2.4	3,351	52	57
Regions Post-Consummation	2	3.5 bil.	13.1	3,351	52	57
BANKING MARKET IN GEORGIA AND TENNESSEE						
Chattanooga Area—Hamilton and Marion Counties in Tennessee, excluding the portion of the town of Monteagle that lies in Marion County; Catoosa, Dade, and Walker Counties in Georgia						
Regions Pre-Consummation	8	206.4 mil.	3.2	1,460	108	22
AmSouth	3	1.1 bil.	17.0	1,460	108	22
Regions Post-Consummation	3	1.3 bil.	20.1	1,460	108	22
BANKING MARKET IN TENNESSEE AND KENTUCKY						
Clarksville and Hopkinsville Area—Christian, Todd, and Trigg Counties in Kentucky; Montgomery and Stewart Counties in Tennessee						
Regions Pre-Consummation	16	39.2 mil.	1.7	823	33	15
AmSouth	3	226.0 mil.	9.7	823	33	15
Regions Post-Consummation	2	265.1 mil.	11.4	823	33	15

NOTE: Data are as of June 30, 2005. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

1. AmSouth recently entered the Daytona Beach market with a de novo branch. Accordingly, June 30, 2005, figures are unavailable.

2. AmSouth recently entered the Oxford market with a de novo branch. Accordingly, June 30, 2005, figures are unavailable.

Appendix B

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES AFTER DIVESTITURES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
ALABAMA BANKING MARKETS REQUIRING DIVESTITURE						
Dallas—Dallas County						
Pre-Divestiture						
Regions Pre-Consummation	2	141.8 mil.	28.7	3,656	717	2
AmSouth	4	61.8 mil.	12.5	3,656	717	2
Regions Post-Consummation	1	203.5 mil.	41.2	3,656	717	2
Post-Divestiture						
Regions Post-Consummation	2	141.8 mil.	29.9	2,983	44	3
Branches Divested to Out-of-Market Purchaser	4	55.6 mil.[1]	11.3	2,983	44	3
ALABAMA BANKING MARKETS REQUIRING DIVESTITURE						
Huntsville Area—Madison County; Limestone County, excluding both the town of Ardmore and the portion of the city of Decatur located in Limestone County						
Pre-Divestiture						
Regions Pre-Consummation	1	1.1 bil.	23.5	2,141	777	15
AmSouth	2	789.0 mil.	16.6	2,141	777	15
Regions Post-Consummation	1	1.9 bil.	40.0	2,141	777	15
Post-Divestiture						
Regions Post-Consummation	1	1.6 bil.	34.6	1,765	402	16
Branches Divested to Out-of-Market Purchaser	7	258.4 mil.[2]	5.4	1,765	402	16
MISSISSIPPI BANKING MARKETS REQUIRING DIVESTITURE						
Clarksdale—Coahoma County, excluding the northern part of the county that includes the cities of Friars Point, Coahoma, Lula, and Jonestown						
Pre-Divestiture						
Regions Pre-Consummation	4	66.0 mil.	15.7	3,283	604	3
AmSouth	2	81.2 mil.	19.3	3,283	604	3
Regions Post-Consummation	2	147.2 mil.	34.9	3,283	604	3
Post-Divestiture						
Regions Post-Consummation	4	66.0 mil.	17.6	2,672	–7	4
Branches Divested to Out-of-Market Purchaser	3	73.1 mil.[1]	17.4	2,672	–7	4
Greenville—Washington County						
Pre-Divestiture						
Regions Pre-Consummation	3	110.3 mil.	17.1	2,394	478	5
AmSouth	5	90.6 mil.	14.0	2,394	478	5
Regions Post-Consummation	3	201.0 mil.	31.1	2,394	478	5

Appendix B—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES AFTER DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Greenville—Washington County—Continued						
Post-Divestiture						
Regions Post-Consummation	3	133.5 mil.	21.7	1,986	71	6
Branches Divested to Out-of-Market Purchaser	5	60.8 mil.[1]	9.4	1,986	71	6
Greenwood—Carroll and Leflore Counties						
Pre-Divestiture						
Regions Pre-Consummation	4	53.6 mil.	10.5	2,035	409	6
AmSouth	2	99.4 mil.	19.5	2,035	409	6
Regions Post-Consummation	1	153.0 mil.	30.0	2,035	409	6
Post-Divestiture						
Regions Post-Consummation	4	53.6 mil.	12.5	1,598	–28	7
Branches Divested to Out-of-Market Purchaser	3	89.5 mil.[1]	17.5	1,598	–28	7
TENNESSEE BANKING MARKETS REQUIRING DIVESTITURE						
Bedford—Bedford County						
Pre-Divestiture						
Regions Pre-Consummation	2	97.6 mil.	21.8	3,005	653	4
AmSouth	3	67.3 mil.	15.0	3,005	653	4
Regions Post-Consummation	2	164.9 mil.	36.8	3,005	653	4
Post-Divestiture						
Regions Post-Consummation	2	97.6 mil.	23.3	2,377	24	5
Branches Divested to Out-of-Market Purchaser	3	60.5 mil.[1]	13.5	2,377	24	5
Cannon—Cannon County						
Pre-Divestiture						
Regions Pre-Consummation	1	52.3 mil.	39.3	5,634	2,240	1
AmSouth	3	38.0 mil.	28.5	5,634	2,240	1
Regions Post-Consummation	1	90.3 mil.	67.8	5,634	2,240	1
Post-Divestiture						
Regions Post-Consummation	1	52.3 mil.	42.2	3,471	77	2
Branches Divested to Out-of-Market Purchaser	3	34.2 mil.[1]	25.7	3,471	77	2
Cumberland—Cumberland County						
Pre-Divestiture						
Regions Pre-Consummation	1	156.7 mil.	24.8	3,189	1,179	5
AmSouth	2	149.9 mil.	23.7	3,189	1,179	5
Regions Post-Consummation	1	306.6 mil.	48.6	3,189	1,179	5
Post-Divestiture						
Regions Post-Consummation	1	199.3 mil.	33.3	2,171	161	6
Branches Divested to Out-of-Market Purchaser	3	96.6 mil.[1]	15.3	2,171	161	6

Appendix B—*Continued*

REGIONS AND AMSOUTH BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES AFTER DIVESTITURES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
DeKalb—DeKalb County						
Pre-Divestiture						
Regions Pre-Consummation	3	62.8 mil.	21.8	3,667	975	2
AmSouth	2	64.4 mil.	22.4	3,667	975	2
Regions Post-Consummation	1	127.2 mil.	44.2	3,667	975	2
Post-Divestiture						
Regions Post-Consummation	2	62.8 mil.	24.0	2,699	7	3
Branches Divested to Out-of-Market Purchaser	3	58.0 mil.[1]	20.1	2,699	7	3
Fayetteville—Lincoln County, excluding the portion of the town of Petersburg that lies in Lincoln County						
Pre-Divestiture						
Regions Pre-Consummation	2	97.8 mil.	23.0	2,477	467	6
AmSouth	4	43.2 mil.	10.2	2,477	467	6
Regions Post-Consummation	1	141.0 mil.	33.2	2,477	467	6
Post-Divestiture						
Regions Post-Consummation	2	97.8 mil.	24.0	2,038	28	7
Branches Divested to Out-of-Market Purchaser	4	38.9 mil.[1]	9.1	2,038	28	7
Paris—Henry County						
Pre-Divestiture						
Regions Pre-Consummation	3	54.3 mil.	12.1	2,809	282	6
AmSouth	4	52.1 mil.	11.6	2,809	282	6
Regions Post-Consummation	3	106.5 mil.	23.7	2,809	282	6
Post-Divestiture						
Regions Post-Consummation	3	54.3 mil.	13.3	2,531	4	6
Branches Divested to In-Market Purchaser	4	46.9 mil.[1]	10.5	2,531	4	6
Rhea—Rhea County						
Pre-Divestiture						
Regions Pre-Consummation	4	39.4 mil.	13.6	2,840	533	3
AmSouth	3	56.6 mil.	19.6	2,840	533	3
Regions Post-Consummation	1	96.0 mil.	33.2	2,840	533	3
Post-Divestiture						
Regions Post-Consummation	4	39.4 mil.	14.9	2,288	6	4
Branches Divested to Out-of-Market Purchaser	5	32.3 mil.[1,3]	11.2	2,288	6	4

NOTE: Data are as of June 30, 2005. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent. Amounts of deposits for branches divested to purchasers take into account potential deposit runoff of up to 10 percent.

1. One branch.
2. Five branches.
3. On September 29, 2006, prior to the merger, AmSouth sold one branch with deposits of $20.7 million to SouthEast Bank and Trust, a market competitor. Those deposits are therefore not reflected in the post-divestiture amount.

Sky Financial Group, Inc. *Bowling Green, Ohio*

Order Approving Acquisition of a Bank Holding Company

Sky Financial Group, Inc. ("Sky"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Wells River Bancorp, Inc. ("Wells River") and its subsidiary bank, Perpetual Savings Bank ("Perpetual"), both of Wellsville, Ohio.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 47,226 (2006)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

Sky, with total consolidated assets of $15 billion, controls Sky Bank,[3] Salineville, Ohio, with branches in Ohio, Indiana, Michigan, Pennsylvania, and West Virginia. Sky is the eighth largest depository organization in Ohio, controlling deposits of $8.1 billion, which represent 4 percent of total deposits of insured depository institutions in Ohio ("state deposits").[4]

Wells River, a small bank holding company with banking assets of approximately $72.6 million, operates one insured depository institution, Perpetual, in Ohio. Perpetual is the 179th largest depository institution in the state, controlling deposits of approximately $57.4 million. On consummation of this proposal, Sky would remain the eighth largest depository organization in Ohio, controlling deposits of approximately $8.2 billion, which represent approximately 4 percent of state deposits.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[5] The Board has carefully considered the competitive effects of the proposal in light of all the facts of record.

Sky and Wells River compete directly in the Youngstown-Warren, Ohio banking market.[6] The Board has reviewed carefully the competitive effects of the proposal in this banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the market, the relative shares of total deposits in depository institutions in the market ("market deposits") controlled by Sky and Wells River,[7] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[8] and other characteristics of the market.

In the Youngstown-Warren banking market, Sky is the largest depository organization, controlling deposits of $2.5 billion, which represent 35.5 percent of market deposits. Perpetual is the 17th largest depository institution in the market, controlling deposits of $57.4 million, which represent less than 1 percent of market deposits. On consummation, Sky would remain the largest depository organization in the market, controlling deposits of approximately $2.5 billion, which represent 36.2 percent of market deposits. The HHI would increase 44 points to 1809.

The proposal would be consistent with DOJ Guidelines in the Youngstown-Warren banking market. Although the market would become highly concentrated as measured by

1. 12 U.S.C. § 1842.

2. In other pending applications, Perpetual has applied to state authorities to convert to a state-chartered commercial bank and to the Board to become a state member bank. Sky plans subsequently to merge Perpetual with Sky Bank, with Perpetual as the surviving entity, and to operate Sky Bank's offices as branches of Perpetual pursuant to section 18(c) of the Federal Deposit Insurance Act and section 9 of the Federal Reserve Act (12 U.S.C. § 1828(c); 12 U.S.C. § 321). Sky intends to change the name of Perpetual to Sky Bank and to move its headquarters to Salineville.

3. Sky also controls Sky Trust, National Association, Pepper Pike, Ohio ("Sky Trust"), a limited-purpose bank that provides only trust services.

4. Asset and deposit data are as of June 30, 2006, and statewide deposit and ranking data are adjusted for subsequent acquisitions through September 12, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

5. 12 U.S.C. § 1842(c)(1).

6. The Youngstown-Warren banking market is defined as Mahoning County, excluding Smith township; Trumbell County, excluding Brookfield and Hartford townships; and Columbiana County, all in Ohio; and the Grant District in Hancock County, West Virginia.

7. Deposit and market data are as of June 30, 2006, reflect merger activity through September 12, 2006, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

8. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

the HHI, the increase in the HHI would be small. As noted, Sky currently controls 35.5 percent of the market, and on consummation of the proposal, Sky's market share would increase less than 1 percent. Furthermore, 16 insured depository institutions other than Sky would continue to operate in the market, including two institutions, each with more than 10 percent of market deposits, and three other institutions, each with more than 5 percent of market deposits. These factors, therefore, indicate that the proposal is not likely to have a significantly adverse competitive effect in the Youngstown-Warren banking market.

The DOJ also has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in the Youngstown-Warren banking market, where Sky and Wells River compete directly, or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by the applicant.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board expects banking organizations contemplating expansion to maintain strong capital levels substantially in excess of the minimum levels specified by the Board's Capital Adequacy Guidelines. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. Sky, Sky Bank, and Perpetual are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that Sky has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange and cash purchase. Sky will use existing resources to fund the cash portion of the transaction.

The Board also has considered the managerial resources of Sky, Wells River, and their subsidiary banks. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking and anti-money-laundering laws. Sky, Wells River, and their subsidiary depository institutions are considered to be well managed. The Board also has considered Sky's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[9] Sky Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of Cleveland, as of October 14, 2004. Perpetual also received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation, as of July 1, 2005. After consummation of the proposal, Sky plans to implement its CRA policies at Perpetual. The proposal would result in efficiencies that would allow Sky to better serve the customers of Sky Bank and Perpetual and would expand the products and services available to Perpetual customers. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching this conclusion, the Board has considered all the facts of record in light of the factors

9. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by Sky with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors, effective October 6, 2006.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin. Absent and not voting: Governor Bies.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

ORDERS ISSUED UNDER SECTION 4 OF THE BANK HOLDING COMPANY ACT

National City Corporation Cleveland, Ohio

Order Approving the Acquisition of a Savings Association and a Notice to Engage in Nonbanking Activities

National City Corporation ("National City"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under sections 4(c)(8) and 4(j) of the BHC Act and section 225.24 of the Board's Regulation Y[1] to acquire Harbor Federal Savings Bank ("Harbor FSB"), a savings association, by merging with its holding company, Harbor Florida Bancshares, Inc. ("Harbor"), both of Fort Pierce, Florida. National City also has requested the Board's approval under those provisions to acquire Appraisal Analysis, Inc. ("Appraisal Analysis"), Fort Pierce, a subsidiary of Harbor, and thereby provide appraisal services for real estate and personal property in accordance with section 225.28(b)(6) of the Board's Regulation Y.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 41,219 (2006)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 4 of the BHC Act.

National City, with total consolidated assets of \$141.5 billion, is the 13th largest depository organization in the United States, controlling deposits of approximately \$83.2 billion, which represent approximately 1 percent of the total amount of deposits of insured depository institutions in the United States.[3] National City operates one insured depository institution, National City Bank, Cleveland, Ohio, with branches in seven states.[4] Harbor, with total consolidated assets of approximately \$3.2 billion, operates one insured depository institution, Harbor FSB, with branches only in Florida. Harbor is the 11th largest depository organization in Florida, controlling deposits of approximately \$2.2 billion, which represent approximately 2 percent of the total amount of deposits of insured depository institutions in the state.

On consummation of the proposal, National City would remain the 13th largest insured depository organization in the United States, with total consolidated assets of approximately \$145.4 billion. National City would control deposits of approximately \$85 billion, representing 1 percent of the total amount deposits of insured depository institutions in the United States.

The Board previously has determined by regulation that the operation of a savings association by a bank holding company is closely related to banking for purposes of section 4(c)(8) of the BHC Act.[5] The Board requires that savings associations acquired by bank holding companies conform their direct and indirect activities to those permissible for bank holding companies under section 4 of the BHC Act.[6] National City has committed to conform all the activities of Harbor FSB to those permissible under section 4(c)(8) of the BHC Act and Regulation Y. In addition, the Board has determined that appraising real estate and personal property is closely related to banking.[7] National City has committed to conduct this activity in accordance with the Board's regulations and orders.

Section 4(j)(2)(A) of the BHC Act requires the Board to determine that the proposed acquisition of Harbor FSB and Appraisal Analysis "can reasonably be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[8] As part of its evaluation under these public interest factors, the Board reviews the financial and managerial resources of the companies involved, the effect of the proposal on competition in the relevant markets, and the

1. 12 U.S.C. §§ 1843(c)(8) and (j); 12 CFR 225.24.
2. 12 CFR 225.28(b)(6).
3. Asset, deposit, and ranking data are as of June 30, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.
4. National City Bank operates in Illinois, Indiana, Kentucky, Michigan, Missouri, Ohio, and Pennsylvania.
5. 12 CFR 225.28(b)(4)(ii).
6. *Id.*
7. 12 CFR 225.28(b)(2)(i).
8. 12 U.S.C. § 1843(j)(2)(A).

public benefits of the proposal.[9] In acting on a notice to acquire a savings association, the Board also reviews the records of performance of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[10] The Board has considered the proposal under these factors in light of all the facts of record, including confidential supervisory and examination information, publicly reported financial and other information, and public comments submitted on the proposal.[11]

Competitive Considerations

As part of the Board's consideration of the public interest factors under section 4 of the BHC Act, the Board has considered carefully the competitive effects of the proposed acquisition of Harbor FSB in light of all the facts of record. National City and Harbor do not compete directly in any relevant banking market. Based on all the facts of record, the Board has concluded that consummation of the proposal would not result in any significantly adverse effect on competition in any relevant banking market.[12]

The Board has considered the effects of the proposed transaction on competition for appraisal services. Harbor and National City do not compete directly in providing the proposed appraisal services. Moreover, the markets for these nonbanking activities are local or regional in scope and are unconcentrated. The record in this case indicates that there are numerous providers of these services. Based on all the facts of record, the Board concludes that consummation of the proposal would have a de minimis effect on competition among providers of appraisal services.

Financial and Managerial Resources

In reviewing the proposal under section 4 of the BHC Act, the Board has carefully considered the financial and managerial resources of National City, Harbor, and their subsidiaries. The Board also has reviewed the effect the transaction would have on those resources in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal supervisors of the organizations involved in the proposal, publicly reported and other financial information, information provided by National City, and public comments received on the proposal.

In evaluating financial resources in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary-insured depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial resources, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the proposal under the financial factors. National City, Harbor, and their subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board finds that National City has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of National City, Harbor, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law and with anti-money-laundering laws. National City, Harbor, and their subsidiary depository institutions are considered to be well managed. The Board also has considered National City's plans for implementing the proposal, including the proposed management after consummation.[13]

Based on all the facts of record, the Board has concluded that the financial and managerial resources of the organiza-

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9. *See* 12 CFR 225.26; *see, e.g., BancOne Corporation*, 83 *Federal Reserve Bulletin* 602 (1997).

10. 12 U.S.C. §2901 et seq.

11. One of the two commenters on the proposal expressed concern that National City's acquisition of Appraisal Analysis could erode the separation between appraisers and the loan-production and credit decision-making processes. National City has committed that it will conduct all appraisal services in compliance with applicable federal regulations and guidance requiring functional separation of appraisals from credit-solicitation and decision-making processes.

12. Another commenter expressed concern about the existing concentration levels of market deposits in markets where Harbor FSB has offices. Because National City Bank currently does not have branches in any of these banking markets, the proposal would not increase the concentration levels of deposits in Harbor FSB's banking markets. Furthermore, the Board reviewed the concentration levels in the Indian River County, Florida banking market, one of the markets where Harbor FSB has branches, in its recent review of the proposed acquisition of Golden West Financial Corporation, Oakland, California, by Wachovia Corporation, Charlotte, North Carolina. The Board found no adverse competitive impact in the market as a result of that transaction. *See Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006).

13. A commenter expressed concern about National City's relationships with unaffiliated pawn shops, cash-advance lenders, and other nontraditional providers of financial services. As a general matter, the activities of the consumer finance businesses identified by the commenter are permissible, and the businesses are licensed by the states where they operate. National City has stated that it does not pursue such nontraditional providers as a line of business. National City also has represented that it does not play any role in the lending practices, credit review, or other business practices of those firms.

tions involved in the proposal are consistent with approval under section 4 of the BHC Act.

CRA PERFORMANCE RECORDS

As previously noted, the Board considers the records of performance under the CRA of the relevant insured depository institutions when acting on a notice to acquire a savings association. The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[14]

The Board received a comment related to the CRA performance record of National City. The commenter alleged, based primarily on data reported under the Home Mortgage Disclosure Act ("HMDA"),[15] that National City extended a disproportionately high number of subprime mortgage loans in the Cincinnati area, particularly to LMI borrowers, as compared to its lending outside Cincinnati.[16]

As provided in the CRA, the Board has evaluated the proposal in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[17]

National City Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency ("OCC"), as of February 22, 2000.[18] Harbor FSB received an "outstanding" rating at its most recent CRA performance evaluation by the Office of Thrift Supervision, as of September 30, 2005. National City has indicated that its CRA program would be implemented at Harbor FSB on consummation of the proposal.

In connection with previous applications by National City, the Board has reviewed the CRA performance records of National City's subsidiary-insured depository institutions.[19] A summary of the most recent CRA evaluations of National City Bank was included in the *Allegiant Order*. Based on its review of the record in this case, the Board hereby reaffirms and adopts the facts and findings detailed in the *Allegiant Order*. The Board also has consulted with the OCC concerning the CRA performance of National City Bank since its last CRA evaluation.

As discussed in the *Allegiant Order*, the most recent CRA evaluation of National City Bank characterized the bank's overall record of home mortgage and small business lending as excellent and commended its level of community development lending.[20] Examiners noted favorably the use of several flexible lending products designed to address the affordable housing needs of LMI individuals and the bank's level of qualified investments. In addition, examiners reported that National City Bank's community development services were excellent and commended the geographic distribution of the bank's branches.

In 2004 and 2005, National City originated housing-related loans reported under HMDA totaling more than $11.6 billion. Of this amount, 13 percent was lent to borrowers in LMI census tracts and 26 percent to LMI borrowers. National City represented that, in 2004 and 2005, its subsidiary banks also made approximately $977 million in qualified community development loans and approximately $235 million in qualified investments and grants in their assessment areas, including significant investments in the Cincinnati area.

In the most recent CRA performance evaluation of Harbor FSB, examiners reported that the savings association's overall lending to LMI borrowers exceeded that of all other lenders in its assessment areas during the evaluation period (January 1, 2003, to December 31, 2004). In addi-

14. 12 U.S.C. §2903.

15. 12 U.S.C. §2801 et seq.

16. As the Board has previously noted, subprime lending is a permissible activity that provides needed credit to consumers who have difficulty meeting conventional underwriting criteria. The Board continues to expect all bank holding companies and their affiliates to conduct their lending operations without any abusive lending practices. *See, e.g., Royal Bank of Canada*, 88 *Federal Reserve Bulletin* 385, 388 (2002). The Board notes that on September 5, 2006, National City signed an agreement to sell its principal subsidiary that originates subprime mortgage loans, First Franklin Financial Corporation ("First Franklin"), San Jose, California, to Merrill Lynch & Co., New York, New York, and also announced its intention to sell to Merrill Lynch $5.6 billion of loans originated by First Franklin.

17. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 at 36,640 (2001).

18. On July 22, 2006, National City consolidated five other subsidiary banks into National City Bank: National City Bank of Indiana, Indianapolis, Indiana; National City Bank of Kentucky, Louisville, Kentucky; National City Bank of Pennsylvania, Pittsburgh, Pennsylvania; National City Bank of Southern Indiana, New Albany, Indiana; and National City Bank of the Midwest, Bannockburn, Illinois. On August 19, 2006, National City also consolidated Pioneer Bank and Trust Company, Maplewood, Missouri, into National City Bank. Each of these banks received either an "outstanding" or a "satisfactory" rating at its most recent CRA evaluation, as have the other insured depository institutions that, since the most recent CRA performance evaluation of National City Bank, have been consolidated into National City Bank.

19. *National City Corporation*, 92 *Federal Reserve Bulletin* C84 (2006); *National City Corporation*, 90 *Federal Reserve Bulletin* 519 (2004); *National City Corporation*, 90 *Federal Reserve Bulletin* 236 (2004) ("*Allegiant Order*"); and *National City Corporation*, 90 *Federal Reserve Bulletin* 382 (2004) ("*Provident Order*").

20. *See Allegiant* and *Provident Orders*. In evaluating the records of performance under the CRA of National City Bank, examiners considered home mortgage loans by certain affiliates in the bank's assessment areas. The loans reviewed by examiners included loans reported by National City Mortgage Corporation, Miamisburg, Ohio (then a subsidiary of National City Bank of Indiana); National City Mortgage Services, Kalamazoo, Michigan (then a subsidiary of National City Bank of the Midwest); and other bank and nonbank affiliates of National City Bank.

tion, examiners characterized Harbor FSB's level of community development lending in the combined assessment area as strong. Examiners also commended Harbor FSB for supporting a wide variety of nonprofit civic organizations in its assessment areas and noted that the savings association offered a high level of banking services, including several products that were beneficial to LMI individuals.

Based on a review of the entire record, and for the reasons discussed above, the Board has concluded that considerations relating to the CRA performance records of the relevant depository institutions are consistent with approval.

OTHER CONSIDERATIONS

In light of public comments on the proposal, the Board also has carefully considered the fair lending record and HMDA data reported by subsidiaries of National City in its evaluation of the public interest factors. A commenter opposed the proposal and alleged, based on 2005 HMDA data, that National City made higher-cost loans to African Americans and Hispanics more frequently than to nonminorities.[21] The Board has analyzed 2004 and 2005 HMDA data reported by subsidiaries of National City in its banks' primary assessment areas, including the Metropolitan Statistical Areas ("MSA") of Cleveland, Cincinnati, and Indianapolis, and statewide in the states where those banks operated branches.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not National City is excluding or imposing higher credit costs on those groups on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[22] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all banks are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance by National City with fair lending laws. In the fair lending reviews that were conducted in conjunction with the most recent CRA performance evaluations of National City, examiners noted no substantive violations of applicable fair lending laws. The Board has also forwarded the commenter's submissions to, and consulted with, the OCC about the fair-lending and consumer-protection compliance records of National City Bank, including the records of First Franklin, which is a subsidiary of the bank.

The record also indicates that National City has taken steps to ensure compliance with fair lending and other consumer protection laws. National City represents that it has a comprehensive fair lending program consisting of lending policies, annual training and testing of lending personnel, fair lending analyses, and oversight and monitoring. In addition, National City states that it performs fair lending analysis using regression modeling and benchmarking and monitors adherence to credit policies using monthly reporting and quality control reviews. National City also represents that its fair lending policies include a second-review program for its residential lending and that its corporate underwriting department conducts a third review of denied applications from minority applicants or for loans used to finance properties in LMI areas. National City intends to implement its consumer compliance and fair lending programs at Harbor FSB after consummation of the proposal.

In addition, the Board has considered the HMDA data in light of other information, including the CRA performance records of National City Bank and Harbor FSB. Based on all the facts of record, the Board has concluded that considerations relating to the fair lending record and HMDA data of National City Bank and Harbor FSB are consistent with approval under section 4 of the BHC Act.

PUBLIC BENEFITS

As part of its evaluation of the public interest factors under section 4 of the BHC Act, the Board also has reviewed carefully the public benefits and possible adverse effects of the proposal. The record indicates that consummation of the proposal would result in benefits to consumers and businesses currently served by Harbor. National City has represented that the proposed transaction would provide Harbor's customers with expanded products and services, including expanded commercial lending products, cash management and international trade services, and fiduciary and trust services. In addition, National City has represented that its acquisition of Appraisal Analysis would increase competition for appraisal services in Florida by increasing the availability of such services.

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21. Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate (APR) exceeds the yield for U.S. Treasury securities of comparable maturity 3 or more percentage points for first-lien mortgages and 5 or more percentage points for second-lien mortgages (12 CFR 203.4).

22. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

The Board has determined that the conduct of the proposed nonbanking activities within the framework of Regulation Y and Board precedent is not likely to result in adverse effects, such as undue concentrations of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. Based on all the facts of record, the Board has concluded that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects. Accordingly, the Board has determined that the balance of the public benefits under section 4(j)(2) of the BHC Act is consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the proposal should be, and hereby is, approved.[23] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by National City and Harbor with the conditions imposed in this order and the commitments made to the Board in connection with the notice. The Board's approval also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c),[24] and to the Board's authority to require such modification or termination of the activities of the bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. For purposes of this action, these conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decisions herein and, as such, may be enforced in proceedings under applicable law.

The acquisition shall not be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors, effective October 13, 2006.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Kroszner and Mishkin. Absent and not voting: Governors Bies and Warsh.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

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23. A commenter requested that the Board hold a public hearing or meeting on the proposal. The Board's regulations provide for a hearing under section 4 of the BHC Act if there are disputed issues of material fact that cannot be resolved in some other manner (12 CFR 225.25(a)(2)). Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application if a meeting or hearing is necessary or appropriate to provide an opportunity for testimony or other presentations. *See* 12 CFR 262.3(i)(2), 262.25(d). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit comments on the proposal and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The request fails to identify disputed issues of fact that are material to the Board's decision that would be clarified by a public meeting or hearing. Moreover, the commenter's request fails to demonstrate why its written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the request for a public hearing or meeting on the proposal is denied.

24. 12 CFR 225.7 and 225.25(c).

June 2007

Legal Developments: First Quarter, 2007

ORDERS ISSUED UNDER BANK HOLDING COMPANY ACT

ORDERS ISSUED UNDER SECTION 3 OF THE BANK HOLDING COMPANY ACT

Bank of America Corporation Charlotte, North Carolina

Order Approving the Acquisition of a Bank Holding Company

Bank of America Corporation ("Bank of America"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire U.S. Trust Corporation ("U.S. Trust") and its subsidiary bank, United States Trust Company, National Association ("U.S. Trust Bank"), both of New York, New York.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (72 *Federal Register* 132 (2007)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the BHC Act.[3]

Bank of America, with total consolidated assets of approximately $1.5 trillion, is the second largest depository organization in the United States.[4] Bank of America operates six insured depository institutions[5] that operate in 30 states and the District of Columbia, and it engages nationwide in numerous nonbanking activities that are permissible under the BHC Act.

U.S. Trust, with total banking assets of approximately $11.1 billion, controls one depository institution, U.S. Trust Bank, with branches in 11 states and the District of Columbia. U.S. Trust also engages in a broad range of permissible nonbanking activities. On consummation of the proposal, Bank of America would remain the second largest depository organization in the United States, with total consolidated assets of approximately $1.5 trillion.

INTERSTATE AND DEPOSIT CAP ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Bank of America is North Carolina,[6] and U.S. Trust Bank is located in California, Connecticut, the District of Columbia, Florida, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Oregon, Pennsylvania, and Texas.[7]

The Board may not approve an interstate acquisition under section 3(d) if the applicant controls, or on consummation of the proposed transaction would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States ("nationwide deposit cap").[8] As required by section 3(d), the Board has carefully considered whether Bank of America controls, or on consummation of the proposed transaction would control, more than 10 percent of the total amount of deposits of insured depository institutions[9] in the United States. In

1. 12 U.S.C. § 1842.

2. U.S. Trust is a wholly owned subsidiary of The Charles Schwab Corporation ("Charles Schwab"), San Francisco, California. Bank of America proposes to acquire all the outstanding common stock of U.S. Trust from Charles Schwab. In addition, Bank of America proposes to acquire the nonbanking subsidiaries of U.S. Trust in accordance with section 4(k) of the BHC Act, 12 U.S.C. § 1843(k).

3. Three commenters expressed concerns on various aspects of the proposal.

4. Asset data are as of December 31, 2006.

5. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

6. *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

7. For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B).

8. One commenter expressed general concerns about the proposal's consistency with the nationwide deposit cap.

9. The BHC Act adopts the definition of "insured depository institution" used in the Federal Deposit Insurance Act (12 U.S.C. § 1811 et seq.) ("FDI Act"). *See* 12 U.S.C. § 1841(n). The FDI Act contains an identical nationwide deposit cap applicable to bank-to-bank mergers and, consequently, many of the terms used in the nationwide deposit cap in the BHC Act refer to terms or definitions contained in the FDI Act. The FDI Act's definition of "insured depository institution" includes all banks (whether or not the institution is a bank for purposes of the BHC Act), savings banks, and savings associations that are insured by the Federal Deposit Insurance Corporation ("FDIC") and insured U.S. branches of foreign banks, as each of those terms is defined in the FDI Act. *See* 12 U.S.C. § 1813(c)(2).

analyzing this matter, the Board calculated the percentage of total deposits of insured depository institutions in the United States and the total deposits that Bank of America controls, and on consummation of the proposal would control, in the same manner as described in the Board's 2004 order approving Bank of America's acquisition of FleetBoston Financial Corporation.[10] These calculations are based on the definition of "deposit" in the FDI Act,[11] the deposit data collected in reports filed by all insured depository institutions,[12] and the methods and adjustments used by the FDIC to compute total insured deposits.

Based on the latest available deposit data reported by all depository institutions, the total amount of deposits of insured depository institutions in the United States is approximately $6.757 trillion as of December 31, 2006. Also based on the latest Call Report, Bank of America (including all its insured depository institution affiliates) controls deposits of approximately $612.0 billion, and U.S. Trust controls deposits of approximately $9.4 billion. Bank of America, therefore, currently controls approximately 9.1 percent of total U.S. deposits. On consummation of the proposed transaction, Bank of America would control approximately 9.2 percent of the total amount of deposits of insured depository institutions in the United States. Therefore, the Board finds that Bank of America does not now control, and on consummation of the proposed transaction would not control, an amount of deposits that would exceed the nationwide deposit cap.

Section 3(d) also prohibits the Board from approving a proposal if, on consummation, the applicant would control 30 percent or more of the total deposits of insured depository institutions in any state in which both the applicant and the organization to be acquired operate an insured depository institution, or such higher or lower percentage that is established by state law ("state deposit cap").[13] On consummation of the proposal, Bank of America would control less than 30 percent of the total amount of deposits of insured depository institutions in California, Connecticut, the District of Columbia, Florida, Massachusetts, New Jersey, New York, North Carolina, Oregon, Pennsylvania, and Texas, and would not hold deposits in excess of any applicable state deposit caps.

All other requirements of section 3(d) of the BHC Act also would be met on consummation of the proposal.[14] Based on all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[15]

Bank of America and U.S. Trust have subsidiary depository institutions that compete directly in 16 banking markets throughout the United States. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by Bank of America and U.S. Trust,[16] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[17] and other characteristics of the markets.

10. *Bank of America Corporation*, 90 *Federal Reserve Bulletin* 217, 219 (2004) ("*BOA/Fleet Order*"); *see also Bank of America Corporation*, 92 *Federal Reserve Bulletin* C5 (2006) (order approving Bank of America's merger with MBNA Corporation, Wilmington, Delaware ("*BOA/MBNA Order*")).

11. Section 3(d) of the BHC Act specifically adopts the definition of "deposit" in the FDI Act (12 U.S.C. § 1842(d)(2)(E)) (incorporating the definition of "deposit" at 12 U.S.C. § 1813(*l*)).

12. Each insured bank in the United States must report data regarding its total deposits in accordance with the definition of "deposit" in the FDI Act on the institution's Consolidated Report of Condition and Income ("Call Report"). Each insured savings association similarly must report its total deposits on the institution's Thrift Financial Report. Deposit data for FDIC-insured U.S. branches of foreign banks and federal branches of foreign banks are obtained from the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks. These data are reported quarterly to the FDIC and are publicly available.

13. 12 U.S.C. § 1842(d)(2)(B)–(D).

14. Bank of America is adequately capitalized and adequately managed as defined by applicable law (12 U.S.C. § 1842(d)(1)(A)). U.S. Trust Bank has been in existence and operated for the minimum period of time required by applicable state law. *See* 12 U.S.C. § 1842(d)(1)(B). The other requirements in section 3(d) of the BHC Act also would be met on consummation of the proposal.

15. 12 U.S.C. § 1842(c)(1).

16. Deposit and market share data are as of June 30, 2006, adjusted to reflect mergers and acquisitions through February 20, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

17. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

A. Banking Markets within Established Guidelines

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in 15 of the 16 banking markets.[18] On consummation of the proposal, three of these markets would remain unconcentrated, eleven markets would remain moderately concentrated, and one market would remain highly concentrated, as measured by the HHI. The change in the HHI measure of concentration in each of these markets would be very small. Moreover, numerous competitors would remain in each of the 15 banking markets.

B. Banking Market Warranting Special Scrutiny

Bank of America and U.S. Trust compete directly in one banking market, Hartford, Connecticut,[19] that warrants a detailed review because the post-consummation market share of Bank of America in that market would exceed 35 percent. In the Hartford banking market, Bank of America is the largest depository organization, controlling deposits of approximately $10.3 billion, which represent approximately 40.5 percent of market deposits. U.S. Trust is the 25th largest depository organization in the market, controlling deposits of $50.6 million, which represent less than 1 percent of market deposits. On consummation of the proposal, Bank of America would remain the largest depository organization in the market, controlling deposits of approximately $10.3 billion, which represent approximately 40.7 percent of market deposits. Bank of America's market share would increase by less than 1 percent, and the HHI would increase by only 16 points to 2142, which is consistent with the DOJ Guidelines.

The Board has considered carefully whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase and the resulting level of concentration in a banking market.[20]

Several factors indicate that the proposal would not have a significantly adverse effect on concentration in the Hartford banking market. Although the market is highly concentrated, as measured by the HHI, the change in market share and market structure would be de minimis, and 32 other depository organizations would continue to operate in the market. In addition, the record of entry into the Hartford banking market evidences the market's attractiveness for entry. Eight depository institutions have entered the market de novo since 2001.

18. These markets, and the effects of the proposal on the concentration of banking resources in these markets, are described in the appendix.

19. The Hartford banking market is defined as the Hartford-New Britain Ranally Metropolitan Area.

20. *See NationsBank Corporation*, 84 *Federal Reserve Bulletin* 129 (1998).

C. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the 16 banking markets where Bank of America and U.S. Trust compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information received from the relevant federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, including information provided by Bank of America.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the proposal under the financial factors. Bank of America, all its subsidiary banks, and U.S. Trust Bank currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board finds that Bank of America has sufficient financial resources to effect the proposal. The proposed transaction is structured as a cash purchase of shares, and Bank of America will use existing resources to fund the purchase.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of Bank of America and U.S. Trust, and their subsidiary banks, including assessments of their management, risk-management systems, and operations.[21] In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws.[22] The Board also has considered Bank of America's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.[23]

21. The Board has considered that Bank of America recently entered into agreements with the Internal Revenue Service ("IRS") and the DOJ with respect to ongoing industrywide investigations being conducted by the DOJ, the IRS, and the Securities and Exchange Commission ("SEC") related to certain practices in the municipal bond industry. Bank of America has voluntarily provided information and continues to work with the three agencies on this matter. The Board has also considered that this month Bank of America settled an SEC enforcement action against Bank of America's subsidiary, Banc of America Securities LLC, related to its research reports. Consistent with the provisions of section 5 of the BHC Act, as amended by the Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999), the Board has relied on examination and other supervisory information provided by the SEC and other appropriate functional regulators about functionally regulated subsidiaries. The Board also has consulted with the SEC about its review of the efforts of Bank of America to comply with federal securities laws. The Board also has considered the willingness and efforts undertaken by Bank of America's management to ensure compliance with all applicable state and federal law and to improve compliance programs and policies in light of these investigations.

22. As part of its consideration of managerial factors, the Board reviewed confidential supervisory information on the policies, procedures, and practices of Bank of America and its subsidiary banks for complying with the Bank Secrecy Act and consulted with the Office of the Comptroller of the Currency ("OCC"). The Board also considered the result of investigations by other authorities concerning anti-money-laundering matters involving Bank of America, which related to deficiencies in handling money transfers through Bank of America's New York branch and to certain deficiencies in customer due diligence and suspicious activity reporting at a subsidiary of Bank of America, Banc of America Investment Services, Inc. These investigations have recently been settled, and Bank of America has taken appropriate steps to revise its anti-money-laundering policies, systems, and controls.

23. One commenter reiterated concerns he had expressed previously about Bank of America's relations with unaffiliated third parties engaged in subprime lending, including OwnIt Mortgage ("OwnIt"), formerly Oakmont Mortgage Company, Woodland Hills, California. Bank of America represented that its investment in OwnIt was a passive, noncontrolling investment and that OwnIt recently terminated its operations. Bank of America provides warehouse lines-of-credit to subprime lenders and other consumer finance companies, purchases subprime mortgage loans from unaffiliated lenders, and securitizes pools of subprime mortgage loans. As a general matter, the activities of the consumer finance businesses identified by the commenter are permissible, and the businesses are licensed by the states where they operate. *See BOA/Fleet Order* 217, at 223 n.29 (2004). Moreover, the commenter provided no evidence that Bank of America has originated, purchased, or securitized "predatory" loans or otherwise engaged in abusive lending practices. Bank of America has policies and procedures to help ensure that the subprime loans it purchases and securitizes are in compliance with applicable state and federal consumer protection laws.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[24] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[25]

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of the subsidiary banks of Bank of America and U.S. Trust, data reported by Bank of America under the Home Mortgage Disclosure Act ("HMDA"),[26] other information provided by Bank of America, confidential supervisory information, and public comments received on the proposal. One commenter questioned Bank of America's record of serving the credit needs of residents of the New York City area. The commenter also expressed concern that the acquisition of U.S. Trust Bank could negatively affect LMI residents of New York City if U.S. Trust Bank's current CRA programs were altered.[27] Two other commenters alleged, based on HMDA data, that Bank of America engaged in disparate treatment of minority individuals in home mortgage lending.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the

24. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

25. 12 U.S.C. § 2903.

26. 12 U.S.C. § 2801 et seq.

27. The commenter also requested that Bank of America implement a number of CRA-related recommendations set forth in the comment letter. The Board has consistently found that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization. *See BOA/Fleet Order* at 232–33. Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the needs of its CRA assessment areas at the time the Board reviews a proposal under the convenience and needs factor.

applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[28]

Bank of America's lead bank, Bank of America, National Association ("BA Bank"), Charlotte, North Carolina, received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of December 31, 2001 ("2001 Evaluation").[29] The only other subsidiary bank of Bank of America subject to the CRA, FIA Card Services, N.A., Wilmington, Delaware,[30] also received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of April 4, 2005. U.S. Trust Bank was formed in 2006 by the conversion of United States Trust Company of New York ("USTC New York"), New York, New York, to a national bank charter and its subsequent merger with U.S. Trust Company, National Association ("USTC Los Angeles"), Los Angeles, California. Both banks were subsidiaries of U.S. Trust and had "outstanding" CRA performance ratings by the Board and the OCC, respectively, before the merger.[31] Bank of America has represented that it would work to combine the community development and community investment activities of BA Bank and U.S. Trust Bank to strengthen and meet the banking needs of the communities in which they operate.

CRA Performance of BA Bank. The 2001 Evaluation of BA Bank was discussed in the *BOA/Fleet Order.*[32] The Board also considered BA Bank's CRA performance in the *BOA/MBNA Order.* Based on a review of the record in this case, the Board hereby reaffirms and adopts the facts and findings detailed in those two orders concerning BA Bank's CRA performance record. Bank of America also provided the Board with additional information about its CRA performance since the Board last reviewed such matters in the *BOA/MBNA Order.*[33] The Board also consulted with the OCC with respect to BA Bank's CRA performance since the *BOA/MBNA Order.*

In the 2001 Evaluation, examiners commended BA Bank's overall lending performance, which they described as demonstrating excellent or good lending-test results in all its rating areas. Examiners reported that the distribution of HMDA-reportable mortgage loans among areas of different income levels was good, and they commended BA Bank for developing mortgage loan programs with flexible underwriting standards, such as its Neighborhood Advantage programs, which assisted in meeting the credit needs of BA Bank's assessment areas. Examiners also reported that the bank's small business lending was excellent or good in the majority of its rating areas, and they commended the distribution of small business loans among businesses of different sizes in several of BA Bank's assessment areas.[34] In addition, examiners noted in the 2001 Evaluation that BA Bank's level of community development lending was excellent.

Since the 2001 Evaluation, BA Bank has maintained a substantial level of home mortgage, small business, and community development lending. The bank originated more than 376,000 HMDA-reportable home mortgage loans totaling approximately $80 billion throughout its assessment areas in 2005.[35] More than 75,000 of those loans totaling more than $8 billion were originated to LMI individuals. In 2006, BA Bank was recognized by the U.S. Small Business Administration ("SBA") for the ninth consecutive year as the leading small business lender in the country, based on its origination of approximately 13,000 SBA loans totaling more than $405 million. Bank of America represented that BA Bank's community development lending during 2005 and 2006 totaled approximately $5.8 billion.[36]

In the 2001 Evaluation, examiners reported that BA Bank consistently demonstrated strong investment-test performance, noting that its performance was excellent or good in the majority of its assessment areas. During the evaluation period, BA Bank funded more than 17,000 housing units for LMI families through its community development investments throughout its assessment areas.[37] Examiners commended BA Bank for taking a leadership role in developing and participating in complex investments that involved multiple participants and both public and private funding.

Since the 2001 Evaluation, BA Bank has continued its strong activities in community development investment in its assessment areas. Bank of America represented that BA Bank's qualifying community development investments during 2005 and 2006 totaled approximately $3.6 billion and that BA Bank's subsidiary community development

28. *See Interagency Questions and Answers Regarding Community Reinvestment,* 66 *Federal Register* 36,620 and 36,639 (2001).

29. The evaluation period for the 2001 Evaluation was January 1, 2000, through December 31, 2001.

30. FIA Card Services was formerly known as MBNA America Bank, National Association, Wilmington, Delaware, and was renamed in June 2006.

31. USTC New York received an overall "outstanding" CRA performance rating from the Board, as of March 15, 2004, and USTC Los Angeles received an overall "outstanding" CRA performance rating from the OCC, as of October 15, 2002. The OCC has not yet evaluated U.S. Trust Bank's CRA performance.

32. *BOA/Fleet Order* at 225–229.

33. Bank of America has provided detailed information about its community development activities in New York City in response to a commenter's concerns about its record of serving the credit needs of the city's residents.

34. In this context, "small business loans" are loans with original amounts of $1 million or less that are secured by nonfarm, nonresidential properties or are commercial and industrial loans to borrowers in the United States.

35. BA Bank originated more than 5,400 HMDA-reportable home mortgage loans totaling approximately $1.6 billion in the New York MSA in 2005, including 785 loans totaling approximately $188 million to LMI individuals.

36. Bank of America advised that information for 2006 is based on preliminary data, which have not been finalized and may be incomplete.

37. Bank of America also has provided grants to nonprofit organizations, such as ACCION and the New Mexico Community Development Loan Fund, that originate microloans in amounts as small as $500 and promote SBA programs.

corporation had helped develop more than 6,200 housing units in LMI census tracts or for LMI individuals since 2003.[38]

Examiners commended BA Bank's service performance throughout its assessment areas in the 2001 Evaluation. They reported that the bank's retail delivery systems were generally good and that the bank's distribution of branches among geographies of different income levels was adequate. Examiners also commended BA Bank for its community development services, which typically responded to the needs of the communities served by the bank throughout its assessment areas.[39]

CRA Performance of U.S. Trust Bank. As noted, U.S. Trust Bank received an overall "outstanding" rating in its March 2004 evaluation.[40] U.S. Trust Bank provides investment management, private banking, and fiduciary services to high-net-worth individuals and institutions and is designated as a wholesale bank for purposes of evaluating its CRA performance. As such, it is evaluated under the community development test, and examiners may consider the bank's community development investments, loans, and services nationwide rather than only in the bank's assessment area.[41]

With respect to community development lending, examiners commended U.S. Trust Bank's responsiveness to the credit needs of its assessment area. Examiners noted that during the evaluation period, U.S. Trust Bank made more than $44 million in qualified community development investments, including a number of low-income housing tax credit investments, which helped meet the assessment area's critical needs for affordable housing.

B. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of Bank of America in light of public comments received on the proposal. Two commenters alleged, based on 2005 and 2006 HMDA data, that Bank of America had denied the home mortgage loan applications of African-American and Hispanic borrowers more frequently than those of nonminority applicants in various metropolitan statistical areas ("MSAs") and nationwide. The commenters also alleged that Bank of America and its subsidiaries made higher-cost loans more frequently to African-American and Hispanic borrowers than to nonminority borrowers.[42] The Board has focused its analysis on the 2005 HMDA data reported by Bank of America and its subsidiary banks.[43]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Bank of America is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[44] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by Bank of America and its subsidiaries. The Board also has consulted with the OCC, the primary federal supervisor of Bank of America's subsidiary banks.

The record, including confidential supervisory information, indicates that Bank of America has taken steps to ensure compliance with fair lending and other consumer protection laws. Bank of America has corporate wide policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations. Bank of America's compliance program includes fair lending policy and product guides, compliance file reviews, testing of HMDA data integrity, and other quality-assurance measures. In addition, Bank of America represented that it provides annual fair lending training to ensure that Bank of America's associates understand their respon-

38. Bank of America also has represented that, during 2005 and 2006, BA Bank's qualifying community development investments in New York City totaled approximately $170 million and qualified community development lending in New York City totaled approximately $700 million.

39. One commenter asserted that Bank of America should ensure that certain banking products and services are made available to LMI customers in New York City. Although the Board has recognized that banks can help to serve the banking needs of communities by making certain products or services available on certain terms or at certain rates, the CRA neither requires an institution to provide any specific types of products or services nor prescribes their costs to the consumer.

40. The evaluation period was from March 16, 2002, through December 31, 2003.

41. *See* 12 CFR 25.25.

42. Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate (APR) exceeds the yield for U.S. Treasury securities of comparable maturity 3 percentage points or more for first-lien mortgages and 5 percentage points or more for second-lien mortgages (12 CFR 203.4).

43. The Board reviewed HMDA data for BA Bank nationwide and in MSAs and states where the bank's primary assessment areas are located. The Board notes that 2006 HMDA data are preliminary and that final data will not be available for analysis until fall 2007.

44. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

sibilities for complying with the fair lending policy and how to employ fair lending "best practices" in all aspects of the lending process. Bank of America has stated that its fair lending policies will continue to apply to current Bank of America operations and that it will review and make appropriate modifications to the fair lending policies that would apply to U.S. Trust Bank's operations after consummation of the proposal.

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance records of the subsidiary banks of Bank of America under the CRA. These established efforts and record of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all of the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Bank of America, comments received on the proposal, and confidential supervisory information. Bank of America represented that the proposal will result in greater convenience for Bank of America and U.S. Trust customers through expanded delivery channels and a broader range of products and services. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance record of the relevant insured depository institutions are consistent with approval of the proposal.

CONCLUSION

Based on the foregoing, and in light of all the facts of record, the Board has determined that the application should be, and hereby is, approved.[45] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Bank of America with the conditions in this order and all the commitments made to the Board in connection with the proposal. For purposes of this transaction, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Richmond, acting pursuant to delegated authority.

By order of the Board of Governors, effective March 27, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

45. One commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 225.16(e), 262.3(i)(2), 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit his views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present his views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

Appendix

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
BOSTON BANKING MARKET IN MASSACHUSETTS AND NEW HAMPSHIRE						
Boston—the Boston Ranally Metropolitan Area (RMA) and the town of Lyndeboro in Hillsborough County, New Hampshire						
Bank of America Pre-Consummation	1	30.0 bil.	23.17	1,231	16	161
U.S. Trust	26	445.7 mil.	.34	1,231	16	161
Bank of America Post-Consummation	1	30.4 bil.	23.51	1,231	16	161
CHARLOTTE—ROCK HILL BANKING MARKET IN NORTH CAROLINA AND SOUTH CAROLINA						
Charlotte-Rock Hill—the Charlotte RMA and the non-RMA portion of Cabarrus County, North Carolina						
Bank of America Pre-Consummation	2	21.8 bil.	23.27	4,741	0	49
U.S. Trust	38	8.7 mil.	.01	4,741	0	49
Bank of America Post-Consummation	2	21.8 bil.	23.28	4,741	0	49
DALLAS BANKING MARKET IN TEXAS						
Dallas—Dallas County; the southeastern quadrant of Denton County (including the cities of Denton and Lewisville); the southwestern quadrant of Collin County (including the cities of McKinney and Plano); Rockwall County; the communities of Forney and Terrell in Kaufman County; and the cities of Midlothian, Waxahachie, and Ferris in Ellis County						
Bank of America Pre-Consummation	2	18.9 bil.	24.50	1,726	3	114
U.S. Trust	75	52.5 mil.	.07	1,726	3	114
Bank of America Post-Consummation	2	18.9 bil.	24.57	1,726	3	114
GREENSBORO-HIGH POINT BANKING MARKET IN NORTH CAROLINA						
Greensboro-High Point—the Greensboro RMA and the non-RMA portions of Davidson (excluding the Winston-Salem RMA portion) and Randolph counties						
Bank of America Pre-Consummation	3	1 bil.	9.03	1,179	0	27
U.S. Trust	27	3.6 mil.	.03	1,179	0	27
Bank of America Post-Consummation	3	1 bil.	9.07	1,179	0	27

Appendix—*Continued*

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
HOUSTON BANKING MARKET IN TEXAS						
Houston—the Houston–Sugar Land–Baytown Metropolitan Statistical Area, consisting of Austin, Brazoria, Chambers, Fort Bend, Galveston, Harris, Liberty, Montgomery, San Jacinto, and Waller counties						
Bank of America Pre-Consummation	2	9.1 bil.	11.17	1,406	1	84
U.S. Trust	70	26.2 mil.	.03	1,406	1	84
Bank of America Post-Consummation	2	9.1 bil.	11.20	1,406	1	84
LOS ANGELES BANKING MARKET IN CALIFORNIA						
Los Angeles—the Los Angeles RMA and the towns of Acton and Rosamond						
Bank of America Pre-Consummation	1	56.4 bil.	21.24	814	5	166
U.S. Trust	58	268.5 mil.	.10	814	5	166
Bank of America Post-Consummation	1	56.6 bil.	21.34	814	5	166
MIAMI-FORT LAUDERDALE BANKING MARKET IN FLORIDA						
Miami-Fort Lauderdale—Broward and Dade counties						
Bank of America Pre-Consummation	2	20.1 bil.	20.12	990	0	99
U.S. Trust	98	0.0 mil.	.00	990	0	99
Bank of America Post-Consummation	2	20.1 bil.	20.12	990	0	99
NAPLES BANKING MARKET IN FLORIDA						
Naples—Collier County, excluding the town of Immokalee						
Bank of America Pre-Consummation	2	1.8 bil.	17.89	1,150	9	36
U.S. Trust	29	24.7 mil.	.25	1,150	9	36
Bank of America Post-Consummation	2	1.8 bil.	18.14	1,150	9	36
NEW YORK BANKING MARKET IN NEW YORK, NEW JERSEY, PENNSYLVANIA, AND CONNECTICUT						
New York—Bronx, Dutchess, Kings, Nassau, New York, Orange, Putnam, Queens, Richmond, Rockland, Suffolk, Sullivan, Ulster, and Westchester counties in New York; Bergen, Essex, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Somerset, Sussex, Union, and Warren counties in New Jersey; Monroe and Pike counties in Pennsylvania; and Fairfield County and portions of Litchfield and New Haven counties in Connecticut						
Bank of America Pre-Consummation	3	56.2 bil.	6.57	1,246	9	285
U.S. Trust	20	5.7 bil.	.67	1,246	9	285
Bank of America Post-Consummation	3	62 bil.	7.24	1,246	9	285

Appendix—*Continued*

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
PHILADELPHIA BANKING MARKET IN NEW JERSEY AND PENNSYLVANIA						
Philadelphia—Bucks, Chester, Delaware, Montgomery, and Philadelphia counties in Pennsylvania; and Burlington, Camden, Cumberland, Gloucester, and Salem counties in New Jersey						
Bank of America Pre-Consummation	5	6.4 bil.	6.09	1,003	0	123
U.S. Trust	109	9.2 mil.	.01	1,003	0	123
Bank of America Post-Consummation	5	6.4 bil.	6.10	1,003	0	123
PORTLAND BANKING MARKET IN OREGON AND WASHINGTON						
Portland—the Portland RMA; the towns of Banks, Molalla, Mount Angel, North Plains, Saint Helens, Scappoose, Vernonia, and Woodburn, Oregon; and Yacolt, Washington						
Bank of America Pre-Consummation	2	4.1 bil.	16.96	1,438	4	42
U.S. Trust	32	22.3 mil.	.09	1,438	4	42
Bank of America Post-Consummation	2	4.1 bil.	17.05	1,438	4	42
RALEIGH BANKING MARKET IN NORTH CAROLINA						
Raleigh—the Raleigh RMA and the non-RMA portions of Franklin, Harnett (excluding the Fayetteville RMA portion), Johnston, and Wake counties						
Bank of America Pre-Consummation	6	1.1 bil.	7.01	1,538	1	31
U.S. Trust	28	1.8 mil.	.01	1,538	1	31
Bank of America Post-Consummation	6	1.1 bil.	7.02	1,538	1	31
SAN FRANCISCO-OAKLAND-SAN JOSE BANKING MARKET IN CALIFORNIA						
San Francisco–Oakland–San Jose—the San Francisco–Oakland–San Jose RMA and the towns of Byron, Hollister, San Juan Bautista, Pescadero, and Point Reyes Station						
Bank of America Pre-Consummation	1	56.2 bil.	27.03	1,349	1	101
U.S. Trust	73	56.9 mil.	.03	1,349	1	101
Bank of America Post-Consummation	1	56.2 bil.	27.06	1,349	1	101

Appendix—*Continued*

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
WASHINGTON BANKING MARKET IN THE DISTRICT OF COLUMBIA, MARYLAND, VIRGINIA, AND WEST VIRGINIA						
Washington—the Washington RMA, the non-RMA portions of Calvert, Charles, Frederick, Prince George's, and St. Mary's counties in Maryland; Fauquier and Loudoun counties in Virginia; Jefferson County in West Virginia; and the independent cities of Alexandria, Fairfax, Falls Church, and Manassas in Virginia						
PNC Pre-Consummation	2	14.8 bil.	11.76	842	1	91
Mercantile	80	16.9 mil.	.01	842	1	91
PNC Post-Consummation	2	14.8 bil.	11.77	842	1	91
WEST PALM BEACH BANKING MARKET IN FLORIDA						
West Palm Beach—Palm Beach County east of Loxahatchee and the towns of Indiantown and Hobe Sound in Martin County						
Bank of America Pre-Consummation	2	5.9 bil.	18.39	1,520	13	62
U.S. Trust	32	115.4 mil.	.36	1,520	13	62
Bank of America Post-Consummation	2	6 bil.	18.75	1,520	13	62

NOTE: Data are as of June 30, 2006. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

Community Bankshares, Inc. Greenwood Village, Colorado

Order Approving the Acquisition of a Bank Holding Company

Community Bankshares, Inc. ("Community"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Citizens Financial Corporation ("Citizens") and its subsidiary bank, The Citizens State Bank of Cortez ("Citizens State Bank"), both of Cortez, Colorado.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 68,817 (2006)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

Community, with total consolidated assets of approximately $1.4 billion, operates the following subsidiary insured depository institutions in California and Colorado: Community Banks of Northern California, Tracy, California; and Community Banks of Colorado ("Community Bank"), Greenwood Village, Colorado. Community is the 17th largest depository organization in Colorado, controlling deposits of $981.1 million, which represent 1.3 percent of total deposits of insured depository institutions in Colorado ("state deposits").[2]

Citizens, with total banking assets of approximately $78 million, operates one insured depository institution with branches only in Colorado. Citizens is the 103rd largest depository organization in Colorado, controlling

1. 12 U.S.C. § 1842.

2. Data are as of June 30, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

deposits of approximately $65 million, which represent less than 1 percent of state deposits.

On consummation of this proposal, Community would remain the 17th largest depository organization in Colorado, controlling deposits of approximately $1 billion, which represent 1.4 percent of state deposits.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[3] The Board has considered carefully the competitive effects of the proposal in light of all the facts of record.

A. Geographic Banking Market

Community and Citizens compete directly in the Cortez, Colorado banking market ("Cortez banking market"). Community contends that the Cortez banking market, as delineated by the Federal Reserve Bank of Kansas City ("Reserve Bank"),[4] does not reflect the true nature of banking competition in Cortez and that the relevant geographic market for analysis should be expanded to include La Plata County, where the city of Durango is located. Community bases its contention on the commuting patterns between Montezuma and La Plata counties.[5]

In defining a geographic market, the Board and the courts have consistently found that the relevant geographic market for analyzing the competitive effects of a proposal must reflect commercial and banking realities and should consist of the local area where customers can practicably turn for alternatives.[6] In reviewing Community's contention, the Board has considered a number of factors to identify the economically integrated area that represents the appropriate local geographic banking market encompassing Cortez for purposes of analyzing the proposal's competitive effects.[7]

The Board reviewed the proximity of Cortez and Durango and the commuting data between their respective counties. A mountain pass between Cortez and Durango reportedly makes commuting and other travel between these cities difficult at times during the winter months. The rate of commuting between Montezuma and La Plata counties remains low at approximately 7 percent of residents despite some increase during the past decade. Other indicators of economic integration, such as entertainment, restaurant, and shopping opportunities available in one market but not in the other, are insufficient to suggest that the low commuting rate understates the economic integration of the counties. Both cities have large discount retail stores and supermarkets.

Banking data also support the Reserve Bank's definition of the Cortez banking market as the relevant geographic market. Interviews by the Reserve Bank with bankers in Cortez and Durango indicate that most, if not all, of the local banks view the two cities as separate markets. Banks in each city generally have few customers from the other city, do not solicit or advertise for business in the other city, and do not monitor the loan or deposit rates of banks in the other city.[8]

Based on the foregoing and a careful review of all the facts of record, including information provided by local banks, the state of Colorado, and other publicly available information, the Board reaffirms that the relevant geographic market within which to evaluate the competitive effects of this proposal is the Cortez banking market, as currently defined by the Reserve Bank.

B. Competitive Effects in the Banking Market

The Board has reviewed carefully the competitive effects of the proposal in the Cortez banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking

3. 12 U.S.C. § 1842(c)(1).

4. The Cortez banking market is defined as Dolores and Montezuma counties, Colorado.

5. Community argues that approximately 7 percent of workers in Montezuma County, where Cortez is located, commute to La Plata County for employment, and that the absolute number of commuters traveling from Montezuma County to La Plata County exceeds the absolute number of commuters traveling to Montezuma County from Dolores County (the other county in the Cortez banking market). Community also notes that the only banking institution in Dolores County is 35 road miles from Cortez and that Durango, where most La Plata County banking institutions are located, is only 45 road miles from Cortez.

6. *See United States v. Phillipsburg National Bank*, 399 U.S. 350 (1970); *United States v. Philadelphia National Bank*, 374 U.S. 321, 357 (1963); *Brown Shoe Co. v. United States*, 370 U.S. 294, 336–337 (1962). *See also First York Ban Corp*, 88 *Federal Reserve Bulletin* 251 (2002); *First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998); *First Union Corporation*, 83 *Federal Reserve Bulletin* 1012, 1013–14 (1997); *Chemical Banking Corporation*, 82 *Federal Reserve Bulletin* 239, 241 (1996); and *Wyoming Bancorporation*, 68 *Federal Reserve Bulletin* 313, 314 (1982).

7. In delineating the relevant geographic market in which to assess the competitive effects of a bank merger or acquisition, the Board reviews population density; worker commuting patterns; the usage and availability of banking products; advertising patterns of financial institutions; the presence of shopping, employment, and other necessities; and other indicia of economic integration and transmission of competitive forces among banks. *See, e.g., First Security Corporation*, 86 *Federal Reserve Bulletin* 122 (2000); *Pennbancorp*, 69 *Federal Reserve Bulletin* 548 (1983).

8. One exception is a bank in the town of Mancos, Colorado, that has attracted depositors from both cities. Mancos is in Montezuma County between Cortez and Durango.

market, the relative shares of total deposits in depository institutions in the market ("market deposits") controlled by Community and Citizens,[9] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[10] and other characteristics of the market.

In the Cortez banking market, the concentration levels on consummation of the proposal would exceed the threshold levels in the DOJ Guidelines. Community's subsidiary, Community Bank, is the fifth largest depository institution in the market, controlling deposits of approximately $51.8 million, which represent approximately 13.4 percent of market deposits. Citizens' subsidiary, Citizens State Bank, is the third largest depository institution in the market, controlling deposits of approximately $65.1 million, which represent approximately 16.8 percent of market deposits. On consummation of the proposal, Community Bank would become the largest depository institution in the market, controlling deposits of approximately $116.9 million, which would represent 30.2 percent of market deposits. The HHI would increase 449 points to 2192.

The Board has considered carefully whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase in and the resulting level of concentration in a banking market.[11]

Several factors indicate that the increase in concentration in the Cortez banking market, as measured by increases in the HHI and Community Bank's market share, overstates the potential competitive effects of the proposal. After consummation, five insured depository institutions would continue to operate in the market, which is an average number of competitors for sparsely populated rural banking markets like the Cortez market. The relative share of market deposits held by each depository institution indicates there is active competition in the market. Each of the four remaining institutions that directly compete with Community Bank will have a market share of between 12 percent and 22 percent on consummation of the proposal. Moreover, the market concentration as measured by the HHI has decreased 624 points during the last decade, from 2367 in 1996[12] to 1743 in 2006, evidencing significant and effective competition by market participants during this period.

In addition, actions by competitors to enter the market in 2007 demonstrate that the market is attractive for entry. Although no depository institutions have entered the market in recent years, two institutions have taken steps within the past year that will lead to entry into the market in 2007 through de novo branches. One bank established a loan production office ("LPO") in Cortez in 2006 and has purchased a building as part of its plans to convert the LPO into a full-service branch in 2007. Another bank plans to open a de novo branch in the market in the near future and has taken significant actions to implement that plan. The Board previously has considered such prospective entry into a market by competitors as evidence of a market's attractiveness for entry.[13]

C. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ also conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in the Cortez banking market. In addition, the appropriate banking agencies were afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in the Cortez banking market or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by Community.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-

9. Deposit and market share data are as of June 30, 2006, adjusted to reflect subsequent mergers and acquisitions through February 12, 2007. No savings associations operate in the market.

10. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

11. *See NationsBank Corp.*, 84 *Federal Reserve Bulletin* 129 (1998).

12. *Aspen Bancshares, Inc.*, 82 *Federal Reserve Bulletin* 665 (1996).

13. *Southern National Corp.*, 83 *Federal Reserve Bulletin* 597 (1997).

only and on a consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. Community, all its subsidiary depository institutions, and Citizens Bank currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that Community has sufficient financial resources to effect the proposal. The proposed transaction is structured as a cash purchase. The purchase would be funded from the proceeds of an issuance of trust preferred securities and debt.

The Board also has considered the managerial resources of Community, Citizens, and their subsidiary depository institutions. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws, including anti-money-laundering laws. The Board also has considered Community's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[14] Community Banks of Northern California and Community Bank both received "satisfactory" ratings at their most recent CRA performance evaluations by the Federal Reserve Bank of San Francisco and the Reserve Bank, as of November 17, 2003, and June 6, 2005, respectively. Citizens State Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Reserve Bank, as of September 5, 2006. After consummation of the proposal, Community plans to implement its CRA policies at Citizens State Bank. Community has represented that the proposal will provide greater convenience to customers through a larger network of branches and automated teller machines and a broader range of financial products and services over an expanded geographic area. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the community to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by Community with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Reserve Bank, acting pursuant to delegated authority.

By order of the Board of Governors, effective March 1, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, and Kroszner. Absent and not voting: Governor Mishkin.

Robert deV. Frierson
Deputy Secretary of the Board

The Industrial Bank of Taiwan Co., Ltd.
Taipei, Taiwan

IBT Holdings Corp.
Cerritos, California

Order Approving the Formation of a Bank Holding Company

The Industrial Bank of Taiwan Co., Ltd. ("IBT") and its wholly owned subsidiary, IBT Holdings Corp., have requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[1] to become bank

14. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

1. 12 U.S.C. § 1842.

holding companies and to acquire EverTrust Bank ("EverTrust"), City of Industry, California.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 46,230 (2006)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 3 of the BHC Act.

IBT, with total consolidated assets of approximately $4 billion, is the 37th largest bank in Taiwan.[2] IBT currently has no banking operations in the United States. EverTrust, with total consolidated assets of approximately $308 million, is the 122nd largest depository institution in California, controlling deposits of approximately $293.6 million, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the state.[3]

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[4]

As noted, IBT does not control a U.S. depository institution, and the proposal would not result in an expansion of EverTrust. Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market. Accordingly, based on all the facts of record, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information received from the federal and state supervisors of EverTrust, publicly reported and other financial information, information provided by IBT, and public comments received on the proposal. The Board has also consulted with the Financial Supervisory Commission ("FSC"), the primary home-country supervisor of IBT.[5]

In evaluating the financial factors in proposals involving the formation of new bank holding companies, the Board reviews the financial condition of the applicant and the target depository institutions. The Board also evaluates the financial position of the pro forma organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors of the proposal. Taiwan's risk-based capital standards are consistent with those established by the Basel Capital Accord (the "Accord"). On consummation, the capital ratios of IBT would continue to exceed the minimum levels that would be required under the Accord and are considered equivalent to the capital levels that would be required of a U.S. banking organization. Furthermore, EverTrust is well capitalized and would remain so on consummation of the proposal. Based on its review of these factors, the Board finds that IBT has sufficient financial resources to effect the proposal. The proposed transaction is structured as a cash purchase.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed supervisory information provided by the FSC and information provided by IBT, including information about compliance with anti-money-laundering laws.[6] In addition, the Board has reviewed the examination records of EverTrust, including assessments of its management, risk-management systems, and operations. The Board has also considered the supervisory experiences of relevant federal and state banking supervisory agencies with EverTrust and the bank's record of compliance with applicable banking law and anti-money-laundering laws.

2. Taiwanese asset and ranking data are as of September 30, 2006, and are based on the exchange rate then in effect. IBT is organized and chartered as an industrial bank in Taiwan. Taiwanese industrial banks may conduct various banking and financial activities, such as lending, securities trading, underwriting, and trust activities. With respect to deposit-taking and foreign-exchange activities, however, they may only serve certain types of customers.

3. Domestic asset and ranking data are as of September 30, 2006. Deposit data are as of June 30, 2006. In this context, depository institutions include commercial banks, savings banks, and savings associations.

4. 12 U.S.C. § 1842(c)(1).

5. The FSC has confirmed that IBT is in good standing and has not objected to the proposal.

6. A commenter expressed concern about alleged money laundering and governmental corruption in Taiwan and the possible impact of these allegations could have on banking in the Asian-American community. The Board has taken into consideration Taiwan's laws and regulations, as well as IBT's and EverTrust's policies and procedures, on anti-money-laundering. Taiwan has enacted laws and regulations to deter money laundering that are consistent with Financial Action Task Force recommendations. Money laundering is a criminal offense in Taiwan, and financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. IBT, a private sector bank, has policies and procedures that are monitored by its audit division and by governmental entities responsible for anti-money-laundering compliance. IBT has confirmed that it will maintain EverTrust's compliance policies and procedures, which are considered satisfactory by its regulators, and that it will conform them to IBT's policies and procedures if those policies are the more stringent.

Moreover, the Board has considered IBT's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval.

Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor.[7] As noted, the FSC is the primary supervisor of commercial and industrial banks in Taiwan, including IBT. The Board has previously determined, in connection with applications involving other banks in Taiwan, that those banks were subject to home-country supervision on a consolidated basis.[8] In this case, the Board has determined that IBT is supervised by the FSC on substantially the same terms and conditions as those other banks. Based on all the facts of record, the Board has concluded that IBT is subject to comprehensive supervision and regulation on a consolidated basis by its home-country supervisor.

The BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act.[9] The Board has reviewed the restrictions on disclosures in jurisdictions where IBT would have material operations and has communicated with the relevant government authorities concerning access to information. IBT has committed that it will make available to the Board such information on its operations and the operations of any of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the International Banking Act, and other applicable federal law. IBT also has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable it to make such information available to the Board. In light of the commitments provided by IBT and other facts of record, the Board has concluded that IBT has provided adequate assurances of access to any necessary information the Board may request. For these reasons, and based on all the facts of record, the Board has concluded that the supervisory factors it is required to consider under section 3(c)(3) of the BHC Act are consistent with approval.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[10] EverTrust received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation, as of November 1, 2003. IBT has represented that it does not plan to make any reductions in products or services offered by EverTrust and may expand them. IBT's financial resources will serve as a source of strength for EverTrust and enhance the bank's ability to meet the banking needs of the communities it serves. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

CONCLUSION

Based on the foregoing and all facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by IBT with the conditions imposed in this order, the commitments made to the Board in connection with the application, and receipt of all other regulatory approvals.[11] For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

7. *See* 12 U.S.C. § 1842(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home-country supervision under the standards set forth in Regulation K. *See* 12 CFR 225.13(a)(4). Regulation K provides that a foreign bank will be considered subject to comprehensive supervision or regulation on a consolidated basis if the Board determines that the bank is supervised or regulated in such a manner that its home-country supervisor receives sufficient information on the worldwide operations of the bank, including its relationships to any affiliate, to assess the bank's overall financial condition and its compliance with laws and regulations. *See* 12 CFR 211.24(c)(1).

8. *See International Commercial Bank of China Co., Ltd.*, 92 *Federal Reserve Bulletin* C199 (2006); *Taiwan Cooperative Bank*, 92 *Federal Reserve Bulletin* C201 (2006); *SinoPac Holdings*, 88 *Federal Reserve Bulletin* 307 (2002); *Chinatrust Financial Holding Company, Ltd.*, 88 *Federal Reserve Bulletin* 303 (2002); *E. Sun Commercial Bank Limited*, 86 *Federal Reserve Bulletin* 238 (2000); *Chinatrust Commercial Bank, Ltd.*, 84 *Federal Reserve Bulletin* 1121 (1998); *Land Bank of Taiwan*, 83 *Federal Reserve Bulletin* 336 (1997); *Taiwan Business Bank*, 81 *Federal Reserve Bulletin* 746 (1995); *Farmers Bank of China*, 81 *Federal Reserve Bulletin* 620 (1995). The supervision of industrial banks and commercial banks in Taiwan is substantially the same.

9. *See* 12 U.S.C. § 1842(c)(3)(A).

10. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

11. IBT also has committed that its subsidiaries will conform their existing direct and indirect nonbanking activities and investments, including by divestiture if necessary, to the requirements of the BHC Act within two years of its acquisition of EverTrust. This conformance period may, in the discretion of the Board, be extended by up to three one-year extensions, taking into consideration the factors set forth in section 4(a)(2) of the BHC Act (12 U.S.C. § 1843(a)(2)). IBT also has committed to ensure that, after consummating its acquisition of EverTrust, neither IBT nor its subsidiaries, directly or indirectly, will engage in new activities or new lines of business or make additional investments in or acquire entities that are inconsistent with the requirements of the BHC Act.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of San Francisco, acting pursuant to delegated authority.

By order of the Board of Governors, effective March 9, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

The PNC Financial Services Group, Inc. Pittsburgh, Pennsylvania

Order Approving the Merger of Bank Holding Companies

The PNC Financial Services Group, Inc. ("PNC"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to merge with Mercantile Bankshares Corporation ("Mercantile"), Baltimore, Maryland, and acquire Mercantile's 11 subsidiary banks.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 69,132 (2006)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

PNC, with total consolidated assets of approximately $98 billion, is the 21st largest depository organization in the United States, controlling deposits of approximately $63.5 billion, which represent less than 1 percent of the total amount of deposits of depository institutions in the United States.[3] PNC owns two subsidiary insured depository institutions that operate in nine states and the District of Columbia,[4] and engages in numerous nonbanking activities that are permissible under the BHC Act. PNC is the 22nd largest depository organization in Maryland, controlling deposits of approximately $313.8 million.

Mercantile's subsidiary banks operate in Delaware, Maryland, Pennsylvania, Virginia, and the District of Columbia. In Maryland, Mercantile is the second largest depository organization, controlling deposits of approximately $11.1 billion.

On consummation of the proposal, PNC would become the 18th largest depository institution in the United States, with total consolidated assets of approximately $116 billion. PNC would control deposits of approximately $75 billion, which represent approximately 1.15 percent of the total amount of deposits of insured depository institutions in the United States. In Maryland, PNC would become the second largest depository organization, controlling deposits of approximately $11.4 billion, which represent approximately 12.3 percent of state deposits.

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met. For purposes of the BHC Act, the home state of PNC is Pennsylvania,[5] and Mercantile is located in Delaware, the District of Columbia, Maryland, Pennsylvania, and Virginia.[6]

Based on a review of all the facts of record, including relevant state and District of Columbia statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[7] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

1. 12 U.S.C. § 1842. PNC proposes to acquire the nonbanking subsidiaries of Mercantile in accordance with section 4(k) of the BHC Act, 12 U.S.C. § 1843(k).

2. Mercantile's largest subsidiary bank, as measured by both assets and deposits, is Mercantile-Safe Deposit and Trust Company ("Mercantile Lead Bank"), Baltimore, Maryland. Mercantile's other subsidiary banks in Maryland are: Annapolis Bank and Trust Company, Annapolis; Citizens National Bank, Laurel; Farmers & Mechanics Bank, Frederick; Mercantile County Bank, Elkton; Mercantile Eastern Shore Bank, Chestertown; Mercantile Southern Maryland Bank, Leonardtown; and Westminster Union Bank, Westminster. Mercantile's subsidiary banks in Virginia are Marshall National Bank and Trust Company, Marshall, and the National Bank of Fredericksburg, Fredericksburg. Its subsidiary bank in Delaware is Mercantile Peninsula Bank, Selbyville.

3. Nationwide asset data are as of September 30, 2006. Nationwide deposit and ranking data are as of June 30, 2006, and reflect merger activity through November 14, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

4. PNC's largest subsidiary bank, as measured by total deposits, is PNC Bank, National Association ("PNC Lead Bank"), Pittsburgh, Pennsylvania, which operates in Florida, Indiana, Kentucky, Maryland, New Jersey, Ohio, Pennsylvania, Virginia, and the District of Columbia. PNC's other subsidiary bank, PNC Bank, Delaware ("PNC Delaware Bank"), Wilmington, Delaware, has branches in Delaware and Pennsylvania.

5. A bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

6. For purposes of section 3(d), the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch (12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B)).

7. 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)(A)–(B). PNC is adequately capitalized and adequately managed, as defined by applicable law. All of Mercantile's subsidiary banks have been in existence and operated for the minimum period of time required by applicable state and District of Columbia laws. On consummation of the proposal, PNC would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States and less than 30 percent of the total amount of deposits of insured depository

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[8]

PNC and Mercantile have subsidiary depository institutions that compete directly in four banking markets: Sussex County, Delaware; York, Pennsylvania; Wilmington in Delaware and Maryland; and Washington in Maryland, Virginia, West Virginia, and the District of Columbia. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by PNC and Mercantile,[9] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[10] and other characteristics of the markets.

A. Banking Markets within Established Guidelines

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in three of the four banking markets.[11] On consummation of the proposal, the Washington market and the York market would remain moderately concentrated, and the Wilmington market would remain highly concentrated, as measured by the HHI. The changes in the HHI measure of concentration in each of these markets are small. Moreover, numerous competitors would remain in each of the three banking markets.

B. Banking Market Warranting Special Scrutiny

PNC and Mercantile compete directly in one banking market that warrants a detailed review, Sussex County, Delaware,[12] because the post-consummation concentration level would exceed the thresholds of the DOJ Guidelines. In the Sussex County banking market, PNC is the fourth largest depository organization, controlling deposits of approximately $257.3 million, which represent approximately 9.8 percent of market deposits. Mercantile is the second largest depository organization in the market, controlling deposits of $426.3 million, which represent approximately 16.2 percent of market deposits. On consummation of the proposal, PNC would become the second largest depository organization in the market, controlling deposits of approximately $683.6 million, which represent approximately 26.0 percent of market deposits. The HHI would increase 317 points to 2010.[13]

The Board has considered carefully whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase and the resulting level of concentration in a banking market.[14]

Several factors indicate that the increase in concentration, as measured by the HHI, overstates the potential

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institutions in Delaware, Maryland, Pennsylvania, Virginia, and the District of Columbia. All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

8. 12 U.S.C. § 1842(c)(1).

9. Deposit and market share data are as of June 30, 2006, adjusted to reflect mergers and acquisitions through January 19, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

10. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

11. These markets, and the effects of the proposal on the concentration of banking resources in these markets, are described in Appendix A.

12. The Sussex County banking market is defined as Sussex County, Delaware, excluding the city of Milford.

13. These market concentration and market share calculations include the weighting of deposits controlled by three thrift institutions in the market at 100 percent. The Board previously has indicated that it may consider the competitiveness of a thrift institution at a level greater than 50 percent of its deposits when appropriate if competition from the institution closely approximates competition from a commercial bank. *See, e.g., Banknorth Group, Inc.*, 75 *Federal Reserve Bulletin* 703 (1989). The thrift institutions in the Sussex County banking market serve as significant sources of commercial loans and provide a broad range of consumer, mortgage, and other banking products. These thrift institutions have ratios of commercial and industrial loans to assets of approximately 14.9 percent, 7 percent, and 5.5 percent, which are comparable to the national average for all commercial banks. Competition from these thrift institutions, therefore, closely approximates competition from commercial banks. *See First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998).

14. *See NationsBank Corporation*, 84 *Federal Reserve Bulletin* 129 (1998).

anticompetitive effect of the proposal in the Sussex County market. After consummation of the proposal, 16 other depository organizations would continue to operate in the market.

In addition, the Board has concluded that the activities of two community credit unions in the market exert sufficient competitive influence to mitigate, in part, the potential adverse competitive effects of the proposal. Both credit unions offer a wide range of consumer products, operate street-level branches, and have membership open to almost all the residents in the market.[15] These active community credit unions control approximately $185.3 million of deposits in the market, which represent approximately 3.4 percent of market deposits on a 50 percent weighted basis. If these credit unions were factored into the market calculations on a 50 percent weighted basis, PNC would control approximately 25.2 percent of market deposits on consummation of the proposal, and the HHI would increase 296 points to 1885.[16]

Moreover, the record of entry into the Sussex County banking market evidences its attractiveness for entry. The Board notes that three depository institutions have entered the market de novo since 2003. Other factors indicate that the market remains attractive for entry. From 1999 to 2004, the market's annualized population growth substantially exceeded the annualized population growth for Delaware as a whole, and the market's annualized income growth also exceeded the annualized income growth for the entire state.

C. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the four banking markets where PNC and Mercantile compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

15. The Board previously has considered the competitiveness of similarly active credit unions as a mitigating factor. *See, e.g., Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006); *F.N.B. Corporation*, 90 *Federal Reserve Bulletin* 481 (2004); *Gateway Bank & Trust Co.*, 90 *Federal Reserve Bulletin* 547 (2004).

16. Before consummation of the proposal, with deposits of these credit unions weighted at 50 percent, PNC would be the fourth largest depository organization in the market, with approximately 9.5 percent of market deposits, and Mercantile would be the second largest depository organization in the market, controlling approximately 15.7 percent of market deposits.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information received from the federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, information provided by PNC, and public comments received on the proposal.[17]

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the proposal under the financial factors. PNC, all its subsidiary banks, and all Mercantile's subsidiary banks currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board finds that PNC has sufficient financial resources to effect the proposal. The proposed transaction is structured as a partial share exchange and partial cash purchase of shares. PNC will use existing resources and the proceeds of a trust preferred securities issuance and long-term debt to fund the cash purchase of the shares.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of PNC, Mercantile, and their subsidiary banks, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-

17. One commenter expressed concern about press reports regarding the theft of a laptop computer containing data about some of Mercantile Lead Bank's customers. In response to the security breach, Mercantile Lead Bank notified potentially affected customers, monitored customer accounts for suspicious activities, and offered customers credit-monitoring services at bank expense. Mercantile and PNC have policies and procedures in place to address data protection and data breaches, as well as to safeguard customer information.

laundering laws.[18] The Board also has considered PNC's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[19] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods, in evaluating bank expansionary proposals.[20]

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of the subsidiary banks of PNC and Mercantile, data reported by PNC and Mercantile under the Home Mortgage Disclosure Act ("HMDA"),[21] other information provided by PNC, confidential supervisory information, and public comments received on the proposal. A commenter alleged, based primarily on 2005 HMDA data, that PNC and Mercantile engaged in discriminatory treatment of minority individuals in the home mortgage lending operations of their subsidiary depository institutions.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the insured depository institutions of PNC and Mercantile. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[22]

PNC Lead Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency ("OCC"), as of April 15, 2002. PNC Delaware Bank also received an "outstanding" rating at its most recent CRA evaluation by the Federal Deposit Insurance Corporation ("FDIC"), as of January 21, 2003. Mercantile Lead Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of April 19, 2004. Each of Mercantile's other subsidiary banks received a "satisfactory" rating at its most recent CRA performance evaluation.[23] PNC has represented that it plans to implement its current CRA program at Mercantile's subsidiary banks.

B. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of PNC and Mercantile in light of public comments received on the proposal. A commenter alleged, based on 2005 HMDA data, that PNC denied the home mortgage loan applications of African-American borrowers more frequently than those of nonminority applicants in various metropolitan statistical areas ("MSAs"). The commenter also alleged that Mercantile denied the home mortgage loan applications of African-American and Hispanic borrowers more frequently than those of nonminority applicants in various states and made inadequate numbers of loans to African Americans and Hispanics. The Board has focused its analysis on the 2005 HMDA data reported by PNC Lead Bank and by each of Mercantile's subsidiary banks.[24]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not PNC or Mercantile are excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[25] HMDA data, therefore, have limitations

18. A commenter reiterated its past criticism of PNC's acquisition of Riggs National Corporation ("Riggs"), Washington, D.C., in 2005, without providing any new information. The commenter previously submitted extensive comments on PNC's application to acquire Riggs, and the Board considered those comments in acting on that proposal. *See The PNC Financial Services Group, Inc.*, 91 *Federal Reserve Bulletin* 424 (2005).

19. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

20. 12 U.S.C. § 2903.

21. 12 U.S.C. § 2801 et seq.

22. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 at 36,640 (2001).

23. Appendix B lists the most recent CRA performance ratings of these banks.

24. The Board reviewed the HMDA data for PNC Lead Bank in the Washington-Arlington-Alexandria, DC-VA-MD-WV MSA; in the Pittsburgh, Pennsylvania, MSA; and in its CRA assessment areas. In addition, the Board reviewed the HMDA data reported by each of Mercantile's subsidiary banks in its respective CRA assessment areas.

25. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high

that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by PNC, Mercantile, and their subsidiaries. The Board also has consulted with the OCC and FDIC, respectively, about the fair-lending compliance records of PNC Lead Bank and Mercantile Lead Bank.

The record, including confidential supervisory information, indicates that PNC and Mercantile have taken steps to ensure compliance with fair lending and other consumer protection laws. PNC and Mercantile each has a fair-lending compliance program that includes a second review process, and periodic self-assessments utilizing comparative file reviews to identify any discriminatory practices with respect to the companies' home mortgage lending. In addition, PNC and Mercantile each has a process for resolving fair lending complaints, and each conducts periodic internal audits of its fair lending program. Both companies also require employees to complete fair-lending training sessions. PNC has represented that Mercantile's current fair-lending compliance program initially would remain in place at Mercantile's subsidiary banks after consummation of the proposal, but it would be replaced by PNC's fair-lending compliance program later in 2007 after Mercantile's subsidiary banks are merged into PNC's subsidiary banks.

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance records of the subsidiary banks of PNC and Mercantile under the CRA. These established efforts and records demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by PNC, comments received on the proposal, and confidential supervisory information. PNC represented that the proposal will result in greater convenience for PNC and Mercantile customers through a larger branch network and a broader variety of products and services. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved.[26] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by PNC with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order unless such period is extended for good cause by the Board or the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors, effective February 15, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Bies, Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

26. A commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for any of the banks to be acquired makes a timely written recommendation of denial of the application. The Board has not received such a recommendation from any appropriate supervisory authority. Under its rules, the Board may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to provide an opportunity for testimony or other presentations (12 CFR 225.16(e), 262.3(i)(2), 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit comments on the proposal and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public hearing or meeting is not required or warranted in this case. Accordingly, the request for a public hearing or meeting is denied.

Appendix A

PNC AND MERCANTILE BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
WILMINGTON BANKING MARKET IN DELAWARE AND MARYLAND						
Wilmington—includes New Castle County, Delaware, and Cecil County, Maryland						
PNC Pre-Consummation	2	1,790,381	13.3	2,616	68	21
Mercantile	7	344,617	2.6	2,616	68	21
PNC Post-Consummation	2	2,134,998	15.8	2,616	68	21
WASHINGTON BANKING MARKET IN THE DISTRICT OF COLUMBIA, MARYLAND, VIRGINIA, AND WEST VIRGINIA						
Washington—includes the Ranally Metro Area (RMA) of Washington, DC–MD–VA–WV; the non-RMA portions of Calvert, Charles, Frederick, and St. Mary's counties in Maryland and Fauquier and Loudon counties in Virginia; Jefferson County, West Virginia; and the Virginia independent cities of Alexandria, Fairfax, Falls Church, and Manassas						
PNC Pre-Consummation	8	2,943,750	2.8	1,026	25	83
Mercantile	7	4,616,421	4.5	1,026	25	83
PNC Post-Consummation	6	7,560,171	7.3	1,026	25	83
YORK BANKING MARKET IN PENNSYLVANIA						
York—includes Adams and York counties						
PNC Pre-Consummation	10	279,184	4.5	1,036	1	15
Mercantile	17	6,973	0.1	1,036	1	15
PNC Post-Consummation	10	286,157	4.6	1,036	1	15

NOTE: Data are as of June 30, 2006, and adjusted to reflect mergers and acquisitions through January 19, 2007. All deposit amounts are in thousands of dollars. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

Appendix B

CRA Performance Evaluations of Mercantile Bankshares Corporation's Other Banks

Bank	CRA Rating	Date	Supervisor
1. Citizens National Bank, Laurel, Maryland	Satisfactory	February 2005	OCC
2. National Bank of Fredericksburg, Fredericksburg, Virginia	Satisfactory	September 2002	OCC
3. Marshall National Bank and Trust Company, Marshall, Virginia	Satisfactory	April 2005	OCC
4. Mercantile Peninsula Bank, Selbyville, Delaware	Satisfactory	June 2005	FDIC
5. Mercantile Southern Maryland Bank, Leonardtown, Maryland	Satisfactory	January 2005	FDIC
6. Westminster Union Bank, Westminster, Maryland	Satisfactory	March 2004	FDIC
7. Mercantile County Bank, Elkton, Maryland	Satisfactory	May 2005	FDIC
8. Mercantile Eastern Shore Bank, Chestertown, Maryland	Satisfactory	October 2004	FDIC
9. Farmers & Mechanics Bank, Frederick, Maryland	Satisfactory	November 2005	FRB
10. Annapolis Bank and Trust Company, Annapolis, Maryland	Satisfactory	April 2005	FRB

ORDERS ISSUED UNDER INTERNATIONAL BANKING ACT

Banco Santander Totta, S.A. *Lisbon, Portugal*

Order Approving Establishment of a Representative Office

Banco Santander Totta, S.A. ("Bank") (formerly known as Banco Totta & Açores, S.A. ("Açores")), Lisbon, Portugal, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA[1] to retain a representative office in Mineola, New York.[2] The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

1. 12 U.S.C. §3107(a).

2. Açores operated the representative office in Mineola. The Açores banking organization was reorganized effective December 16, 2004. In connection with the reorganization, a new holding company, Santander Totta SGPS, S.A., was created, and Açores merged with Açores' two subsidiary banks, Companhia Geral de Crédito Predial Português, S.A. ("Crédito") and Banco Santander Portugal, S.A., with Crédito as the survivor. Crédito then changed its name to Banco Santander Totta, S.A.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in Mineola (*Newsday, Inc.*, May 19, 2006). The time for filing comments has expired, and all comments have been considered.

Bank, with total consolidated assets of approximately $44.6 billion,[3] is the third largest privately owned banking organization in Portugal. Bank provides a broad range of banking, financial, and other services to corporate and retail clients primarily in Portugal. Outside Portugal, Bank operates a subsidiary bank in Angola; branches in the United Kingdom, Luxembourg, Puerto Rico, and Madeira; and representative offices in Germany, Canada, Switzerland, Venezuela, France, and South Africa. In the United States, Bank has one nonbank subsidiary, Totta & Açores, Newark, New Jersey, that engages in money-remittance services in Connecticut, New Jersey, New York, and Massachusetts.

Bank is a subsidiary of Banco Santander Central Hispano, S.A. ("Santander"), Madrid, Spain.[4] Through its offices and subsidiaries, Santander offers banking, financial, and other services worldwide. In the United States, Santander indirectly controls two U.S. insured depository institutions[5] and owns several U.S. subsidiaries that engage

3. Asset data are as of September 30, 2006.

4. Santander indirectly controls approximately 99.6 percent of Bank's voting shares.

5. Santander controls Banco Santander Puerto Rico, San Juan, Puerto Rico, a state-chartered bank with offices only in Puerto Rico;

in nonbanking activities. Santander and its foreign bank subsidiaries operate a number of direct offices in the United States.

Bank assumed the existing operations of Açores in connection with a corporate reorganization. No changes in the activities of Bank's representative office have occurred as a result of the reorganization. That office acts as a liaison between Bank and its existing and potential customers. The office's activities include soliciting new business, conducting research, marketing various services, and receiving applications for extensions of credit and executing loan documents on behalf of Bank.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a representative office, the Board must consider whether (1) the foreign bank has furnished the information the Board needs to assess the application adequately; (2) the foreign bank and any foreign bank parent engage directly in the business of banking outside of the United States; and (3) the foreign bank and any foreign bank parent are subject to comprehensive supervision on a consolidated basis by their home-country supervisors.[6] The Board also considers additional standards as set forth in the IBA and Regulation K.[7]

As noted above, Bank and Santander engage directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home-country authorities, the Board previously has determined, in connection with applications involving other banks in Portugal, that those banks were subject to home-country supervision on a consolidated basis.[8] Bank is supervised by the Bank of Portugal on substantially the same terms and conditions as those other banks. With respect to Bank's parent, the Board previously has determined that Santander is subject to comprehensive supervision on a consolidated basis by the Bank of Spain.[9] Based on all the facts of record, including the above information, it has been determined that Bank and Santander are subject to comprehensive supervision on a consolidated basis by their home-country supervisors.

The Board also has taken into account the additional standards set forth in section 7 of the IBA and Regulation K.[10] The Bank of Portugal and the Bank of Spain have no objection to Bank's retention of the representative office.

With respect to the financial and managerial resources of Bank, taking into consideration its record of operations in its home country, its overall financial resources, and its standing with its home-country supervisor, financial and managerial factors are consistent with approval of Bank's retention of the representative office. Bank appears to have the experience and capacity to support the representative office and has established controls and procedures for the representative office to ensure compliance with U.S. law, as well as controls and procedures for its worldwide operations generally.

Portugal is a member of the Financial Action Task Force and subscribes to its recommendations on measures to combat money laundering. In accordance with these recommendations, Portugal has enacted laws and created legislative and regulatory standards to deter money laundering. Money laundering is a criminal offense in Portugal, and financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations that are monitored by governmental entities responsible for anti-money-laundering compliance.

With respect to access to information about Bank's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which Bank operates and has communicated with relevant government authorities regarding access to information. Bank and Santander have committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank and Santander have committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from

and Sovereign Bank, Wyomissing, Pennsylvania, a savings association with offices in Connecticut, Delaware, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, and Rhode Island.

6. 12 U.S.C. §3107(a)(2); 12 CFR 211.24(d)(2). In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

7. 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3).

8. *See, e.g., Caixa Económica Montepio Geral*, 86 *Federal Reserve Bulletin* 700 (2000); *Banco Comercial Português, S.A.*, 86 *Federal Reserve Bulletin* 613 (2000); *Banco Espírito Santo, S.A., et al.*, 86 *Federal Reserve Bulletin* 418 (2000); *Caixa Geral de Depósitos S.A.*, 85 *Federal Reserve Bulletin* 774 (1999).

9. *See e.g., Banco Santander, S.A.*, 85 *Federal Reserve Bulletin* 441 (1999).

10. *See* 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). The additional standards set forth in section 7 of the IBA and Regulation K include the following: whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; and the bank's record of operation.

third parties for disclosure of such information. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank and Santander have provided adequate assurances of access to any necessary information that the Board may request.

On the basis of all the facts of record, and subject to the commitments made by Bank and Santander, as well as the terms and conditions set forth in this order, Bank's application to retain the representative office in Mineola, New York, is hereby approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.[11] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank and Santander with the commitments made in connection with this application and with the conditions in this order.[12] The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with this decision and may be enforced in proceedings under 12 U.S.C. § 1818 against Bank and its affiliates.

By order, approved pursuant to authority delegated by the Board, effective March 16, 2007.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

11. *See* 12 CFR 265.7(d)(12).

12. The Board's authority to approve the retention of the representative office parallels the continuing authority of the state of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the New York State Banking Department to license the representative office in accordance with any terms or conditions that it may impose.

The Bank of Nova Scotia
Toronto, Canada

Order Approving Establishment of a Branch

The Bank of Nova Scotia ("Bank"), Toronto, Canada, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of the IBA[1] to establish a branch in Houston, Texas. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in Houston (*The Houston Chronicle*, November 20, 2006). The time for filing comments has expired, and all comments received have been considered.

Bank, with total assets of $338 billion, is the third largest commercial bank in Canada.[2] It provides a variety of banking services to retail and corporate customers through more than 950 branches in Canada. It also provides stock brokerage, insurance brokerage, fund management, and financial advisory services through subsidiaries.

In the United States, Bank operates branches in Portland, Oregon, and New York, New York; and agencies in Atlanta, Georgia, and San Francisco, California.[3] Bank also engages in financing, investment advisory, securities, fiduciary and custody, and money transmission activities through subsidiaries.

The proposed branch would replace Bank's existing representative office in Houston. It would engage in a wholesale banking business, offering corporate investment, lending, and cash management services to existing and prospective customers. Bank is a qualifying foreign banking organization under Regulation K.[4]

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside of the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[5] The Board also may consider additional standards set forth in the IBA and Regulation K.[6]

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided

1. 12 U.S.C. § 3105(d).

2. Asset data are as of October 31, 2006.

3. In connection with this proposal, Bank has filed notice under section 211.22(b)(1) of Regulation K (12 CFR 211.22(b)(1)) to change its home state from New York to Texas. Bank's branch in Portland was established before the enactment of the IBA in 1978. *See* 12 U.S.C. § 3103(b). Bank's New York office is currently licensed as an agency by the state of New York. Because the office accepts large-denomination deposits from U.S. residents, it is treated as a branch for purposes of the IBA. As a consequence of Bank's change of home state, Bank's branch in New York must limit its deposit taking to that permitted to an agency under the IBA and Regulation K.

4. 12 CFR 211.23(b).

5. 12 U.S.C. § 3105(d)(2); 12 CFR 211.24(c)(1). In assessing this standard, the Board considers, among other factors, the extent to which the home-country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; and (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. These are indicia of comprehensive, consolidated supervision. No single factor is essential, and other elements may inform the Board's determination.

6. 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3).

the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home-country authorities, the Board previously has determined, in connection with applications involving other banks in Canada, that those banks were subject to home-country supervision on a consolidated basis by their home-country supervisor, the Office of the Superintendent of Financial Institutions ("OSFI").[7] Bank is supervised by the OSFI on substantially the same terms and conditions as those other banks. Based on all the facts of record, it has been determined that Bank is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.

The additional standards set forth in section 7 of the IBA and Regulation K have also been taken into account.[8] The OSFI has no objection to the establishment of the proposed branch.

Canada's risk-based capital standards are consistent with those established by the Basel Capital Accord ("Accord"). Bank's capital is in excess of the minimum levels that would be required by the Accord and is considered equivalent to capital that would be required of a U.S. banking organization. Managerial and other financial resources of Bank also are considered consistent with approval, and Bank appears to have the experience and capacity to support the proposed branch. Bank has established controls and procedures for the proposed branch to ensure compliance with U.S. law and for its operations in general.

Canada is a member of the Financial Action Task Force and subscribes to its recommendations on measures to combat money laundering and terrorist financing. In accordance with those recommendations, Canada has enacted laws and adopted regulations to deter money laundering and terrorist financing. Money laundering is a criminal offense in Canada, and financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering and terrorist financing throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations, and its compliance with applicable laws and regulations is monitored by the bank's auditors and the OSFI.

With respect to access to information about Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. Bank has committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, the OSFI may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Based on the foregoing and all the facts of record, Bank's application to establish a branch is hereby approved.[9] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[10] For purposes of this action, these commitments and conditions are deemed to be conditions imposed by the Board in writing in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective March 13, 2007.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

7. *See Toronto-Dominion Bank*, 92 *Federal Reserve Bulletin* C100 (2006); *Bank of Montreal*, 92 *Federal Reserve Bulletin* C14 (2006). *See also Toronto-Dominion Bank*, 82 *Federal Reserve Bulletin* 1052 (1996); *Bank of Montreal*, 80 *Federal Reserve Bulletin* 925 (1994).

8. *See* 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). These standards include (i) whether the bank's home-country supervisor has consented to the establishment of the office; (ii) the financial and managerial resources of the bank; (iii) whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; (iv) whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; (v) whether the bank and its U.S. affiliates are in compliance with U.S. law; (vi) the needs of the community; and (vii) the bank's record of operation.

9. Approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.

10. The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the state of Texas to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the state of Texas to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

FINAL ENFORCEMENT DECISIONS ISSUED BY THE BOARD

IN THE MATTER OF

Seresa T. Morgan
A Former Institution-Affiliated Party of

Civitas BankGroup, Inc.
Franklin, Tennessee

Docket No. 06-020-E-I

Order of Prohibition Issued Upon Consent Pursuant to Section 8(e) of the Federal Deposit Insurance Act, as Amended WHEREAS, pursuant to sections 8(e) and (i)(3) of the Federal Deposit Insurance Act, as amended (the "FDI Act") (12 U.S.C. §§ 1818(e) and (i)(3)), the Board of Governors of the Federal Reserve System (the "Board of Governors") issues this consent Order of Prohibition (the "Order") against Seresa T. Morgan ("Morgan"), a former institution-affiliated party, as defined in sections 3(u) and 8(b)(3) of the FDI Act (12 U.S.C. §§ 1813(u) and 1818(b)(3)), of Civitas BankGroup, Inc., Franklin, Tennessee, previously known as Cumberland Bancorp, Inc., a registered bank holding company ("Civitas");

WHEREAS, on January 5, 2007, the Board of Governors issued a Notice of Intent to Prohibit Issued Pursuant to Section 8(e) of the Federal Deposit Insurance Act, as amended (the "Notice") against Morgan alleging that when Morgan was employed by Civitas, she allegedly participated in violations of law, unsafe or unsound practices, and breaches of fiduciary duty in connection with the embezzlement of over $197,000 from Civitas, and falsification of its books and records; that she was thereafter terminated from her position as an employee of Civitas; and that she had executed a promissory note requiring her to make repayment to Civitas;

WHEREAS, on January 12, 2007, Morgan filed an answer to the Notice; and

WHEREAS, this Order resolves the proceeding initiated by issuance of the Notice; and

WHEREAS, by affixing her signature hereunder, Morgan has consented to the issuance of this Order by the Board of Governors and has agreed to comply with each and every provision of this Order, and has waived any and all rights she might otherwise have pursuant to 12 U.S.C. § 1818 or 12 CFR Part 263, or otherwise: (a) to a hearing for the purpose of taking evidence with respect to any matter implied or set forth in this Order; (b) to obtain judicial review of this Order or any provision hereof; and (c) to challenge or contest in any manner the basis, issuance, terms, validity, effectiveness, or enforceability of this Order or any provision hereof.

NOW, THEREFORE, prior to the taking of any testimony or adjudication of, or finding on, any issue of fact or law implied or set forth herein, and without this Order constituting an admission by Morgan of any allegation made or implied by the Board of Governors in connection with this proceeding, and solely for the purpose of settlement of this proceeding without protracted hearings or testimony:

IT IS HEREBY ORDERED, pursuant to sections 8(e) and 8(b)(3) of the FDI Act (12 U.S.C. §§ 1818(e) and (b)(3)), that:

1. Morgan, without the prior written approval of the Board of Governors and, where necessary pursuant to section 8(e)(7)(B) of the FDI Act (12 U.S.C. § 1818(e)(7)(B)), another federal financial institution regulatory agency, is hereby and henceforth prohibited from:
   (a) participating in any manner in the conduct of the affairs of any institution or agency specified in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)), including, but not limited to, any insured depository institution or any holding company of an insured depository institution;
   (b) soliciting, procuring, transferring, attempting to transfer, voting or attempting to vote any proxy, consent, or authorization with respect to any voting rights in any institution described in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A));
   (c) violating any voting agreement previously approved by any federal banking agency; and
   (d) voting for a director, or serving or acting as an institution-affiliated party, such as an officer, director, or employee in any institution described in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)).
2. All communications regarding this Order shall be addressed to:
   (a) Mr. John H. Atkinson
Assistant Vice President
Department of Banking Supervision
and Regulation
Federal Reserve Bank of Atlanta
1000 Peachtree Street, N.E.
Atlanta, GA 30309-4470
   (b) Ms. Seresa T. Morgan
304 Highland Heights
Goodlettsville, TN 37072
With a copy to:
   (c) Larry D. Woods, Esq.
P.O. Box 24727
Nashville, TN 37202
3. Any violation of this Order shall separately subject Morgan to appropriate civil or criminal penalties, or both, under sections 8(i) and (j) of the FDI Act (12 U.S.C. §§ 1818(i) and (j)).
4. The provisions of this Order shall not bar, estop, or otherwise prevent the Board of Governors, or any other federal or state agency or department, from taking any other action affecting Morgan.
5. Each provision of this Order shall remain fully effective and enforceable until expressly stayed, modified, terminated, or suspended in writing by the Board of Governors.

By order of the Board of Governors effective this 22nd day of February, 2007.

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM

JENNIFER J. JOHNSON
Secretary of the Board

(signed)
Seresa T. Morgan

Legal Developments: Second Quarter, 2007

ORDERS ISSUED UNDER BANK HOLDING COMPANY ACT

ORDERS ISSUED UNDER SECTION 3 OF THE BANK HOLDING COMPANY ACT

1st Source Corporation South Bend, Indiana

Order Approving the Acquisition of a Bank Holding Company

1st Source Corporation ("1st Source"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire FINA Bancorp, Inc. ("FINA") and its subsidiary bank, First National Bank, Valparaiso ("First National"), both of Valparaiso, Indiana.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (72 *Federal Register* 13,108 (2007)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

1st Source, with total consolidated assets of approximately $3.8 billion, operates one insured depository institution subsidiary, 1st Source Bank, with branches in Indiana and Michigan. 1st Source is the fifth largest depository organization in Indiana, controlling deposits of $2.7 billion, which represent 3 percent of total deposits of insured depository institutions in Indiana ("state deposits").[3]

FINA, with total consolidated assets of approximately $611 million, operates one insured depository institution, First National, with branches only in Indiana. First National is the 34th largest depository organization in Indiana, controlling deposits of approximately $526.7 million.

On consummation of this proposal, and after accounting for the proposed divestiture, 1st Source would remain the fifth largest depository organization in Indiana, controlling deposits of approximately $3.2 billion, which represent 3.6 percent of state deposits.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[4]

1st Source and FINA compete directly in three banking markets: Gary-Hammond, Indiana; La Porte, Indiana-Michigan; and Starke, Indiana.

The Board has reviewed carefully the competitive effects of the proposal in each of the three banking markets where 1st Source and FINA compete directly, in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by 1st Source and FINA,[5] the concentration level of market deposits and the increase in that level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[6]

1. 12 U.S.C. § 1842.

2. 1st Source proposes to merge FINA with and into Hickory Acquisition, Inc. ("Hickory"), a wholly owned subsidiary of 1st Source organized solely to effect the proposed acquisition. Immediately following the merger of FINA with and into Hickory, Hickory would merge with and into 1st Source.

3. Asset data are as of March 31, 2007, and statewide deposit and ranking data are as of June 30, 2006, and reflect merger activity through May 9, 2007. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

4. 12 U.S.C. § 1842(c)(1).

5. Deposit and market share data are as of June 30, 2006, adjusted to reflect subsequent mergers and acquisitions through February 23, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market-share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

6. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI

other characteristics of the markets, and commitments made by 1st Source to divest one or more branches in the Starke banking market.

A. Banking Market with Divestiture

1st Source and FINA compete directly in one banking market, the Starke market, that warrants a detailed review of competitive effects.[7] In this market, the concentration level on consummation of the proposal, after accounting for the proposed divestiture, would exceed the threshold levels in the DOJ Guidelines.

1st Source Bank is the largest depository institution in the Starke banking market, controlling deposits of approximately $70 million, which represent approximately 31 percent of market deposits. First National is the fifth largest depository institution in the market, controlling deposits of approximately $13 million, which represent approximately 6 percent of market deposits. On consummation and without the proposed divestiture, the HHI in this market would increase 369 points, from 2236 to 2605, and the pro forma market share of the combined entity would be 37 percent.

To reduce the potential adverse effects on competition in the Starke banking market, 1st Source has committed to divest at least one branch with no less than $6.4 million in deposits to an out-of-market insured depository organization.[8] On consummation of the proposed merger, and after accounting for the divestiture, 1st Source would remain the largest depository institution in the market, controlling deposits of approximately $77 million, which represent 34.7 percent of market deposits. The HHI would increase no more than 237 points to 2473.

The Board carefully has considered whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market.[9] In this market, the record indicates that the proposal would not have a significantly adverse impact on competition, despite the post-consummation increase in the HHI and market share. On consummation of the proposal and the proposed divestiture to a competitively suitable insured depository institution, at least five other insured depository institutions would continue to operate in the market. In addition, the concentration of deposits in the market has decreased since 2000.

B. Banking Markets without Divestiture

Consummation of the proposal without divestitures would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in the Gary-Hammond and La Porte banking markets.[10] On consummation of the proposal, the Gary-Hammond banking market would remain moderately concentrated and the La Porte banking market would remain highly concentrated, as measured by the HHI. The change in the HHI measure of concentration in each of these markets would be small, however, and numerous competitors would remain in each banking market.

C. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ also has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the competitive effects of the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in the three banking markets where 1st Source and FINA compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by 1st Source.

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is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

7. The Starke banking market is defined as Starke County, Indiana.

8. 1st Source has committed that, before consummation of the proposed merger, it will execute an agreement for the proposed divestiture in the Starke banking market with a purchaser that the Board determines to be competitively suitable. 1st Source also has committed to complete the divestiture within 180 days after consummation of the proposed merger. In addition, 1st Source has committed that, if it is unsuccessful in completing the proposed divestiture within such time period, it will transfer the unsold branch to an independent trustee who will be instructed to sell the branch to an alternate purchaser or purchasers in accordance with the terms of this order and without regard to price. The trust agreement, trustee, and any alternate purchaser must be deemed acceptable by the Board. *See BankAmerica Corporation*, 78 *Federal Reserve Bulletin* 338 (1992); *United New Mexico Financial Corporation*, 77 *Federal Reserve Bulletin* 484 (1991).

9. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase in and resulting level of concentration in a banking market.

10. These banking markets and the effects of the proposal on the concentration of banking resources in them are described in the appendix.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-only and on a consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organizations at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. 1st Source and its subsidiary depository institution, and First National, currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that 1st Source has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange and cash payment. The cash portion would be funded from the proceeds of an issuance of trust preferred securities and a dividend from 1st Source Bank.

The Board also has considered the managerial resources of 1st Source, FINA, and their subsidiary banks. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws and with anti-money-laundering laws. 1st Source, FINA, and their subsidiary depository institutions are considered well managed. The Board also has considered 1st Source's plans for implementing the proposal, including the proposed management after consummation, and has consulted the other relevant supervisory agencies concerning these plans.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[11] 1st Source Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of Chicago, as of May 23, 2005. First National received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of December 5, 2003. After consummation of the proposal, 1st Source plans to implement its CRA policies at First National. 1st Source has represented that the proposal would provide greater convenience to customers through a larger network of branches and ATMs and a broader range of financial products and services over an expanded geographic area. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the communities to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its decision, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by 1st Source with the conditions imposed in this order and the commitments made to the Board in connection with the application, including the divestiture commitment discussed above. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Chicago, acting pursuant to delegated authority.

By order of the Board of Governors, effective May 15, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

11. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

Appendix

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES WITHOUT DIVESTITURES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
INDIANA AND INDIANA–MICHIGAN BANKING MARKETS						
Gary-Hammond—Lake County; Porter County, excluding Pine township; and New Durham, Clinton, Cass, Dewey, and Prairie townships in La Porte County, Indiana						
1st Source Pre-Consummation	17	54.8 mil.	.7	1,108	8	27
FINA	7	499.2 mil.	6.1	1,108	8	27
1st Source Post-Consummation	6	554 mil.	6.8	1,108	8	27
La Porte—La Porte County, excluding New Durham, Clinton, Cass, Dewey, and Prairie townships; Olive and Warren townships in St. Joseph County; and Pine township in Porter County, all in Indiana; and New Buffalo, Three Oaks, Galien, and Weesaw townships in Berrien County, Michigan						
1st Source Pre-Consummation	3	142.8 mil.	10.0	2,063	20	13
FINA	12	14.1 mil.	1.0	2,063	20	13
1st Source Post-Consummation	3	156.9 mil.	11.0	2,063	20	13

NOTE: All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

The Bank of New York Mellon Corporation New York, New York

Order Approving the Formation of a Bank Holding Company and the Merger of Bank Holding Companies

The Bank of New York Mellon Corporation ("BNYMellon") has requested the Board's approval under section 3 of the Bank Holding Company Act ("BHC Act")[1] to become a bank holding company by merging with The Bank of New York Company, Inc. ("BONY"), New York, New York, and Mellon Financial Corporation ("Mellon"), Pittsburgh, Pennsylvania, and thereby acquiring The Bank of New York ("BONY Lead Bank"), New York, New York, Mellon Bank, N.A. ("Mellon Lead Bank"), Pittsburgh, Pennsylvania, and the other subsidiary banks of BONY and Mellon.[2] BNYMellon is a newly organized corporation formed to facilitate BONY's acquisition of Mellon. BNYMellon also has filed with the Board an election to become a financial holding company pursuant to sections 4(k) and (l) of the BHC Act and section 225.82 of Regulation Y.[3] BNYMellon

1. 12 U.S.C. § 1842. In addition, BONY and Mellon each has requested the Board's approval to hold and exercise options to purchase up to 19.9 percent of each other's common stock on the occurrence of certain events. Both options would expire on consummation of the merger of Mellon and BONY into BNYMellon.

2. BONY Lead Bank and Mellon Lead Bank are the largest subsidiary banks of their parent holding companies, as measured by both assets and deposits. BONY operates one other subsidiary bank, The Bank of New York (Delaware), Newark, Delaware. Mellon's other subsidiary banks are: Mellon United National Bank, Miami, Florida; Mellon 1st Business Bank, National Association, Los Angeles, California; and Mellon Trust of New England, National Association, Boston, Massachusetts.

3. *See* 12 U.S.C. § 1843(k) and (l); 12 CFR 225.82. BNYMellon has certified that the subsidiary depository institutions of BONY and Mellon are well capitalized and well managed, and BNYMellon has

also proposes to acquire BNY International Financing Corporation, New York, New York, and Mellon Overseas Investment Corporation, Greenville, Delaware, both Edge Act corporations organized under section 25 of the Federal Reserve Act.[4]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (72 *Federal Register* 12,800, 13,108, and 16,788 (2007)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

BONY, with total consolidated assets of approximately $99.9 billion, is the 18th largest depository organization in the United States, controlling deposits of approximately $30.1 billion.[5] BONY's subsidiary banks operate main offices or branches in Connecticut, Delaware, New Jersey, and New York, and BONY engages in numerous nonbanking activities that are permissible under the BHC Act.

Mellon, with total consolidated assets of approximately $40.5 billion, is the 33rd largest depository organization in the United States, controlling deposits of approximately $22.1 billion. Mellon's subsidiary banks operate main offices or branches in seven states,[6] and Mellon engages in numerous nonbanking activities that are permissible under the BHC Act.

On consummation of the proposal, BNYMellon would become the 12th largest depository organization in the United States, with total consolidated assets of approximately $154 billion. BNYMellon would control deposits of approximately $52.2 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States.

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the home state of such bank holding company if certain conditions are met. For purposes of the BHC Act, the home state of BONY is New York.[7] Mellon is located in California, Delaware, Florida, Maryland, Massachusetts, New Jersey, and Pennsylvania.[8]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[9] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[10]

BONY and Mellon have subsidiary depository institutions that compete directly in four banking markets: Los Angeles, California; Miami-Fort Lauderdale Area, Florida; Wilmington, in Delaware and Maryland; and Boston in Massachusetts and New Hampshire. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by BONY and Mellon,[11] the concentration levels of market deposits and

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provided all the information required under Regulation Y. Based on all the facts of record, the Board has determined that the election to become a financial holding company will become effective on consummation of the proposal, if on that date all subsidiary depository institutions of BONY and Mellon remain well capitalized and well managed, and if each subsidiary insured depository institution of BONY and Mellon has received a rating of at least "satisfactory" at its most recent performance evaluation under the Community Reinvestment Act ("CRA") (12 U.S.C. § 2901 et seq). BNYMellon proposes to acquire the nonbanking subsidiaries of BONY and Mellon in accordance with section 4(k) of the BHC Act, 12 U.S.C. § 1843(k).

4. 12 U.S.C. § 601 et seq. As this acquisition is being made as part of a proposal requiring approval under section 3 of the BHC Act, separate approval under the Federal Reserve Act is not required (12 CFR 211.5(e)(iii)).

5. Nationwide asset data are as of March 31, 2007. Nationwide deposit and ranking data are as of March 31, 2007, and reflect merger activity through that date. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

6. Mellon's subsidiary banks operate main offices and branches in California, Delaware, Florida, Maryland, Massachusetts, New Jersey, and Pennsylvania.

7. A bank holding company's home state is the state in which the total deposits of all subsidiary banks of the company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later (12 U.S.C. § 1841(o)(4)(C)).

8. For purposes of section 3(d), the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch (12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B)).

9. 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)(A)–(B). BNYMellon is adequately capitalized and adequately managed, as defined by applicable law. All of Mellon's subsidiary banks have been in existence and operated for the minimum period of time required by applicable state laws. On consummation of the proposal, BNYMellon would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States. The proposal also would comply with relevant state deposit caps, each of which is 30 percent. *See* Fla. Stat. § 658.2953(7)(b); Md. Code Ann., Fin. Inst. § 5–1013; Mass. Gen. Laws ch. 167, § 39; and N.J. Stat. Ann. § 17.9A–148(E). The other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

10. 12 U.S.C. § 1842(c)(1).

11. Deposit and market share data are as of June 30, 2006, adjusted to reflect mergers and acquisitions through March 31, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift

the increase in those levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[12] and other characteristics of the markets.

In delineating the relevant product market in which to assess the competitive effects of a bank acquisition or merger, the Supreme Court has determined that "commercial banking" is the appropriate line of commerce because the cluster of banking products and services provided by commercial banks is unique relative to other types of financial institutions.[13] To measure the "cluster of products and services," the Court has used bank deposits to measure the concentration and market shares in the relevant banking markets.

Based on deposit data, consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in each of the four banking markets.[14] On consummation of the proposal, the Los Angeles and Miami–Fort Lauderdale area markets would remain unconcentrated, and the Boston market would remain moderately concentrated, as measured by the HHI. Although the Wilmington market would remain highly concentrated, the increase in concentration would be minimal. Numerous depository institution competitors would remain in each of the four markets.

Although the subsidiary banks of BONY accept deposits, neither BONY nor Mellon engages in retail banking to a significant degree to support their banking operations,[15] which makes the amount of deposits a less-reliable measure of the competitive effects of the merger in this case. Significant business lines of the subsidiary banks of BONY and Mellon include custody services; clearing, corporate trust, and depository receipts services; securities lending; transfer agent services; fund administration and accounting services; and foreign exchange (collectively "securities services").[16] Accordingly, in analyzing the competitive effects, the Board has taken the additional step of considering measures of securities services that more closely reflect the effect of the proposal on competition.

Securities services are provided on a national basis, and most customers for these services are large corporations, institutions, and other financially sophisticated entities. An appropriate measure of these services is domestic assets under custody. BONY is the third largest provider of securities services, with a market share of approximately 18.2 percent, and Mellon is the fifth largest provider of these services, with a market share of approximately 6.7 percent.[17] Together, BONY and Mellon would be the largest provider of these services, with a market share of 24.9 percent. This measure of the competitive effects of the proposal indicates that the overlapping market, as measured by the HHI, would remain moderately concentrated, with the HHI increasing 246 points from 1542 to 1788. After consummation, 21 other participants would remain in the market.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the four banking markets where BONY and Mellon compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of

institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group,* 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation,* 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.,* 77 *Federal Reserve Bulletin* 52, 55 (1991).

12. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

13. *See United States v. Phillipsburg National Bank,* 399 U.S. 350, 359 (1970); *United States v. Philadelphia National Bank,* 374 U.S. 321, 356 (1963).

14. These banking markets, and the effect of the proposal on the concentration of banking resources in the markets based on deposit data, are described in the appendix.

15. In October 2006, BONY Lead Bank sold its retail banking business, including 338 branches, and its regional middle market business, to JPMorgan Chase & Co., New York, New York. In December 2001, Mellon Lead Bank sold its consumer, small business, and regional banking businesses, including most of its branches, to Citizens Financial Group, Inc., Providence, Rhode Island. BONY Lead Bank and Mellon Lead Bank each currently maintains a small network of branches to serve private banking and private wealth-management clients.

16. BONY and Mellon also provide the following types of services through their subsidiary banks: asset management, private wealth management and private banking, and cash and treasury management.

17. These market shares are calculated as if State Street Corporation ("State Street") has consummated its proposed acquisition of Investors Financial Services Corp. ("IFS"), both of Boston, Massachusetts. State Street has filed an application with the Board for approval to acquire IFS and that application is pending. State Street and IFS are also significant providers of securities services.

record, including confidential reports of examination and other supervisory information received from the federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, information provided by BONY, and public comments received on the proposal.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the proposal under the financial factors. BONY, Mellon, and their subsidiary banks currently are well capitalized, and BNYMellon and each bank that it would control would be well capitalized on consummation of the proposal. Based on its review of the record, the Board finds that BNYMellon has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. In addition, the Board has considered BNYMellon's plans for implementing the proposal, including the proposed management after consummation. In considering the managerial resources, the Board has reviewed the examination records of BONY and Mellon and their subsidiary banks, including assessments of their management, risk-management systems, and operations. Moreover, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering ("AML") laws. Banking organizations operating in the United States are required to implement and operate effective AML programs. Accordingly, the Board has considered the existing AML programs at BONY's and Mellon's subsidiary banks, including recent enhancements at BONY Lead Bank.[18] The Board expects that BNYMellon will take all necessary steps to ensure that sufficient resources, training, and managerial efforts are dedicated to maintaining a fully effective compliance risk-management system to ensure compliance with AML statutes and regulations throughout its organization.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.[19]

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[20] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[21]

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of the subsidiary banks of BONY and Mellon, data reported by BONY under the Home Mortgage

18. BONY Lead Bank entered into written agreements in February 2000 ("2000 Written Agreement") and April 2006 ("2006 Written Agreement"), with the Federal Reserve Bank of New York and the New York State Banking Department to address deficiencies in the bank's compliance with federal and state AML statutes and regulations. The written agreements included requirements that the bank develop and implement plans to strengthen independent testing of its AML program, enhance training of its personnel in suspicious-transaction identification and reporting, and improve its enhanced due-diligence program. The Board has reviewed carefully the progress made by the bank in implementing the 2006 Written Agreement's requirements and more broadly in enhancing its AML compliance.

In May 2007, a suit was filed against BONY Lead Bank by the Russian Federal Customs Service in a Russian court for damages allegedly resulting from money transfers that BONY Lead Bank had made to and from Russia from 1996 to 1999. These transactions were also considered in connection with the execution of the 2000 Written Agreement and were investigated by the U.S. Department of Justice, which entered into a Non-Prosecution Agreement with BONY Lead Bank on November 8, 2005. The Board will continue to monitor the suit by the Russian authorities and notes that neither Board action on this proposal nor any supervisory action by the Board under the BHC Act would interfere with the ability of a foreign court to resolve any litigation pertaining to this matter.

19. A commenter expressed concern about BONY's relationships with unaffiliated third parties engaged in subprime lending. BONY has represented that it provides corporate trust and custody services relating to some issuances backed by subprime loans or involving issuers who originate or securitize subprime loans. BONY also indicated that it provides commercial credit to some originators of subprime mortgages. In addition, BONY noted that it acts as a swap counterparty in connection with some subprime loan securitization transactions and that its proprietary treasury portfolio, and some funds for which BONY acts as investment manager, include securities that may be partially backed by subprime assets. BONY has represented that it does not play any role in the lending practices or credit review processes of its customers who engage in subprime lending. The Board expects all banking organizations to conduct their operations in a safe and sound manner with adequate systems to manage operational, compliance, and reputational risk.

20. 12 U.S.C. §2901 et seq.; 12 U.S.C. §1842(c)(2).

21. 12 U.S.C. §2903.

Disclosure Act ("HMDA"),[22] other information provided by BONY and Mellon, confidential supervisory information, and public comments received on the proposal. Two commenters expressed concerns about BONY's record of serving the credit and investment needs of LMI communities in its assessment areas.[23] One commenter alleged, based on HMDA data, that BONY engaged in disparate treatment of minority individuals in home mortgage lending.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the insured depository institutions of BONY and Mellon. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[24]

BONY Lead Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of New York, as of May 16, 2005 ("2005 Evaluation").[25] BONY's other subsidiary bank, The Bank of New York (Delaware), received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Deposit Insurance Corporation ("FDIC"), as of November 21, 2005. Mellon Lead Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency ("OCC"), as of May 15, 2005. Each of Mellon's other subsidiary banks received an "outstanding" or "satisfactory" rating at its most recent CRA performance evaluation.[26] The existing CRA programs of BONY's and Mellon's subsidiary banks will continue after consummation of the proposal.[27]

BONY Lead Bank and Mellon Lead Bank have been designated as wholesale banks for purposes of evaluating their CRA performances.[28] Insured depository institutions designated as wholesale institutions are evaluated under the community development test, and examiners may consider the institution's community development investments, loans, and services nationwide rather than only in the institution's assessment areas.[29] BONY Lead Bank received its wholesale bank designation after the 2005 Evaluation, while Mellon Lead Bank was evaluated as a wholesale bank in its 2005 evaluation.

CRA Performance of BONY Lead Bank. As noted, BONY Lead Bank received an overall "satisfactory" rating in the 2005 Evaluation.[30] Under the lending test, examiners concluded that the bank demonstrated adequate responsiveness to the retail credit needs of its two rating areas, given the bank's capacity to meet the areas' credit needs and overall market conditions.[31] They described the distribution of HMDA-reportable loans among borrowers of different income levels as good and reported that the bank's geographic distribution of loans to small businesses was adequate.[32]

In the interim between the 2005 Evaluation and the sale of its retail banking business in October 2006, BONY Lead Bank remained an active mortgage lender in its assessment areas. In 2005, BONY Lead Bank made more than $1.7 billion of HMDA-reportable loans in its assessment areas. The bank's percentages of home purchase loans and refinance loans originated in LMI geographies in the Bronx, Brooklyn, and Manhattan all exceeded the percentages for the aggregate of lenders in 2005.[33]

In the 2005 Evaluation, examiners commended BONY Lead Bank's community lending performance.[34] During

22. 12 U.S.C. § 2801 et seq.

23. The commenters also requested that BONY implement a number of CRA-related recommendations set forth in their comment letters. The Board has consistently found that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization. *See Bank of America Corporation*, 93 *Federal Reserve Bulletin* C52, n. 27 (2007). Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the credit needs of its CRA assessment areas at the time the Board reviews a proposal under the convenience and needs factor.

24. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 at 36,640 (2001).

25. Two commenters expressed concern over the "low satisfactory" ratings BONY Lead Bank received under the lending and service tests for its assessment area in the New York metropolitan area. The bank received an "outstanding" rating under the investment test for the assessment area, and examiners concluded that the bank's record of CRA performance during the review period, when viewed as a whole, merited a rating of "satisfactory."

26. Mellon 1st Business Bank, National Association received a "satisfactory" rating from the FDIC, as of February 11, 2003, when the bank was a state-chartered nonmember bank doing business as Mellon 1st Business Bank. Mellon United National Bank received an "outstanding" rating at its most recent CRA evaluation by the OCC, as of December 31, 2003; and Boston Safe Deposit and Trust Company, the predecessor of Mellon Trust of New England, National Association, received an "outstanding" rating at its last CRA evaluation by the Federal Reserve Bank of Boston, as of September 30, 2002.

27. BNYMellon has indicated that in the longer term, the CRA program of the merged organization will combine the best elements of the CRA programs of BONY and Mellon.

28. *See* 12 CFR 228.25; 12 CFR 25.25.

29. Two commenters questioned how, as a designated wholesale bank, BONY Lead Bank will serve the credit needs of the communities in which it operates.

30. Full-scope evaluations were conducted in BONY Lead Bank's assessment areas in the New York multistate metropolitan area (CT-NJ-NY) ("New York metropolitan assessment area") and in the nonmetropolitan portions of New York State.

31. Examiners noted that housing prices in the bank's assessment areas were disproportionately high in comparison with income levels, which made homeownership very difficult for LMI borrowers, particularly for low-income borrowers.

32. In this context, small businesses are businesses with gross annual revenues of $1 million or less.

33. The lending data of the aggregate lenders represent the cumulative lending for all financial institutions that reported HMDA data in a market.

34. One commenter asserted that BONY should provide community development loans with principal amounts of less than $5 million.

the evaluation period, the bank made community development loans totaling $724 million, which supported affordable housing construction, economic revitalization projects, and community development groups, including those serving persons with disabilities. Examiners reported that 64 percent of the community development lending by dollar volume helped develop affordable housing, which examiners described as a significant need in the bank's assessment areas.

BONY Lead Bank has continued its community development lending since the 2005 Evaluation. BONY represented that the bank extended more than 80 community development loans totaling $612 million in its assessment areas in 2005 and 2006.

In the 2005 Evaluation, BONY Lead Bank received an "outstanding" rating under the investment test. The bank's new qualifying community development investments during the evaluation period totaled $176 million and were primarily in the form of affordable housing initiatives. BONY Lead Bank also donated $3 million during the evaluation period to community development organizations engaged in affordable housing development, social services, and neighborhood revitalization efforts in its New York metropolitan assessment area.[35]

BONY Lead Bank represented that it made almost $174 million in qualified community development investments during 2005 and 2006. These included investments totaling more than $170 million in projects to create affordable housing through the low-income housing tax credit program. In addition, the bank made more than $3 million in community development grants during 2005 and 2006 to a range of groups involved in affordable housing and community and economic development in the bank's assessment areas.

In the 2005 evaluation, BONY Lead Bank received a "low satisfactory" rating for the service test. Examiners noted that the bank's retail delivery systems were reasonably accessible to geographies and individuals of different income levels and reported that the bank provided an adequate level of community development services.[36] Examiners reported that bank employees conducted seminars on first-time home buying, provided financial education to LMI individuals, and served on the boards of community organizations that address the credit needs of LMI areas and individuals.

CRA Performance of Mellon Lead Bank. As noted, Mellon Lead Bank received an overall "outstanding" rating in its May 2005 evaluation. Mellon Lead Bank provides investment management, private banking, and fiduciary services to high-net-worth individuals and institutions and is designated as a wholesale bank for purposes of evaluating its CRA performance.

With respect to community development lending, examiners commended Mellon Lead Bank's responsiveness to the credit needs of its assessment areas. Examiners noted that during the evaluation period, Mellon Lead Bank made more than $200 million in qualified community development investments. They indicated that the majority of Mellon Lead Bank's community development investments were mortgage-backed securities and collateralized mortgage obligations secured by properties in its combined assessment areas.

B. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of BONY in light of public comment received on the proposal. A commenter alleged, based on 2006 HMDA data, that BONY made higher-cost loans more frequently to African American and Hispanic borrowers than to nonminority borrowers.[37] Since selling its retail banking business in October 2006, BONY no longer originates retail mortgage loans except in limited instances when requested to do so by its private banking clients. The Board has focused its analysis on the 2005 HMDA data reported by BONY and its subsidiary banks.[38]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not BONY is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[39] HMDA data, therefore, have limitations that make them an

Although the Board has recognized that banks can help serve the banking needs of communities by making certain products or services available, the CRA does not require an institution to provide any specific type of product to consumers.

35. A commenter criticized the level of BONY Lead Bank's charitable contributions. The CRA does not require an institution to make any specific investment in, or contribution to, community groups.

36. As noted, BONY Lead Bank sold its retail banking business, including most of its branches, in October 2006 and has been designated a wholesale bank for purposes of the CRA. Accordingly, any future CRA evaluations of the bank will not include a review of its delivery of retail banking services but will consider the extent and level of innovation of the bank's community development services.

37. Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate (APR) exceeds the yield for U.S. Treasury securities of comparable maturity 3 percentage points or more for first-lien mortgages and 5 percentage points or more for second-lien mortgages (12 CFR 203.4).

38. The Board reviewed the 2005 HMDA data for BONY Lead Bank for 2005 in its assessment areas. The Board notes that 2006 HMDA data are preliminary and that final data will not be available for analysis until fall 2007.

39. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by BONY and its subsidiaries. The Board also has consulted with the Federal Reserve Bank of New York about the fair-lending compliance record of BONY Lead Bank.

The record, including confidential supervisory information, indicates that BONY has taken steps to ensure compliance with fair lending and other consumer protection laws. BONY has a fair-lending compliance program that includes a second-review process, and periodic self-assessments involving statistical and regression analyses to identify any indicator of disparate treatment or disparate impact. In addition, BONY has a process for resolving fair lending complaints and requires employees to complete fair-lending training sessions. BNYMellon has represented that BONY's current fair-lending compliance program will remain in place after consummation of the proposal.[40]

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance records of the subsidiary banks of BONY under the CRA. These established efforts and records of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by BNYMellon, comments received on the proposal, and confidential supervisory information.[41] BNYMellon has represented that the proposal would provide customers of both organizations with increased credit availability and expanded access to products and services. Based on a review of the entire record and for the reasons discussed above, the Board has concluded that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved.[42] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by BNYMellon with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order unless such period is extended for good cause by the Board or the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors, effective June 14, 2007.

Voting for this action: Chairman Bernanke and Governors Warsh, Kroszner, and Mishkin. Absent and not voting: Vice Chairman Kohn.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

40. BNYMellon has represented that in the longer term, the fair-lending compliance program of the merged organization would combine the best elements of the fair-lending compliance programs of BONY and Mellon.

41. One commenter expressed concern about possible job losses resulting from this proposal. The effect of a proposed acquisition on employment in a community is not among the limited factors the Board is authorized to consider under the BHC Act, and the convenience and needs factor has been interpreted consistently by the federal banking agencies, the courts, and the Congress to relate to the effect of a proposal on the availability and quality of banking services in the community. *See, e.g., Wells Fargo & Company*, 82 *Federal Reserve Bulletin* 445, 457 (1996).

42. One commenter requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 225.16(e), 262.3(i)(2), 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit its views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present its views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

Appendix

BONY AND MELLON BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
WILMINGTON BANKING MARKET IN DELAWARE AND MARYLAND						
Wilmington—includes New Castle County, Delaware, and Cecil County, Maryland						
BONY Pre-Consummation	23	80,836	.08	1,949	0	36
Mellon	25	35,649	.03	1,949	0	36
BNYMellon Post-Consummation	21	116,485	.11	1,949	0	36
LOS ANGELES BANKING MARKET IN CALIFORNIA						
Los Angeles—includes the Los Angeles Ranally Metro Area and the towns of Acton in Los Angeles County and Rosamond in Kern County						
BONY Pre-Consummation	159	721	.00	799	0	174
Mellon	20	2,602,448	.98	799	0	174
BNYMellon Post-Consummation	20	2,603,169	.98	799	0	174
BOSTON BANKING MARKET IN MASSACHUSETTS AND NEW HAMPSHIRE						
Boston—includes the Boston MA–NH Ranally Metro Area and the towns of Athol, Hubbardston, Orange, Petersham, Phillipston, Royalston, and Warwick in Massachusetts; and the towns of Antrim, Bennington, Deering, Dublin, Fitzwilliam, Francestown, Greenfield, Hancock, Jaffrey, Lyndeborough, Peterborough, Rindge, Sharon, and Temple in New Hampshire						
BONY Pre-Consummation	163	10	.00	1,123	0	167
Mellon	4	8,353,381	6.45	1,123	0	167
BNYMellon Post-Consummation	4	8,353,391	6.45	1,123	0	167
MIAMI–FORT LAUDERDALE AREA BANKING MARKET IN FLORIDA						
Miami–Fort Lauderdale—includes Broward and Dade counties						
BONY Pre-Consummation	99	4	.00	984	0	103
Mellon	14	1,371,208	1.37	984	0	103
BNYMellon Post-Consummation	14	1,371,212	1.37	984	0	103

NOTE: Data are as of June 30, 2006, and are adjusted to reflect mergers and acquisitions through March 31, 2007. All deposit amounts are in thousands of dollars. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

C-B-G, Inc.
West Liberty, Iowa

Order Approving the Acquisition of Shares of a Bank Holding Company

C-B-G, Inc. ("C-B-G"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire additional shares, up to 35 percent of the voting shares of Washington Bancorp ("Washington") and thereby acquire an additional interest in Washington's subsidiary bank, Federation Bank, both of Washington, Iowa. At the time it filed this application, C-B-G owned 24 percent of Washington's voting shares.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (72 *Federal Register* 8,161 (2007)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

C-B-G, with banking assets of approximately $193.1 million, is the 69th largest depository organization in Iowa, controlling deposits of $164.9 million, which represent less than 1 percent of total deposits of insured depository institutions in Iowa ("state deposits").[3] Washington, with total banking assets of approximately $105.5 million, is the 174th largest depository organization in Iowa, controlling $70.2 million in deposits. On consummation of the proposal, C-B-G would become the 48th largest depository organization in Iowa, controlling approximately $235.1 million in deposits, which represents less than 1 percent of state deposits.

The Board received comments objecting to the proposal from the management of Washington and from some of its directors and shareholders. The Board previously has stated that, in evaluating acquisition proposals, it must apply the criteria in the BHC Act in the same manner to all proposals, regardless of whether they are supported or opposed by the management of the institutions to be acquired.[4] Section 3(c) of the BHC Act requires the Board to review each application in light of certain factors specified in the BHC Act. These factors require consideration of the effects of the proposal on competition, the financial and managerial resources and future prospects of the companies and depository institutions concerned, and the convenience and needs of the communities to be served.[5]

In considering these factors, the Board is mindful of the potential adverse effects that contested acquisitions might have on the financial and managerial resources of the company to be acquired and the acquiring organization. The Board has long held that, if the statutory criteria are met, withholding approval based on other factors, such as whether the proposal is acceptable to the management of the organization to be acquired, would be outside the limits of the Board's discretion under the BHC Act.[6] As explained below, the Board has carefully considered the statutory criteria in light of all the comments received and information submitted by C-B-G. The Board also has carefully considered all other available information, including information accumulated in the application process, supervisory information of the Board and other agencies, and relevant examination reports. In considering the statutory factors, particularly the effect of the proposal on the financial and managerial resources of C-B-G, the Board has reviewed financial information, including the terms and cost of the proposal and the resources that C-B-G proposes to devote to the transaction.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by C-B-G.

Several commenters expressed concerns about the amount of leverage that C-B-G has reported on its balance sheet, and the size of C-B-G's proposed investment in

1. 12 U.S.C. § 1842.

2. In April 2005, the Board approved an application by C-B-G to acquire up to 24.35 percent of Washington's voting shares as a noncontrolling investment. *C-B-G, Inc.*, 91 *Federal Reserve Bulletin* 421 (2005) ("2005 Order").

3. Asset data are as of March 31, 2007. Statewide deposit and ranking data are as of June 30, 2006, and reflect merger and acquisition activity as of April 27, 2007. Deposit data reflect the total deposits reported by each organization's insured depository institution in their Consolidated Reports of Condition and Income or Thrift Financial Reports. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

4. *See, e.g., Juniata Valley Financial Corp.*, 92 *Federal Reserve Bulletin* C171 (2006) ("Juniata"); *Central Pacific Financial Corp.*, 90 *Federal Reserve Bulletin* 93, 94 (2004) ("Central Pacific"); *North Fork Bancorporation, Inc.*, 86 *Federal Reserve Bulletin* 767, 768 (2000) ("North Fork"); *The Bank of New York Company, Inc.*, 74 *Federal Reserve Bulletin* 257, 259 (1988) ("BONY").

5. In addition, the Board is required by section 3(c) of the BHC Act to disapprove a proposal if the Board does not receive adequate assurances that it can obtain information on the activities or operations of the company and its affiliates. *See* 12 U.S.C. § 1842(c). One commenter asserted that the proposed transaction would have a negative impact on the local ownership and control of Washington. Such concerns are outside the statutory factors that the Board is authorized to consider when reviewing an application under the BHC Act. *See Western Bancshares, Inc. v. Board of Governors*, 480 F.2d 749 (10th Cir. 1973).

6. *See Juniata; Central Pacific; FleetBoston Financial Corporation*, 86 *Federal Reserve Bulletin* 751, 752 (2000); *North Fork; BONY.*

Washington in relation to C-B-G's total assets. Commenters also contended that the proposal could imperil C-B-G's future financial condition.[7]

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-only and on a consolidated basis, as well as the financial condition of the subsidiary depository institutions and of their significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. Both C-B-G's and Washington's subsidiary depository institutions currently are well capitalized and would remain so on consummation. Based on its review of the record, the Board also finds that C-B-G has sufficient financial resources to effect the proposal. The proposed transaction is structured as a cash purchase of shares, and C-B-G would use existing resources to fund the purchase.

The Board also has considered the managerial resources of C-B-G, Washington, and their subsidiary depository institutions. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking agencies with the organizations and their records of compliance with applicable banking laws, including anti-money-laundering laws.

Some commenters contended that the voting-rights restrictions on shareholders who own more than 10 percent of Washington's shares could prevent C-B-G from serving as a source of financial and managerial strength to Federation Bank, as required under the Board's Regulation Y.[8] C-B-G has acknowledged that, if it does acquire control of 25 percent or more of Washington's shares, it will be required, if necessary, to serve as a source of financial and managerial strength to Federation Bank. The Board has carefully considered the capacity of C-B-G to serve as a source of financial and managerial strength to its subsidiary banks, including Federation Bank, on approval and consummation of the proposal.

Based on all the facts of record, including public comments, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.[9]

COMPETITIVE AND CONVENIENCE AND NEEDS CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. Section 3 also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the Board finds that the anticompetitive effects of the proposal clearly are outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[10] C-B-G and Washington do not compete directly in any relevant banking market. Based on all the facts of record, the Board has concluded that consummation of the proposal would have no significantly adverse effect on competition or on the concentration of banking resources in any relevant banking market and that competitive factors are consistent with approval.

In addition, considerations relating to the convenience and needs of the communities to be served, including the records of performance of the institutions involved under the Community Reinvestment Act ("CRA"),[11] are consistent with approval of the application. Community Bank, C-B-G's sole subsidiary bank, received a "satisfactory" rating and Federation Bank received an "outstanding" rating at their most recent evaluations for CRA performance by the FDIC.[12] C-B-G has represented that the proposal will not result in any changes in the services or products offered by Federation Bank.[13]

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved.[14] In reaching its conclusion, the Board

7. The commenters asserted that C-B-G would have only limited influence over Washington's operations due to a provision in Washington's articles of incorporation that restricts the voting rights of shareholders who own more than 10 percent of Washington's voting shares. The Board has analyzed the effect of the proposal on C-B-G's general financial condition more broadly.

8. *See* 12 CFR 225.4(a)(1).

9. Several commenters expressed concern that the proposal could subject Federation Bank to liability under the cross-guarantee provision of the Federal Deposit Insurance Act, 12 U.S.C. § 1815(e) ("FDI Act"), in the event that a subsidiary bank of C-B-G were to fail or require assistance from the Federal Deposit Insurance Corporation ("FDIC"). The Board notes that the application of this provision of the FDI Act is a matter that would be decided by the FDIC.

10. 12 U.S.C. § 1842(c)(1).

11. 12 U.S.C. § 2901 et seq.

12. The most recent CRA performance evaluations of Community Bank and Federation Bank were as of May 2004 and December 2004, respectively. Wilton Savings Bank, a subsidiary bank of C-B-G which was merged into Community Bank in January 2006, received a "satisfactory" rating at its last CRA evaluation, as of November 2003.

13. One commenter contended that the proposal would have a deleterious effect on the services Federation Bank provides to its local community.

14. In connection with the application that the Board approved in 2005, C-B-G made commitments to ensure that it would not control Washington or Federation Bank for purposes of the BHC Act. These

has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by C-B-G with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Chicago, acting pursuant to delegated authority.

By order of the Board of Governors, effective May 24, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

JENNIFER J. JOHNSON
Secretary of the Board

First Busey Corporation Urbana, Illinois

Order Approving the Merger of Bank Holding Companies

First Busey Corporation ("First Busey"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to merge with Main Street Trust, Inc. ("Main Street") and thereby acquire its subsidiary bank, Main Street Bank & Trust, both of Champaign, Illinois.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (71 *Federal Register* 76,339 (2006)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

First Busey, with total consolidated assets of approximately $2.5 billion, controls two subsidiary insured depository institutions that operate in Illinois, Indiana, and Florida: Busey Bank, also in Urbana, and Busey Bank, National Association, Port Charlotte, Florida. First Busey is the 33rd largest depository organization in Illinois, controlling deposits of $1.5 billion, which represent less than 1 percent of total deposits of insured depository institutions in Illinois ("state deposits").[2]

Main Street, with total consolidated assets of approximately $1.5 billion, controls one insured depository institution that operates only in Illinois. Main Street is the 36th largest depository organization in Illinois, controlling deposits of approximately $1.2 billion.

On consummation of this proposal, and after accounting for the proposed divestiture, First Busey would become the 24th largest depository organization in Illinois, controlling deposits of approximately $2.7 billion, which represent less than 1 percent of state deposits.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[3]

First Busey and Main Street have subsidiary depository institutions that compete directly in three markets in Illinois: Bloomington-Normal, Champaign-Urbana, and Peoria.[4] The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by First Busey and Main Street,[5] the concentration level of market deposits and the increase in that level

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commitments are listed in the appendix to the 2005 Order and were modified by the Board's letter dated October 25, 2006. One commenter urged that the Board continue to require C-B-G to abide by those commitments if the Board approves C-B-G's current proposal. C-B-G proposes to own up to 35 percent of the voting shares of Washington and, thus, would be deemed to control Washington for purposes of the BHC Act without regard to the previous commitments considered. *See* 12 U.S.C. § 1841(a)(2)(A). Accordingly, the Board has determined in this case not to impose the restrictions contained in the commitments, and not to require compliance with the commitments on consummation of the proposal. For the reasons discussed in this order, the Board has concluded that C-B-G meets the statutory factors required to own more than 25 percent of Washington and to exercise the rights attendant to that level of ownership.

1. 12 U.S.C. § 1842.

2. Asset data are as of March 31, 2007, and statewide deposit and ranking data are as of June 30, 2006, and reflect merger activity through May 21, 2007. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

3. 12 U.S.C. § 1842(c)(1).

4. These banking markets are described below and in the appendix.

5. Deposit and market share data are as of June 30, 2006, adjusted to reflect subsequent mergers and acquisitions through May 21, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market share

as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[6] other characteristics of the markets, and commitments made by First Busey to divest five branches of Main Street Bank & Trust in the Champaign-Urbana banking market.

A. Banking Market Warranting Special Scrutiny

First Busey and Main Street compete directly in one banking market, Champaign-Urbana,[7] that warrants a detailed review of the competitive effects of the proposal. First Busey's market share on consummation of the proposal, including proposed divestiture, would exceed 35 percent in this market.

Busey Bank is the largest depository institution in the Champaign-Urbana banking market, controlling deposits of approximately $1.1 billion, which represent approximately 27 percent of market deposits. Main Street Bank & Trust is the second largest depository institution in the market, controlling deposits of approximately $538.5 million, which represent approximately 13 percent of market deposits. To reduce the potential adverse effects on competition in the Champaign-Urbana banking market, First Busey has committed to divest five branches of Main Street Bank & Trust that have at least $110.2 million in total deposits to another insured depository organization in the market.[8] On consummation of the proposed merger, and after accounting for the proposed divestiture, First Busey would remain the largest depository institution in the market, controlling deposits of approximately $1.6 billion, which would represent not more than 36 percent of market deposits. The HHI would not increase more than 506 points to 1561.[9]

The application raises special concerns because First Busey, the largest institution in the banking market, proposes to merge with the market's second largest competitor. No other institution controls more than 6 percent of market deposits. The Board has previously recognized that merger proposals involving the largest depository institutions in markets structured like the Champaign-Urbana market warrant close review due to the size of those institutions relative to other market competitors.[10] The Board, therefore, has considered whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market.[11]

A number of factors indicate that the increase in concentration in the Champaign-Urbana banking market, as measured by the market share of the combined organization, overstates the potential competitive effects of the proposal in the market. After consummation, and taking into account the proposed divestiture, at least 39 other insured depository institutions would continue to compete in the market. In addition, the proposed divestiture to a banking organization operating in the Champaign-Urbana banking market would strengthen the competitive position of an in-market participant.

The Board notes that two community credit unions also exert a competitive influence in the Champaign-Urbana banking market.[12] Both institutions offer a wide range of consumer products, operate street-level branches, and have

calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

6. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

7. The Champaign-Urbana banking market is defined as Champaign County; Ford County, excluding Brenton, Mona, Pella, and Rogers townships; Artesia and Loda townships in Iroquois County; Butler, Middlefork, Pilot, Oakwood, and Vance townships in Vermilion County; Garret, Tuscola, Camargo, Murdock, and Newman townships in Douglas County; Piatt County, excluding Willow Branch and Cerro Gordo townships; Santa Anna township in De Witt County; and Bellflower township in McLean County, all in Illinois.

8. First Busey has committed that, before consummation of the proposed merger, it will execute an agreement for the proposed divestiture in the Champaign-Urbana banking market with a purchaser that the Board determines to be competitively suitable. First Busey also has committed to complete the divestiture within 180 days after consummation of the proposed merger. In addition, First Busey has committed that, if it is unsuccessful in completing the proposed divestiture within such time period, it will transfer any unsold branches to an independent trustee who will be instructed to sell the branches to an alternate purchaser or purchasers in accordance with the terms of this order and without regard to price. Both the trustee and any alternate purchaser must be deemed acceptable by the Board. *See BankAmerica Corporation*, 78 *Federal Reserve Bulletin* 338 (1992); *United New Mexico Financial Corporation*, 77 *Federal Reserve Bulletin* 484 (1991).

9. The calculations of market share and concentration include the weighting at 100 percent of deposits controlled by two thrift institutions in the market. The Board previously has indicated that it may consider the competitiveness of a thrift institution at a level greater than 50 percent of its deposits if competition from the institution closely approximates competition from a commercial bank. *See, e.g., BankNorth Group, Inc.* 75 *Federal Reserve Bulletin* 703 (1989). The thrift institutions in the Champaign-Urbana banking market serve as significant sources of commercial loans and provide a broad range of consumer, mortgage, and other banking products. These thrift institutions have ratios of commercial and industrial loans to assets of approximately 6 percent and 8 percent, which are comparable to the national average for all commercial banks. Competition from these thrift institutions, therefore, closely approximates competition from commercial banks. *See First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998).

10. *See Firstar Corporation*, 87 *Federal Reserve Bulletin* 236, 238 (2001).

11. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase in and resulting level of concentration in a banking market. *See NationsBank Corp.*, 84 *Federal Reserve Bulletin* 129 (1998).

12. The Board previously has considered the competitiveness of certain active credit unions as a mitigating factor. *See, e.g., Regions Financial Corporation*, 93 *Federal Reserve Bulletin* C16 (2007); *Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006);

memberships open to almost all the residents in the market. In this light, the Board concludes that their activities in this banking market exert sufficient competitive influence that mitigate, in part, the potential competitive effects of the proposal.[13]

Moreover, the record of recent entry into the Champaign-Urbana banking market evidences its attractiveness for entry. Since 2002, five depository institutions have entered the market de novo, and nine depository institutions have entered the market by acquisition. Other factors also indicate that the market remains attractive for entry. For example, from 2002 to 2005, the market's average annualized income growth exceeded the average annualized income growth for all metropolitan areas in Illinois.

Based on all the facts of record and for the reasons discussed above, the Board believes that competitive considerations in the Champaign-Urbana banking market are consistent with approval in this case. The Board continues to have concerns, however, about the structure of this banking market and believes that future mergers in the market involving First Busey or its successors in would warrant special consideration. The Board intends to scrutinize carefully any future acquisition proposal that would increase First Busey's market share in the Champaign-Urbana banking market.

B. Banking Markets within Established Guidelines

Consummation of the proposal in the remaining banking markets, Bloomington-Normal and Peoria, would be consistent with Board precedent and within the thresholds in the DOJ Guidelines without divestitures.[14] On consummation of the proposal, the Bloomington-Normal banking market would remain highly concentrated, and the Peoria banking markets would remain unconcentrated. Numerous competitors would remain in both banking markets.

C. Agency Views and Conclusion on Competitive Considerations

The DOJ also has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal, taking into account the proposed divestiture, would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

F.N.B. Corporation, 90 *Federal Reserve Bulletin* 481 (2004); *Gateway Bank & Trust Co.*, 90 *Federal Reserve Bulletin* 547 (2004).

13. The two community credit unions control approximately $138.8 million in deposits in the market, which represent approximately 2 percent of market deposits on a 50 percent weighted basis. Accounting for the revised weightings of these deposits, First Busey would control approximately 36 percent of market deposits on consummation of the proposal, and the HHI would not increase more than 490 points to 1514.

14. The effects of the proposal on the concentration of banking resources in these markets are described in the appendix.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in the three banking markets where First Busey and Main Street compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by First Busey.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-only and on a consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. First Busey, Main Street, and their subsidiary depository institutions currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that First Busey has sufficient financial resources to effect the proposal. The proposed transaction is structured primarily as a share exchange.

The Board also has considered the managerial resources of First Busey, Main Street, and their subsidiary depository institutions. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws and with anti-money-laundering laws. First Busey, Main Street and their subsidiary depository institutions are considered well managed. The Board also has considered First Busey's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[15] Busey Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Federal Insurance Deposit Corporation ("FDIC"), as of December 1, 2005.[16] Main Street Bank & Trust received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of December 1, 2006. After consummation of the proposal, First Busey plans to maintain Main Street Bank & Trust's CRA policies until Main Street Bank & Trust is merged into Busey Bank. First Busey has represented that consummation of the proposal would allow it to provide a broader range of financial products and services over a larger area. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the community to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

Conclusion

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by First Busey with the conditions imposed in this order and the commitments made to the Board in connection with the application, including the divestiture commitment discussed above. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of Chicago, acting pursuant to delegated authority.

By order of the Board of Governors, effective June 14, 2007.

Voting for this action: Chairman Bernanke and Governors Warsh, Kroszner, and Mishkin. Absent and not voting: Vice Chairman Kohn.

Robert deV. Frierson
Deputy Secretary of the Board

15. 12 U.S.C. §2901 et seq.; 12 U.S.C. §1842(c)(2).

16. Busey Bank, National Association was rated "satisfactory" by the Office of the Comptroller of the Currency, as of August 2, 2004, when it was doing business as Tarpon Coast National Bank and before its acquisition by First Busey.

Appendix

First Busey and Main Street Banking Markets Consistent with Board Precedent and DOJ Guidelines without Divestitures

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Increase in HHI	Remaining number of competitors
Illinois Banking Markets						
Bloomington–Normal—McLean County; and El Paso, Kansas, Panola, and Minonk townships in Woodford County						
First Busey Pre-Consummation	4	242.6 mil.	10.1	1,238	134	27
Main Street	5	158.5 mil.	6.7	1,238	134	27
First Busey Post-Consummation	2	401.1 mil.	16.8	1,238	134	27
Peoria—Peoria and Tazewell Counties, and Woodford County, excluding El Paso, Kansas, Panola, and Minonk townships						
First Busey Pre-Consummation	12	123.0 mil.	2.6	859	1	33
Main Street	32	10.7 mil.	.2	859	1	33
First Busey Post-Consummation	12	133.7 mil.	2.8	859	1	33

Note: Data are as of June 30, 2006, and reflect merger activity through May 21, 2007. Deposit amounts are unweighted. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

Huntington Bancshares Incorporated Columbus, Ohio

Penguin Acquisition, LLC Baltimore, Maryland

Order Approving the Merger of Bank Holding Companies and the Formation of a Bank Holding Company

Huntington Bancshares Incorporated ("Huntington"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Sky Financial Group, Inc. ("Sky"), Bowling Green, and its subsidiary bank, Sky Bank, Salineville, both of Ohio.[2] In addition, Huntington's wholly owned subsidiary, Penguin Acquisition, LLC, Baltimore, Maryland, has requested the Board's approval under section 3 of the BHC Act to become a bank holding company and merge with Sky.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (72 *Federal Register* 6242 (2007)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the BHC Act.[3]

Huntington, with total consolidated assets of approximately \$35.3 billion, is the 46th largest depository organization in the United States.[4] Huntington controls one depository institution, The Huntington National Bank ("HNB"),[5] also in Columbus, that operates in six states[6] and engages in numerous nonbanking activities that are permissible under the BHC Act. Huntington is the fourth largest depository organization in Ohio, controlling deposits of approximately \$16.3 billion.

1. 12 U.S.C. § 1842.
2. In addition, Huntington proposes to acquire the nonbanking subsidiaries of Sky in accordance with section 4(k) of the BHC Act, 12 U.S.C. § 1843(k).
3. Three commenters expressed concerns about various aspects of the proposal.
4. Asset and ranking data are as of December 31, 2006.
5. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.
6. Huntington operates branches in Ohio, Florida, Indiana, Kentucky, Michigan, and West Virginia.

Sky, with total consolidated assets of approximately $18 billion, controls Sky Bank, which operates in Ohio, Indiana, Michigan, Pennsylvania, and West Virginia.[7] Sky also engages in a broad range of permissible nonbanking activities. In Ohio, Sky is the seventh largest depository organization, controlling deposits of approximately $8.6 billion.

On consummation of the proposal, Huntington would become the 34th largest depository institution in the United States, with total consolidated assets of approximately $53 billion. Huntington would control deposits of approximately $38.3 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States. In Ohio, Huntington would become the third largest depository organization, controlling deposits of approximately $24.9 billion, which represent approximately 11.9 percent of the total amount of deposits of insured depository institutions in the state ("state deposits").

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Huntington is Ohio,[8] and Sky is located in Ohio, Indiana, Michigan, Pennsylvania, and West Virginia.[9]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[10] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[11]

Huntington and Sky have subsidiary depository institutions that compete directly in the following 12 banking markets: Cleveland, Columbus, Dayton, Akron, Toledo, Canton, Lima, Dover-New Philadelphia, Fremont, and Logan banking markets in Ohio; the Indianapolis banking market in Indiana; and the Cincinnati multistate banking market in Ohio, Indiana, and Kentucky. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions controlled by Huntington and Sky in the markets ("market deposits"),[12] the concentration level of market deposits and the increases in those levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[13] and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in all 12 banking markets.[14] On consummation of the proposal, 11 markets would remain moderately concentrated and one market would remain highly concen-

7. Sky also controls Sky Trust, National Association, Pepper Pike, Ohio ("Sky Trust"), a limited-purpose depository institution that provides only trust services.

8. *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

9. For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and 1842(d)(2)(B).

10. 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)(A)–(B). Huntington is adequately capitalized and adequately managed, as defined by applicable law. Sky Bank has been in existence and operated for the minimum periods of time required by all applicable state laws, including Indiana state law (five years). *See* Burns Ind. Code Ann. § 28-2-17-20. On consummation of the proposal, Huntington would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States. Huntington also would comply with the state deposit caps in all relevant states, including Ohio and West Virginia where it will control less than 25 percent of state deposits in each state. *See* O.R.C. § 115.05 and West Virginia Code § 31A-2-12a. All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

11. 12 U.S.C. § 1842(c)(1).

12. Deposit and market share data are as of June 30, 2006, adjusted to reflect mergers and acquisitions through February 7, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

13. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

14. Those banking markets and the effects of the proposal on the concentration of banking resources therein are described in the appendix.

trated, as measured by the HHI. The change in the HHI in the highly concentrated market would be small. Moreover, numerous competitors would remain in each of the 12 banking markets.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the 12 banking markets where Huntington and Sky compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information received from the relevant federal and state supervisors of the organizations involved in the proposal, and publicly reported and other financial information, including information provided by Huntington.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and the organizations' nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the proposal under the financial factors. Huntington, Sky, and their subsidiary depository institutions are currently well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board finds that Huntington has sufficient financial resources to effect the proposal. The proposed transaction is structured as a combination share exchange and cash purchase.[15]

15. Huntington will use existing resources to fund the purchase.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of Huntington, Sky, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws. Huntington, Sky, and their subsidiary depository institutions are considered to be well managed. The Board also has considered Huntington's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

Convenience and Needs Considerations

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[16]

The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[17]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of the subsidiary depository institutions of Huntington and Sky, data reported by Huntington and Sky under the Home Mortgage Disclosure Act ("HMDA"),[18] other information provided by Huntington, confidential supervisory information, and public comments received on the proposal. One commenter alleged that Huntington and Sky made an insufficient number of mortgage loans in LMI census tracts, thereby diminishing residents' access to bank credit and encouraging predatory mortgage lending in those areas. All three commenters alleged that neither Huntington nor Sky had adequately served LMI communities due to an insufficient number of branches and services in those communities. They also asserted that this alleged insufficiency of branches had contributed to the growth of payday

16. 12 U.S.C. §2901 et seq.; 12 U.S.C. §1842(c)(2).

17. 12 U.S.C. §2903.

18. 12 U.S.C. §2801 et seq.

lending in LMI areas. Two commenters also expressed concern that the proposal would lead to closings of the combined organization's branches in LMI areas.

A. CRA Performance Evaluations

As provided in the CRA, the Board has reviewed the proposal in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[19]

HNB received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency ("OCC"), as of March 31, 2003 ("2003 Evaluation").[20] Sky Bank received a "satisfactory" CRA performance rating by the Federal Reserve Bank of Cleveland, as of March 13, 2006 ("2006 Evaluation").[21] Huntington has represented that it would continue its CRA program in the combined institution.

CRA Performance of HNB. In the 2003 Evaluation, HNB received a "high satisfactory" rating on each of the lending, investment, and service tests for its CRA performance overall and in Ohio.[22] Examiners reported that the bank's overall distribution of loans to borrowers of different income levels was good and that its geographic distribution of loans was adequate. In addition, examiners noted that HNB provided a relatively high level of community development services and reported that its service-delivery systems were accessible to geographies and individuals of different income levels in its assessment areas.

In the bank's Cleveland and Columbus assessment areas, examiners concluded that the geographic distribution of HNB's home purchase loans and home refinance loans was adequate. Examiners characterized the bank's geographic distribution of its home improvement loans as excellent in the Cleveland assessment area and good in the Columbus assessment area. Examiners also rated HNB's distribution of loans by borrower income level for home purchase and home refinance as good in its Cleveland and Columbus assessment areas and as excellent for home improvement loans in its Cleveland assessment area. Moreover, examiners commended HNB for providing community development loans that were very responsive to community needs in the Cleveland and Columbus assessment areas, including loans totaling $12.26 million to developers of affordable housing. In addition, examiners noted that HNB's use of flexible loan programs contributed positively to the bank's lending performance, including its participation in affordable housing programs and its Community Access Mortgage product for borrowers in LMI tracts, under which borrowers with have higher debt-to-income ratios could qualify for loans.

Since the 2003 Evaluation, HNB represented that it has introduced additional mortgage products to assist LMI borrowers, including a mortgage product offering up to 100 percent financing with no mortgage insurance on owner-occupied properties in LMI census tracts and on properties purchased by LMI borrowers in census tracts of any income level. Another new product, the "Welcome Home" program, offers a fixed-rate mortgage with no down-payment requirement and reduced mortgage insurance for those with slightly impaired credit and limited funds for closing costs. HNB has made loans totaling more than $176 million through the "Welcome Home" program. A variation of this product is used in Cleveland's "Help Eliminate Loans that are Predatory" program, an initiative by Fannie Mae and local banking institutions, including HNB and Sky Bank, to create a fund to refinance mortgages for borrowers who have mortgages with problematic features, such as severe prepayment policies.[23]

In the 2003 Evaluation, examiners characterized HNB's performance under the investment test as good in the Cleveland and Columbus assessment areas. Examiners concluded that the investments were responsive to identified needs in those areas for affordable housing, financial assistance for small business, and revitalization of LMI areas. Huntington made investments totaling $73.5 million from 2004 through 2006.

Examiners rated HNB's performance under the service test in the Cleveland and Columbus assessment areas as good in the 2003 Evaluation. Although examiners noted that the percentages of branches in LMI geographies in those assessment areas were generally lower than the percentages of the population in those LMI geographies, they reported that the operational hours and services of the bank's branches were accessible to residents in LMI areas, with many branches offering services on Saturdays and making branch personnel available for appointments outside standard service hours. Examiners also noted that telephone banking services were offered in English and Spanish. Additionally, examiners commended HNB for providing a high level of community development services to numerous organizations serving the Cleveland and Columbus assessment areas, with bank representatives serving in leadership roles in such organizations. Some of these services included establishing and supervising student banking programs in elementary schools with students from primarily LMI areas, participation on a committee

19. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

20. The evaluation period for the 2003 Evaluation was January 1, 1999, through December 31, 2002, for the lending test and July 1, 1999, through December 31, 2002, for the service and investment tests.

21. Sky Trust, a special-purpose bank, is not subject to the CRA (12 CFR 228.11(3)).

22. HNB's statewide rating for Ohio was based primarily on full-scope evaluations conducted in HNB's Cleveland and Columbus assessment areas, the bank's major markets in Ohio. Limited-scope evaluations were conducted in HNB's 13 other Ohio assessment areas.

23. HNB participates in similar initiatives in Montgomery County, where Dayton is located, and Toledo.

formed by the City of Cleveland to address abusive lending practices that targeted LMI borrowers, and providing training for nonprofit organizations offering services to LMI individuals and families. HNB represents that since the 2003 Evaluation, it has provided more than 4,000 community development services, including financial literacy education for children and adults in both the Cleveland and Columbus metropolitan areas.

CRA Performance of Sky Bank. As noted, Sky Bank received an overall "satisfactory" rating in the 2006 Evaluation.[24] Examiners reported that taken as a whole, Sky Bank's distribution of lending reflected a good penetration among customers of different income levels. Furthermore, examiners noted that Sky Bank was a leader in making community development loans and qualified investments and that it provided a relatively high level of community development services. Examiners found Sky Bank's service-delivery systems to be reasonably accessible to all portions of, and to individuals of different income levels in, its assessment areas.

In its statewide assessment area in Ohio, Sky Bank received a "high satisfactory" rating on the lending test.[25] Overall geographic income distribution of loans was considered adequate by examiners, while lending distribution by borrower income was considered good. Although examiners reported weaker performance in Sky Bank's Cleveland-Akron metropolitan statistical area ("MSA") assessment area, they noted that Sky Bank's presence in the Cleveland-Akron market was relatively new and that it faced significant competition from well-established financial institutions in that market. In addition, examiners stated that they considered Sky Bank's operations in that market to be consistent with the overall operations of the institution. Examiners reported that the bank had a high level of community development lending in the Cleveland-Akron MSA assessment area.

Examiners rated Sky's overall service performance in the Cleveland-Akron MSA assessment area as adequate. Examiners noted that retail office locations in LMI geographies in this assessment area were limited, but also noted that Sky Bank provided a relatively high level of community development services in that area.

24. The evaluation period for the 2006 Evaluation was January 1, 2003, through December 31, 2004, for home mortgage and home improvement loans under the lending test and October 1, 2003, to March 31, 2006, for community development loans and investments under the lending and investment tests and community development services under the service test.

25. This rating was based on the bank's lending performance in its Ohio assessment areas where full-scope examinations were performed in the following areas: the Cleveland-Akron MSA, the Canton-Massillon MSA, and the Northwestern Ohio nonmetropolitan assessment areas. Examiners also reviewed the bank's assessment areas in Ohio where limited-scope examinations were performed to ensure consistency with the overall lending activity. Sky's assessment areas where limited-scope examinations were performed included its assessment areas in the Columbus and Toledo MSAs.

B. Branch Closings

Two commenters expressed concern about the proposal's possible effect on branch closings. Huntington has represented that management is considering internal recommendations on branch closings, relocations, and consolidations in overlapping markets after consummation of the proposal but that no final decisions have been made. Huntington also represented that it would follow HNB's branch closing policy with respect to any of those actions that are related to the proposal.

The Board has considered carefully HNB's branch closing policy and its record of opening and closing branches. HNB's branch closing policy requires the bank to ensure that its products and services meet the needs and convenience of the communities in which it does business, including LMI communities. In making a decision on whether to close a branch, bank management must review and assess any factors and potential changes that, if implemented, might reasonably improve the viability of an office and reduce the need to close that office. If a potential branch closing is in an LMI community, the policy also requires that HNB's CRA experts assess the impact on the community and contact neighborhood representatives and interested community groups to discuss and evaluate ways to minimize adverse effects of the proposed closing on the community and local customers. If the bank decides to close a branch, its management must make every reasonable effort to facilitate the availability of its services and products to customers of the closed office. The Board also has considered that federal banking law provides a specific mechanism for addressing branch closings that requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory agency before closing a branch.[26]

In the 2003 Examination, OCC examiners concluded that HNB's record of opening and closing branches had a favorable or neutral impact on LMI census tracts in its full-scope Ohio assessment areas. The Board has consulted with the OCC on the bank's record of branch openings and closings since the 2003 Evaluation. The OCC will continue to review the branch opening and closing record of HNB in the course of conducting CRA performance evaluations.

C. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of Huntington and Sky in light of public

26. Section 42 of the Federal Deposit Insurance Act (12 U.S.C. § 1831r-1), as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34, 844 (1999)), requires that a bank provide the public with at least 30 days' notice and the appropriate federal supervisory agency and customers of the branch with at least 90 days' notice before the date of the proposed branch closing. The bank also is required to provide reasons and other supporting data for the closing, consistent with the institution's written policy for branch closings.

comments received on the proposal. Two commenters alleged, based on 2004 and 2005 HMDA data, that Huntington had denied the home mortgage loan applications of African-American borrowers more frequently than those of nonminority applicants in the Columbus metropolitan area. The Board has focused its analysis on the 2005 and preliminary 2006 HMDA data reported by HNB.[27]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Huntington is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[28] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by Huntington and its subsidiaries. The Board also has consulted with the OCC, the primary federal supervisor of HNB.

The record, including confidential supervisory information, indicates that Huntington has taken steps to ensure compliance with fair lending and other consumer protection laws. Huntington has corporatewide policies and procedures to help ensure compliance with all fair lending and other consumer protection laws and regulations. Ongoing monitoring by corporate compliance management is designed to ensure compliance with policies and procedures. Huntington's compliance program also includes quarterly assessments of fair-lending compliance for each line of business, routine reviews of loans, and regular testing to note areas of weakness and recommend action plans for improvement. With respect to mortgage lending, Huntington sells the majority of the mortgages that it originates on the secondary market, and its standard procedure is to submit applications through automated underwriting systems that only examine objective data concerning the loan applicant. In addition, Huntington represented that its compliance staff members frequently receive training on best compliance practices from industry and government experts. Huntington has stated that its fair lending policies will apply to the combined institution after consummation of the proposal.

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance record of HNB under the CRA. These established efforts and record of performance demonstrate that the institution is active in helping to meet the credit needs of its entire communities.

D. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all of the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Huntington, comments received on the proposal, and confidential supervisory information. Huntington states that the proposal will result in greater convenience for Huntington and Sky customers through expanded delivery channels and a broader range of products and services. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance record of the relevant insured depository institutions are consistent with approval of the proposal.

CONCLUSION

Based on the foregoing, and in light of all the facts of record, the Board has determined that the applications should be, and hereby are, approved.[29]

27. The Board reviewed HMDA data for Huntington in Ohio and in the Cleveland, Columbus, and Toledo MSAs where the bank's primary assessment areas are located. The Board notes that 2006 HMDA data are preliminary and that final data will not be available for analysis until fall 2007.

28. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

29. Three commenters requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 225.16(e), 262.3(i)(2), 262.25(d)). The Board has considered carefully the commenters' requests in light of all the facts of record. In the Board's view, the commenters had ample opportunity to submit their views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenters' requests fail to demonstrate why written comments do not present their views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Huntington with the conditions in this order and all the commitments made to the Board in connection with the proposal. For purposes of these transactions, those commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors, effective June 4, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Appendix

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
OHIO BANKING MARKETS						
Cleveland—Cuyahoga, Geauga, Lake, and Lorain counties; Medina County, excluding the city of Wadsworth, the townships of Guilford, Sharon, and Wadsworth, and the village of Seville; the cities of Aurora and Streetsboro, the townships of Freedom, Hiram, Mantua, Nelson, Shalersville, and Windham, and the villages adjoining these townships in Portage County; the cities of Hudson, Macedonia, and Twinsburg, the townships of Boston, Northfield Center, Richfield, Sagamore Hills, and Twinsburg, and the villages adjoining these townships in Summit County; and the city of Vermilion in Erie County						
Huntington Pre-Consummation	6	2.41 bil.	4.0	1,781	15	41
Sky	11	1.15 bil.	1.9	1,781	15	41
Huntington Post-Consummation	4	3.56 bil.	5.9	1,781	15	41
Columbus—Franklin, Delaware, Fairfield, Hocking, Licking, Madison, Morrow, Pickaway, and Union counties; and Perry County, excluding Harrison township						
Huntington Pre-Consummation	1	8.30 bil.	28.0	1,662	60	59
Sky	12	323.mil.	1.1	1,662	60	59
Huntington Post-Consummation	1	8.63 bil.	29.1	1,662	60	59
Dayton—Montgomery, Greene, Miami, and Preble counties						
Huntington Pre-Consummation	6	456 mil.	4.9	1,553	14	30
Sky	11	129 mil.	1.4	1,553	14	30
Huntington Post-Consummation	6	585 mil.	6.3	1,553	14	30

Appendix—*Continued*

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Akron—Summit County, excluding the cities of Hudson, Macedonia, and Twinsburg, the townships of Boston, Northfield Center, Richfield, Sagamore Hills, and Twinsburg, and the villages adjoining those townships; Portage County, excluding the cities of Aurora and Streetsboro, the townships of Freedom, Hiram, Mantua, Nelson, Shalersville, and Windham, and the villages adjoining those townships; the city of Wadsworth, the townships of Guilford, Sharon, and Wadsworth, and the village of Seville in Medina County; the townships of Lake and Lawrence and the villages of Canal, Fulton, and Hartville in Stark County; the city of Rittman, the townships of Chippewa and Milton, and the villages adjoining those townships in Wayne County						
Huntington Pre-Consummation	7	396 mil.	4.6	1,379	23	22
Sky	10	212 mil.	2.5	1,379	23	22
Huntington Post-Consummation	6	608 mil.	7.1	1,379	23	22
Toledo—Lucas, Fulton, and Ottawa counties and Wood County, excluding the city of Fostoria						
Huntington Pre-Consummation	4	969 mil.	10.9	1,666	319	20
Sky	3	1.29 bil.	14.5	1,666	319	20
Huntington Post-Consummation	1	2.26 bil.	25.5	1,666	319	20
Canton—Stark County, excluding the townships of Lake and Lawrence; Carroll County; and the township of Smith and the village of Sebring in Mahoning County						
Huntington Pre-Consummation	2	796 mil.	15.1	1,700	307	16
Sky	6	535 mil.	10.2	1,700	307	16
Huntington Post-Consummation	1	1.33 bil.	25.3	1,700	307	16
Lima—Allen and Putnam counties; the townships of Clay, Duchouquet, Goshen, Logan, Moulton, Pusheta, Salem, Union, and Wayne in Auglaize County; the township of Liberty in Hardin County; and the township of Washington in Van Wert County						
Huntington Pre-Consummation	2	317 mil.	12.7	1,390	276	16
Sky	5	273 mil.	10.9	1,390	276	16
Huntington Post-Consummation	1	591 mil.	23.6	1,390	276	16

Appendix—*Continued*

Banking Markets Consistent with Board Precedent and DOJ Guidelines—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Dover–New Philadelphia—Tuscarawas and Harrison counties and the townships of Salt Creek, Paint, Berlin, Walnut Creek, and Clark in Holmes County						
Huntington Pre-Consummation	1	363 mil.	25.7	1,377	191	18
Sky	9	53 mil.	3.7	1,377	191	18
Huntington Post-Consummation	1	415 mil.	29.4	1,377	191	18
Fremont—Sandusky County						
Huntington Pre-Consummation	7	39 mil.	6.0	1,977	78	10
Sky	6	43 mil.	6.5	1,977	78	10
Huntington Post-Consummation	2	82 mil.	12.5	1,977	78	10
Logan—Logan County						
Huntington Pre-Consummation	3	65 mil.	11.5	1,725	375	11
Sky	2	92 mil.	16.2	1,725	375	11
Huntington Post-Consummation	1	157 mil.	27.8	1,725	375	11
BANKING MARKET IN INDIANA						
Indianapolis—Indianapolis MSA, consisting of Boone, Hamilton, Hancock, Hendricks, Johnson, Marion, Morgan, and Shelby counties; and Green township in Madison County, all in Indiana						
Huntington Pre-Consummation	9	617 mil.	2.6	1,283	44	49
Sky	4	2.01 bil.	8.5	1,283	44	49
Huntington Post-Consummation	3	2.62 bil.	11.1	1,283	44	49
CINCINNATI BANKING MARKET IN OHIO, INDIANA, AND KENTUCKY						
Cincinnati—Hamilton, Brown, Butler, Clermont, and Warren counties in Ohio; Boone, Bracken, Campbell, Gallatin, Grant, Kenton, and Pendleton counties in Kentucky; and Dearborn County in Indiana						
Huntington Pre-Consummation	5	1.53 bil.	3.9	1,799	1	77
Sky	66	14 mil.	0.0	1,799	1	77
Huntington Post-Consummation	5	1.55 bil.	4.0	1,799	1	77

NOTE: Data are as of June 30, 2006. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift deposits weighted at 50 percent.

ORDERS ISSUED UNDER FEDERAL RESERVE ACT

First State Bank Conway, Arkansas

Order Approving Establishment of a Branch

First State Bank ("Bank"), a state member bank, has requested the Board's approval under section 9 of the Federal Reserve Act ("Act")[1] to establish a branch at 6039 Heber Spring Road West, Quitman, Arkansas.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in accordance with the Board's Rules of Procedure.[2] The time for filing comments has expired, and the Board has considered the notice and all comments received in light of the factors specified in the Act.

Bank is the 19th largest depository institution in Arkansas, controlling approximately $390.5 million in deposits, which represents less than 1 percent of the total amount of deposits of insured depository institutions in the state.[3] Bank's main office and ten branches are in Faulkner and White counties, Arkansas, and the proposed branch would be in neighboring Cleburne County.

Section 9(3) of the Act[4] requires a state member bank to obtain Board approval before establishing a branch. The Board is required by section 9(4) of the Act to consider the financial condition of the applying bank, the general character of its management, and whether its corporate powers are consistent with the purposes of the Act, when acting on a branch application.[5] Regulation H, which implements section 9(4),[6] enumerates the factors that the Board must consider, including (1) the financial history and condition of the applying bank and the general character of its management; (2) the adequacy of the bank's capital and its future earnings prospects; (3) the convenience and needs of the community to be served by the branch; and (4) in the case of branches with deposit-taking capability, the bank's performance under the Community Reinvestment Act ("CRA").[7]

The Board has carefully considered the application in light of these factors and public comment received from a competing bank in Quitman. The commenter asserted that the community's demographic and economic characteristics would not support another profitable branch.

In considering the financial history and condition, future earnings prospects, and capital adequacy of Bank, the Board has reviewed reports of examination, other supervisory information, publicly reported and other financial information, and information provided by Bank and the commenter. Bank is well capitalized and would remain so on consummation of the proposal. The Board also has reviewed Bank's business plan and financial projections for the branch, including the projections for deposits, income, and costs. After carefully considering all the facts of record, the Board has concluded that the financial history and condition, capital adequacy, and future earnings prospects of Bank are consistent with approval of the proposal.

In considering Bank's managerial resources, the Board has reviewed the bank's examination record, including assessments of its management, risk-management systems, and operations. The Board also has considered its supervisory experiences with Bank and the bank's record of compliance with applicable banking law,[8] including anti-money-laundering laws. Bank is considered to be well managed. Based on this review and all the facts of record, the Board has concluded that the character of Bank's management is consistent with approval of the proposal.

The Board also has considered the convenience and needs of the community to be served, taking into account the comment received, and the bank's performance under the CRA. Bank received a "satisfactory" rating by the Federal Deposit Insurance Corporation at its most recent CRA performance evaluation, as of February 17, 2004.[9] The Board generally considers the entry of a new competitor in a community to be a positive factor when assessing the effect of a proposal on the convenience and needs of the community because new entry provides additional alternatives to consumers and businesses. Bank has represented that the proposed branch would provide residents of the Quitman area with another convenient source of banking services and offer extended service hours.[10] For these reasons and based on a review of the entire record, the Board concludes that the convenience and needs considerations and Bank's record of performance under the CRA are consistent with approval of the proposal.

1. 12 U.S.C. § 321 et seq.
2. 12 CFR 262.3(b).
3. Statewide ranking and deposit data are as of June 30, 2006, and reflect mergers as of June 1, 2007.
4. 12 U.S.C. § 321 and 12 CFR 208.6(b).
5. 12 U.S.C. § 322.
6. 12 CFR 208.6(b).
7. 12 U.S.C. § 2901 et seq.
8. The commenter also expressed concern about Bank's construction of the proposed branch facility without obtaining regulatory approval to establish a branch. Bank established a loan production office in April 2007 at the proposed branch site in Quitman, which did not require the Board's prior approval. The Bank has confirmed to the Board that the Quitman loan production office is not engaged in any activities that would cause the office to be a branch within the meaning of the Act or the Board's implementing regulations. *See* 12 CFR 208.2(c).
9. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 at 36,640 (2001).
10. In reviewing this proposal, the Board has considered the comments in light of Bank's plans and projections for the proposed branch, as well as its financial and managerial resources. The Board also has reviewed the deposit and demographic data for the relevant banking market, which includes all of Cleburne County. The data indicate modest increases in population from 2000 to 2006 and consistent moderate growth in deposits during the same time period.

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. The Board's approval is specifically conditioned on Bank's compliance with all commitments made to the Board in connection with the proposal. The commitments and conditions relied on by the Board are deemed to be conditions imposed in writing in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

Approval of this application is also subject to the establishment of the proposed branch within one year of the date of this order, unless such period is extended by the Board or the Federal Reserve Bank of St. Louis, acting under authority delegated by the Board.[11]

By order of the Board of Governors, effective June 20, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

11. The commenter requested that the Board hold a public meeting or hearing on the proposal. The Act does not require the Board to hold a public hearing on an application to establish a branch. Under its rules, the Board may, in its discretion, hold a public meeting or hearing on an application if necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 262.3(e), 262.25(d)). The Board has considered carefully the commenter's request in light of all the facts of record. In the Board's view, the commenter had ample opportunity to submit his views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenter's request fails to demonstrate why written comments do not present his views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the request for a public meeting or hearing on the proposal is denied.

ORDERS ISSUED UNDER INTERNATIONAL BANKING ACT

The Royal Bank of Scotland plc Edinburgh, Scotland

Order Approving Establishment of a Branch

The Royal Bank of Scotland plc ("Bank"), Edinburgh, Scotland, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under sections 5(a) and 7(d) of the IBA[1] to establish a branch in Greenwich, Connecticut. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in newspapers of general circulation in Greenwich, Connecticut (*Greenwich Time*), and Stamford, Connecticut (*The Advocate*), on November 3, 2006. The time for filing comments has expired, and all comments received have been considered.

Bank, with total assets of $1.6 trillion, is the second largest commercial bank in the United Kingdom.[2] Bank is wholly owned by The Royal Bank of Scotland Group plc ("RBS Group"), Edinburgh, Scotland. RBS Group's shares are widely held, with no shareholder or group of shareholders controlling more than 5 percent of shares. Bank provides a variety of banking services to retail and corporate customers in 27 countries, including the United States.[3] In the United States, Bank operates an uninsured state branch in New York, New York; representative offices in Houston, Texas, and Los Angeles, California; and Greenwich Capital Markets, Inc. ("GCM"), Greenwich, Connecticut, a registered broker-dealer specializing in debt capital markets services. Bank also owns Citizens Financial Group, Inc. ("Citizens"), Providence, Rhode Island, a registered bank holding company with $163 billion in consolidated assets.[4] Bank is a qualifying foreign banking organization under Regulation K.[5]

The establishment of the Greenwich branch is the first component in a long-range plan to relocate Bank's U.S. branch and GCM to the same location. After completion of a new corporate headquarters in Stamford, Connecticut, in late 2008 or early 2009, Bank expects to move the Greenwich branch and GCM to Stamford.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether the foreign bank (1) engages directly in the business of banking outside of the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[6] The Board also considers additional standards set forth in the IBA and Regulation K.[7]

1. 12 U.S.C. §§3103(a) and 3105(d).

2. Asset data are as of September 30, 2006.

3. Bank also conducts banking activities through its subsidiary, National Westminster Bank Plc, London, United Kingdom.

4. Asset data are as of September 30, 2006.

5. 12 CFR 211.23(b).

6. 12 U.S.C. §3105(d)(2); 12 CFR 211.24. In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisors: (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

7. 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3).

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues. With respect to supervision by home-country authorities, the Federal Reserve previously has determined that Bank is subject to home-country supervision on a consolidated basis.[8] There has been no material change in the manner in which Bank is supervised by the Financial Services Authority ("FSA"). Based on all the facts of record, it has been determined that Bank is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.

The Board has also taken into account the additional standards set forth in section 7 of the IBA and Regulation K.[9] The FSA has no objection to Bank's establishment of the proposed branch.

The United Kingdom's risk-based capital standards are consistent with those established by the Basel Capital Accord. Bank's capital is in excess of the minimum levels that would be required by the Basel Capital Accord and is considered equivalent to capital that would be required of a U.S. banking organization. Managerial and other financial resources of Bank are consistent with approval, and Bank appears to have the experience and capacity to support the proposed branch. In addition, Bank has established controls and procedures for the proposed office to ensure compliance with U.S. law, as well as controls and procedures for its worldwide operations generally.

The United Kingdom is a member of the Financial Action Task Force and subscribes to its recommendations on measures to combat money laundering. In accordance with these recommendations, the United Kingdom has enacted laws and created legislative and regulatory standards to deter money laundering. Money laundering is a criminal offense in the United Kingdom, and financial institutions are required to establish internal policies, procedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations. Bank's compliance with applicable laws and regulations is monitored by Bank's internal auditors and the FSA.

With respect to access to information about Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. RBS Group and Bank have committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, RBS Group and Bank have committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that RBS Group and Bank have provided adequate assurances of access to any necessary information that the Board may request.

With respect to the interstate aspect of this proposal, section 5(a)(2) of the IBA, as amended by section 104 of the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994,[10] authorizes a foreign bank to establish and operate a de novo state branch in a state outside its home state subject to certain requirements. The proposal complies with the requirements of section 5(a)(2) of the IBA.[11] The Board has determined that all the other criteria referred to in section 5(a)(3) of the IBA, including the criteria in section 7(d) of the IBA, have also been met.[12] Accordingly, the proposed transaction is consistent with the requirements of section 5 of the IBA. Based on the foregoing and all the facts of record, Bank's application to establish the proposed branch is hereby approved by the

8. *The Royal Bank of Scotland Group plc*, 89 *Federal Reserve Bulletin* 386 (2003).

9. *See* 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). These standards include: whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; and the bank's record of operation.

10. 12 U.S.C. § 3103(a)(2).

11. Section 5(a)(2) of the IBA authorizes a foreign bank to establish and operate a de novo state branch outside its home state to the extent that a state-chartered bank with the same home state as the foreign bank may do so under section 18(d)(4) of the Federal Deposit Insurance Act ("FDIA"). The Federal Deposit Insurance Corporation has authorized state nonmember banks to establish de novo state branches outside their home state, pursuant to section 18(d)(4) of the FDIA, when the two states involved permit de novo entry on a nationwide reciprocal basis. Connecticut and Rhode Island permit de novo entry on a nationwide reciprocal basis.

12. Section 5(a) of the IBA also requires that certain conditions in section 44 of the FDIA be met in order for the Board to approve an interstate branching transaction. *See* 12 U.S.C. § 3103(a)(3)(C) (referring to sections 44(b)(1), 44(b)(3), and 44(b)(4) of the FDIA, 12 U.S.C. §§ 1831u(b)(1), (b)(3), and (b)(4)). The Board has determined that Bank is in compliance with state filing requirements. Bank was adequately capitalized as of the date the application was filed, and on consummation of this proposal, Bank would continue to be adequately capitalized and adequately managed. The Board has determined, after consultation with the Secretary of the Treasury, that the financial resources of Bank are equivalent to those required for a domestic bank to receive approval for interstate branching under section 44 of the FDIA. The Board also must take into account community reinvestment considerations, including the record of Bank's domestic insured depository institutions, under the Community Reinvestment Act ("CRA"). *See* 12 U.S.C. § 3103(a)(3)(C); 12 U.S.C. § 1831u(b)(3). Bank's domestic insured depository institutions, owned through Citizens, each received "outstanding" or "satisfactory" ratings at its most recent CRA performance evaluations by the appropriate federal regulators. Based on all the facts of record, the Board concludes that community reinvestment considerations are consistent with approval.

Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board. Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of the application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[13] The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with this decision and may be enforced in proceedings under 12 U.S.C. § 1818 against Bank and its affiliates.

By order, approved pursuant to authority delegated by the Board, effective April 26, 2007.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

13. The Board's approval of this application does not supplant the authority of Connecticut to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

Victoria Mutual Building Society Kingston, Jamaica

Order Approving Establishment of a Representative Office

Victoria Mutual Building Society ("Bank"), Kingston, Jamaica, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA[1] to establish a representative office in Miami, Florida. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

Notice of the application, affording interested persons an opportunity to submit comments, has been published in a newspaper of general circulation in Miami-Dade County, Florida (*The Miami Herald*, February 18, 2005). The time for filing comments has expired, and all comments have been considered.

Bank, with total consolidated assets of approximately \$682 million,[2] is the fourth largest deposit-taking institution and second largest building society in Jamaica.[3] Bank primarily engages in residential mortgage lending and retail banking activities through 15 offices in Jamaica. Bank's domestic subsidiaries offer insurance, investment management, real estate brokerage, and property management services. Bank also operates representative offices and money-transmitter subsidiaries in the United Kingdom and Canada.

The proposed representative office would act as a liaison between Bank's head office and existing and prospective customers in the United States. The office would solicit business, market products and services of the head office and of Bank's real estate brokerage subsidiary in Jamaica, and provide information to customers concerning their accounts. In connection with Bank's mortgage lending operations, it also would solicit prospective borrowers, assemble credit information, arrange for property inspections and appraisals, assist in the preparation of loan applications, and transmit applications and supporting documentation to the head office.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a representative office, the Board must consider whether the foreign bank: (1) engages directly in the business of banking outside of the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[4] The Board also considers additional standards set forth in the IBA and Regulation K.[5] The Board considers the supervision standard to have been when it determines that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.[6] This is a lesser standard than the comprehensive, consolidated supervision standard applicable to applications to establish branch or agency offices of a foreign bank. The Board considers the lesser standard sufficient for approval

1. 12 U.S.C. § 3107(a).
2. Asset data are as of December 31, 2006.
3. Bank is a mutual organization with more than 680,000 members. Each member is considered to be a shareholder and has one vote. No single shareholder controls the organization.

4. 12 U.S.C. § 3107(a)(2); 12 CFR 211.24(d)(2). In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.
5. 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3).
6. *See, e.g., Banco Latinoamericano de Exportaciones S.A., Federal Reserve Bulletin* C128 (2006); *Banco Financiera Comercial Hondureña, S.A.*, 91 *Federal Reserve Bulletin* 444 (2005); *Jamaica National Building Society*, 88 *Federal Reserve Bulletin* 59 (2002); *RHEINHYP Rheinische Hypothekenbank AG*, 87 *Federal Reserve Bulletin* 558 (2001); *see also Promstroybank of Russia*, 82 *Federal Reserve Bulletin* 599 (1996); *Komercni Banka, a.s.*, 82 *Federal Reserve Bulletin* 597 (1996); *Commercial Bank "Ion Tiriac," S.A.*, 82 *Federal Reserve Bulletin* 592 (1996).

of representative-office applications because representative offices may not engage in banking activities.[7]

In connection with this application, Bank has provided certain commitments to the Board that limit the activities of the representative office. It has committed that the representative office would engage only in certain specified activities and would not make credit decisions; solicit or accept deposits; process or initiate transactions on behalf of Bank; or engage in activities related to securities trading, foreign exchange, or money transmission.

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home-country authorities, the Board has considered the following information. The Bank of Jamaica ("BOJ") is the licensing, regulatory, and supervisory authority for banks and all other financial institutions in Jamaica and, as such, is the home-country supervisor for Bank. The BOJ has pursued a program of reforms intended to update its regulatory and supervisory framework. The BOJ authorizes the establishment of foreign offices of Jamaican banks, regulates those offices, and reviews their operations in connection with annual on-site examinations of the head office.

The Board previously determined, in connection with an application involving another bank from Jamaica, that the bank was subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.[8] Bank is supervised by the BOJ on substantially the same terms and conditions as that other Jamaican bank. Based on all the facts of record, including commitments provided by Bank limiting the activities of the proposed office, it has been determined that Bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.

The additional standards set forth in section 7 of the IBA and Regulation K have also been taken into account.[9] The BOJ has no objection to the establishment of the proposed representative office.

With respect to the financial and managerial resources of Bank, taking into consideration its record of operations in its home country, its overall financial resources, and its standing with its home-country supervisor, financial and managerial factors are consistent with approval of the proposed representative office. Bank appears to have the experience and capacity to support the proposed representative office and has established controls and procedures for the proposed representative office to ensure compliance with U.S. law, as well as controls and procedures for its worldwide operations generally.

Although Jamaica is not a member of the Financial Action Task Force, Jamaica is a member of the Caribbean Financial Action Task Force and subscribes to its measures on combating money laundering and terrorist financing. Jamaica also participates in other international fora that address the prevention of money laundering and terrorist financing.[10] It has enacted laws and the BOJ has promulgated implementing regulations and guidelines aimed at preventing money laundering and terrorist financing. Money laundering and financing terrorism are criminal offenses in Jamaica. The laws, regulations, and guidelines require financial institutions, including building societies, to establish and implement policies, procedures, and controls for the purpose of preventing and detecting money laundering and terrorist financing and to report certain cash transactions and suspicious transactions to appropriate authorities. An institution's compliance with applicable laws, regulations, and guidelines is monitored by the BOJ and the institution's external auditors. Bank has policies and procedures to comply with these laws and regulations.

With respect to access to information on Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed, and the Board has communicated with relevant government authorities regarding access to information. Bank has committed to make available to the Board such information on the operations of Bank and any of its affiliates as the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, the BOJ may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

On the basis of all the facts of record, and subject to the commitments made by Bank, as well as the terms and

7. 12 CFR 211.24(d)(2)).

8. *Jamaica National Building Society*, 88 *Federal Reserve Bulletin* 59 (2002).

9. *See* 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). The additional standards set forth in section 7 of the IBA and Regulation K include the following: whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; and the bank's record of operation.

10. Jamaica is a member of the Organization of American States Inter-American Drug Abuse Control Commission Group of Experts for the Control of Money Laundering and the Inter-American Convention against Corruption. Jamaica is also party to the 1988 United Nations Convention against the Illicit Traffic of Narcotics and Psychotropic Substances and the United Nations International Convention against Transnational Organized Crime.

conditions set forth in this order, Bank's application to establish the representative office is hereby approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.[11] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require or recommend termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the commitments made in connection with this application and with the conditions in this order.[12] The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with this decision and may be enforced in proceedings under 12 U.S.C. § 1818 against Bank and its affiliates.

By order, approved pursuant to authority delegated by the Board, effective June 14, 2007.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

11. *See* 12 CFR 265.7(d)(12).

12. The Board's authority to approve the establishment of the proposed representative office parallels the continuing authority of the state of Florida to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the state of Florida or its agent, the Florida Office of Financial Regulation, to license the representative office in accordance with any terms or conditions that it may impose.

December 2007

Legal Developments: Third Quarter, 2007

ORDERS ISSUED UNDER BANK HOLDING COMPANY ACT

ORDERS ISSUED UNDER SECTION 3 OF THE BANK HOLDING COMPANY ACT

Bank of America Corporation Charlotte, North Carolina

Order Approving the Acquisition of a Bank Holding Company

Bank of America Corporation ("Bank of America"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire ABN AMRO North America Holding Company ("ABN AMRO North America") and thereby indirectly acquire LaSalle Bank Corporation ("LaSalle"), both of Chicago, Illinois, and its subsidiary banks, LaSalle Bank National Association ("LaSalle Bank"), Chicago, and LaSalle Bank Midwest National Association ("LaSalle Bank Midwest"), Troy, Michigan.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (72 *Federal Register* 31,582 (2007)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the BHC Act.[3]

Bank of America, with total consolidated assets of approximately $1.5 trillion, is the second largest depository organization in the United States.[4] Bank of America controls seven insured depository institutions[5] that operate in thirty-one states and the District of Columbia. In Illinois, Bank of America is the 14th largest depository organization, controlling deposits of $5.4 billion, which represent 1.6 percent of the total amount of deposits of insured depository institutions in the state ("state deposits").[6]

ABN AMRO North America has total consolidated assets of approximately $160 billion and controls indirectly two depository institutions, LaSalle Bank and LaSalle Bank Midwest, which operate in Illinois, Indiana, and Michigan. In Illinois, ABN AMRO North America is the second largest depository organization, controlling deposits of $37 billion, which represent 11.2 percent of state deposits.

On consummation of the proposal, Bank of America would remain the second largest depository organization in the United States, with total consolidated assets of approximately $1.7 trillion. Bank of America would become the largest depository organization in Illinois, controlling deposits of approximately $42.4 billion, which represent approximately 12.9 percent of the total amount of state deposits.

INTERSTATE AND DEPOSIT CAP ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Bank of America is North Carolina,[7] and ABN AMRO North America's subsidiary banks are located in Illinois, Indiana, and Michigan.[8]

1. 12 U.S.C. § 1842.
2. ABN AMRO North America is a wholly owned subsidiary of ABN AMRO Bank N.V. ("ABN AMRO"), Amsterdam, the Netherlands. Bank of America also proposes to acquire two other subsidiaries of ABN AMRO North America, Standard Federal International, LLC and LaSalle Trade Services Corporation, both of Chicago, which are agreement corporations under section 25 of the Federal Reserve Act ("FRA"), 12 U.S.C. § 601 et seq. In addition, Bank of America proposes to acquire the nonbanking subsidiaries of ABN AMRO North America, other than ABN AMRO WCS Holding Company ("WCS Holding"), New York, New York, in accordance with section 4(k) of the BHC Act, 12 U.S.C. § 1843(k). ABN AMRO North America would divest WCS Holding and its subsidiaries by distributing them to ABN AMRO before Bank of America consummates the proposed transaction.
3. Four commenters supported the proposal, and 18 commenters expressed concerns about various aspects of the proposal.
4. Asset data are as of June 30, 2007, and are adjusted to reflect the acquisition by Bank of America of U.S. Trust Corporation and its subsidiary bank, United States Trust Company, National Association ("U.S. Trust Bank"), both of New York, New York, that was consummated on July 2, 2007. *See Bank of America Corporation*, 93 *Federal Reserve Bulletin* C49 (2007) ("*BOA/U.S. Trust Order*").
5. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.
6. State deposit data and rankings are as of June 30, 2006.
7. *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.
8. For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or

The Board may not approve an interstate acquisition under section 3(d) if the applicant (including all its insured depository institution affiliates) controls, or on consummation of the proposed transaction would control, more than 10 percent of the total amount of deposits of insured depository institutions in the United States ("nationwide deposit cap").[9] As required by section 3(d), the Board has carefully considered whether Bank of America controls, or on consummation of the proposed transaction would control, more than 10 percent of the total amount of deposits of insured depository institutions[10] in the United States. In analyzing this matter, the Board calculated the percentage of total deposits of insured depository institutions in the United States and the total deposits that Bank of America controls, and on consummation of the proposal would control, based on the definition of "deposit" in the FDI Act,[11] the deposit data collected in reports filed by all insured depository institutions,[12] and the methods and adjustments used by the FDIC to compute total deposits. These calculations were made using the methodology described in the Board's 2004 order approving Bank of America's acquisition of FleetBoston Financial Corporation[13] and take into account the voluntary use by some insured depository institutions of the newly revised Call Report and Thrift Financial Report forms, which became available in the first quarter of 2007.[14]

Based on the latest available deposit data reported by all insured depository institutions, the total amount of deposits of insured depository institutions in the United States is approximately $6.828 trillion as of June 30, 2007. Also based on the latest Call Report, Bank of America (including all its insured depository institution affiliates) controls deposits of approximately $615.4 billion, and ABN AMRO North America controls deposits of approximately $59.1 billion. Bank of America, therefore, currently controls approximately 9.01 percent of total U.S. deposits. On consummation of the proposed transaction, Bank of America would control approximately 9.88 percent of the total amount of deposits of insured depository institutions in the United States. Accordingly, the Board finds that Bank of America does not now control, and on consummation of the proposed transaction would not control, an amount of deposits that would exceed the nationwide deposit cap.[15]

Section 3(d) also prohibits the Board from approving a proposal if, on consummation, the applicant would control 30 percent or more of the total deposits of insured depository institutions in any state in which both the applicant and the organization to be acquired operate an insured depository institution, or the applicable percentage of state deposits established by state law ("state deposit cap").[16] On consummation of the proposal, Bank of America would control less than 30 percent of the total amount of deposits of insured depository institutions in Illinois, Indiana, and Michigan and would not hold deposits in excess of any applicable state deposit caps.

All other requirements of section 3(d) of the BHC Act also would be met on consummation of the proposal.[17] Based on all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or

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headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and (d)(2)(B).

9. Several commenters expressed concerns about the proposal's consistency with the nationwide deposit cap.

10. The BHC Act adopts the definition of "insured depository institution" used in the Federal Deposit Insurance Act (12 U.S.C. § 1811 et seq.) ("FDI Act"). *See* 12 U.S.C. § 1841(n). The FDI Act's definition of "insured depository institution" includes all banks (whether or not the institution is a bank for purposes of the BHC Act), savings banks, and savings associations that are insured by the Federal Deposit Insurance Corporation ("FDIC") and insured U.S. branches of foreign banks, as each of those terms is defined in the FDI Act. *See* 12 U.S.C. § 1813(c)(2).

11. Section 3(d) of the BHC Act specifically adopts the definition of "deposit" in the FDI Act (12 U.S.C. § 1842(d)(2)(E)) (incorporating the definition of "deposit" at 12 U.S.C. § 1813(l)).

12. Each insured bank in the United States must report data regarding its total deposits in accordance with the definition of "deposit" in the FDI Act on the institution's Consolidated Report of Condition and Income ("Call Report"). Each insured savings association similarly must report its total deposits on the institution's Thrift Financial Report. Deposit data for FDIC-insured U.S. branches of foreign banks and federal branches of foreign banks are obtained from the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks. These data are reported quarterly to the FDIC and are publicly available.

13. *Bank of America Corporation*, 90 *Federal Reserve Bulletin* 217, 219 (2004) ("*BOA/Fleet Order*"); *see also Bank of America Corporation*, 92 *Federal Reserve Bulletin* C5 (2006) (order approving Bank of America's merger with MBNA Corporation, Wilmington, Delaware) ("*BOA/MBNA Order*")).

14. Reporting on the revised Call Report and Thrift Financial Report forms is voluntary until calendar year 2008. Most insured depository institutions continue to use the previously authorized version of these forms. To compute the amount of deposits held by those institutions, the Board used the formula described in the *BOA/Fleet Order* to combine the appropriate lines from the previous version of the forms. Some insured depository institutions are already using the revised versions of the Call Report and the Thrift Financial Report. The amount of deposits held by those institutions was computed as outlined in Appendix A.

15. Bank of America's lead bank, Bank of America, National Association, Charlotte, North Carolina, recently acquired nonvoting convertible shares of Countrywide Financial Corporation ("Countrywide"), Calabasas, California, which operates a savings association. This investment by Bank of America was a noncontrolling investment for purposes of the BHC Act and was made pursuant to section 4(c)(6) of the BHC Act (12 U.S.C. § 1843(c)(6)). Because the investment did not cause Countrywide's subsidiary savings association to become an "affiliate" of Bank of America, as defined by the BHC Act, the deposits of Countrywide are not included in the calculation of the deposit cap, which, by statute, refers only to affiliated insured depository institutions of a bank holding company. *See* 12 U.S.C. § 1841(k).

16. 12 U.S.C. § 1842(d)(2)(B)–(D).

17. Bank of America is adequately capitalized and adequately managed as defined by applicable law (12 U.S.C. § 1842(d)(1)(A)). LaSalle Bank and LaSalle Bank Midwest have been in existence and operated for the minimum period of time required by applicable state law. *See* 12 U.S.C. § 1842(d)(1)(B). The other requirements in section 3(d) of the BHC Act also would be met on consummation of the proposal.

would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[18]

Bank of America and ABN AMRO North America have subsidiary depository institutions that compete directly in five banking markets in Illinois: Aurora, Chicago, Elgin, Joliet, and Woodstock. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by Bank of America and ABN AMRO North America,[19] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[20] and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in each of the five banking markets.[21] The change in the HHI's measure of concentration would be small and numerous competitors would remain in each market. On consummation, three markets would remain unconcentrated and two markets would remain moderately concentrated, as measured by the HHI.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the five banking markets where Bank of America and ABN AMRO North America compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information received from the relevant federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by Bank of America.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary banks and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the proposal under the financial factors. Bank of America and its subsidiary banks, LaSalle Bank, and LaSalle Bank Midwest are all well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board finds that Bank of America has sufficient financial resources to effect the proposal. The proposed transaction is structured as a cash purchase of shares, and Bank of America will use existing resources to fund the purchase.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of Bank of America, ABN AMRO North America, and their subsidiary banks, including assessments of their management, risk-management systems, and operations.[22]

18. 12 U.S.C. § 1842(c)(1).

19. Deposit and market share data are as of June 30, 2007, adjusted to reflect mergers and acquisitions through July 9, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

20. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

21. These markets and the effects of the proposal on the concentration of banking resources in these markets are described in Appendix B.

22. A commenter opposing the proposal expressed concern about Bank of America's connection to investigations and lawsuits related to the bankruptcy of Parmalat SpA, Parma, Italy. The commenter also expressed unsubstantiated concerns about Bank of America's student

In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking law, including anti-money-laundering laws.[23] The Board also has considered Bank of America's plans for implementing the proposal, including with respect to the proposed management of the organization after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.[24]

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[25] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[26]

The Board has considered carefully all the facts of record, including reports of examination of the CRA performance records of the subsidiary banks of Bank of America and ABN AMRO North America, data reported by Bank of America under the Home Mortgage Disclosure Act ("HMDA"),[27] other information provided by Bank of America, confidential supervisory information, and public comments received on the proposal.

Four commenters supported the proposal. Those commenters commended Bank of America's focus on economic integration in the communities in which it operates, sponsorship of homebuyer events in LMI communities, and financial support for small business and microlending programs. Several other commenters expressed concerns about either the lending record of Bank of America or its ability to adequately meet its CRA obligations, and some of them opposed the proposal or recommended approval only if subject to conditions suggested by the commenter.[28] Some commenters alleged that Bank of America has not addressed the diversity and community reinvestment needs of California communities or expressed concern about the CRA performance of Bank of America in California. Another commenter alleged that Bank of America has discriminated against, and has not addressed the convenience and needs of, LMI and minority residents of Chicago. One other commenter alleged more generally, based on HMDA data, that Bank of America has engaged in disparate treatment of minority individuals in home mortgage lending.

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications

loan policies. The Board has considered these comments in light of all the facts of record, including reports of examination assessing the financial and managerial resources of the organizations, information on the allegations raised by the pending lawsuits, and information provided by the Office of the Comptroller of the Currency ("OCC").

23. As part of its consideration of managerial factors, the Board has reviewed confidential supervisory information on the policies, procedures, and practices of Bank of America and its subsidiary banks for complying with the Bank Secrecy Act and consulted with the OCC. One commenter reiterated concerns that it previously expressed about the handling of certain money transfers through the New York branch of Bank of America, National Association ("BA Bank"), Charlotte, North Carolina. The Board notes that this matter was addressed in the *BOA/U.S. Trust Order* at footnote 22 and incorporates those findings in this order.

24. Some commenters expressed concerns about Bank of America's relations with unaffiliated third parties engaged in subprime lending. The commenters provided no evidence that Bank of America has originated, purchased, or securitized "predatory" loans or otherwise engaged in abusive lending practices. Bank of America has policies and procedures to help ensure that the subprime loans it purchases and securitizes are in compliance with applicable state and federal consumer protection laws. Bank of America stated that it conducts extensive due diligence reviews of the third-party loan originators with which it does business, as well as the loans that it purchases and the servicers of each pool, to help ensure that Bank of America is not facilitating "predatory" lending. The Board expects all banking organizations to conduct their operations in a safe and sound manner with adequate systems to manage operational, compliance, and reputational risks and will take appropriate supervisory actions to address and prevent abusive lending practices.

25. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

26. 12 U.S.C. § 2903.

27. 12 U.S.C. § 2801 et seq.

28. Some commenters criticized Bank of America's performance under its previous community reinvestment pledges, urged the Board to require Bank of America to provide specific pledges or plans or to take certain future actions, or asked the Board to condition its approval on a commitment by Bank of America to improve its CRA record. The Board consistently has stated that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization and that the enforceability of any such third-party pledges, initiatives, and agreements are matters outside the CRA. *See BOA/Fleet Order* at 232–33. Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the credit needs of its assessment areas at the time the Board reviews a proposal under the convenience and needs factor.

process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[29]

Bank of America's lead bank, BA Bank, received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of December 31, 2001 ("BOA 2001 Evaluation").[30] The two other subsidiary banks of Bank of America subject to the CRA, FIA Card Services, N.A., Wilmington, Delaware, and U.S. Trust Bank, also received "outstanding" ratings at their most recent CRA performance evaluations.[31]

ABN AMRO North America's lead subsidiary bank, LaSalle Bank, received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of December 31, 2002 ("2002 Evaluation").[32] The other subsidiary bank, LaSalle Bank Midwest, received a "satisfactory" rating at its most recent CRA performance evaluation by the OCC, as of December 31, 2002.[33] Bank of America has represented that it would combine the community development and community investment activities of BA Bank and ABN AMRO North America's subsidiary banks to strengthen and help meet the banking needs of its communities.[34]

CRA Performance of BA Bank. The BOA 2001 Evaluation was discussed in the *BOA/Fleet Order.*[35] The Board also considered BA Bank's CRA performance earlier this year in the *BOA/U.S. Trust Order.* Based on a review of the record in this case, the Board hereby reaffirms and adopts the facts and findings detailed in those orders concerning BA Bank's CRA performance record. Bank of America also provided the Board with additional information about its CRA performance since the Board last reviewed such matters in the *BOA/U.S. Trust Order.* In addition, the Board has consulted with the OCC with respect to BA Bank's CRA performance since the *BOA/U.S. Trust Order.*

In the BOA 2001 Evaluation, examiners commended BA Bank's overall lending performance, which they described as demonstrating excellent or good lending-test results in all its rating areas. Examiners reported that the bank's distribution of HMDA-reportable mortgage loans among areas of different income levels was good, and they commended BA Bank for developing mortgage loan programs with flexible underwriting standards. In addition, examiners reported that the bank's small business lending was excellent or good in the majority of its rating areas, and they commended the distribution of small business loans among businesses of different sizes in several of BA Bank's assessment areas.[36] Examiners also noted in the BOA 2001 Evaluation that BA Bank's level of community development lending was excellent.

Since the BOA 2001 Evaluation, BA Bank has maintained a substantial level of home mortgage, small business, and community development lending. In 2005 and 2006, the bank originated more than 756,000 HMDA-reportable home mortgage loans totaling approximately $161 billion throughout its assessment areas, including more than $18 billion in loans to LMI individuals.[37] In 2006, BA Bank was recognized by the U.S. Small Business Administration ("SBA") for the ninth consecutive year as the leading small business lender in the country, based on its origination of SBA loans totaling more than $405 million.[38] As noted in the *BOA/U.S. Trust Order,* BA Bank's community development lending during 2005 and 2006 totaled approximately $5.8 billion.[39]

In the BOA 2001 Evaluation, examiners reported that BA Bank consistently demonstrated strong performance under the investment test, noting that its performance was excellent or good in the majority of its assessment areas.[40]

29. *See Interagency Questions and Answers Regarding Community Reinvestment,* 66 *Federal Register* 36,620 and 36,639 (2001).

30. The evaluation period for the BOA 2001 Evaluation was January 1, 2000, through December 31, 2001.

31. FIA Card Services, N.A., formerly known as MBNA America Bank, National Association, was last evaluated by the OCC as of April 4, 2005. U.S. Trust Bank was formed in 2006 by the conversion of United States Trust Company of New York ("USTC New York") to a national bank charter and its subsequent merger with U.S. Trust Company, National Association ("USTC Los Angeles"). The CRA performance of USTC New York was evaluated by the Federal Reserve Bank of New York as of March 15, 2004, before its sale to Bank of America and conversion to a national bank charter in 2006. The CRA performance of USTC Los Angeles was last evaluated by the OCC as of October 15, 2002. The OCC has not yet evaluated U.S. Trust Bank's CRA performance.

32. The evaluation period for the 2002 Evaluation was January 1, 2000, through December 31, 2002.

33. LaSalle Bank Midwest was formerly known as Standard Federal Bank, N.A., Troy, Michigan.

34. Several commenters questioned Bank of America's efforts in awarding contracts to minority- and women-owned businesses. Although the Board fully supports programs designed to promote equal opportunity and economic opportunities for all members of society, the comments about supplier diversity programs are beyond the factors the Board is authorized to consider under the BHC Act. *See e.g., Deutsche Bank AG,* 85 *Federal Reserve Bulletin* 509, 513 (1999).

35. *BOA/Fleet Order* at 225–229.

36. In this context, "small business loans" are loans with original amounts of $1 million or less that are secured by nonfarm, nonresidential properties or are commercial and industrial loans to borrowers in the United States.

37. In California in 2005 and 2006, the bank originated more than 150,000 HMDA-reportable home mortgage loans totaling approximately $51 billion throughout its assessment areas, including more than $2.8 billion in loans to LMI individuals. In the Chicago metropolitan statistical area ("MSA"), the bank originated more than 20,000 HMDA-reportable home mortgage loans totaling approximately $2.2 billion throughout its assessment areas, including more than $610 million in loans to LMI individuals.

38. Bank of America represented that BA Bank's small business loans of less than $50,000 in California in 2006 more than doubled from the level attained in 2005, both in number and dollar amounts of such loans.

39. BA Bank's community development lending during 2005 and 2006 in its California assessment areas and in the Chicago market totaled approximately $1.2 billion and $34 million, respectively. BA Bank has entered into partnerships with approximately 500 housing-counseling agencies throughout its assessment areas, including 16 housing-counseling agencies in the Chicago metropolitan area, to offer pre- and post-purchase home mortgage counseling to LMI borrowers. Such counseling includes reviewing the buyer's credit report, income, and debt; preparing a budget; and conducting an affordability analysis.

40. One commenter criticized the amount of Bank of America's charitable donations and its methodology for making these donations.

During the evaluation period, BA Bank funded more than 17,000 housing units for LMI families with its community development investments throughout its assessment areas.[41] Examiners commended BA Bank for taking a leadership role in developing and participating in complex investments that involved multiple participants and both public and private funding.

Since the BOA 2001 Evaluation, BA Bank has maintained a substantial level of community development investment activities in its assessment areas. Bank of America represented that BA Bank's qualifying community development investments totaled approximately $3.7 billion during 2005 and 2006, and that BA Bank's subsidiary community development corporation had helped develop more than 6,200 housing units in LMI census tracts or for LMI individuals since 2003.[42]

Examiners commended BA Bank's service performance throughout its assessment areas in the BOA 2001 Evaluation. They reported that the bank's retail delivery systems were generally good and that the bank's distribution of branches among geographies of different income levels was adequate. Examiners also commended BA Bank for its community development services, which typically responded to the needs of the communities served by the bank throughout its assessment areas.

CRA Performance of LaSalle Bank. As noted, LaSalle Bank received an overall "outstanding" rating in the 2002 Evaluation, with "outstanding" ratings on both the lending and investment tests and a "high satisfactory" rating on the service test. Examiners noted that LaSalle Bank's mortgage and small business lending performance was excellent and had a positive impact on individuals and businesses in LMI areas as well as persons of different income levels. In addition, examiners found that the bank's community development lending activity was excellent and that several lines of business, ranging from commercial credit to apartment lending, contributed to the bank's community development lending efforts. Examiners noted that during the evaluation period, LaSalle Bank extended 390 community development loans totaling more than $523 million, including $182 million in loans for affordable housing and multifamily community development projects.

In the 2002 Evaluation, examiners characterized LaSalle Bank's performance under the investment test as excellent. They reported that the bank made more than 700 qualified community development investments totaling approximately $140 million during the evaluation period, despite significant competition from more than 300 insured depository institutions in its assessment areas. Examiners also reported that LaSalle Bank made 715 CRA qualified grants and contributions to community organizations in its assessment areas during the evaluation period, totaling more than $4 million, with half of those grants and contributions to organizations providing community development services to LMI individuals. In addition, examiners commended LaSalle Bank's excellent level of community development services, particularly in providing financial education.

B. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of Bank of America in light of public comments received on the proposal. One commenter alleged, based on 2005 HMDA data, that Bank of America denied the home mortgage loan applications of African American and Hispanic borrowers more frequently than those of nonminority applicants in various MSAs and nationwide. The commenter also alleged, based on 2005 and preliminary 2006 HMDA data, that Bank of America and its subsidiary banks made disproportionately higher-cost loans to African American and Hispanic borrowers than to nonminority borrowers.[43] The Board has focused its analysis primarily on the 2006 HMDA data reported by BA Bank.[44]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Bank of America is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[45] HMDA data, therefore, have limitations

Bank of America represented that it has a record of providing significant corporate philanthropic donations in all the communities that it serves. The Board notes that neither the CRA nor the agencies' implementing rules require institutions to engage in charitable giving.

41. Bank of America also has provided grants to nonprofit organizations that promote SBA programs and originate microloans in amounts as low as $500.

42. Bank of America represented that BA Bank's qualifying community development investments during 2005 and 2006 in its California assessment areas and in the Chicago market totaled approximately $821 million and $82 million, respectively. Bank of America further represented that BA Bank made at least 11 Low Income Housing Tax Credit investments totaling more than $134 million in 2005 and 2006 in California, which supported the renovation or construction of 1,070 housing units for LMI individuals and senior citizens. The bank also stated that it has allocated more than $27 million to California Community Development Financial Institutions ("CDFIs") since 2005 in more than 20 of its assessment areas, including $9.4 million for CDFIs focused on small business microfinancing and $17.7 million for CDFIs focused on affordable housing.

43. Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate (APR) exceeds the yield for U.S. Treasury securities of comparable maturity 3 or more percentage points for first-lien mortgages and 5 or more percentage points for second-lien mortgages (12 CFR 203.4.)

44. The Board reviewed HMDA data for BA Bank nationwide and in the MSAs noted by the commenter.

45. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by Bank of America and its subsidiaries. The Board also has consulted with the OCC, the primary federal supervisor of Bank of America's subsidiary banks.

The record, including confidential supervisory information, indicates that Bank of America has taken steps through policies and procedures to ensure compliance with fair lending and other consumer protection laws and regulations.[46] Bank of America's compliance program includes fair-lending policy and product guides, compliance file reviews, testing of HMDA data's integrity, and other quality-assurance measures. In addition, Bank of America represented that it provides fair lending training annually to ensure that Bank of America's associates understand their responsibility for complying with the fair lending policy and how to employ fair lending "best practices" in all aspects of the lending process. Bank of America has stated that its fair lending policies will continue to apply to current Bank of America operations and that it will review and make appropriate modifications to the fair lending policies that will apply to the operations of LaSalle Bank and LaSalle Bank Midwest after consummation of the proposal.

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance records of the subsidiary banks of Bank of America under the CRA. These established efforts and record of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

C. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Bank of America, comments received on the proposal, and confidential supervisory information.[47] Bank of America represented that the proposal would result in greater convenience for Bank of America and LaSalle customers through expanded delivery channels and a broader range of products and services. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval of the proposal.[48]

CONCLUSION

Based on the foregoing, and in light of all the facts of record, the Board has determined that the application should be, and hereby is, approved.[49] In reaching its

46. One commenter alleged that the terms of Bank of America's credit card contracts are unfair and deceptive and suggested that the Board should require Bank of America to modify its credit card contracts to avoid unfair and deceptive consequences and to adopt certain credit card-related practices that have been adopted by other banking organizations. Bank of America has stated that it does not engage in or condone deceptive practices and that it conducts multiple, ongoing reviews to ensure that the terms, conditions, and marketing of its credit card products are appropriate and comply with applicable laws and regulations, including the Truth in Lending Act and the Board's Regulation Z. The Board has consulted with the OCC, the primary federal supervisor of Bank of America's subsidiary bank that engages in credit card operations.

47. Some commenters expressed concern that the proposed acquisition would result in a loss of jobs. The effect of a proposed transaction on employment in a community is not among the factors that the Board is authorized to consider under the BHC Act, and the federal banking agencies, courts, and the Congress consistently have interpreted the convenience and needs factor to relate to the effect of a proposal on the availability and quality of banking services in the community. *See, e.g., Wells Fargo & Company,* 82 *Federal Reserve Bulletin* 445, 457 (1996).

48. One commenter reiterated comments it made in connection with the *BOA/Fleet Order* and *BOA/MBNA Order,* urging the Board not to approve the proposal until Bank of America meets certain "commitments" regarding its lending programs in Hawaii and its goal for mortgage lending to Native Hawaiians on Hawaiian Home Lands. *See e.g., BOA/Fleet Order* at 232–33. As noted in that order, Bank of America's publicly announced plans to engage in certain lending programs in Hawaii were not commitments to the Board, and these plans were not conditions to the Board's approvals in earlier applications by Bank of America or its predecessors. *See id.* As also previously noted, the Board views the enforceability of such third-party pledges, initiatives, and agreements as matters outside the CRA. Bank of America has represented that it has complied with its commitment to the State of Hawaii's Department of Hawaiian Home Lands by making loans and investments exceeding $151 million under the terms of that commitment.

49. Several commenters requested that the Board hold a public meeting or hearing on the proposal. Section 3 of the BHC Act does not require the Board to hold a public hearing on an application unless the appropriate supervisory authority for the bank to be acquired makes a written recommendation of denial of the application. The Board has not received such a recommendation from the appropriate supervisory authorities. Under its rules, the Board also may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 225.16(e), 262.25(d)). The Board has considered carefully the commenters' requests in light of all the facts of record. In the Board's view, the commenters had ample opportunity to submit their views and, in

conclusion, the Board has considered all the facts of record in light of the factors that is required to consider under the BHC Act, the FRA, and other applicable statutes.[50] The Board's approval is specifically conditioned on compliance by Bank of America with the conditions in this order and all the commitments made to the Board in connection with the proposal. For purposes of this transaction, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Richmond, acting pursuant to delegated authority.

By order of the Board of Governors, effective September 14, 2007.

fact, submitted written comments that the Board has considered carefully in acting on the proposal. The commenters' requests fail to demonstrate why written comments do not present their views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the requests for a public meeting or hearing on the proposal are denied.

50. A number of commenters have contended that a longer public comment period should have been provided in light of, or that consideration of the proposal should be delayed until a final disposition of, litigation in the Netherlands concerning the need for ABN AMRO shareholder approval of the proposed transaction. As discussed above, the Board has carefully reviewed the record in this case, in light of the Board's limited jurisdiction under the BHC Act and the International Banking Act (12 U.S.C. § 3101 et seq.). The Board notes that the Supreme Court of the Netherlands has ruled that the proposed acquisition of ABN AMRO North America did not require shareholder approval and, accordingly, this matter has been resolved. Further, as noted above, the commenters have had ample opportunity to submit their views and, in fact, have provided written submissions that the Board has considered carefully in acting on the proposal. Moreover, the Board is required under applicable law and its regulations to act on applications submitted under the BHC Act and the FRA within specified time periods. Based on all the facts of record, the Board concludes that the record is sufficient to act on this proposal under the factors the Board is required to consider under the relevant statutes and that delay in considering the proposal or extension of the comment period on the bases set forth by these commenters is not warranted.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Appendix A

Computation of the Amount of Deposits Held by Institutions Using the Revised Call Report and Thrift Financial Report Forms

INSURED BANKS WITHOUT FOREIGN DEPOSITS

The amount of deposits held by insured banks without foreign deposits using the revised Call Report was computed by adding the "Total deposit liabilities before exclusions (gross) as defined in section 3(l) of the Federal Deposit Insurance Act and FDIC regulations," reported on Schedule RC-O, and the "Interest accrued and unpaid on deposits in domestic offices," reported on Schedule RC-G.

INSURED BANKS WITH FOREIGN DEPOSITS

The amount of deposits held by insured banks with foreign deposits using the revised Call Report was computed by subtracting "Total foreign deposits" from the "Total deposit liabilities before exclusions (gross) as defined in Section 3(l) of the Federal Deposit Insurance Act and FDIC regulations," reported on Schedule RC-O, and adding the "Interest accrued and unpaid on deposits in domestic offices," reported on Schedule RC-G.

INSURED SAVINGS ASSOCIATIONS

The amount of deposits held by insured savings associations using the revised Thrift Financial Report was computed by subtracting "Total Foreign Deposits" from the "Total Deposit Liabilities Before Exclusions (Gross) as Defined in Section 3(l) of the FDI Act and FDIC Regulations," reported on Schedule DI, and adding "Accrued Interest Payable—Deposits," reported on Schedule SC.

Appendix B

ILLINOIS BANKING MARKETS WITH COMPETITIVE OVERLAP

Bank	Rank	Amount of deposits	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Aurora—The southern three tiers of townships in Kane County (Virgil, Campton, St. Charles, Kaneville, Blackberry, Geneva, Batavia, Big Rock, Sugar Grove, and Aurora townships); Little Rock, Bristol, Oswego, Fox, and Kendall townships in Kendall County; and Sandwich township in De Kalb County						
Bank of America Pre-Consummation ...	27	$42.5 mil.	.6	1,042	1	40
ABN AMRO North America	25	$50.6 mil.	.7	1,042	1	40
Bank of America Post-Consummation ..	18	$93.1 mil.	1.4	1,042	1	40
Chicago—Cook, Du Page, and Lake counties						
Bank of America Pre-Consummation ...	12	$4.6 bil.	2.1	807	69	192
ABN AMRO North America	1	$36.5 bil.	16.5	807	69	192
Bank of America Post-Consummation ..	1	$41.1 bil.	18.6	807	69	192
Elgin—Marengo, Seneca, Nunda, Riley, Coral, Grafton, and Algonquin townships in McHenry County; and the northern two tiers of townships in Kane County (Hampshire, Rutland, Dundee, Burlington, Plato, and Elgin townships).						
Bank of America Pre-Consummation ...	27	$28.4 mil.	.5	573	2	38
ABN AMRO North America	19	$107.4 mil.	1.7	573	2	38
Bank of America Post-Consummation ..	15	$135.7 mil.	2.2	573	2	38
Joliet—Will County (excluding Florence, Wilmington, Reed, Custer, and Wesley townships); Aux Sable township in Grundy County; and Na-Au-Say and Seward townships in Kendall County.						
Bank of America Pre-Consummation ...	28	$46.5 mil.	.6	1,203	3	53
ABN AMRO North America	8	$202.2 mil.	2.5	1,203	3	53
Bank of America Post-Consummation ..	8	$248.7 mil.	3.1	1,203	3	53
Woodstock—Chemung, Alden, Hebron, Richmond, Burton, Dunham, Hartland, Greenwood, McHenry, and Dorr townships in McHenry County						
Bank of America Pre-Consummation ...	19	$7.5 mil.	.3	843	2	24
ABN AMRO North America	9	$84.9 mil.	3.7	843	2	24
Bank of America Post-Consummation ..	9	$92.3 mil.	4.0	843	2	24

NOTE: All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent.

Mercantile Bancorp, Inc. Quincy, Illinois

Order Approving the Acquisition of a Bank Holding Company

Mercantile Bancorp, Inc. ("Mercantile"), a bank holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire HNB Financial Services, Inc. ("HNB") and thereby acquire its subsidiary bank, HNB National Bank ("HNB Bank"), both of Hannibal, Missouri.

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (72 *Federal Register* 33,506 (2007)). The time for filing comments has expired, and the Board has considered the application and all comments received in light of the factors set forth in section 3 of the BHC Act.

Mercantile, with total consolidated assets of approximately $1.4 billion, controls eight subsidiary banks that operate in Florida, Illinois, Kansas, and Missouri. Mercantile is the 60th largest depository organization in Missouri, controlling deposits of $290.7 million, which represent less than 1 percent of total deposits of insured depository institutions in Missouri ("state deposits").[2]

HNB, with total consolidated assets of $164.9 million, is the 111th largest depository organization in Missouri, controlling deposits of approximately $133.3 million. On consummation of this proposal, Mercantile would become the 35th largest depository organization in Missouri, controlling deposits of approximately $424 million, which represent less than 1 percent of state deposits.

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Mercantile is Illinois,[3] and HNB is located in Missouri.[4]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[5] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[6]

Mercantile and HNB have subsidiary depository institutions that compete directly in two banking markets: St. Louis, Missouri-Illinois; and Hannibal, Missouri. The Board has reviewed carefully the competitive effects of the proposal in each banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by Mercantile and HNB,[7] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[8] and other characteristics of the markets.

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1. 12 U.S.C. § 1842.

2. Asset data are as of March 31, 2007; statewide deposit and ranking data are as of June 30, 2006, and reflect merger activity through July 6, 2007. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

3. *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

4. For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and 1842(d)(2)(B).

5. 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)(A)–(B). Mercantile is adequately capitalized and adequately managed, as defined by applicable law. HNB Bank has been in existence and operated for the minimum period of time required by Missouri state law (five years). *See* Mo. Rev. Stat. § 362.077.1. On consummation of the proposal, Mercantile would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States. Mercantile also would comply with the state deposit cap in Missouri, where it will control less than 13 percent of state deposits. *See* Mo. Rev. Stat. § 362.915. All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

6. 12 U.S.C. § 1842(c)(1).

7. Deposit and market share data are as of June 30, 2006, adjusted to reflect mergers and acquisitions through July 6, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

8. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ guidelines in the St. Louis market.[9] On consummation of the proposal, there would be no increase in concentration and the St. Louis market would remain unconcentrated as measured by the HHI. In addition, numerous competitors would remain in the market.[10]

The Hannibal banking market[11] warrants a detailed review of the competitive effects because the post-consummation concentration level would exceed the threshold levels in the DOJ Guidelines. In the Hannibal banking market, Mercantile is the largest depository organization, controlling deposits of approximately $106.3 million, which represent approximately 19 percent of market deposits. HNB is the second largest depository organization in the market, also controlling deposits of approximately $106.3 million. On consummation of the proposal, Mercantile would remain the largest depository organization in the market, controlling deposits of approximately $212.6 million, which represent approximately 37.9 percent of market deposits. The HHI would increase 718 points to 1972.

One thrift institution operating in the market serves as a significant source of commercial loans and provides a broad range of consumer, mortgage, and other banking products. Competition from this thrift institution closely approximates competition from a commercial bank. Accordingly, the Board has concluded that deposits controlled by this institution should be weighted at 100 percent in market-share calculations.[12] Accounting for the revised weighting of these deposits, Mercantile would control approximately 34.6 percent of market deposits on consummation of the proposal, and the HHI would increase 599 points to 1871.

The Board has considered carefully whether other factors either mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase and the resulting level of concentration in the banking market.[13]

In this market, the record indicates that the proposal would not have a significant adverse impact on competition. After consummation of the proposal, ten other depository organizations would continue to operate in the market. In addition, the second largest competitor in the market would have a branch network comparable to Mercantile's branch network.

The Board also has concluded that the activities of a community credit union in the market exert a sufficient competitive influence to mitigate, in part, the potential adverse competitive effects of the proposal. The credit union offers a wide range of consumer products, operates street-level branches, and has membership open to all the residents in the market.[14] This active community credit union controls approximately $10.8 million in deposits in the market, which represent approximately 1 percent of market deposits on a 50 percent weighted basis. Accounting for the revised weighting of these deposits, Mercantile would control approximately 34.3 percent of market deposits on consummation of the proposal, and the HHI would increase 588 points to 1839.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, including the number of competitors that would remain in the Hannibal banking market after consummation, the branch networks of competitors, the presence of an active credit union, and other data, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in either banking market where Mercantile and HNB compete directly or in any other relevant banking market. Accord-

implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

9. The St. Louis banking market is defined as: (1) in Missouri—the city of St. Louis; Franklin, Jefferson, Lincoln, Saint Charles, St. Louis, Warren, and Washington counties; Roark, Boeuf, Canaan, and Brush Creek townships and the cities of Hermann and Owensville, all in Gasconade County; Boone township in Crawford County; and Loutre township in Montgomery County; and (2) in Illinois—Bond, Calhoun, Clinton, Jersey, Macoupin, Madison, Monroe, and St. Clair counties; the western part of Randolph County (defined by Route 3 on the east and the Kaskaskia River on the south), including the cities of Red Bud, Ruma, and Evansville; Washington County, excluding Ashley and Du Bois townships; and the city of Centralia.

10. On consummation of the proposal, the HHI would remain unchanged at 665 for the St. Louis market. Mercantile operates the 63rd largest depository organization in the market, controlling deposits of approximately $100.4 million, which represent less than 1 percent of market deposits. HNB operates the 114th largest depository organization in the market, controlling deposits of approximately $27.1 million. After consummation, Mercantile would operate the 56th largest depository organization in the market, controlling deposits of approximately $127.5 million, which represent less than 1 percent of market deposits. One hundred thirty-nine depository institutions would remain in the banking market.

11. The Hannibal banking market is defined as Marion and Ralls counties and the Monroe township in Monroe County, all in Missouri.

12. The Board previously has indicated that it may consider competition from a thrift institution at a level greater than 50 percent of its deposits when appropriate. *See, e.g., Banknorth Group, Inc.*, 75 *Federal Reserve Bulletin* 703 (1989). The thrift institution in the Hannibal banking market has a ratio of commercial and industrial loans to assets of more than 10 percent, which is comparable to the national average for all commercial banks. *See First Union Corporation*, 84 *Federal Reserve Bulletin* 489 (1998).

13. *See NationsBank Corporation*, 84 *Federal Reserve Bulletin* 129 (1998).

14. The Board previously has considered competition from similarly active credit unions as a mitigating factor. *See, e.g., The PNC Financial Services Group, Inc.*, 93 *Federal Reserve Bulletin* C65 (2007); *Wachovia Corporation*, 92 *Federal Reserve Bulletin* C183 (2006); *F.N.B. Corporation*, 90 *Federal Reserve Bulletin* 481 (2004); *Gateway Bank & Trust Co.*, 90 *Federal Reserve Bulletin* 547 (2004).

ingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, and information provided by Mercantile.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-only and on a consolidated basis, as well as the financial condition of the subsidiary depository institutions and the organizations' nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered carefully the financial factors of the proposal. Mercantile, HNB, and their subsidiary depository institutions currently are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board also finds that Mercantile has sufficient financial resources to effect the proposal. The proposed transaction is structured as a cash purchase that would be funded from the proceeds of issuing trust preferred securities and debt.

The Board also has considered the managerial resources of Mercantile, HNB, and their subsidiary depository institutions. The Board has reviewed the examination records of these institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant banking supervisory agencies with the organizations and their records of compliance with applicable banking laws and with anti-money-laundering laws. The Board also has considered Mercantile's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[15] All of Mercantile's banks received "outstanding" or "satisfactory" ratings at their most recent CRA performance evaluations by the banks' primary federal supervisors. HNB Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of July 14, 2003. After consummation of the proposal, Mercantile plans to integrate its CRA program with HNB Bank's operations. Mercantile has represented that consummation of the proposal would allow it to provide a broader range of financial products and services over a larger area. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the communities to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by Mercantile with the conditions imposed in this order and the commitments made to the Board in connection with the application. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transaction may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of St. Louis, acting pursuant to delegated authority.

By order of the Board of Governors, effective August 7, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

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15. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

Wells Fargo & Company
San Francisco, California

Order Approving the Merger of Bank Holding Companies

Wells Fargo & Company ("Wells Fargo"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire Greater Bay Bancorp ("Greater Bay"), East Palo Alto, and its subsidiary bank, Greater Bay Bank, National Association ("GB Bank"), Palo Alto, both in California.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published (72 *Federal Register* 35,246 (2007)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the BHC Act.

Wells Fargo, with total consolidated assets of approximately $539.9 billion, is the fifth largest depository organization in the United States,[3] controlling deposits of approximately $329.8 billion, which represent 4.3 percent of the total amount of deposits of insured depository institutions in the United States. Wells Fargo's subsidiary banks operate in 23 states, including California. Wells Fargo is the second largest depository institution in California, controlling $101.9 billion in deposits.

Greater Bay has total consolidated assets of $7.3 billion and operates only in California. It is the 18th largest depository organization in the state, controlling deposits of approximately $5.3 billion.

On consummation of the proposal, Wells Fargo would remain the fifth largest depository institution in the United States, with total consolidated assets of approximately $547.2 billion. Wells Fargo would control deposits of approximately $335.3 billion, which represent approximately 4.4 percent of the total amount of deposits of insured depository institutions in the United States. In California, Wells Fargo would remain the second largest depository organization, controlling deposits of approximately $107.2 billion, which represent approximately 15 percent of the total amount of deposits of insured depository institutions in the state.

1. 12 U.S.C. § 1842.

2. Wells Fargo also proposes to acquire the nonbanking subsidiaries of Greater Bay in accordance with section 4(k) of the BHC Act, 12 U.S.C. § 1843(k). In addition, Wells Fargo has requested the Board's approval to hold and, in certain circumstances, exercise an option to purchase up to 19.9 percent of Greater Bay's stock. The option would terminate on consummation of Wells Fargo's acquisition of Greater Bay.

3. Asset data are as of June 30, 2007; national deposit and ranking data are as of March 31, 2007; statewide deposit and ranking data are as of June 30, 2006. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

INTERSTATE ANALYSIS

Section 3(d) of the BHC Act allows the Board to approve an application by a bank holding company to acquire control of a bank located in a state other than the bank holding company's home state if certain conditions are met. For purposes of the BHC Act, the home state of Wells Fargo is Minnesota,[4] and Greater Bay is located in California.[5]

Based on a review of all the facts of record, including relevant state statutes, the Board finds that the conditions for an interstate acquisition enumerated in section 3(d) of the BHC Act are met in this case.[6] In light of all the facts of record, the Board is permitted to approve the proposal under section 3(d) of the BHC Act.

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[7]

Wells Fargo and Greater Bay have subsidiary depository institutions that compete directly in five banking markets in California: Monterey-Seaside-Marina; San Francisco-Oakland-San Jose; Santa Cruz; Santa Rosa; and Watsonville. The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative shares of total deposits in depository institutions controlled by Wells Fargo and Greater Bay

4. *See* 12 U.S.C. § 1842(d). A bank holding company's home state is the state in which the total deposits of all banking subsidiaries of such company were the largest on July 1, 1966, or the date on which the company became a bank holding company, whichever is later.

5. For purposes of section 3(d) of the BHC Act, the Board considers a bank to be located in the states in which the bank is chartered or headquartered or operates a branch. *See* 12 U.S.C. §§ 1841(o)(4)–(7) and 1842(d)(1)(A) and 1842(d)(2)(B).

6. 12 U.S.C. §§ 1842(d)(1)(A)–(B) and 1842(d)(2)(A)–(B). Wells Fargo is adequately capitalized and adequately managed, as defined by applicable law. California does not have a minimum age requirement applicable to the proposal. On consummation of the proposal, Wells Fargo would control less than 10 percent of the total amount of deposits of insured depository institutions in the United States and less than 30 percent of state deposits. All other requirements of section 3(d) of the BHC Act would be met on consummation of the proposal.

7. 12 U.S.C. § 1842(c)(1).

8. Deposit and market share data are as of June 30, 2006, adjusted to reflect mergers and acquisitions through June 29, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant

in the markets ("market deposits"),[8] the concentration level of market deposits and the increases in these levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[9] and other characteristics of the markets.

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in all five banking markets.[10] On consummation of the proposal, each market would remain moderately concentrated, as measured by the HHI. Also, the change in the HHI measure of concentration would be very small and numerous competitors would remain in each market.

The DOJ has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the transaction would not likely have a significantly adverse effect on competition in any relevant banking market. In addition, the appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the five banking markets where Wells Fargo and Greater Bay compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

FINANCIAL, MANAGERIAL, AND SUPERVISORY CONSIDERATIONS

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination and other supervisory information received from the relevant federal supervisors of the organizations involved in the proposal, and publicly reported and other financial information, including information provided by Wells Fargo.

In evaluating financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has considered the proposal carefully under the financial factors. Wells Fargo, Greater Bay, and their subsidiary depository institutions are currently well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board finds that Wells Fargo has sufficient financial resources to effect the proposal. The proposed transaction is structured primarily as a share exchange.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of Wells Fargo, Greater Bay, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant bank supervisory agencies with the organizations and their records of compliance with applicable banking laws and with anti-money-laundering laws. Wells Fargo, Greater Bay, and their subsidiary depository institutions are considered well managed. The Board also has considered Wells Fargo's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval, as are the other supervisory factors under the BHC Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board is required to consider the effects of the proposal on the convenience and needs of the communities to be served and to take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[11] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant

competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386, 387 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743, 744 (1984). Thus, the Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52, 55 (1991).

9. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

10. Those banking markets and the effects of the proposal on the concentration of banking resources therein are described in Appendix A.

11. 12 U.S.C. §2901 et seq.; 12 U.S.C. §1842(c)(2).

depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[12]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of the subsidiary depository institutions of Wells Fargo and Greater Bay, data reported by Wells Fargo and Greater Bay under the Home Mortgage Disclosure Act ("HMDA"),[13] other information provided by Wells Fargo, confidential supervisory information, and public comment received on the proposal. A commenter expressed concerns about Wells Fargo's record of serving the credit and community-development-investment needs of its assessment areas,[14] particularly in California, and criticized a specific credit product offered by WF Bank.[15] The commenter also alleged, based on HMDA data, that WF Bank engaged in disparate treatment of African American individuals in home mortgage lending. In addition, the commenter contended, without specific allegations, that GB Bank had demonstrated little responsiveness to community needs during its operating history. The commenter also expressed concern that the proposal would lead to closings of the combined organization's branches.

A. CRA Performance Evaluations

As provided in the CRA, the Board reviewed the proposal in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the insured depository institutions of Wells Fargo and Greater Bay. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[16]

Wells Fargo's lead bank, WF Bank, received an "outstanding" rating at its most recent CRA performance evaluation by the OCC, as of September 30, 2004 ("2004 WF Bank Evaluation"). Each of Wells Fargo's other subsidiary banks that is subject to the CRA received an "outstanding" or "satisfactory" rating at its most recent CRA performance evaluation.[17] GB Bank also received an "outstanding" CRA performance rating by the OCC, as of May 17, 2006 ("2006 GB Bank Evaluation"). Wells Fargo has represented that it would implement its CRA programs, policies, and procedures at GB Bank.

CRA Performance of WF Bank. In the 2004 WF Bank Evaluation, the bank received "outstanding" ratings on each of the lending, investment, and service tests for its CRA performance overall and in California.[18] Examiners reported that WF Bank's overall lending performance was excellent and that it had a good distribution of home mortgage loans to borrowers of different income levels. They also noted that the bank had an excellent geographic distribution of small loans to small businesses.[19]

In WF Bank's California assessment areas, examiners concluded that the bank's distribution of loans among borrowers of different income levels was good and that its lending levels reflected an excellent responsiveness to credit needs. Examiners reported that the bank's community development lending had a positive impact on its performance within the state and commended the bank for providing flexible lending programs to meet the credit

12. 12 U.S.C. § 2903.

13. 12 U.S.C. § 2801 et seq.

14. The commenter also requested that Wells Fargo renew certain community commitments that it made in 1998 and make annual community goals. In addition, the commenter requested that Wells Fargo Bank, National Association ("WF Bank"), Sioux Falls, South Dakota, agree to declare a six-month moratorium on home mortgage foreclosures because of current concerns about the mortgage industry. The Board has consistently stated that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization. *See Bank of America Corporation*, 93 *Federal Reserve Bulletin* C49, C52 footnote 27 (2007). Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the credit needs of its CRA assessment areas at the time the Board reviews a proposal under the convenience and needs factor. Wells Fargo represented that it will continue to communicate with, and provide information regarding its CRA performance to, community organizations. Wells Fargo also noted that it works with customers who encounter financial difficulties to prevent foreclosures whenever possible.

15. The commenter urged WF Bank to reduce the price of its Direct Deposit Advance Service, which the commenter characterized as a costly payday-loan product. Wells Fargo represented that the service provides an open-end line of credit available only to WF Bank's checking account customers who have recurring income electronically deposited in their checking accounts. Wells Fargo indicated that although the service is a higher-priced form of credit, it provides customers with short-term emergency access to funds. Wells Fargo indicated that it has developed tools to help customers understand how the service works and whether other lower-cost alternatives may be available. The Board has consulted with the Office of the Comptroller of the Currency ("OCC"), WF Bank's primary federal supervisor, about this product. The Board also recognizes that although banks can help to serve the banking needs of communities by making certain products or services available on certain terms or at certain rates, the CRA neither requires an institution to provide any specific types of products or services nor prescribes the costs charged for them.

16. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001); 72 *Federal Register* 37,922 at 37,951 (2007).

17. Appendix B lists the most recent CRA ratings of Wells Fargo's other subsidiary depository institutions that are subject to the CRA.

18. The evaluation period for the California assessment areas was October 1, 2001, through December 31, 2003, for HMDA and small business lending under the lending test; and November 1, 2001, through September 30, 2004, for community development lending under the lending test and for the investment and service tests.

19. Small businesses are businesses with gross annual revenues of $1 million or less. Small loans to small businesses include loans with original amounts of $1 million or less that are either secured by nonfarm, nonresidential properties or classified as commercial and industrial loans.

needs in its assessment areas, including the credit needs of LMI individuals and businesses. WF Bank represented that since the 2004 WF Bank Evaluation, it has provided 401 community development loans in California totaling more than $1.2 billion.[20]

Examiners characterized the bank's investment activity in the 2004 WF Bank Evaluation as reflecting an excellent level of responsiveness to a wide variety of community development needs in its California assessment areas, particularly the need for affordable housing. They reported that WF Bank funded 4,038 investments during the evaluation period, totaling more than $307 million and benefiting more than 2,000 different entities that help meet community development needs. WF Bank represented that it has generally provided increased levels of community development investments since the 2004 WF Bank Evaluation. The bank stated that between 2004 and 2006 it provided more than 4,450 community development investments and grants in California totaling more than $330 million, including more than $11 million in investments and grants in San Francisco. In addition, WF Bank represented that it has made numerous investments in or grants to programs directed at community-based small businesses since 2004.

Examiners commended WF Bank for providing services that showed an excellent responsiveness to banking needs in its assessment areas. They reported that the bank's services were accessible to essentially all portions of its assessment areas and that the bank's alternative delivery systems, including ATMs, banking by phone or mail, and Internet banking, helped accessibility throughout all geographies. Examiners also noted that the level of community development services the bank provided had an overall positive influence on its performance under the service test in its California assessment areas. WF Bank represented that since the 2004 WF Bank Evaluation, it also has implemented several programs to improve financial literacy and to make banking services accessible to traditionally underserved communities.

CRA Performance of GB Bank. As noted, GB Bank received an overall "outstanding" rating in the 2006 GB Bank Evaluation.[21] Examiners reported that the bank's level of lending activity was adequate and that its geographic distribution of small loans to businesses was good in the San Francisco Bay Area assessment area. Examiners also commended GB Bank's level of community development lending and noted that the bank made 89 community development loans totaling $294 million in this assessment area during the evaluation period. In addition, they reported that the bank's performance under the investment test in the San Francisco assessment area was excellent and that many of the bank's qualified investments provided affordable housing and economic revitalization. Examiners found that GB Bank's distribution of branches was good and that the bank's retail services and alternate delivery systems were responsive to the needs of the community. They also commended GB Bank's community development services.

B. Branch Closings

The commenter expressed concern about the proposal's possible effect on branch closings. Wells Fargo represented that as a result of the acquisition, branches might be closed in those markets where branches of WF Bank overlap with those of GB Bank but that it has not made any decisions about specific branches to be closed, relocated, or consolidated. Wells Fargo has indicated that it would follow its own branch closing policy with respect to branch closings, relocations, and consolidations related to the proposal.

The Board has considered carefully Wells Fargo's branch closing policy and its record of opening and closing branches. The Board notes that the branch closing policy, which applies to all Wells Fargo subsidiary banks that are subject to the CRA, generally requires a CRA impact report and recommendation to be prepared for any branch closing in an LMI area. A CRA impact report also is required for a branch closing that is more than five miles from another Wells Fargo branch. Each CRA impact report must include alternatives to closing and steps that could be taken to mitigate the effect of the proposed closing on the community served.

In the 2004 WF Bank Evaluation, examiners reported that the bank's branch opening and closing activity in LMI areas did not have an impact on the overall evaluation of its performance under the service test in California. Examiners noted, however, that such activity in the assessment areas receiving full-scope reviews generally had a positive effect on the evaluation of the bank's performance. The Board has consulted with the OCC on WF Bank's record of branch openings and closings since the 2004 WF Bank Evaluation. The OCC will continue to review WF Bank's record of opening and closing branches in the course of conducting CRA performance evaluations.

The Board also has considered that federal banking law provides a specific mechanism for addressing branch closings. Federal law requires an insured depository institution to provide notice to the public and to the appropriate federal supervisory agency before closing a branch.[22]

20. The commenter urged Wells Fargo to provide a "one-stop" loan product for multifamily housing to enhance its competitive position in California. Wells Fargo noted that WF Bank has recently established such a loan product that is available to the bank's existing nonprofit developers of affordable multifamily housing.

21. The evaluation period for the 2006 GB Bank Evaluation was January 1, 2004, through December 31, 2005, for HMDA and CRA data under the lending test; and January 1, 2004, through June 5, 2006, for community development lending under the lending test and for the service and investment tests.

22. Section 42 of the Federal Deposit Insurance Act (12 U.S.C. § 1831r-1), as implemented by the Joint Policy Statement Regarding Branch Closings (64 *Federal Register* 34,844 (1999)), requires that a bank provide the public with at least 30 days' notice and the appropriate federal supervisory agency and customers of the branch with at least 90 days' notice before the date of the proposed branch closing. The bank also is required to provide reasons and other supporting data for the closing, consistent with the institution's written policy for branch closings.

C. HMDA and Fair Lending Record

The Board has carefully considered the fair lending records and HMDA data of Wells Fargo and Greater Bay in light of public comment received on the proposal. The commenter alleged that Wells Fargo had engaged in disparate treatment of African American individuals in the pricing of home mortgage loans in six Metropolitan Statistical Areas ("MSAs"), including the Los Angeles MSA.[23] The Board has focused its analysis on the 2005 and preliminary 2006 HMDA data reported by Wells Fargo.[24]

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not Wells Fargo is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[25] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by Wells Fargo and its subsidiaries. The Board also has consulted with the OCC, the primary federal supervisor of WF Bank.

The record, including confidential supervisory information, indicates that Wells Fargo has taken steps to ensure compliance with fair lending and other consumer protection laws. All Wells Fargo business units, whether those units are separate companies or line-of-business departments in a subsidiary bank or nonbanking subsidiary, develop and maintain comprehensive compliance programs for all laws and regulations applicable to their business, including fair lending compliance programs. Wells Fargo's Compliance and Risk Management Group provides oversight for and guidance on these compliance programs, and a corporate fair lending committee that includes senior executives from Wells Fargo's consumer lending subsidiaries coordinates Wells Fargo's enterprise-wide fair lending strategy. Wells Fargo's subsidiary banks and home mortgage lending subsidiaries provide fair lending training for their employees and conduct self-assessments and audits to verify compliance and consistent underwriting practices. Several subsidiaries also provide second-review programs for credit applications designated for denial. Wells Fargo has stated that it will review and make appropriate modifications to the fair lending policies for GB Bank's operations after consummation of the proposal.

The Board also has considered the HMDA data in light of other information, including the programs described above and the overall performance records of the subsidiary banks of Wells Fargo and Greater Bay under the CRA. These established efforts and records of performance demonstrate that the institutions are active in helping to meet the credit needs of their entire communities.

D. Conclusion on Convenience and Needs and CRA Performance

The Board has considered carefully all the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by Wells Fargo, public comment received on the proposal, and confidential supervisory information. Wells Fargo has represented that consummation of the proposal would provide customers of Greater Bay with expanded access to the products and services offered by Wells Fargo's bank and nonbank subsidiaries. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant insured depository institutions are consistent with approval of the proposal.

CONCLUSION

Based on the foregoing, and in light of all the facts of record, the Board has determined that the applications should be, and hereby are, approved. In reaching its

23. The commenter based the allegation on a study it recently completed using loan-pricing data reported under HMDA in 2005. The commenter urged WF Bank to institute an underwriting system that directs a borrower to the least expensive loan available to that customer regardless of the lending channel chosen by the customer to apply for a loan. Wells Fargo noted that the study did not include Federal Housing Administration loans designed for LMI borrowers or reflect the fact that the majority of Wells Fargo's loans to individuals were priced below the thresholds that require HMDA price reporting. Wells Fargo has represented that its pricing is fully disclosed, competitive, and reflects the customer's particular credit risk. In addition, Wells Fargo stated that its subsidiary banks offer prime pricing options to all first mortgage customers who qualify for such pricing regardless of the channel or division through which the customer applies.

24. The Board reviewed HMDA data reported by Wells Fargo's significant lending subsidiaries in California and Texas and in the Los Angeles, Houston, and Chicago MSAs where Wells Fargo's primary assessment areas are located. The Board notes that 2006 HMDA data are preliminary and that final data will not be available for analysis until fall 2007.

25. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act and other applicable statutes. The Board's approval is specifically conditioned on compliance by Wells Fargo with the conditions in this order and all the commitments made to the Board in connection with the proposal. For purposes of this transaction, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

The proposal may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of San Francisco, acting pursuant to delegated authority.

By order of the Board of Governors, effective August 21, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

Appendix A

BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES

Bank	Rank	Amount of deposits	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
MONTEREY-SEASIDE-MARINA BANKING MARKET						
Monterey-Seaside-Marina—Monterey-Seaside-Marina Ranally Metro Area (RMA)						
Wells Fargo Pre-Consummation	1	$659.8 mil.	22.6	1,499	17	14
Greater Bay	13	$10.8 mil.	.4	1,499	17	14
Wells Fargo Post-Consummation	1	$670.6 mil.	23.0	1,499	17	14
SAN FRANCISCO-OAKLAND-SAN JOSE BANKING MARKET						
San Francisco-Oakland-San Jose—San Francisco-Oakland-San Jose RMA and the towns of Byron, Hollister, Pescadero, Point Reyes Station, and San Juan Bautista						
Wells Fargo Pre-Consummation	2	$40.5 bil.	19.4	1,427	93	109
Greater Bay	9	$5.0 bil.	2.4	1,427	93	109
Wells Fargo Post-Consummation	2	$45.5 bil.	21.8	1,427	93	109
SANTA CRUZ BANKING MARKET						
Santa Cruz—Santa Cruz RMA						
Wells Fargo Pre-Consummation	3	$420.0 mil.	13.8	1,767	215	12
Greater Bay	6	$236.9 mil.	7.8	1,767	215	12
Wells Fargo Post-Consummation	2	$656.9 mil.	21.6	1,767	215	12
SANTA ROSA BANKING MARKET						
Santa Rosa—Santa Rosa RMA and the city of Cloverdale						
Wells Fargo Pre-Consummation	3	$830.1 mil.	13.8	1,043	3	21
Greater Bay	18	$7.1 mil.	.1	1,043	3	21
Wells Fargo Post-Consummation	3	$837.3 mil.	14.0	1,043	3	21

Appendix A—*Continued*

Banking Markets Consistent with Board Precedent and DOJ Guidelines—Continued

Bank	Rank	Amount of deposits	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Watsonville Banking Market						
Watsonville—Watsonville RMA						
Wells Fargo Pre-Consummation	1	$187.8 mil.	23.5	1,650	113	11
Greater Bay	10	$19.3 mil.	2.4	1,650	113	11
Wells Fargo Post-Consummation	1	$207.2 mil.	25.9	1,650	113	11

Note: Data are as of June 30, 2006. All amounts of deposits are unweighted. All rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent.

Appendix B

CRA Performance Evaluations

Subsidiary Bank	CRA Rating	Date	Supervisor
1. Placer Sierra Bank, Auburn, California	Satisfactory	March 2005	Federal Reserve
2. Wells Fargo Bank Northwest, National Association, Ogden Utah	Satisfactory	December 2005	OCC
3. Wells Fargo HSBC Trade Bank, National Association, San Francisco, California	Outstanding	June 2006	OCC
4. Wells Fargo Financial National Bank, Las Vegas, Nevada	Outstanding	June 2006	OCC
5. Wells Fargo Financial Bank, Sioux Falls, South Dakota	Outstanding	March 2005	FDIC

Orders Issued under Section 4 of the Bank Holding Company Act

National City Corporation Cleveland, Ohio

Order Approving the Acquisition of a Savings Association and Notice to Engage in Nonbanking Activities

National City Corporation ("National City"), a financial holding company within the meaning of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under sections 4(c)(8) and 4(j) of the BHC Act and section 225.24 of the Board's Regulation Y[1] to acquire Mid America Bank, fsb ("Mid America"), a savings association, by merging with its holding company, MAF Bancorp, Inc. ("MAF"), both of Clarendon Hills, Illinois. National City also has requested the Board's approval under those provisions to acquire St. Francis Equity Properties, Inc. ("St. Francis"), Brookfield, Wisconsin, a subsidiary of Mid America, and thereby engage in community development activities in accordance with section 225.28(b)(12) of the Board's Regulation Y.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (72 *Federal Register* 28,491 (2007)). The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in section 4 of the BHC Act.

1. 12 U.S.C. §§ 1843(c)(8) and (j); 12 CFR 225.24.

2. 12 CFR 225.28(b)(12). National City also proposes to acquire Mid America Insurance Agency, Inc., Clarendon Hills, and Mid America Re, Inc., Burlington, Vermont, in accordance with section 4(k) of the BHC Act, 12 U.S.C. § 1843(k).

National City, with total consolidated assets of $138.5 billion, is the 13th largest depository organization in the United States, controlling deposits of approximately $88.6 billion, which represent approximately 1 percent of the total amount of deposits of insured depository institutions in the United States.[3] National City controls one insured depository institution, National City Bank, Cleveland, Ohio, that operates in eight states.[4] National City is the ninth largest depository organization in Illinois, controlling deposits of approximately $7.2 billion, which represent approximately 2.3 percent of the total amount of deposits of insured depository institutions in the state ("state deposits").

MAF has total consolidated assets of approximately $10.4 billion and Mid America, MAF's only subsidiary insured depository institution, operates in Illinois and Wisconsin. MAF is the 12th largest depository organization in Illinois, controlling deposits of approximately $5.7 billion.

On consummation of the proposal, National City would remain the 13th largest insured depository organization in the United States, with total consolidated assets of approximately $150.7 billion. National City would control deposits of approximately $95.7 billion, representing 1.4 percent of the total amount of deposits of insured depository institutions in the United States. In Illinois, National City would become the fourth largest insured depository organization, controlling deposits of approximately $12.9 billion, which represent approximately 4 percent of state deposits.

The Board previously has determined by regulation that the operation of a savings association by a bank holding company is closely related to banking for purposes of section 4(c)(8) of the BHC Act.[5] The Board requires that savings associations acquired by bank holding companies conform their direct and indirect activities to those permissible for bank holding companies under section 4 of the BHC Act.[6] National City has committed to conform all the activities of Mid America to those that are permissible under section 4(c)(8) of the BHC Act and Regulation Y. The Board also has determined that community development activities are closely related to banking, and National City has committed to conduct those activities in accordance with the Board's regulations and orders.[7]

Section 4(j)(2)(A) of the BHC Act requires the Board to determine that the proposed acquisition of Mid America and St. Francis "can reasonably be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[8] As part of its evaluation under these public interest factors, the Board reviews the financial and managerial resources of the companies involved, the effect of the proposal on competition in the relevant markets, and the public benefits of the proposal.[9] In acting on a notice to acquire a savings association, the Board also reviews the records of performance of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[10] The Board has considered the proposal under these factors in light of all the facts of record, including confidential supervisory and examination information, publicly reported financial and other information, and public comments submitted on the proposal.

COMPETITIVE CONSIDERATIONS

The Board has considered carefully the competitive effects of National City's acquisition of MAF, including Mid America and St. Francis.[11] National City Bank and Mid America compete directly in four banking markets in Illinois: Aurora, Chicago, Elgin, and Joliet.[12] The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the markets, the relative share of total deposits of National City Bank and Mid America in the markets ("market deposits"),[13] the concentration level of market deposits and the increase in this level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Guidelines ("DOJ Guidelines"),[14] and other characteristics of the markets.

3. Asset and nationwide deposit-ranking data are as of March 31, 2007. Statewide deposit and ranking data are as of June 30, 2006, and reflect merger activity through July 5, 2007. In this context, insured depository institutions include commercial banks, savings banks, and savings associations.

4. National City Bank operates branches in Florida, Illinois, Indiana, Kentucky, Michigan, Missouri, Ohio, and Pennsylvania.

5. 12 CFR 225.28(b)(4)(ii).

6. *Id.*

7. 12 CFR 225.28(b)(11).

8. 12 U.S.C. § 1843(j)(2)(A).

9. *See* 12 CFR 225.26; *see, e.g., BancOne Corporation*, 83 *Federal Reserve Bulletin* 602 (1997).

10. 12 U.S.C. § 2901 et seq.

11. *See First Hawaiian, Inc.*, 79 *Federal Reserve Bulletin* 966 (1993).

12. These banking markets and the effects of the proposal on the concentration of banking resources in them are described in the appendix.

13. Deposit and market-share data are as of June 30, 2006, and reflect merger activity through July 5, 2007. The deposits of thrift institutions are included at 50 percent, except as noted below. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift institution deposits in the market-share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991). In this case, Mid America's deposits are weighted at 50 percent pre-merger and at 100 percent post-merger to reflect the resulting ownership by a commercial banking organization.

14. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher than normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited purpose and other nondepository financial entities.

Consummation of the proposal would be consistent with Board precedent and the DOJ Guidelines in each relevant banking market. After consummation of the proposal, the Chicago and Elgin markets would remain unconcentrated, and the Aurora and Joliet markets would remain moderately concentrated. In each of these markets, the changes in the HHI measure of concentration would be small and numerous competitors would remain. Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any of the four banking markets where National City Bank and Mid America compete directly or in any other relevant banking market.

The Board also has considered the effects of the proposed transaction on competition in community development activities. National City and St. Francis do not both engage in community development activities in any relevant market. Moreover, the market for this nonbanking activity is local in scope and unconcentrated, and there are numerous participants that engage in these activities. Based on all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition among providers of community development activities in any relevant market.

Financial and Managerial Resources

In reviewing the proposal under section 4 of the BHC Act, the Board has carefully considered the financial and managerial resources of National City, MAF, and their subsidiaries. The Board also has reviewed the effect the transaction would have on those resources in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal supervisors of the organizations involved in the proposal, and publicly reported and other financial information, including information provided by National City.

In evaluating financial resources in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved on both a parent-only and consolidated basis, as well as the financial condition of the subsidiary insured depository institutions and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial resources, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the proposal under the financial factors. National City, MAF, and their subsidiary depository institutions are well capitalized and would remain so on consummation of the proposal. Based on its review of the record, the Board finds that National City has sufficient financial resources to effect the proposal. The proposed transaction is structured as a share exchange.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of National City, MAF, and their subsidiary depository institutions, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of the other relevant financial supervisory agencies with the organizations and their records of compliance with applicable banking law and with anti-money-laundering laws. National City, MAF, and their subsidiary depository institutions are considered to be well managed. The Board also has considered National City's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board has concluded that the financial and managerial resources of the organizations involved in the proposal are consistent with approval under section 4 of the BHC Act.

CRA Performance Records

As previously noted, the Board considers the records of performance under the CRA of the relevant insured depository institutions when acting on a notice to acquire a savings association. The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account a relevant depository institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[15]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of National City's and MAF's subsidiary depository institutions, data reported under the Home Mortgage Disclosure Act ("HMDA")[16] by the subsidiaries of National City and MAF that engage in home mortgage lending, other lending data reported under the CRA, other information provided by National City and MAF, confidential supervisory information provided by the federal supervisor of each bank, and public comment received on the proposal.

The Board received a comment related to the CRA performance records of National City Bank and Mid America. The commenter alleged that in the Milwaukee

15. 12 U.S.C. §2903.

16. 12 U.S.C. §2801 et seq.

area, National City has not adequately served the mortgage credit needs of LMI borrowers[17] and that Mid America has not provided adequate levels of loans of less than $100,000 to businesses.[18]

As provided in the CRA, the Board has evaluated the proposal in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[19]

National City Bank received an "outstanding" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency ("OCC"), as of June 30, 2005 ("NC Evaluation").[20] Mid America received an "outstanding" rating at its most recent CRA performance evaluation by the Office of Thrift Supervision ("OTS"), as of July 18, 2005 ("MA Evaluation"). National City has indicated that Mid America's CRA program will remain in place on consummation of the proposal.

CRA Performance of National City Bank. In addition to the overall "outstanding" rating that National City Bank received in the NC Evaluation, the bank received separate overall "outstanding" or "satisfactory" ratings for its CRA performance in each of the states reviewed. Examiners reported that the bank's distribution of HMDA loans to borrowers of different income levels was excellent, as was the bank's distribution of small loans to businesses in LMI census tracts.[21] Examiners stated that the bank's record of community development lending and qualified community development investments demonstrated excellent responsiveness to community credit and investment needs.

17. As the commenter acknowledges, National City Bank operates no branches in the Milwaukee area. The Milwaukee area, therefore, is not part of the bank's assessment areas for purposes of evaluating its CRA performance.

18. The commenter also requested that National City and Mid America commit to implement a number of the commenter's recommendations. The Board has consistently found that neither the CRA nor the federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization. *See, e.g., Bank of America Corporation,* 93 *Federal Reserve Bulletin* C52, footnote 27 (2007). Instead, the Board focuses on the existing CRA performance record of an applicant and the programs that an applicant has in place to serve the credit needs of its assessment areas at the time the Board reviews the proposed acquisition of an insured depository institution.

19. *See Interagency Questions and Answers Regarding Community Reinvestment,* 66 *Federal Register* 36,620 at 36,640 (2001).

20. The evaluation periods were October 1, 1999, through December 31, 2004, for the lending test; and February 23, 2000, through June 30, 2005, for the service and investment tests. The NC Evaluation included the activities within National City Bank's assessment areas of five affiliated banks that were consolidated into National City Bank in July 2006 and of three nonbank mortgage lending subsidiaries of National City.

21. "Small loans to businesses" are loans with original amounts of $1 million or less that are either secured by nonfarm, nonresidential properties or classified as commercial and industrial loans.

Since the NC Evaluation, National City has continued its high level of CRA lending activity. In 2005 and 2006, it made more than $22 billion HMDA-reportable loans in National City Bank's assessment areas. National City also made approximately $1.2 billion in total qualified community development loans during 2005 and 2006 in the bank's assessment areas.

Examiners rated National City's performance under the investment test as "outstanding" or "high satisfactory" in most of the states reviewed. They reported that the bank's investments were complex in nature and demonstrated excellent responsiveness to the needs of the community. During the evaluation period, the bank made qualified investments totaling more than $182 million and contributed more than $5 million to charities with community development purposes.

National City continued to make a significant amount of qualified investments since the NC Evaluation. In 2005 and 2006, National City made approximately $222 million in qualified investments and grants in the bank's assessment areas. These investments included several projects that created affordable housing through the low-income-housing tax credit program.

Examiners concluded that the bank's retail banking services generally were accessible to geographies and individuals of different income levels. They also reported that the bank generally provided a high level of community development services, including service by bank employees on the boards of nonprofit groups involved in providing affordable housing and other services to LMI individuals.

CRA Performance of Mid America. As noted, Mid America received an overall "outstanding" rating in the MA Evaluation.[22] Under the lending test, examiners commended the savings association's responsiveness to the credit needs of its assessment areas. Examiners characterized Mid America as a market leader in originating mortgages reportable under HMDA in LMI geographies and to LMI borrowers when compared with its peer group. In addition, they commended Mid America for offering numerous innovative and flexible programs to LMI borrowers, including several mortgage lending programs in the Chicago and Milwaukee areas under which the savings association made more than 1,100 loans totaling more than $167 million. Examiners also reported that the savings association's geographic distribution of small loans to businesses was good and that a significant percentage of Mid America's small loans to businesses were in amounts of $100,000 or less.

In the MA Evaluation, examiners described Mid America's performance as a community development lender as excellent. During the evaluation period, the savings association originated community development loans totaling

22. The evaluation periods were January 1, 2003, through December 31, 2005, for the lending test; and July 1, 2002, through June 30, 2005, for the service and investment tests. Full-scope evaluations were conducted in the Chicago-Naperville-Joliet Metropolitan Statistical Area ("MSA") in Illinois, and in the Milwaukee-Waukesha MSA in Wisconsin. Limited-scope evaluations were conducted in other areas in Wisconsin.

$53.4 million, including more than $40 million in multifamily loans that supported affordable housing in LMI areas. Examiners also reported that Mid America made qualifying community development investments during the evaluation period totaling $18.3 million, which included investments in Chicago-based community investment funds for affordable housing development and in 14 projects in Wisconsin that were eligible for the low-income housing tax credit.

Examiners noted that Mid America's retail delivery systems were reasonably accessible to all geographies in its assessment areas. In addition, examiners reported that the bank provided a reasonable level of community development services and noted that bank employees conducted more than 200 seminars on homebuying and served on the boards of organizations that address community needs such as affordable housing and educational programs for inner-city youths.

Conclusion on CRA Performance. Based on a review of the entire record, and for the reasons discussed above, the Board has concluded that considerations relating to the CRA performance records of the relevant depository institutions are consistent with approval.

OTHER CONSIDERATIONS

In light of public comments on the proposal, the Board also has carefully considered the fair lending record and HMDA data reported by subsidiaries of National City and MAF in its evaluation of the public interest factors. A commenter alleged, based on 2005 HMDA data for the Milwaukee MSA, that National City made a disproportionately small number of mortgage loans to female borrowers and made a disproportionately high number of high-cost loans to Hispanic borrowers.[23] The commenter also alleged that Mid America made a disproportionately small number of prime loans to African American borrowers. The Board has analyzed the 2005 and 2006 HMDA data reported by the insured depository institution subsidiaries of National City and MAF in their primary assessment areas, including the Milwaukee MSA, and statewide in the states where those institutions operated branches.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, denials, or pricing among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not National City or MAF is excluding or imposing higher credit costs on those groups on a prohibited basis. The Board recognizes that HMDA data alone, even with the addition of pricing information, provide only limited information about the covered loans.[24] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance by National City, MAF, and their subsidiaries with fair lending laws. The Board has consulted with the OCC and the OTS about the fair-lending and consumer-protection compliance records of National City Bank and Mid America.

The record indicates that National City and MAF have taken steps to ensure compliance with fair lending and other consumer protection laws. National City has a centralized compliance function and has implemented corporate-wide compliance policies and procedures to help ensure that all National City business lines comply with all fair lending and other consumer protection laws and regulations. It employs compliance officers and staff responsible for compliance training and monitoring, and conducts file reviews for compliance with federal and state consumer protection rules and regulations for all product lines and origination sources. National City also regularly performs self-assessments of its compliance with fair lending laws and provides training in fair lending policy for its employees. MAF also employs compliance techniques, such as a second-review process for mortgage loans and annual fair lending training for its employees. MAF also conducts internal testing of products and practices for illegal discrimination, which includes testing for potential steering of certain products to minority borrowers and the use of regression analysis of credit and pricing decisions. National City has indicated that Mid America's fair lending and consumer compliance program will remain in place on consummation of the proposal.

The Board also has considered the HMDA data in light of other information, including the CRA performance records of National City Bank and Mid America. Based on all the facts of record, the Board has concluded that the fair lending

23. Beginning January 1, 2004, the HMDA data required to be reported by lenders were expanded to include pricing information for loans on which the annual percentage rate (APR) exceeds the yield for U.S. Treasury securities of comparable maturity 3 or more percentage points for first-lien mortgages and 5 or more percentage points for second-lien mortgages (12 CFR 203.4).

24. The data, for example, does not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

record and HMDA data of National City and MAF are consistent with approval under section 4 of the BHC Act.

PUBLIC BENEFITS

As part of its evaluation of the public interest factors under section 4 of the BHC Act, the Board also has reviewed carefully the public benefits and possible adverse effects of the proposal. The record indicates that consummation of the proposal would result in benefits to consumers and businesses currently served by Mid America. National City has represented that the proposed transaction would provide Mid America's customers with expanded products and services, including a wider range of commercial lending products, brokerage, and trust services. In addition, National City has represented that its acquisition of St. Francis would facilitate the provision of low-income housing, including affordable housing for seniors, in Wisconsin.

The Board has determined that the conduct of the proposed nonbanking activities within the framework of Regulation Y and Board precedent is not likely to result in adverse effects, such as undue concentrations of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices. Based on all the facts of record, the Board has concluded that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects. Accordingly, the Board has determined that the balance of the public benefits under section 4(j)(2) of the BHC Act is consistent with approval.

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the proposal should be, and hereby is, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by National City and Mid America with the conditions imposed in this order and the commitments made to the Board in connection with the notice. The Board's approval also is subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c),[25] and to the Board's authority to require such modification or termination of the activities of the bank holding company or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. For purposes of this action, these conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The acquisition shall not be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of Cleveland, acting pursuant to delegated authority.

By order of the Board of Governors, effective August 29, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

25. 12 CFR 225.7 and 225.25(c).

Appendix

ILLINOIS BANKING MARKETS WITH COMPETITIVE OVERLAP

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Aurora—the southern three tiers of townships in Kane County (Virgil, Compton, St. Charles, Kaneville, Blackberry, Geneva, Batavia, Big Rock, Sugar Grove, and Aurora townships); Little Rock, Bristol, Oswego, Fox, and Kendall townships in Kendall County; and Sandwich township in DeKalb County						
National City Pre-Consummation	14	110,529	1.6	1,041	−12	40
MAF	22	68,727	1.0	1,041	−12	40
National City Post-Consummation ...	6	247,982	3.6	1,041	−12	40

Appendix—*Continued*

ILLINOIS BANKING MARKETS WITH COMPETITIVE OVERLAP—Continued

Bank	Rank	Amount of deposits (dollars)	Market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
Chicago—Cook, Du Page, and Lake counties						
National City Pre-Consummation	12	4,269,259	2.0	741	–4	183
MAF	17	2,427,389	1.1	741	–4	183
National City Post-Consummation ...	4	9,124,037	4.1	741	–4	183
Elgin—Marengo, Seneca, Nunda, Riley, Coral, Grafton, and Algonquin townships in McHenry County; and the northern two tiers of townships in Kane County (Hampshire, Rutland, Dundee, Burlington, Plato, and Elgin townships)						
National City Pre-Consummation	37	12,979	.2	571	18	37
MAF	8	284,241	4.8	571	18	37
National City Post-Consummation ...	2	581,461	9.4	571	18	37
Joliet—Will County (excluding Florence, Wilmington, Reed, Custer, and Wesley townships); Aux Sable township in Grundy County; and Na-Au-Say and Seward townships in Kendall County						
National City Pre-Consummation	7	245,060	3.0	1,200	–8	48
MAF	24	69,879	.9	1,200	–8	48
National City Post-Consummation ...	4	384,817	4.7	1,200	–8	48

NOTE: All rankings, market deposit shares, and HHIs are based on thrift institution deposits weighted at 50 percent, except that MAF's thrift institution deposits are weighted at 50 percent pre-merger and 100 percent post-merger.

Order Determining that Certain Activities Are Complementary to the Financial Activity of Underwriting and Selling Health Insurance

The Federal Deposit Insurance Corporation ("FDIC") has asked the Board to determine whether the disease management and mail-order pharmacy activities described below and conducted by WellPoint, Inc. ("WellPoint"), Indianapolis, Indiana, are permissible for a financial holding company ("FHC") under the Bank Holding Company Act ("BHC Act"), as amended by the Gramm-Leach-Bliley Act ("GLB Act"). WellPoint has filed an application with the FDIC to obtain deposit insurance for a proposed de novo industrial loan company ("ILC"), ARCUS Financial Bank, Salt Lake City, Utah ("Bank").[1] The FDIC has imposed a temporary moratorium on acting on applications for deposit insurance by ILCs controlled by companies that are engaged in any nonbanking activity that is not permissible for an FHC under section 4 of the BHC Act[2] or for all savings and loan holding companies under the Home Owners' Loan Act.[3]

Section 4(k) of the BHC Act permits a bank holding company that qualifies to be an FHC to engage in a broad range of activities that are defined by statute to be financial in nature.[4] The BHC Act also permits FHCs to engage in any activity that the Board determines, in consultation with

1. Because of the special exception from the definition of "bank" in the BHC Act for ILCs chartered in certain states (12 U.S.C. § 1841(c)(2)(H)), WellPoint would not become a bank holding company on acquisition of Bank. This order addresses only the issue of whether the disease management and mail-order pharmacy activities described below are permissible for FHCs. This order does not address any other issues raised by the deposit insurance application filed by WellPoint with the FDIC or the special ILC exception in the BHC Act.

2. 12 U.S.C. § 1843.

3. *See* Moratorium on Certain Industrial Bank Applications and Notices, 72 *Federal Register* 5290 (Feb. 5, 2007). The FDIC's moratorium is scheduled to expire on January 31, 2008.

4. *See* 12 U.S.C. § 1843(k)(4).

the Secretary of the Treasury, to be financial in nature or incidental to a financial activity.[5]

In addition, the BHC Act permits an FHC to engage in any activity that the Board (in its sole discretion) determines, by regulation or order, is "complementary to a financial activity and does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally."[6] This statutory provision was intended to allow the Board to permit an FHC to engage, on a limited basis, in an activity that appears to be commercial rather than financial in nature when the activity is meaningfully connected to a financial activity such that it complements the financial activity.[7] This limited authority was designed to allow FHCs to remain competitive with other providers of financial services and to better provide financial services to their customers in a developing marketplace. Although WellPoint is not a bank holding company, the FDIC has requested that the Board determine the permissibility of WellPoint's disease management and mail-order pharmacy activities under the BHC Act, as amended by the GLB Act.

WellPoint is principally engaged in underwriting and selling health insurance. Underwriting and selling health insurance as principal, agent, or broker are activities deemed by Congress in the GLB Act to be financial in nature.[8] WellPoint is one of the largest health insurance companies in the United States, with total revenues of $57 billion for the year ending December 31, 2006, and total assets of $51.8 billion as of December 31, 2006. WellPoint, through its regulated insurance company subsidiaries, provides health insurance in 21 states, is the Blue Cross/Blue Shield licensee in 14 states, and provides health insurance to more than 34 million members. WellPoint's insurance offerings include preferred provider, health maintenance, point of service, Medicare and Medicaid health plans; vision, dental, pharmacy benefit, life, disability, and long-term care insurance products; and consumer-directed, high-deductible, and limited-service health insurance products. WellPoint also engages in a variety of related activities, including claims processing.

In addition, WellPoint provides disease management and mail-order pharmacy services to persons who obtain health insurance from WellPoint or another insurance company. These activities are conducted through subsidiaries that are not themselves insurance companies. Through its disease management services, WellPoint provides insurance plan members with access to a variety of tools and resources designed to help them maintain healthy lifestyles and properly manage their medical conditions. For example, WellPoint uses data analysis software to identify plan members that have, or are at high risk of developing, chronic or complex health conditions, such as diabetes or kidney or heart disease. WellPoint employees then contact and work with the plan member (and his or her physician, as appropriate) to provide information on treatment options and ways of managing the member's care in an appropriate and cost-effective manner and to help coordinate the member's access to and use of health services and related insurance coverages.

Other disease management services provided by WellPoint to plan members include flu vaccinations; health screenings and assessments (*for example*, for cholesterol or blood pressure); a toll-free "Nurse Line" to respond to questions about injuries or conditions; access to online and audiotape libraries with information on a wide variety of health topics; and assistance in developing personalized plans for achieving a variety of health-related goals, such as tobacco-use cessation, weight and stress management, and proper diet and nutrition. These disease management services typically are provided by, or under the direction of, licensed health-care professionals (including doctors and nurses) employed by WellPoint.

The WellPoint subsidiaries engaged in providing mail-order pharmacy services fill prescriptions for customers who have pharmacy benefit insurance coverage from WellPoint or another insurance company, provide drug-related information to customers, and track potential issues with customer prescriptions, such as drug interactions. WellPoint's mail-order pharmacy subsidiaries are state-licensed and employ state-licensed pharmacists. WellPoint has indicated that most customers who use mail-order pharmacy services are persons with chronic health conditions or "maintenance" medication requirements.[9]

WellPoint's disease management and mail-order pharmacy activities are not within the scope of activities that, to date, have been determined to be financial in nature, incidental to a financial activity, or complementary to a financial activity under the BHC Act. The activities do not themselves involve the provision of insurance, are not regulated as insurance by state insurance authorities, and are not provided by an affiliate that is licensed as an insurance company or as an insurance agent or broker. Both activities also involve the provision of health-care services that, while related to insurance underwriting activities, are themselves nonfinancial activities. The Board concludes, however, for the reasons set forth below, that there is a reasonable basis for construing these activities as complementary to a financial activity within the meaning of the GLB Act.

5. *Id.* at § 1843(k)(1)(A) and (2).

6. *Id.* at § 1843(k)(1)(B).

7. *See* 145 Cong. Rec. H11529 (daily ed. Nov. 4, 1999) (Statement of Chairman Leach) ("It is expected that complementary activities would not be significant relative to the overall financial activities of the organization.").

8. 12 U.S.C. § 1843(k)(4)(B).

9. WellPoint offers these mail-order pharmacy services as part of a broader "pharmacy benefit management" program offered by its subsidiaries. Pharmacy benefit managers ("PBMs") provide employers a variety of services to improve the pharmacy benefit coverages for employees, including arranging a network of retail pharmacies where plan members can fill prescriptions under the plan and assisting plan sponsors in developing and managing the list of drugs and their costs that the plan will cover. *See* Federal Trade Commission, *Pharmacy Benefit Managers: Ownership of Mail-Order Pharmacies* at p. ii (August 2005) ("FTC Report").

Both disease management and mail-order pharmacy activities help employers that obtain health insurance from an insurance company to manage and reduce the risks and costs of providing health insurance to employees. WellPoint has indicated that many of its customers request or demand that health insurers include disease management services or mail-order pharmacy services in the health insurance program designed for the customer and its employees. WellPoint has indicated that employers do so because the services help employers better manage and reduce their health insurance costs (i) in the case of disease management services, by promoting healthy lifestyle choices, reducing unnecessary doctor or hospital visits, and assisting customers with chronic conditions in developing and pursuing available treatment options to manage properly their condition; and (ii) in the case of mail-order pharmacy services, by providing employers and employees (particularly those with chronic conditions) access to a low-cost provider of prescriptions.

WellPoint also has provided data demonstrating that many of the largest health insurers in the United States provide disease management and mail-order pharmacy services both to their own insurance customers and to customers of other health insurance companies. These data indicate, for example, that of the ten largest health insurers in the United States in terms of the dollar value of direct premiums written in 2006, six provide disease management services and five provide mail-order pharmacy services.[10] These data also indicate that for both services all but one of these large insurance companies currently provide the service to customers who obtain health insurance from the insurance company *or* another insurance company. The Federal Trade Commission also has found that many large insurers provide "in-house" PBM services and that many PBMs own their own mail-order pharmacies.[11]

Based on the foregoing and other facts of record, the Board concludes that disease management and mail-order pharmacy activities complement the financial activity of underwriting and selling health insurance.

As noted above, section 4(k)(1)(B) of the BHC Act requires that the Board determine that any proposed complementary activity does not pose a substantial risk to the safety or soundness of depository institutions or the financial system generally.[12] Moreover, the Board previously has stated that complementary activities should be limited in size and scope relative to the financial activities that they complement.[13]

WellPoint's disease management and mail-order pharmacy activities in the aggregate currently account for less than 1 percent of WellPoint's consolidated total assets and less than 4 percent of WellPoint's consolidated total annual revenues. The total assets of WellPoint's subsidiaries engaged in disease management and mail-order pharmacy activities also constitute less than 4 percent of the total capital (calculated in accordance with applicable statutory accounting principles) of all regulated insurance company subsidiaries and health plans of WellPoint. To limit the potential size and safety and soundness risks of the proposed activities, the Board has conditioned its determination in this order that the disease management and mail-order pharmacy activities conducted by WellPoint are complementary to a financial activity on the requirement that these activities in the aggregate must not account for more than 2 percent of WellPoint's consolidated total assets or 5 percent of its consolidated total annual revenues. In addition, the total assets of WellPoint's subsidiaries engaged in disease management or mail-order pharmacy activities in the aggregate may not exceed 5 percent of the total capital (calculated in accordance with applicable statutory accounting principles) of all regulated insurance company subsidiaries and health plans of WellPoint.

The Board also has considered the types of risks to which WellPoint is exposed by conducting disease management and mail-order pharmacy activities and confidential information provided by WellPoint concerning how it manages and addresses those risks. WellPoint has indicated, for example, that it maintains liability insurance and provides extensive training to the employees engaged in these activities to ensure compliance with applicable laws and regulations, including relevant privacy laws and regulations. The Board notes, moreover, that WellPoint's mail-order pharmacy units and the pharmacists they employ, as well as the doctors and nurses employed by the subsidiaries engaged in disease management services, are licensed and regulated by appropriate state licensing boards.

WellPoint also has indicated that it does not expect that Bank will make loans to, engage in cross-marketing activities with, or have other direct business relationships with the WellPoint subsidiaries that provide disease management or mail-order pharmacy services. Any future extensions of credit by Bank to, or other covered transactions by Bank with, these or other affiliates, including any covered transaction with an unaffiliated person the proceeds of which are transferred to or used for the benefit of an affiliate, must comply with sections 23A and 23B of the Federal Reserve Act and the Board's Regulation W.[14]

For these reasons, the Board concludes that the proposed activities do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.[15]

10. These data are based on a 2006 National Association of Insurance Commissioners report of market share by direct premiums written by all accident and health insurance carriers and have been adjusted to exclude certain large insurance carriers that engage exclusively or predominantly in underwriting nonhealth accident insurance.

11. *See* FTC Report at p. i and v.

12. 12 U.S.C. § 1843(k)(1)(B).

13. *See* 68 *Federal Register* 68493, 68497 (Dec. 9, 2003).

14. 12 U.S.C. 371c, 371c-1; 12 CFR Part 223.

15. Because this order is issued in response to a request from the FDIC, the Board has not determined whether WellPoint's conduct of the proposed activities "can reasonably be expected to produce benefits to the public, such as greater convenience, increased competition, or gains in efficiency, that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices." *See*

The Board's decision is based on all the facts of record, including the representations made to the Board in connection with this order. The Board's decision is subject to, and is specifically conditioned on compliance with, the terms and conditions set forth in this order.

By order of the Board of Governors, effective September 7, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

ORDERS ISSUED UNDER SECTIONS 3 AND 4 OF THE BANK HOLDING COMPANY ACT

The Bank of Nova Scotia Toronto, Canada

Order Approving the Acquisition of Shares of a Bank and a Savings Association

The Bank of Nova Scotia ("BNS"), a foreign bank that is a financial holding company for purposes of the Bank Holding Company Act ("BHC Act"), has requested the Board's approval under section 3 of the BHC Act[1] to acquire 10 percent of the outstanding voting shares of First BanCorp ("FBC"), San Juan, and, indirectly, its subsidiary bank, FirstBank of Puerto Rico, Santurce, both of Puerto Rico. In addition, BNS has requested approval under section 4 of the BHC Act to acquire indirectly FBC's subsidiary savings association, FirstBank Florida, Miami, Florida.[2]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in the *Federal Register* (72 *Federal Register* 18,250 (2007)). The time for filing comments has expired, and the Board has considered the notice and all comments received in light of the factors set forth in sections 3 and 4 of the BHC Act.

BNS, with total consolidated assets of $373 billion, is the third largest commercial bank in Canada[3] and provides a variety of banking services to retail and corporate customers through more than 950 branches in Canada. It also provides stock brokerage, insurance brokerage, fund management, and financial advisory services through subsidiaries. In the United States, BNS operates branches in Houston, Texas; Portland, Oregon; and New York, New York; and agencies in Atlanta, Georgia; and San Francisco, California. BNS also has branches in the U.S. Virgin Islands and Puerto Rico. Scotia Bank de Puerto Rico ("Scotia Bank"), San Juan, BNS's subsidiary bank, operates only in Puerto Rico. BNS also provides custody and trust services through The Bank of Nova Scotia Trust Company of New York, New York, New York, a nondepository trust company.

FBC, with total consolidated assets of approximately $17.3 billion, is the 45th largest depository organization in the United States, controlling deposits of approximately $10.8 billion, which represent less than 1 percent of the total amount of deposits of insured depository institutions in the United States.[4] If BNS were deemed to control FBC, BNS would become the 42nd largest depository organization in the United States, with total consolidated assets of approximately $18.9 billion, controlling deposits of approximately $12.4 billion.

NONCONTROLLING INVESTMENT

Although the acquisition of less than a controlling interest in a bank or bank holding company is not a normal acquisition for a bank holding company, the requirement in section 3(a)(3) of the BHC Act to obtain the Board's approval before a bank holding company acquires more than 5 percent of the voting shares of a bank suggests that Congress contemplated acquisitions by bank holding companies of between 5 and 25 percent of the voting shares of banks.[5] On this basis, the Board previously has approved the acquisition by a bank holding company of less than a controlling interest in a bank or bank holding company.[6]

BNS has stated that it does not propose to control or exercise a controlling influence over FBC and that its indirect investment in FBC's subsidiary depository institutions would also be a passive investment. BNS has agreed to abide by certain commitments ("Passivity Commitments") that are substantially similar to commitments previously relied on by the Board in determining that an investing bank holding company would not be able to exercise a controlling influence over another bank holding

12 U.S.C. § 1843(j)(2). For the same reason, the Board has not reviewed the financial and managerial resources of WellPoint and the other factors set forth in section 225.26(b) of the Board's Regulation Y (12 CFR § 225.26(b)).

1. 12 U.S.C. § 1842. *See* 12 CFR 225.15.

2. 12 U.S.C. § 1843. *See* 12 CFR 225.24. BNS's indirect investments in the nonbank subsidiaries of FBC and FirstBank Florida, all in Puerto Rico and the U.S. Virgin Islands, are made in accordance with section 4(c)(9) of the BHC Act and 225.23(f)(1) of Regulation K, because these locations are outside the United States for purposes of the International Banking Act ("IBA") and Regulation K (12 U.S.C § 3101(7); 12 U.S.C. § 1843(c)(9); 12 CFR 211.23(f)(1) and 211.2(i)).

3. Canadian asset and ranking data are as of April 30, 2007. Both are based on the exchange rate then in effect.

4. Domestic asset data are as of March 31, 2007; deposit and ranking data are as of June 30, 2006, and reflect subsequent mergers and acquisitions through April 6, 2007. In this context, the "United States" includes any state of the United States, the District of Columbia, any territory of the United States, Puerto Rico, Guam, American Samoa, and the Virgin Islands. In this context, depository institutions include commercial banks, savings banks, and savings associations.

5. *See* 12 U.S.C. § 1842(a)(3).

6. *See, e.g., Passumpsic Bancorp*, 92 *Federal Reserve Bulletin* C175 (2006); *Brookline Bancorp, MHC*, 86 *Federal Reserve Bulletin* 52 (2000).

company for purposes of the BHC Act.[7] For example, BNS has committed not to exercise or attempt to exercise a controlling influence over the management or policies of FBC or any of its subsidiaries; not to seek or accept representation on the board of directors of FBC or any of its subsidiaries; and not to have any director, officer, employee, or agent interlocks with FBC or any of its subsidiaries. BNS also has committed not to attempt to influence the dividend policies, loan decisions, or operations of FBC or any of its subsidiaries.

Based on these considerations and all the other facts of record, the Board has concluded that BNS would not acquire control of, or have the ability to exercise a controlling influence over, FBC or its subsidiary depository institutions through the proposed acquisition of FBC's voting shares. The Board notes that the BHC Act would require BNS to file an application and receive the Board's approval before the company could directly or indirectly acquire additional shares of FBC or attempt to exercise a controlling influence over FBC.[8]

COMPETITIVE CONSIDERATIONS

Section 3 of the BHC Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of an attempt to monopolize the business of banking in any relevant banking market. The BHC Act also prohibits the Board from approving a bank acquisition that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by the probable effect of the proposal in meeting the convenience and needs of the community to be served.[9] The Board also must consider the competitive effects of a proposal to acquire a savings association under the public benefits factor of section 4 of the BHC Act.

FirstBank of Puerto Rico and Scotia Bank, whose deposits are insured by the Federal Deposit Insurance Corporation ("FDIC"), compete directly in the Aguadilla, Mayaguez, Ponce, and San Juan banking markets in Puerto Rico.[10] BNS also competes directly with FirstBank of Puerto Rico through branch offices[11] in the St. John-St. Thomas and the St. Croix banking markets in the U.S. Virgin Islands.[12] BNS and First Bank Florida do not compete directly in any banking market.

The Board has reviewed carefully the competitive effects of the proposal in each of these banking markets in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets; the relative shares of total deposits in depository institutions in the market ("market deposits") controlled by FBC and BNS;[13] the concentration level of market deposits and the increase in the level as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines");[14] other characteristics of the market; and the Passivity Commitments made by BNS with respect to FirstBank of Puerto Rico.

A. Banking Markets within Established Guidelines

Consummation of the proposal would be consistent with Board precedent and within the thresholds in the DOJ Guidelines in the Aguadilla, Mayaguez, Ponce, and San Juan banking markets in Puerto Rico.[15] On consummation

7. The commitments made by BNS are set forth in Appendix A.

8. *See, e.g., Emigrant Bancorp, Inc.*, 82 *Federal Reserve Bulletin* 555 (1996); *First Community Bancshares, Inc.*, 77 *Federal Reserve Bulletin* 50 (1991).

9. 12 U.S.C. § 1842(c)(1).

10. These banking markets, and the effects of the proposal on the concentration of banking resources in these markets, are described in Appendix B.

11. Deposits held by BNS's branch offices in the U.S. Virgin Islands are not insured by the FDIC. Pursuant to the IBA, a foreign bank wishing to engage in retail deposit-taking in the United States must organize or acquire an insured U.S. depository institution. Branch offices of foreign banks, with few exceptions, must confine their deposit-taking in the United States to activities not requiring FDIC insurance, such as wholesale deposit-taking (12 U.S.C. § 3104(c)). Typically, the Board has taken the view that these branches do not fully compete with U.S. depository institutions for purposes of the competitive analysis. *See Banco Santander Central Hispano, S.A.*, 92 *Federal Reserve Bulletin* C151 (2006).
Because the U.S. Virgin Islands are not a "State" for purposes of the IBA, however, the limitation on retail deposit-taking does not apply to branches of foreign banks in the U.S. Virgin Islands (12 U.S.C. §§ 3101(7) and 3104(c)). As such, branches of foreign banks operating in the U.S. Virgin Islands may accept retail deposits and offer a full range of banking services in direct competition with local depository institutions to the extent permissible under local law and regulation. In light of all the facts of record, including information provided by the U.S. Virgin Islands Division of Banking and Insurance, the Board has concluded that BNS does compete with local depository institutions for retail deposits, small business loans, and various other banking services in the U.S. Virgin Islands and that uninsured deposits held by BNS branch offices, therefore, should be included for purposes of calculating relevant market data.

12. The St. John-St. Thomas banking market includes the islands of St. John and St. Thomas. The St. Croix banking market includes the island of St. Croix.

13. Deposit and market share data are as of June 30, 2006, are adjusted to reflect subsequent mergers and acquisitions through April 6, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

14. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

15. The effect of the proposal on the concentration of banking resources in these markets is described in Appendix B.

of the proposal, three banking markets would remain highly concentrated and one market would remain moderately concentrated, as measured by the HHI. The change in the HHI in the three highly concentrated markets would be small. In each of the four banking markets, numerous competitors would remain.

B. Two Banking Markets Warranting Special Scrutiny

BNS and FBC compete directly in two banking markets that warrant a detailed review: St. John-St. Thomas and St. Croix. As discussed below, if BNS were to acquire control of FBC, the post-consummation concentration levels would exceed the DOJ Guidelines, and BNS's resulting market share would exceed 35 percent in both markets.

St. John-St. Thomas Banking Market. BNS is the third largest depository institution in the St. John-St. Thomas market, controlling $212 million in deposits, which represents 13.3 percent of market deposits. FirstBank of Puerto Rico is the second largest depository institution in the market, controlling $576 million in deposits, which represents 36.2 percent of market deposits. If considered a combined organization on consummation of the proposal, BNS and FirstBank of Puerto Rico would be the largest depository organization in the banking market, controlling $788 million in deposits, which would represent approximately 49.5 percent of market deposits. The proposal would exceed the DOJ Guidelines because the HHI for the St. John-St. Thomas banking market would increase 965 points to 5000.

St. Croix Banking Market. BNS is the third largest depository institution in the St. Croix market, controlling $131 million in deposits, which represents 20.8 percent of market deposits. FirstBank of Puerto Rico is the largest depository institution in the market, controlling $177 million in deposits, which represents 28.1 percent of market deposits. If considered a combined organization on consummation of the proposal, BNS and FirstBank of Puerto Rico would be the largest depository organization in the St. Croix banking market, controlling $308 million in deposits, which would represent approximately 48.9 percent of market deposits. The proposal would exceed the DOJ Guidelines because the HHI for the St. Croix banking market would increase 1171 points to 3359.

Competitive Effects in the Two Markets. The market indexes suggest that consummation of the proposal would raise competitive issues in both the St. John-St. Thomas and St. Croix banking markets.[16] After careful analysis of the record, the Board has concluded, however, that no significant reduction in competition is likely to result from BNS's proposed indirect investment in FirstBank of Puerto Rico. Of particular significance in this case is the structure of the proposed investment, which is designed to limit the ability of BNS to control FBC. Although the Board previously has noted that one company need not acquire control of another company to lessen competition between them substantially, both BNS and FBC have proposed special safeguards to limit access by BNS to competitively sensitive information and to limit the potential for BNS to influence the policies or management of FBC in the St. John-St. Thomas and St. Croix banking markets.[17]

As noted, the record shows that BNS intends to be a passive investor and that there will be no officer or director interlocks between BNS and FBC or FirstBank of Puerto Rico, although FBC has agreed to allow BNS to have a nonparticipating observer on FBC's board. The Board recognizes that a significant reduction in competition can result from the sharing of nonpublic financial information between two organizations that are not under common control. To address this concern, FBC and BNS have committed that FBC would restrict BNS from having access to any information that would allow anticompetitive behavior in the St. John-St. Thomas and St. Croix banking markets. For example, BNS would not be provided access to operational or management information regarding the operations of FBC in the U.S. Virgin Islands, and BNS's representative will not be present when any matters concerning those operations are presented to FBC's board. These restrictions and commitments, including the Passivity Commitments noted above, limit BNS's access to confidential information that could enable it to engage in anticompetitive behavior in the St. John-St. Thomas and St. Croix banking markets with respect to FirstBank of Puerto Rico. Anticompetitive behavior otherwise might occur in these banking markets through either coordinating BNS's activities with FBC or influencing the behavior of FBC.[18]

C. Views of Other Agencies and Conclusion on Competitive Considerations

The DOJ also has reviewed the proposal and has advised the Board that it does not believe that BNS's acquisition of 10 percent of the voting shares of FBC would likely have a significantly adverse effect on competition in any relevant banking market at this time. The appropriate banking agencies have been afforded an opportunity to comment and have not objected to the proposal.

Accordingly, in light of all the facts of record, the Board concludes that consummation of the proposal would not have a significantly adverse effect on competition or on the

16. The Board also notes that one depository institution entered the St. Thomas-St. John banking market de novo in 2006.

17. *See, e.g., Passumpsic Bancorp*, 92 *Federal Reserve Bulletin* C175 (2006); *BOK Financial Corp.*, 81 *Federal Reserve Bulletin* 1052, 1053–54 (1995); *SunTrust Banks, Inc.*, 76 *Federal Reserve Bulletin* 542 (1990); *First State Corp.*, 76 *Federal Reserve Bulletin* 376, 379 (1990); *Sun Banks, Inc.*, 71 *Federal Reserve Bulletin* 243 (1985).

18. There are no other legal, contractual, or statutory provisions that would allow greater access to the bank's financial information in the two banking markets than is available to shareholders with less than a 5 percent interest.

concentration of resources in any relevant banking market and that competitive considerations are consistent with approval.

Financial, Managerial, and Supervisory Considerations

Section 3 of the BHC Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board also reviews financial and managerial resources of the organizations involved in a proposal under section 4 of the BHC Act.[19] The Board has carefully considered these factors in light of all the facts of record, including confidential supervisory and examination information from the various U.S. banking supervisors of the institutions involved, publicly reported and other financial information, and information provided by BNS. The Board also has consulted with the Office of the Superintendent of Financial Institutions ("OSFI"), the agency with primary responsibility for the supervision and regulation of Canadian banks, including BNS.

In evaluating the financial factors in expansion proposals by banking organizations, the Board reviews the financial condition of the organizations involved both on a parent-only and on a consolidated basis, as well as the financial condition of the subsidiary depository organizations and significant nonbanking operations. In this evaluation, the Board considers a variety of information, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the pro forma organization, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

The Board has carefully considered the financial factors of this proposal. Canada's risk-based capital standards are consistent with those established by the Basel Capital Accord ("Accord"). The capital ratios of BNS would continue to exceed the minimum levels that would be required under the Accord and are considered equivalent to the capital levels that would be required of a U.S. banking organization. Furthermore, the U.S. subsidiary depository institutions involved are well capitalized and would remain so on consummation. The Board also has considered the financial resources of BNS and the other organizations involved and the effects of this proposal on the capital and financial resources of FBC and its subsidiary depository institutions. Based on its review of these factors, the Board finds that BNS has sufficient financial resources to effect the proposal and that the financial factors are consistent with approval. The proposed transaction is structured as a share purchase to be funded with available cash resources.

The Board also has considered the managerial resources of the organizations involved. The Board has reviewed the examination records of FBC, its depository institutions, and the U.S. banking operations of BNS, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences and those of other relevant banking supervisory agencies, including the Office of Thrift Supervision ("OTS") and the FDIC, with the organizations and their records of compliance with applicable banking law and with anti-money-laundering laws.[20]

Based on all the facts of record, the Board has concluded that considerations relating to the managerial resources and future prospects of the organizations involved in the proposal are consistent with approval. Section 3 of the BHC Act also provides that the Board may not approve an application involving a foreign bank unless the bank is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in the bank's home country.[21] As noted, the OSFI is the primary supervisor of Canadian banks, including BNS. The Board previously has determined that BNS is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[22] Based on this finding and all the facts of record, the Board has concluded that BNS continues to be subject to comprehensive supervision on a consolidated basis by its home-country supervisor.

Based on all the facts of record, the Board has concluded that considerations relating to the financial and managerial resources and future prospects of the organizations involved

19. 12 CFR 225.26(b).

20. On March 16, 2006, the Board issued a cease and desist order ("Order") requiring FBC to address accounting deficiencies for certain mortgage loans, which subsequently led it to restate the company's financial statements. *See In the Matter of First Bancorp*, Doc. No. 06-006-B-HC. In a separate and coordinated action, the FDIC also issued a cease and desist order against FirstBank of Puerto Rico. The Order required, among other actions, that FBC hire an independent consultant to review its mortgage portfolio; establish policies and procedures to ensure appropriate classification of loans; submit a written capital plan to ensure that the consolidated organization maintains an adequate capital position; and submit an acceptable liquidity contingency plan. The Board has reviewed carefully the progress made by FBC in implementing the Order's requirements. The Board expects that FBC will continue to take all necessary steps to ensure compliance with the Order.

21. 12 U.S.C. § 1843(c)(3)(B). As provided in Regulation Y, the Board determines whether a foreign bank is subject to consolidated home-country supervision under the standards set forth in Regulation K. *See* 12 CFR 225.13(a)(4). Regulation K provides that a foreign bank will be considered subject to comprehensive supervision or regulation on a consolidated basis if the Board determines that the bank is supervised or regulated in such a manner that its home-country supervisor receives sufficient information on the worldwide operations of the bank, including its relationship with any affiliates, to assess the bank's overall financial condition and its compliance with laws and regulations. *See* 12 CFR 211.24(c)(1).

22. *The Bank of Nova Scotia*, 93 *Federal Reserve Bulletin* C73 (2007).

in the proposal are consistent with approval, as are the other supervisory factors.[23]

CONVENIENCE AND NEEDS AND CRA PERFORMANCE CONSIDERATIONS

In acting on a proposal under section 3 of the BHC Act, the Board also must consider the effects of the proposal on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[24] The Board also must review the records of performance under the CRA of the relevant insured depository institutions when acting on a notice under section 4 of the BHC Act to acquire voting securities of an insured savings association.[25]

As provided in the CRA, the Board has evaluated the proposal in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[26]

Scotia Bank received a "satisfactory" rating from the FDIC at its most recent CRA performance evaluation, as of March 1, 2005. FirstBank of Puerto Rico received a "satisfactory" rating at its most recent CRA performance evaluation by the FDIC, as of September 1, 2006, and FirstBank Florida received a "satisfactory" rating from the OTS at its most recent CRA performance evaluation, as of February 28, 2005.

Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the communities to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

PUBLIC BENEFITS

As noted above, BNS also has filed a notice under section 4(c)(8) and 4(j) of the BHC Act for its proposed indirect investment in FirstBank Florida. The Board previously has determined by regulation that the operation of a savings association by a bank holding company is closely related to banking for purposes of section 4(c)(8) of the BHC Act.[27] To approve this notice, the Board also must determine that the proposed acquisition of FirstBank Florida "can reasonably be expected to produce benefits to the public that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices."[28]

As part of its evaluation of the public interest factors under section 4 of the BHC Act, the Board has reviewed carefully the public benefits and possible adverse effects of the proposal. The record indicates that consummation of the proposal would result in benefits to consumers currently served by FBC. BNS's investment in FBS, and thus indirectly in FirstBank Florida, would strengthen FBC's capital position and allow FBC to better serve its customers. For the reasons discussed above and based on the entire record, the Board has determined that the conduct of the proposed nonbanking activities within the framework of Regulation Y and Board precedent is not likely to result in adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking practices.

Based on all the facts of record, the Board concludes that consummation of the proposal can reasonably be expected to produce public benefits that would outweigh any likely adverse effects. Accordingly, the Board has determined that the balance of the public benefits under section 4(j)(2) of the BHC Act is consistent with approval.

OTHER CONSIDERATIONS

BNS also requests that it be permitted to acquire an indirect interest in FBC's noncontrolling minority investment in Sun American Bancorp and its subsidiary bank, Sun American Bank, both in Boca Raton, Florida (collectively, "Sun American"), without filing an application for the Board's prior approval under section 3 of the BHC Act.[29] FBC has entered into and complied with commitments not to exer-

23. Section 3 of the BHC Act also requires the Board to determine that an applicant has provided adequate assurances that it will make available to the Board such information on its operations and activities and those of its affiliates that the Board deems appropriate to determine and enforce compliance with the BHC Act (12 U.S.C. § 1842(c)(3)(A)). The Board has reviewed the restrictions on disclosure in the relevant jurisdictions in which the applicant operates and has communicated with relevant government authorities concerning access to information. In addition, BNS previously has committed that, to the extent not prohibited by applicable law, it will make available to the Board such information on the operations of its affiliates that the Board deems necessary to determine and enforce compliance with the BHC Act, the IBA, and other applicable federal law. BNS also previously has committed to cooperate with the Board to obtain any waivers or exemptions that may be necessary to enable its affiliates to make such information available to the Board. In light of these commitments, the Board has concluded that BNS has provided adequate assurances of access to any appropriate information the Board may request.

24. 12 U.S.C. § 2901 et seq.; 12 U.S.C. § 1842(c)(2).

25. *See, e.g., North Fork Bancorporation, Inc.*, 86 *Federal Reserve Bulletin* 767 (2000).

26. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 at 36,640 (2001); 72 *Federal Register* 37,922 at 37,951 (2007).

27. 12 CFR 225.28(b)(4)(ii).

28. *See* 12 U.S.C. § 1843(j)(2)(A).

29. 12 U.S.C. § 1842(a)(3). In 2004, FBC was approved to acquire up to 9.9 percent of the voting shares of Sun American Bancorp, previously Southern Security Bank Corporation. *See* letter to Ms. Szendrey-Ramos from Ms. Tham, Federal Reserve Bank of New York, dated May 10, 2004.

cise or attempt to exercise a controlling influence over Sun American that are similar to the Passivity Commitments noted above, and BNS would have no meaningful interaction or influence over Sun American through BNS's proposed minority, noncontrolling investment in FBC. Based on all the facts of record, the Board has determined that no regulatory purpose would be served by requiring BNS to file an application under the BHC Act for such an investment; accordingly, the Board will not require BNS to file an application.[30]

CONCLUSION

Based on the foregoing and all the facts of record, the Board has determined that the application and notice should be, and hereby are, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the BHC Act. The Board's approval is specifically conditioned on compliance by BNS with the conditions imposed in this order and the commitments made to the Board in connection with the proposal. The Board's approval of the nonbanking aspects of the proposal is also subject to all the conditions set forth in Regulation Y, including those in sections 225.7 and 225.25(c),[31] and to the Board's authority to require such modification or termination of the activities of BNS or any of its subsidiaries as the Board finds necessary to ensure compliance with, and to prevent evasion of, the provisions of the BHC Act and the Board's regulations and orders issued thereunder. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The bank-related portion of the proposal shall not be consummated before the 15th calendar day after the effective date of this order, and no part of the proposal may be consummated later than three months after the effective date of this order, unless such period is extended for good cause by the Board or by the Federal Reserve Bank of New York, acting pursuant to delegated authority.

By order of the Board of Governors, effective August 9, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

30. The Board notes that the requirements of section 3(d) of the BHC Act would be met if BNS were to acquire control of Sun American (12 U.S.C. § 1842(d).

31. 12 CFR 225.7 and 225.25(c).

Appendix A

PASSIVITY COMMITMENTS

In connection with its application to acquire up to 10 percent of First BanCorp ("FBC"), San Juan, Puerto Rico, Bank of Nova Scotia ("BNS"), Toronto, Canada, commits that it will not directly or indirectly:

1. Exercise or attempt to exercise a controlling influence over the management or policies of FBC or any of its subsidiaries;
2. Seek or accept representation on the board of directors of FBC or any of its subsidiaries;
3. Have or seek to have any employee or representative serve as an officer, agent, or employee of FBC or any of its subsidiaries;
4. Take any action that would cause FBC or any of its subsidiaries to become a subsidiary of BNS or any of BNS's subsidiaries;
5. Acquire or retain shares that would cause the combined interests of BNS and any of BNS's subsidiaries and their officers, directors, and affiliates to equal or exceed 25 percent of the outstanding voting shares of FBC or any of its subsidiaries;
6. Propose a director or slate of directors in opposition to a nominee or slate of nominees proposed by the management or board of directors of FBC or any of its subsidiaries;
7. Solicit or participate in soliciting proxies with respect to any matter presented to the shareholders of FBC or any of its subsidiaries;
8. Attempt to influence the dividend policies or practices; the investment, loan, or credit decisions or policies; the pricing of services; personnel decisions; operations activities (including the location of any offices or branches or their hours of operation, etc.); or any similar activities of FBC or any of its subsidiaries;
9. Dispose or threaten to dispose of shares of FBC or any of its subsidiaries in any manner as a condition of specific action or nonaction by FBC or any of its subsidiaries; or
10. Enter into any other banking or nonbanking transactions with FBC or any of its subsidiaries, except that BNS may establish and maintain deposit accounts with FBC, provided that the aggregate balances of all such accounts do not exceed $500,000 and that the accounts are maintained on substantially the same terms as those prevailing for comparable accounts of persons not affiliated with FBC.

Notwithstanding the foregoing, BNS and FBC's subsidiary, First Bank of Puerto Rico, directly or indirectly, may act as a syndication or administrative agent, or in a similar agency or arranging capacity, in connection with a loan syndication or similar credit offering (together, "syndication") in which the other institution is a participating lender or member of the syndicate (together, "member"), provided that (1) the total fee income derived by either party as a member in such syndications in a calendar year will be less than 5 percent of First Bank of Puerto Rico's total fee income in dollar amounts in that year, (2) the loans booked by either party as a member in connection with such syndications in a calendar year will account for no more than 10 percent of the aggregate dollar amount of all loans committed and originated by First Bank of Puerto Rico in that year, and (3) any syndication-related arrangements between BNS and First Bank of Puerto Rico will be nonexclusive and on an arm's length basis on market terms.

Appendix B

BNS AND FBC BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES

Bank	Rank	Amount of deposits (millions of dollars)	Share of market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
PUERTO RICO BANKING MARKETS						
Aguadilla—Aguada, Aguadilla, Anasco, Isabela, Lares, Moca, Rincon, and San Sebastian municipios						
BNS Pre-Merger	6	28.6	2.31	3,175	12	8
FBC	5	30.7	2.49	3,175	12	8
BNS Post-Merger	4	59.3	4.80	3,175	12	8
Mayaguez—Cabo Rojo, Hormigueros, Lajas, Las Marias, Maricao, Mayaguez, Sabana Grande, and San German municipios						
BNS Pre-Merger	11	7.0	.35	2,633	3	10
FBC	6	71.7	3.55	2,633	3	10
BNS Post-Merger	6	78.7	3.90	2,633	3	10
Ponce—Adjuntas, Coamo, Guanica, Guayanilla, Juana Diaz, Penuelas, Ponce, Santa Isabel, Villalba, and Yauco municipios						
BNS Pre-Merger	7	88.8	4.02	1,921	21	11
FBC	10	56.3	2.55	1,921	21	11
BNS Post-Merger	5	145.1	6.57	1,921	21	11

Appendix B—*Continued*

BNS AND FBC BANKING MARKETS CONSISTENT WITH BOARD PRECEDENT AND DOJ GUIDELINES—Continued

Bank	Rank	Amount of deposits (millions of dollars)	Share of market deposit shares (percent)	Resulting HHI	Change in HHI	Remaining number of competitors
San Juan—Aibonito, Aguas Buenas, Arecibo, Arroyo, Barceloneta, Barranquitas, Bayamon, Caguas, Camuy, Canovanas, Carolina, Catano, Cayey, Ceiba, Ciales, Cidra, Comerio, Corozal, Culebra, Dorado, Fajardo, Florida, Guayama, Guaynabo, Gurabo, Hatillo, Humacao, Jayuya, Juncos, Las Piedras, Loiza, Luquillo, Manati, Maunabo, Morovis, Naugabo, Naranjito, Orocovis, Patillas, Quebradillas, Rio Grande, Salinas, San Juan, San Lorenzo, Toa Alta, Toa Baja, Trujillo Alto, Utuado, Vega Alta, Vega Baja, Vieques, and Yabucoa municipios						
BNS Pre-Merger	11	1,044	1.95	1,521	87	10
FBC	1	11,878	22.16	1,521	87	10
BNS Post-Merger	1	12,922	24.11	1,521	87	10

NOTE: Deposit and market-share data are as of June 30, 2006, are adjusted to reflect subsequent mergers and acquisitions through April 6, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. All deposit data are in millions of dollars. Data for the St. Thomas-St. John and St. Croix banking markets are discussed in the order.

ORDERS ISSUED UNDER BANK MERGER ACT

County Bank
Merced, California

Order Approving the Acquisition and Establishment of Branches

County Bank,[1] a state member bank, has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act ("Bank Merger Act")[2] to purchase all the assets and assume all the liabilities of eleven California branches of National Bank of Arizona ("NBA"), Tucson, Arizona. County Bank also has applied under section 9 of the Federal Reserve Act ("FRA") to establish and operate branches at the locations of those branches.[3]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in local publications in accordance with the Bank Merger Act and the Board's Rules of Procedure.[4] As required by the Bank Merger Act, a report on the competitive effects of the merger was requested from the United States Attorney General and a copy of the request was provided to the Federal Deposit Insurance Corporation. The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the Bank Merger Act and the FRA.

County Bank, with total assets of approximately $1.8 billion, operates only in California.[5] County Bank is the 45th largest insured depository institution in California, control-

1. County Bank is a subsidiary of Capital Corp of the West, Merced, a bank holding company.

2. 12 U.S.C. § 1828(c).

3. 12 U.S.C. § 321. These branches are listed in the appendix.

4. 12 CFR 262.3(b).

5. Asset data are as of March 31, 2007. Deposit data and state rankings are as of June 30, 2006. In this context, the term "insured depository institutions" includes insured commercial banks, savings banks, and savings associations.

ling deposits of approximately $1.5 billion, which represents less than 1 percent of the total amount of deposits of insured depository institutions in the state ("state deposits").

NBA operates in Arizona and California. In California, NBA is the 156th largest insured depository institution in the state, controlling deposits of approximately $198.8 million. On consummation of the proposal, County Bank would become the 40th largest insured depository institution in California, controlling deposits of approximately $1.7 billion, which represents less than 1 percent of state deposits.

COMPETITIVE CONSIDERATIONS

The Bank Merger Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The Bank Merger Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[6]

County Bank and NBA compete directly in three relevant banking markets in California: Fresno, Los Banos, and Merced. The Board has reviewed carefully the competitive effects of the proposal in each banking market in light of all the facts of record. In particular, the Board has considered the number of competitors that would remain in the banking markets, the relative shares of total deposits in depository institutions in the markets ("market deposits") controlled by County Bank and NBA,[7] the concentration levels of market deposits and the increase in those levels as measured by the Herfindahl–Hirschman Index ("HHI") under the Department of Justice Merger Guidelines ("DOJ Guidelines"),[8] and other characteristics of the markets.

Consummation of the proposal in the Fresno banking market[9] would be consistent with Board precedent and within the thresholds in the DOJ Guidelines.[10] On consummation of the proposal, it would remain moderately concentrated, and numerous competitors would remain in the market.

County Bank and NBA also compete directly in two banking markets, Los Banos and Merced,[11] that require a detailed review of the competitive effects of the proposal. In each market, County Bank is the largest depository institution and already controls approximately half the market deposits. The Board previously has recognized that merger proposals involving a depository institution with a large market share relative to the shares of other market competitors warrant close review.[12]

After careful analysis of the record, the Board has concluded that no significant reduction in competition is likely to result from County Bank's proposed acquisition of NBA's branches in the Los Banos and Merced banking markets. As noted below, County Bank's existing market shares in the two banking markets would increase only slightly on consummation of the proposal. Moreover, the increase in concentration levels in each of these highly concentrated markets on consummation of the proposal would not exceed the threshold levels in the DOJ Guidelines. The Board has also considered other factors indicating that the proposal would not have a significantly adverse effect on competition in either banking market.[13]

Los Banos Banking Market. County Bank is the largest insured depository institution in the Los Banos banking market, controlling deposits of approximately $217.3 million, which represent approximately 49.8 percent of market deposits. NBA is the fifth largest depository institution in the market, controlling deposits of approximately $6.4 mil-

6. 12 U.S.C. § 1828(c)(5).

7. Deposit and market share data are as of June 30, 2006, adjusted to reflect subsequent mergers and acquisitions through August 24, 2007, and are based on calculations in which the deposits of thrift institutions are included at 50 percent. The Board previously has indicated that thrift institutions have become, or have the potential to become, significant competitors of commercial banks. *See, e.g., Midwest Financial Group*, 75 *Federal Reserve Bulletin* 386 (1989); *National City Corporation*, 70 *Federal Reserve Bulletin* 743 (1984). Thus, the Board regularly has included thrift institution deposits in the market share calculation on a 50 percent weighted basis. *See, e.g., First Hawaiian, Inc.*, 77 *Federal Reserve Bulletin* 52 (1991).

8. Under the DOJ Guidelines, a market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. The Department of Justice ("DOJ") has informed the Board that a bank merger or acquisition generally will not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI more than 200 points. The DOJ has stated that the higher-than-normal HHI thresholds for screening bank mergers and acquisitions for anticompetitive effects implicitly recognize the competitive effects of limited-purpose and other nondepository financial entities.

9. The Fresno banking market is defined as the Fresno metropolitan area, including the Fresno Ranally Metro Area and the towns of Chowchilla, Kingsburg, Parlier, Reedley, Orange Cove, Dinuba, Coarsegold, Oakhurst, Prather, and Shaver Lake.

10. On consummation of the proposal, the HHI would remain unchanged at 1208 for the Fresno market. County Bank operates the 14th largest depository institution in the market, controlling deposits of approximately $183.2 million, which represents less than 2 percent of market deposits. NBA controls $12.2 million in deposits, which represents less than 1 percent of market deposits. After consummation, County Bank would become the 13th largest depository institution in the market, controlling deposits of approximately $195.3 million, which represents approximately 2 percent of market deposits. Twenty-six depository institutions would remain in the banking market.

11. The Los Banos banking market is defined as southwestern Merced County, excluding the Merced Ranally Metro Area, Livingston, and Mariposa; and including the towns of Dos Palos and Los Banos.

12. *See Firstar Corporation*, 87 *Federal Reserve Bulletin* 236, 238 (2001); *The Citizens Bank*, 91 *Federal Reserve Bulletin* 438 (2005); and *First Busey Corporation*, 93 *Federal Reserve Bulletin* C90 (2007).

13. The Board has evaluated whether other factors mitigate the competitive effects of the proposal or indicate that the proposal would have a significantly adverse effect on competition in the market. The number and strength of factors necessary to mitigate the competitive effects of a proposal depend on the size of the increase in and resulting level of concentration in a banking market. *See NationsBank Corp.*, 84 *Federal Reserve Bulletin* 129 (1998).

lion. On consummation, County Bank would remain the largest depository institution in the market, controlling deposits of approximately $223.7 million.

The NBA deposits that County Bank proposes to acquire in the Los Banos market represent less than 1.5 percent of the total market deposits, and the HHI would increase 146 points to 3477, which is consistent with the DOJ Guidelines. Accordingly, the proposal would not signi¿cantly increase the market concentration.

Other factors indicate that the increase in concentration in the Los Banos banking market, as measured by the market share of the combined organization, overstates the potential competitive effects of the proposal in the market. After consummation, two of County Bank's three competitors in the market would control 21 percent and 18 percent of market deposits, respectively. In addition, the market appears to be moderately attractive for entry. For example, the population growth rate of the Los Banos market between 2002 and 2005 increased signi¿cantly faster than the average growth rate in other rural markets in California or in rural markets nationwide during the same time period. The Los Banos market also experienced higher deposit growth rates than the average deposit growth rates in California nonmetropolitan counties and in nonmetropolitan counties nationwide during the last three years.

Merced Banking Market. County Bank also is the largest insured depository institution in the Merced banking market,[14] controlling deposits of approximately $668.6 million, which represent approximately 50.4 percent of market deposits. NBA is the tenth largest depository institution in the market, controlling deposits of approximately $1.6 million. On consummation, County Bank would control deposits of approximately $670.2 million, which would represents 50.5 percent of market deposits.

County Bank proposes to acquire only a small amount of deposits in this market, and the proposal would not signi¿cantly increase the market concentration. On consummation, County Bank's market share would increase by only 0.1 percent. The HHI would increase 12 points to 3035, which is consistent with the DOJ Guidelines.

Other factors also indicate that this small increase in concentration in the Merced banking market would not have signi¿cant anticompetitive effects. After consummation, eight insured depository institutions would continue to compete with County Bank in the market. The market also appears to be moderately attractive for entry. Since 2000, the population in the banking market has grown more rapidly than the average population growth in urban markets in California and nationwide.

Agency Views and Conclusion on Competitive Considerations. The DOJ also has conducted a detailed review of the potential competitive effects of the proposal and has advised the Board that consummation of the proposal would not likely have a signi¿cantly adverse effect on competition in any relevant banking market. Based on all the facts of record, the Board concludes that consummation of the proposal would not have a signi¿cantly adverse effect on competition or on the concentration of resources in the three banking markets where County Bank and NBA compete directly or in any other relevant banking market. Accordingly, the Board has determined that competitive considerations are consistent with approval.

14. The Merced banking market is de¿ned as the Merced metropolitan area, including the Merced Ranally Metro Area and the towns of Livingston and Mariposa.

FINANCIAL AND MANAGERIAL RESOURCES AND FUTURE PROSPECTS

The Bank Merger Act requires the Board to consider the ¿nancial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including con¿dential reports of examination, other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other ¿nancial information, and information provided by County Bank.

In evaluating ¿nancial factors in expansion proposals by banking organizations, the Board considers a variety of measures in this evaluation, including capital adequacy, asset quality, and earnings performance. In assessing ¿nancial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the ¿nancial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

County Bank and NBA are well capitalized, and County Bank would remain so on consummation of the proposal. Capital Corp of the West also would remain well capitalized on consummation of the proposal. Based on its review of the record in this case, the Board ¿nds that County Bank has sufficient ¿nancial resources to effect the proposal. The proposed transaction is structured as a cash purchase that will be funded through the issuance of trust preferred securities by Capital Corp of the West.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of County Bank and NBA, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences with the relevant organizations and the organizations' records of compliance with applicable banking law, including anti-money-laundering laws. County Bank and NBA are considered to be well managed. The Board also has considered County Bank's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board concludes that considerations relating to the ¿nancial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval under the Bank Merger Act.

CONVENIENCE AND NEEDS CONSIDERATIONS

In acting on a proposal under the Bank Merger Act, the Board also must consider its effects on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[15] County Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of San Francisco, as of March 26, 2007. NBA received a "satisfactory" rating at its most recent CRA performance evaluation by the Office of the Comptroller of the Currency, as of October 20, 2003. After consummation of the proposal, County Bank plans to implement its CRA policies at the NBA branches. County Bank has represented that consummation of the proposal would allow it to provide a broader range of financial products and services over a larger area. Based on all the facts of record, the Board concludes that considerations relating to the convenience and needs of the communities to be served and the CRA performance records of the relevant depository institutions are consistent with approval.

OTHER CONSIDERATIONS

County Bank also has applied under section 9 of the FRA to establish and operate branches at NBA's locations listed in the appendix. The Board has assessed the factors it is required to consider when reviewing an application under section 9 of the FRA and finds those factors to be consistent with approval.[16]

CONCLUSION

Based on the foregoing and all facts of record, the Board has determined that the applications should be, and hereby are, approved. In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the Bank Merger Act and the FRA. The Board's approval is specifically conditioned on compliance by County Bank with the conditions imposed in this order, the commitments made to the Board in connection with the applications, and receipt of all other regulatory approvals. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transactions may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of San Francisco, acting pursuant to delegated authority.

By order of the Board of Governors, effective September 25, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

15. 12 U.S.C. § 2901 et seq.
16. 12 U.S.C. § 322; 12 CFR 208.6(b).

Appendix

BRANCHES IN CALIFORNIA TO BE ESTABLISHED BY COUNTY BANK

Caruthers
2200 West Tahoe Avenue

Coalinga
410 North Fifth Street

Dos Palos
2142 Blossom Street

Farmersville
400 West Visalia Road

Hanford
890 West Lacey Boulevard

Lemoore
142 West D Street

Mendota
567 Oller Street

Merced
2936 G Street

Needles
1019 West Broadway Street

Tulare
140 East Tulare Avenue

Visalia
800 West Main Street

East West Bank
Pasadena, California

Order Approving the Merger of Banks and Establishment of Branches

East West Bank[1] has requested the Board's approval under section 18(c) of the Federal Deposit Insurance Act[2] ("Bank

1. East West Bank is a subsidiary of East West Bancorp, Inc., Pasadena, California, a financial holding company.
2. 12 U.S.C. § 1828(c).

Merger Act") to merge with Desert Community Bank ("Desert Bank"), Victorville, California, both state member banks, with East West Bank as the surviving entity. East West Bank also has applied under section 9 of the Federal Reserve Act ("FRA") to establish and operate branches at Desert Bank's main office and branch locations.[3]

Notice of the proposal, affording interested persons an opportunity to submit comments, has been published in local publications in accordance with the Bank Merger Act and the Board's Rules of Procedure.[4] As required by the Bank Merger Act, a report on the competitive effects of the merger was requested from the United States Attorney General and a copy of the request was provided to the Federal Deposit Insurance Corporation. The time for filing comments has expired, and the Board has considered the proposal and all comments received in light of the factors set forth in the Bank Merger Act and the FRA.

East West Bank, with total assets of approximately $10.7 billion, operates in California and Texas.[5] In California, East West Bank is the 15th largest insured depository institution, controlling deposits of approximately $7.1 billion, which represent 1 percent of the total amount of deposits of insured depository institutions in the state ("state deposits").

Desert Bank operates only in California and is the 85th largest insured depository institution in the state, controlling deposits of approximately $494.4 million. On consummation of the proposal, East West Bank would remain the 15th largest insured depository institution in California, controlling deposits of approximately $7.6 billion, which represents 1.1 percent of state deposits.

Competitive Considerations

The Bank Merger Act prohibits the Board from approving a proposal that would result in a monopoly or would be in furtherance of any attempt to monopolize the business of banking in any relevant banking market. The Bank Merger Act also prohibits the Board from approving a proposal that would substantially lessen competition in any relevant banking market, unless the anticompetitive effects of the proposal are clearly outweighed in the public interest by its probable effect in meeting the convenience and needs of the community to be served.[6] East West Bank and Desert Bank do not compete directly in any relevant banking market. Based on all the facts of record, the Board has concluded that consummation of the proposal would not have a significantly adverse effect on competition or on the concentration of resources in any relevant banking market and that competitive considerations are consistent with approval.

3. 12 U.S.C. § 321. These branches are listed in the appendix.

4. 12 CFR 262.3(b).

5. Asset data are as of March 31, 2007. Deposit data and state rankings are as of June 30, 2006. In this context, the term "insured depository institutions" includes insured commercial banks, savings banks, and savings associations.

6. 12 U.S.C. § 1828(c)(5).

Financial and Managerial Resources and Future Prospects

The Bank Merger Act requires the Board to consider the financial and managerial resources and future prospects of the companies and depository institutions involved in the proposal and certain other supervisory factors. The Board has considered these factors in light of all the facts of record, including confidential reports of examination, other supervisory information from the primary federal and state supervisors of the organizations involved in the proposal, publicly reported and other financial information, information provided by East West Bank, and public comment on the proposal.

In evaluating financial factors in expansion proposals by banking organizations, the Board considers a variety of measures in this evaluation, including capital adequacy, asset quality, and earnings performance. In assessing financial factors, the Board consistently has considered capital adequacy to be especially important. The Board also evaluates the financial condition of the combined organization at consummation, including its capital position, asset quality, and earnings prospects, and the impact of the proposed funding of the transaction.

East West Bank and Desert Bank are well capitalized, and the resulting bank would remain so on consummation of the proposal. East West Bancorp will also remain well capitalized on consummation of the proposal. Based on its review of the record in this case, the Board finds that East West Bank has sufficient financial resources to effect the proposal. The proposed transaction is structured as a combination share exchange and cash purchase. East West Bank will use existing resources to fund the cash portion of the transaction.

The Board also has considered the managerial resources of the organizations involved and the proposed combined organization. The Board has reviewed the examination records of East West Bank and Desert Bank, including assessments of their management, risk-management systems, and operations. In addition, the Board has considered its supervisory experiences with the relevant organizations and the organizations' records of compliance with applicable banking law, including anti-money-laundering laws. East West Bank and Desert Bank are considered to be well managed. The Board also has considered East West Bank's plans for implementing the proposal, including the proposed management after consummation.

Based on all the facts of record, the Board concludes that considerations relating to the financial and managerial resources and future prospects of the organizations involved in the proposal are consistent with approval under the Bank Merger Act.

Convenience and Needs Considerations

In acting on a proposal under the Bank Merger Act, the Board also must consider its effects on the convenience and needs of the communities to be served and take into account the records of the relevant insured depository institutions under the Community Reinvestment Act ("CRA").[7] The CRA requires the federal financial supervisory agencies to encourage insured depository institutions to help meet the credit needs of the local communities in which they operate, consistent with their safe and sound operation, and requires the appropriate federal financial supervisory agency to take into account an institution's record of meeting the credit needs of its entire community, including low- and moderate-income ("LMI") neighborhoods, in evaluating bank expansionary proposals.[8]

The Board has considered carefully all the facts of record, including evaluations of the CRA performance records of East West Bank and Desert Bank, data reported by East West Bank and Desert Bank under the Home Mortgage Disclosure Act ("HMDA"),[9] other information provided by the banks, confidential supervisory information, and public comment received on the proposal. Twenty-eight commenters supported the proposal and commended East West Bank's efforts to meet the banking needs of its diverse communities. Three commenters opposed or expressed concerns about the proposal. One commenter asserted that East West Bank had not adequately served the credit and investment needs of LMI communities in its assessment areas. In addition, two commenters alleged that East West Bank and Desert Bank failed to provide adequate banking services to all groups of individuals who historically have had insufficient access to banking services.[10]

A. CRA Performance Evaluations

As provided in the CRA, the Board has evaluated the convenience and needs factor in light of the evaluations by the appropriate federal supervisors of the CRA performance records of the relevant insured depository institutions. An institution's most recent CRA performance evaluation is a particularly important consideration in the applications process because it represents a detailed, on-site evaluation of the institution's overall record of performance under the CRA by its appropriate federal supervisor.[11]

East West Bank received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of San Francisco, as of May 15, 2006 ("2006 Evaluation"). Desert Bank also received a "satisfactory" rating at its most recent CRA performance evaluation by the Federal Reserve Bank of San Francisco, as of May 31, 2005 ("2005 Evaluation"). East West Bank's current CRA program will be implemented at the resulting bank after consummation of the proposed merger with Desert Bank.

CRA Performance of East West Bank. In the 2006 evaluation, East West Bank received an "outstanding" rating on its lending test, a "needs to improve" rating on its investment test, and a "low satisfactory" rating on its service test.[12] Examiners reported that, throughout the California assessment areas, the bank's overall geographic and borrower distribution of loans reflected excellent participation in LMI census tracts.[13] Although the examiners found that East West Bank's community development investments were low compared to the opportunity in its area, the examiners determined that the bank's level of community development lending in California demonstrated excellent responsiveness to the need for affordable housing in its assessment areas in the state. In addition to direct loans for community development projects, the bank also offered $70 million in credit enhancements, such as letters of credit, to support the construction or rehabilitation of more than 1,500 housing units.

Examiners reported that the bank's excellent responsiveness to credit needs within LMI areas was a strength in its overall performance. They found that the percentage of the bank's total mortgage loans in LMI areas was substantially higher than the percentage reported by the aggregate of all lenders ("aggregate lenders")[14] to LMI areas in Southern California.[15] In most of East West Bank's Northern California assessment area, the examiners commended the bank's distribution of home purchase and refinance loans.[16] Furthermore, examiners determined that East West Bank's small business lending in LMI areas of its Southern California assessment area was strong and generally exceeded the performance of the aggregate lenders in those areas. More than one-third of the bank's small business loans were made in LMI areas, and a majority of its small business loans was extended to businesses with revenues of $1 million or less in the cities of Los Angeles and Santa Ana and the surrounding areas.[17]

7. 12 U.S.C. § 2901 et seq.

8. 12 U.S.C. § 2903.

9. 12 U.S.C. § 2801 et seq.

10. Two commenters criticized East West Bank and Desert Bank for not providing effective banking services in languages other than English and Chinese. East West Bank stated that its ATMs and telephone services are available in English, Chinese, and Spanish and that it provides retail banking and mortgage lending services in multiple languages other than English. In addition, East West Bank has conducted first-time home-buyer seminars in Spanish and has expanded its home mortgage programs, which were originally created for Chinese Americans, to serve other borrowers.

11. *See Interagency Questions and Answers Regarding Community Reinvestment*, 66 *Federal Register* 36,620 and 36,639 (2001).

12. One commenter expressed concern about these latter two ratings for East West Bank's assessment areas in California. Examiners concluded that the bank's overall record of CRA performance during the review period merited a rating of "satisfactory." Notably, the lending test is weighted more heavily than either the investment or service test in determining the institutional rating.

13. The Southern California assessment area is defined as Los Angeles County and portions of Orange County. The Northern California assessment area is defined as San Francisco County and portions of Alameda, San Mateo, and Santa Clara counties.

14. The lending data of the aggregate lenders represent the cumulative lending for all financial institutions that have reported mortgage lending as part of their CRA data in a particular area.

15. East West Bank noted that it offers a home loan program with affordable interest rates for persons who would not qualify for traditionally underwritten loans.

16. More than half of the 1–4 and multifamily loans extended by East West Bank in its California assessment areas were made in LMI areas in 2006, while LMI areas comprised 35.8 percent of those assessment areas.

17. For purposes of the evaluation, "small business loans" are loans that have original amounts of $1 million or less and are either secured

Examiners concluded that East West Bank's performance under the service test throughout California assessment areas was adequate. In general, retail banking services were reasonably accessible to all portions of the assessment areas.

CRA Performance of Desert Bank. As noted, Desert Bank received an overall "satisfactory" rating in its May 2005 examination. Although Desert Bank focuses on commercial lending, it offers a full range of banking products and services. Examiners concluded that the bank's overall lending levels reflected good responsiveness to community credit needs. In particular, they noted that the bank's distribution of small business loans was excellent and that such lending was strongest in LMI census tracts. In addition, more than half of the bank's small business loans were extended to businesses with revenues of $1 million or less. Business loans in small-dollar amounts made by the bank helped meet an important credit need of its communities. Examiners found community development lending and investments to be adequate, and they rated Desert Bank as "high satisfactory" for its services.

B. HMDA and Fair Lending Record and Other Issues

The Board has carefully considered the fair lending records and HMDA data reported by East West Bank and Desert Bank in 2005 in light of public comments received on the proposal. Two commenters expressed concern that East West Bank focused its services too narrowly on the Chinese American population in its assessment areas and did not effectively serve other populations of historically underserved minority communities. In addition, one commenter questioned the bank's lending record and asserted that East West Bank made a disproportionately small number of home mortgage loans to Latinos, African Americans, and Southeast Asian Americans.

Although the HMDA data might reflect certain disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in certain local areas, they provide an insufficient basis by themselves on which to conclude whether or not East West Bank is excluding or imposing higher costs on any group on a prohibited basis. The Board recognizes that HMDA data alone, even with the recent addition of pricing information, provide only limited information about the covered loans.[18] HMDA data, therefore, have limitations that make them an inadequate basis, absent other information, for concluding that an institution has engaged in illegal lending discrimination.

The Board is nevertheless concerned when HMDA data for an institution indicate disparities in lending and believes that all lending institutions are obligated to ensure that their lending practices are based on criteria that ensure not only safe and sound lending but also equal access to credit by creditworthy applicants regardless of their race or ethnicity. Because of the limitations of HMDA data, the Board has considered these data carefully and taken into account other information, including examination reports that provide on-site evaluations of compliance with fair lending laws by East West Bank.

The record, including confidential supervisory information, indicates that East West Bank has taken steps and developed programs to ensure compliance with all fair lending and other consumer protection laws and regulations. These efforts include bankwide fair lending training for all employees. The bank also has a second review process for all loans recommended for denial to ensure that all applicants are evaluated properly, and it performs fair lending audits and examinations. Examiners found no evidence of discriminatory lending practices at East West Bank.

The Board also has considered the HMDA data in light of other information, including the overall performance record of East West Bank under the CRA. The institution's record of performance demonstrates that it is active in helping to meet the credit needs of all the communities it serves.

C. Conclusion on Convenience and Needs Considerations

The Board has considered carefully the CRA performance, fair lending records, and HMDA data of East West Bank and Desert Bank in light of public comments received on the proposal. The Board also has considered carefully all of the facts of record, including reports of examination of the CRA records of the institutions involved, information provided by East West Bank, comments received on the proposal, and confidential supervisory information. The Board notes that the proposal would provide customers of Desert Bank with a broader array of products and services, including expanded options for affordable mortgage loans and ATM networks. Based on a review of the entire record, and for the reasons discussed above, the Board concludes that considerations relating to the convenience and needs factor and the CRA performance records of the relevant depository institutions are consistent with approval.

OTHER CONSIDERATIONS

East West Bank also has applied under section 9 of the FRA to establish and operate branches at Desert Bank's loca-

by nonfarm or nonresidential real estate or are classified as commercial and industrial loans. One commenter criticized East West Bank for not making a sufficient number of loans under $100,000. The Board has previously noted that the CRA does not require an institution to provide any specific type of products or services in its assessment area.

18. The data, for example, do not account for the possibility that an institution's outreach efforts may attract a larger proportion of marginally qualified applicants than other institutions attract and do not provide a basis for an independent assessment of whether an applicant who was denied credit was, in fact, creditworthy. In addition, credit history problems, excessive debt levels relative to income, and high loan amounts relative to the value of the real estate collateral (reasons most frequently cited for a credit denial or higher credit cost) are not available from HMDA data.

tions listed in the appendix. The Board has assessed the factors it is required to consider when reviewing an application under section 9 of the FRA and finds those factors to be consistent with approval.[19]

CONCLUSION

Based on the foregoing and all facts of record, the Board has determined that the applications should be, and hereby are, approved.[20] In reaching its conclusion, the Board has considered all the facts of record in light of the factors that it is required to consider under the Bank Merger Act and the FRA. The Board's approval is specifically conditioned on compliance by East West Bank with the conditions imposed in this order, the commitments made to the Board in connection with the applications, and receipt of all other regulatory approvals. For purposes of this action, the conditions and commitments are deemed to be conditions imposed in writing by the Board in connection with its findings and decision herein and, as such, may be enforced in proceedings under applicable law.

The proposed transactions may not be consummated before the 15th calendar day after the effective date of this order, or later than three months after the effective date of this order, unless such period is extended for good cause by the Board or the Federal Reserve Bank of San Francisco, acting pursuant to delegated authority.

By order of the Board of Governors, effective July 16, 2007.

Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

19. 12 U.S.C. §322; 12 CFR 208.6(b).

20. Three commenters requested that the Board hold a public meeting or hearing on the proposal. Neither the Bank Merger Act nor the FRA requires the Board to hold a public meeting or hearing. Under its rules, the Board may, in its discretion, hold a public meeting or hearing on an application to acquire a bank if a meeting or hearing is necessary or appropriate to clarify factual issues related to the application and to provide an opportunity for testimony (12 CFR 262.3(e) and 262.25(d)). The Board has considered carefully the commenters' requests in light of all the facts of record. In the Board's view, the commenters have had ample opportunity to submit their views and, in fact, submitted written comments that the Board has considered carefully in acting on the proposal. The requests by the commenters fail to demonstrate why the written comments do not present their views adequately or why a meeting or hearing otherwise would be necessary or appropriate. For these reasons, and based on all the facts of record, the Board has determined that a public meeting or hearing is not required or warranted in this case. Accordingly, the requests for a public meeting or hearing on the proposal are denied.

Appendix

BRANCHES IN CALIFORNIA TO BE ESTABLISHED BY EAST WEST BANK

Adelanto
10474 Rancho Road

Apple Valley
16003 Quantico Road

Barstow
945 E. Armory Road

Hesperia
15479 Main Street

Victorville
12022 Dunia Road
12470 Hesperia Road
12530 Hesperia Road
14800 La Paz Drive

Wrightwood
1261 Highway 2

Phelan
48895 Phelan Road

ORDERS ISSUED UNDER INTERNATIONAL BANKING ACT

Caixa Econômica Federal Brasília, Brazil

Order Approving Establishment of a Representative Office

Caixa Econômica Federal ("Bank"), Brasília, Brazil, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA[1] to establish a representative office in Jersey City, New Jersey. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

Notice of the application, affording interested persons an opportunity to submit comments, has been published in a newspaper of general circulation in New Jersey (*The New York Times*, January 28, 2007). The time for filing comments has expired, and all comments received have been considered.

Bank, a state-owned entity with total consolidated assets of approximately $98 billion,[2] is the second largest bank in

1. 12 U.S.C. §3107(a).

2. Data are as of December 31, 2006.

Brazil.[3] The Federative Republic of Brazil, including the states and the municipalities, owns all the capital of Bank, but Bank has its own equity and management autonomy. Bank currently has operations only in Brazil, where it provides commercial and retail banking services and investment banking services throughout the country. Through its subsidiaries, Bank manages a development fund, administers Brazilian lotteries, and offers insurance products. Bank also is the main fiscal agent for the Brazilian government, and it provides financing for the government's housing, education, and infrastructure projects.

The proposed representative office would market products of Bank in the United States, act as a liaison between Bank's head office in Brazil and its prospective U.S.-based customers, and develop relationships with international organizations.

In acting on a foreign bank's application under the IBA and Regulation K to establish a representative office, the Board takes into account whether the foreign bank: (1) engages directly in the business of banking outside of the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[4] The Board also considers additional standards set forth in the IBA and Regulation K.[5] The Board will consider that the supervision standard has been met where it determines that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities. This is a lesser standard than the comprehensive, consolidated supervision standard applicable to applications to establish branch or agency offices of a foreign bank. The Board considers the lesser standard sufficient for approval of representative office applications because representative offices may not engage in banking activities.[6]

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to home-country supervision of Bank, the Board has considered the following information. Bank is subject to the regulatory and supervisory authority of the Central Bank of Brazil ("Central Bank"), which has primary responsibility for the regulation of financial institutions in Brazil. The Board previously has determined that the Central Bank exercises a significant degree of supervision over the activities of four other Brazilian banks. In each case, the supervision exercised by the Central Bank was found to be sufficient to allow for the approval of a representative office in the United States by the applicant.[7] Based on all the facts of record, it has been determined that Bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.

The additional standards set forth in section 7 of the IBA and Regulation K have also been taken into account.[8] The Central Bank has no objection to the establishment of the proposed representative office. With respect to the financial and managerial resources of Bank, taking into consideration its record of operations in its home country, its overall financial resources, and its standing with its home-country supervisor, financial and managerial factors are consistent with approval. Bank appears to have the experience and capacity to support the proposal and has established controls and procedures for the proposed representative office to ensure compliance with U.S. law and for its operations in general.

Brazil is a member of the Financial Action Task Force and subscribes to its recommendations on measures to combat money laundering. In accordance with those recommendations Brazil has enacted laws and created legislative and regulatory standards to deter money laundering. Money laundering is a criminal offense in Brazil, and financial institutions are required to establish internal policies, pro-

3. The Bank's board of directors consists of seven members. The Minister of Economy appoints five members, including the chairman; the Minister of Planning, Budget and Management appoints one member; and the Bank's president occupies the remaining seat and serves as vice chairman of the board.

4. 12 U.S.C. §3107(a)(2); 12 CFR 211.24(d)(2). In assessing this standard, the Board considers, among other factors, the extent to which the home-country supervisors: (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. These are indicia of comprehensive, consolidated supervision. No single factor is essential, and other elements may inform the Board's determination.

5. 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2).

6. 12 CFR 211.24(d)(2).

7. *See Banco Bandeirantes, S.A.*, 81 *Federal Reserve Bulletin* 742 (1995); *Unibanco-União de Bancos Brasileiros, S.A.*, 82 *Federal Reserve Bulletin* 1148 (1996); *Banco BBA-Creditanstalt S.A.*, 85 *Federal Reserve Bulletin* 518 (1999); *Banco Itaú S.A.*, 86 *Federal Reserve Bulletin* 851 (2000). The Board later determined that two privately owned commercial banks in Brazil, Banco Itaú and Banco Bradesco, were subject to comprehensive consolidated supervision by the Central Bank in connection with each bank's election to be treated as a financial holding company. Banco Itaú's election was declared effective in February 2002, and Banco Bradesco's election was declared effective in January 2004. Bank is a government-owned bank with a mandate to carry out certain policy initiatives of the Brazilian government. As such, some of its activities differ from those of privately owned Brazilian banks.

8. *See* 12 U.S.C. §3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). These standards include: whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; and the bank's record of operation.

cedures, and systems for the detection and prevention of money laundering throughout their worldwide operations. Bank has policies and procedures to comply with these laws and regulations that are monitored by governmental entities responsible for anti-money-laundering compliance.

With respect to access to information about Bank's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which Bank operates and has communicated with relevant government authorities regarding access to information. Bank has committed to make available to the Board such information on the operations of Bank and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, the Central Bank may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Based on the foregoing and all the facts of record, and subject to the commitments made by Bank and the terms and conditions set forth in this order, Bank's application to establish the representative office is hereby approved.[9] Should any restrictions on access to information on the operations or activities of Bank and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require termination of any of Bank's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[10] For purposes of this action, these commitments and conditions are deemed to be conditions imposed by the Board in writing in connection with its findings and decision and, as such, may be enforced in proceedings under applicable law.

By order, approved pursuant to authority delegated by the Board, effective August 7, 2007.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

9. Approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board. *See* 12 CFR 265.7(d)(12).

10. The Board's authority to approve the establishment of the proposed representative office parallels the continuing authority of the state of New Jersey to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the state of New Jersey or its agent, the New Jersey Department of Banking and Insurance, to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

The State Export-Import Bank of Ukraine, Inc.
Kiev, Ukraine

Order Approving Establishment of a Representative Office

The State Export-Import Bank of Ukraine, Inc. ("Bank"), Kiev, Ukraine, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 10(a) of the IBA[1] to establish a representative office in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a representative office in the United States.

Notice of the application, affording interested persons an opportunity to submit comments, has been published in a newspaper of general circulation in New York, New York (*New York Post*, August 18, 2006). The time for filing comments has expired, and all comments received have been considered.

Bank, with total consolidated assets of approximately $3.7 billion,[2] is the sixth largest commercial bank in Ukraine and provides wholesale and retail banking services through a network of domestic branches.[3]

The proposed representative office is intended to act as a liaison between Bank's head office in Ukraine, other financial institutions, and its existing and prospective customers in Ukraine and the United States. The office would engage in representative functions in connection with the activities of Bank, solicit new business, provide information to customers concerning their accounts, promote business investment in and trading opportunities with Ukraine, conduct research, and receive applications for extensions of credit and other banking services on behalf of Bank.

Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a representative office, the Board must consider whether the foreign bank: (1) engages directly in the business of banking outside of the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home-country supervisor.[4] The

1. 12 U.S.C. § 3107(a).

2. Unless otherwise indicated, data are as of December 31, 2006.

3. Bank is wholly owned by the government of Ukraine and operates as a commercial bank in addition to promoting trade by and with Ukrainian companies.

4. 12 U.S.C. § 3107(a)(2); 12 CFR 211.24(d)(2). In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home-country supervisors (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or

Board also considers additional standards set forth in the IBA and Regulation K.[5] The Board considers the supervision standard to have been met when it determines that the applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.[6] This is a lesser standard than the comprehensive, consolidated supervision standard applicable to applications to establish branch or agency offices of a foreign bank. The Board considers the lesser standard sufficient for approval of representative-office applications because representative offices may not engage in banking activities.[7]

In connection with this application, Bank has provided certain commitments that limit the activities of the representative office. It has committed that the representative office would engage only in certain specified activities and would not make credit decisions; solicit or accept deposits; process or initiate transactions on behalf of Bank; or engage in activities related to securities trading, foreign exchange, or money transmission.

As noted above, Bank engages directly in the business of banking outside the United States. Bank also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

With respect to supervision by home-country authorities, the Board has considered the following information. Bank is supervised by the National Bank of Ukraine ("NBU"), which is responsible for the regulation and supervision of financial institutions operating in Ukraine and is in the process of enhancing its supervisory framework. The NBU issues rules and implements regulations concerning accounting requirements, asset quality, management, operations, capital adequacy, loan classification, and loan-loss-reserve requirements. In addition, the NBU has authority to order corrective measures, impose sanctions, and assume management of a financial institution or liquidate it.

The NBU supervises and regulates Bank in Ukraine through a combination of on-site examinations and off-site monitoring. On-site examinations are conducted biennially and cover capital adequacy, asset quality, profitability, liquidity, and compliance with the law. If necessary, the NBU can also conduct special on-site examinations. The NBU conducts off-site monitoring of Bank through the review of required daily, monthly, and quarterly reports. An external audit is also part of the supervisory process and must be conducted at least annually.

Based on all the facts of record, including the commitments provided by Bank limiting the activities of the proposed office, it has been determined that Bank is subject to a supervisory framework that is consistent with the activities of the proposed representative office, taking into account the nature of such activities.

The additional standards set forth in section 7 of the IBA and Regulation K have also been taken into account.[8] The NBU has no objection to the establishment of the proposed representative office.

With respect to the financial and managerial resources of Bank, taking into consideration its record of operations in its home country, its overall financial resources, and its standing with its home-country supervisor, financial and managerial factors are consistent with approval. Bank appears to have the experience and capacity to support the proposed representative office and has established controls and procedures for the proposed representative office to ensure compliance with U.S. law.

Although Ukraine is not a member of the Financial Action Task Force ("FATF"), Ukraine has enacted laws based on the general recommendations of the FATF. Additionally, Ukraine participates in international fora that address the prevention of money laundering.[9] Money laundering is a criminal offense in Ukraine, and banks are required to establish internal policies and procedures for the detection and prevention of money laundering.[10] Legislation and regulations require banks to adopt know-your-customer policies, report suspicious transactions, and maintain records. Bank has established anti-money-laundering policies and procedures, which include the implementation of know-your-customer policies, suspicious activity reporting procedures, and related training programs and manuals.

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comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

5. 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3).

6. *See, e.g., Victoria Mutual Building Society*, 93 *Federal Reserve Bulletin* C106, footnote 6 (2007); *Banco Financiera Comercial Hondurena*, 91 *Federal Reserve Bulletin* 444 (2005); *Jamaica National Building Society*, 88 *Federal Reserve Bulletin* 59 (2002).

7. 12 CFR 211.24(d)(2).

8. *See* 12 U.S.C. § 3105(d)(3)–(4); 12 CFR 211.24(c)(2)–(3). These standards include: whether the bank's home-country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the bank has procedures to combat money laundering, whether there is a legal regime in place in the home country to address money laundering, and whether the home country is participating in multilateral efforts to combat money laundering; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; and the bank's record of operation.

9. Ukraine is party to the 1988 United Nations Convention Against the Illicit Traffic of Narcotics and Psychotropic Substances, the United Nations International Convention Against Transnational Organized Crime, the United Nations International Convention for the Suppression of the Financing of Terrorism, and the Council of Europe Convention on Laundering, Search, Seizure, and Confiscation of Proceeds from Crime.

10. In 2001 and 2002, Ukraine was designated by the FATF as a non-cooperative country. In response, Ukraine enacted legislation to strengthen its anti-money-laundering regime in 2002 and 2003. Among other measures, the legislation expanded the definition of money laundering, strengthened enforcement, and established a financial intelligence unit, the State Committee for Financial Monitoring. As a consequence of these improvements, Ukraine was removed from the list of non-cooperative countries by the FATF on February 27, 2004. In light of these and other actions taken by Ukraine to strengthen its anti-money-laundering policies and procedures, including identifying terrorist financing as a separate crime, the Board believes that factors related to anti-money-laundering are consistent with approval of the application to establish a representative office.

Bank's internal and external auditors review compliance with requirements to prevent money laundering.

With respect to access to information on Bank's operations, the restrictions on disclosure in relevant jurisdictions in which Bank operates have been reviewed and relevant government authorities have been communicated with regarding access to information. Bank has committed to make available to the Board such information on the operations of Bank and any of its affiliates as the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act of 1956, as amended, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, Bank has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In addition, subject to certain conditions, the NBU may share information on Bank's operations with other supervisors, including the Board. In light of these commitments and other facts of record, and subject to the condition described below, it has been determined that Bank has provided adequate assurances of access to any necessary information that the Board may request.

Based on the foregoing and all the facts of record, and subject to the commitments made by Bank and the terms and conditions set forth in this order, Bank's application to establish the representative office is hereby approved by the Director of the Division of Banking Supervision and Regulation, with the concurrence of the General Counsel, pursuant to authority delegated by the Board.[11] Should any restrictions on access to information on the operations or activities of Bank or any of its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by Bank or its affiliates with applicable federal statutes, the Board may require or recommend termination of any of Bank's direct and indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by Bank with the conditions imposed in this order and the commitments made to the Board in connection with this application.[12] For purposes of this action, these commitments and conditions are deemed to be conditions imposed in writing by the Board in connection with its finding and decision and may be enforced in proceedings under 12 U.S.C. § 1818 against Bank and its affiliates.

By order, approved pursuant to authority delegated by the Board, effective August 17, 2007.

ROBERT DEV. FRIERSON
Deputy Secretary of the Board

11. *See* 12 CFR 265.7(d)(12).

12. The Board's authority to approve the establishment of the proposed representative office parallels the continuing authority of the state of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the state of New York or its agent, the New York State Banking Department, to license the proposed office of Bank in accordance with any terms or conditions that it may impose.

FINAL ENFORCEMENT DECISION ISSUED BY THE BOARD

IN THE MATTER OF

Michelle M. Moore, Former Institution-Affiliated Party of RBC Centura Bank, Rocky Mount, North Carolina, Respondent

Docket Nos. 06-035-E-1 A, 06-035-B-1

FINAL DECISION

This is an administrative proceeding pursuant to the Federal Deposit Insurance Act ("the FDI Act") in which the Board Enforcement Counsel seeks to prohibit the Respondent, Michelle M. Moore ("Respondent"), from further participation in the affairs of any financial institution and to require her to pay restitution based on actions she took while employed at RBC Centura Bank, Rocky Mount, North Carolina (the "Bank").

Upon review of the administrative record, the Board issues this Final Decision adopting the Recommended Decision ("Recommended Decision") of Administrative Law Judge Ann Z. Cook (the "ALJ"), and orders the issuance of the attached Order of Prohibition and to Cease and Desist.

I. STATEMENT OF THE CASE

A. Statutory and Regulatory Framework

Under the FDI Act and the Board's regulations, the ALJ is responsible for conducting proceedings on a notice of charges relating to a proposed order requiring payment of restitution or prohibition from banking (12 U.S.C. §§ 1818(b), 1818(e)(4)). The ALJ issues a recommended decision that is referred to the Board together with any exceptions to those recommendations filed by the parties. The Board makes the final findings of fact, conclusions of law, and determination whether to issue the requested orders (12 CFR 263.38).

The FDI Act sets forth the substantive basis upon which a federal banking agency may issue against a bank official or employee an order of prohibition from further participation in banking. To issue such an order, the Board must make each of three findings: (1) that the respondent engaged in identified *misconduct*, including a violation of law or regulation, an unsafe or unsound practice, or a breach of fiduciary duty; (2) that the conduct had a specified *effect*, including financial loss to the institution or gain to the respondent; and (3) that the respondent's conduct involved either personal dishonesty or a willful or continuing disregard for the safety or soundness of the institution (12 U.S.C. § 1818(e)(1)(A)–(C)).

The FDI Act also spells out the requirements for an order requiring restitution, which is a type of cease-and-desist order under the Act. Specifically, a cease-and-desist order may be imposed when the agency has reasonable cause to believe that the respondent has engaged or is about to engage in an unsafe or unsound practice in conducting the business of a depository institution, or that the respondent has violated or is about to violate a law, rule, or regulation or condition imposed in writing by the agency (12 U.S.C. § 1818(b)(1)). Such an order may require the respondent to make restitution if the respondent was "unjustly enriched" in connection with the violation or practice, or the violation or practice in involved "reckless disregard" of the law or applicable regulations or a prior agency order (12 U.S.C. § 1818(b)(6)(A)).

An enforcement proceeding is initiated by filing and serving on the respondent a notice of intent to prohibit. Under the Board's regulations, the respondent must file an answer within 20 days of service of the notice (12 CFR 263.19(a)). Failure to file an answer constitutes a waiver of the respondent's right to contest the allegations in the notice, and a final order may be entered unless good cause is shown for failure to file a timely answer (12 CFR 263.19(c)(1)).

B. Procedural History

On January 5, 2007, the Board issued a Notice of Intent to Prohibit and Notice of Charges and of Hearing ("Notice") that sought an order of prohibition against Respondent based on her conduct while employed at the Bank, and an order requiring her to make restitution to the Bank. A Board investigator, under the direction of Enforcement Counsel, personally served the Notice on Respondent on January 19, 2007. Respondent acknowledged that she had received the Notice in two subsequent voice mail messages to Enforcement Counsel. The Notice directed Respondent to file a written answer within 20 days of the date of service of the Notice in accordance with 12 CFR 263.19, and warned that failure to do so would constitute a waiver of her right to appear and contest the allegations. Nonetheless, Respondent failed to file an answer within the 20-day period or thereafter.

On March 29, 2007, Enforcement Counsel filed a Motion for Entry of an Order of Default against Respondent. On April 12, 2007, the ALJ issued an Order to Show Cause, providing Respondent until May 1, 2007, to file an answer to the Notice and to show good cause for having failed to do so previously. The Order was delivered by overnight delivery to Respondent's address. To date, Respondent has not filed any reply to the Order to Show Cause or answered the Notice.

C. Respondent's Actions

The Notice alleges that Respondent was employed as a teller and then a Customer Service Officer for Bank from May 2001 through May 2004. Her duties included overseeing the balancing of other tellers' cash supply and accounting for cash at the branch at which she worked. By virtue of her position, she had access to the cash drawers and cash vault of the branch. By using that access, Respondent was able make unauthorized withdrawals of over $66,000 from an account of one customer, using the proceeds for her own purposes. She concealed her activity by changing the address field for statements so that the statements no longer were sent to the customer's home. When the customer noticed she was no longer receiving statements, she spoke to Respondent about the problem. Respondent subsequently sent a letter on Bank letterhead falsely informing the customer that the account contained over $107,000, when in fact its funds were reduced by the amounts that Respondent had stolen. Shortly thereafter, Respondent made an unauthorized withdrawal from another customer's account and deposited the proceeds into the account of the first customer. Within a few weeks, however, the defalcation in the first customer's account was discovered by another Bank employee, and Respondent abruptly resigned. The Bank restored its customers' accounts for the amounts embezzled by Respondent, and froze Respondent's personal account at Bank. As a result of these actions, Bank's total loss was approximately $59,823.53.

II. DISCUSSION

The Board Rules of Practice and Procedure set forth the requirements of an answer and the consequences of a failure to file an answer to a Notice. Under the Rules, failure to file a timely answer "constitutes a waiver of [a respondent's] right to appear and contest the allegations in the notice" (12 CFR 263.19(c)). If the ALJ finds that no good cause has been shown for the failure to file, the judge "shall file . . . a recommended decision containing the findings and the relief sought in the notice." *Id.* An order based on a failure to file a timely answer is deemed to be issued by consent. *Id.*

In this case, Respondent failed to file an answer to the Notice despite notice to her of the consequences of such failure, and also failed to respond to the ALJ's Order to Show Cause. Respondent's failure to file an answer constitutes a default.

Respondent's default requires the Board to consider the allegations in the Notice as uncontested. The allegations in the Notice, described above, meet all the criteria for entry of an order of prohibition under 12 U.S.C. § 1818(e). It was a breach of fiduciary duty, unsafe and unsound practice, and violation of law or regulation, for Respondent to make unauthorized withdrawals from customers' accounts and to use Bank systems to conceal her actions. Respondent's actions resulted in loss to the Bank and financial gain to the Respondent, in that the Respondent used the proceeds for her own purposes and the Bank was forced to repay its customers for the amounts embezzled by Respondent. Finally, such actions also exhibit personal dishonesty and willful disregard for the safety and soundness of the Bank.

For the same reasons, the allegations in the Notice meet all the criteria for the entry of an order requiring restitution. Respondent engaged in an unsafe or unsound practice and a violation of law when she made unauthorized withdrawals from customers' accounts, and she was unjustly enriched by her actions in that she used the proceeds of her defalcation for her own purposes.

Accordingly, the requirements for an order of prohibition and for an order for restitution have been met and the Board hereby issues such an order.

CONCLUSION

For these reasons, the Board orders the issuance of the attached Order of Prohibition and Order to Cease and Desist.

By Order of the Board of Governors, this ninth day of July, 2007.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JENNIFER J. JOHNSON
Secretary of the Board

ORDER OF PROHIBITION AND TO CEASE AND DESIST

WHEREAS, pursuant to sections 8(b) and 8(e) of the Federal Deposit Insurance Act, as amended, (the "FDI Act") (12 U.S.C. § 1818(b) and (e)), the Board of Governors of the Federal Reserve System ("the Board") is of the opinion, for the reasons set forth in the accompanying Final Decision, that a final Order of Prohibition and to Cease and Desist should issue against MICHELLE M. MOORE ("Moore"), a former employee and institution-affiliated party, as defined in Section 3(u) of the FDI Act (12 U.S.C. § 1813(u)), of RBC Centura Bank, Rocky Mount, North Carolina.

NOW, THEREFORE, IT IS HEREBY ORDERED, pursuant to section 8(e) of the FDI Act, 12 U.S.C. § 1818(e), that:

1. In the absence of prior written approval by the Board, and by any other Federal financial institution regulatory agency where necessary pursuant to section 8(e)(7)(B) of the FDI Act (12 U.S.C. § 1818(e)(7)(B)), Moore is hereby prohibited:
   (a) from participating in any manner in the conduct of the affairs of any institution or agency specified in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)), including, but not limited to, any insured depository institution, any insured depository institution holding company or any U.S. branch or agency of a foreign banking organization;
   (b) from soliciting, procuring, transferring, attempting to transfer, voting or attempting to vote any proxy, consent or authorization with respect to any voting rights in any institution described in subsection 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A));
   (c) from violating any voting agreement previously approved by any Federal banking agency; or
   (d) from voting for a director, or from serving or acting as an institution-affiliated party as defined in section 3(u) of the FDI Act (12 U.S.C. § 1813(u)), such as an officer, director, or employee in any institution described in section 8(e)(7)(A) of the FDI Act (12 U.S.C. § 1818(e)(7)(A)).
2. On or before the effective date of this Order, Moore shall make restitution to the Bank in the sum of $59,823.53 for its loss as a result of Moore's violations and unsafe or unsound practices.
3. Any violation of this Order shall separately subject Moore to appropriate civil or criminal penalties or both under section 8 of the FDI Act (12 U.S.C. § 1818).
4. This Order, and each and every provision hereof, is and shall remain fully effective and enforceable until expressly stayed, modified, terminated or suspended in writing by the Board.

This Order shall become effective at the expiration of 30 days after service is made.

By Order of the Board of Governors, this ninth day of July, 2007.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JENNIFER J. JOHNSON
Secretary of the Board

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