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RESERVE BANK
OF NEW YORK

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SECOND DISTRICT HIGHLIGHTS



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YEAR 2000 AND NEW YORK FINANCIAL INSTITUTIONS

Over the past year and a half, in particular, financial institution supervisors and regulators and market participants have been working earnestly in developing approaches to the various dimensions of the Year 2000 problem. In the New York area, various groups have held forums, workshops and planning sessions addressing issues such as internal and external testing, contingency planning and global connectivity. My sense is that we have benefitted tremendously from these efforts. Going forward, it seems appropriate that we continue to focus and further enhance current information-exchanges across sectors within the financial community. After considering several mechanisms, we at the Federal Reserve Bank of New York thought that it would be useful to develop an inter-organization compendium which would contain some of the critical guidance issued by financial market regulators and supervisors, as well as some of the plans developed by financial industry groups. As the New York market is our primary interest, it seemed that such a document would be most effective and practicable if its orientation were focused on

implications for New York area financial organizations.

Our hope is that this compendium will be an additional tool for disseminating key guidance that will be useful to financial market participants as they approach evolving Year 2000 issues. It includes information concerning proposed external testing dates for securities market participants, key dates for banking organizations, a proposed model checklist for Year 2000 project teams, as well as suggested approaches to contingency planning and guidance for insurance firms and banks. In some cases, the "articles" included here have been distributed to institutions by their supervisors. However, I think you will find that any previously issued guidance presented here continue to be relevant and serve to further sharpen our understanding of the issues.

We welcome your comments on additional ways that we may provide useful information on Year 2000 to the New York financial community.

Ernest T. Patrikis
First Vice President
Federal Reserve Bank of New York

THE FEDERAL RESERVE'S YEAR 2000 SUPERVISION PROGRAM

This guidance was originally issued as SR 97-29 (SUP) by the Federal Reserve on November 12, 1997. It provides an overview of the various dimensions of the Federal Reserve's Year 2000 Program.

INTRODUCTION

Over the past several months, the Federal Reserve has intensified a range of efforts to address Year 2000 compliance issues. These efforts include: heightening the level of awareness in the U.S. and international banking markets of the importance of Year 2000 readiness; developing with the other federal banking agencies an inter-agency statement setting forth the steps that should be taken by domestic and foreign banks operating in the United States to address the century date change and establishing uniform, coordinated examination programs; examining banking organizations supervised by the Federal Reserve to determine the level of awareness and attention to Year 2000 compliance obligations; requiring the discussion of Year 2000-related issues at meetings between senior bank officials and Federal Reserve staff; appointing an official in the Board's Division of Banking Supervision and Regulation to address Year 2000 issues on a full time basis; designating senior staff at each Reserve Bank to coordinate Year 2000 supervisory-related matters; and providing information to Congress, the media, and the public about Year 2000 issues associated with the banking industry.

This letter provides an update on the current status of the Federal Reserve's Year 2000 supervision program and gives additional guidance on steps to be taken by Federal Reserve examiners and supervisors to address deficiencies found in a banking organization's Year 2000 remediation program.

A copy of this letter should be forwarded to the CEO or an appropriate alternative senior official at each domestic and foreign banking organization supervised by the Federal Reserve. The contents of the letter should also be conveyed to appropriate safety and soundness, international and consumer affairs examination and supervision staff.

OVERVIEW

Achieving Year 2000 readiness in the banking industry is critical to ensuring the safety and soundness of the banking system. For this reason, promoting Year 2000 compliance by banking organizations is one of the highest pri-

orities of the Federal Reserve's supervision program. To this end, the Federal Reserve is committed to determining whether the state member banks, bank holding companies and other banking organizations it supervises are preparing adequately for the century date change and to ensuring that deficiencies in Year 2000 readiness are quickly identified and addressed, if necessary through the use of appropriate supervisory follow-up actions. Reserve Bank examiners are currently conducting examinations to monitor banking organizations' Year 2000 readiness, and the Federal Reserve has established a multi-stage plan to address problems identified through the examination process.

In the event that a Reserve Bank determines that a banking organization's planning, project management or risk assessment program for Year 2000 compliance is not satisfactory, the Reserve Bank will promptly send the organization a notification letter advising the bank, U.S. branch or agency of a foreign bank, or company to submit a written plan for Year 2000 compliance to the Reserve Bank. The plan should satisfactorily describe management's efforts to address all Year 2000-related deficiencies and establish an acceptable time frame for compliance. The Reserve Bank will also require that the banking organization submit periodic progress reports (on a monthly or other appropriate basis) detailing its efforts to ensure Year 2000 readiness. If a banking organization's compliance plan and progress reports provide indications that it is not prepared to meet its Year 2000 readiness obligations, the Reserve Bank will promptly determine the suitable enforcement action needed to better ensure compliance.

An important part of the Federal Reserve's Year 2000 supervision program involves the evaluation of merger and acquisition proposals submitted by state member banks, bank holding companies and other financial institutions subject to Federal Reserve supervision. In considering expansion proposals, an important element of the Federal Reserve's assessment of the financial and managerial factors will be an applicant's ability to ensure Year 2000 readiness for the combined organization.

A banking organization's ability to provide uninterrupted services to its customers and to continue to comply with all applicable consumer protection statutes and regulations should be critical elements of a banking organization's Year 2000 readiness program. A vital aspect of the Federal Reserve's Year 2000 supervision program requires that Reserve Bank examiners take special care to ensure that their evaluation of a banking organization's Year 2000 compliance program focuses on the steps being taken by the banking organization to achieve full compliance with these laws and regulations at the time of the century date change.

Finally, in recognition of the important role played by foreign banking organizations in U.S. financial markets, the Federal Reserve will continue to work through the Basle Committee on Banking Supervision, other central bank and supervisory forums, and individual home country supervisors to promote Year 2000 readiness in foreign banking institutions.

EXAMINATION OF ALL BANKS BY MID-1998

The Federal Reserve is actively engaged in the examination of Year 2000 readiness of all state member banks and selected other financial institutions subject to Federal Reserve supervision. These examinations, which are being undertaken in conformity with the May 5, 1997 FFIEC statement entitled "Year 2000 Project Management Awareness" (Interagency Statement), are to be completed by June 30, 1998. A principal objective of the examinations is to identify any banking organizations that need additional supervisory attention pertaining to their readiness for Year 2000.

As part of each examination, a banking organization's Year 2000 planning and project management are to be carefully and thoroughly analyzed to help assess its state of readiness for the century date change and its progress in meeting its plan. Such analysis and conclusions should be given significant weight when assessing the risk profile of the organization and when rating the organization's information systems, internal risk management processes, senior management, and overall condition. Deficiencies with respect to Year 2000 readiness may result in a downgrading of management or of the organization's overall supervisory rating.

In all cases, examiners are to include a statement addressing the organization's Year 2000 readiness on the Examiner's Comments page of the examination report, including a review of any deficiencies. Further, the status

of the organization's Year 2000 readiness and the examiner's or Reserve Bank's conclusions or concerns in this regard should be discussed with bank management and directors at every suitable opportunity—most particularly at the examination exit meeting—and at subsequent presentations of examination findings to management, directors or committees of the board, and at other meetings held at the organization or Reserve Bank, or with other bank regulatory authorities.

EXAMINING FOR YEAR 2000 CREDIT RISK

The Interagency Statement noted that a banking organization's corporate customers depend on computer systems that must be Year 2000 compliant and that customers who have not adequately addressed Year 2000 issues may experience a disruption in business. The resulting adverse effects on the corporate customers' financial condition could jeopardize their ability to repay their loans. Bank lenders should consider the extent of this credit risk in the course of developing underwriting and loan review standards. To do so effectively, banking organizations need to monitor and assess the Year 2000 readiness efforts of their corporate customers and, where appropriate, should give serious consideration to writing Year 2000 compliance provisions into their loan documentation or to other suitable steps to prevent undue credit or operational risk. Examiners should take into account the banking organization's efforts to address credit risk arising from Year 2000 issues when assessing the organization's credit risk management and overall condition.

SUPERVISORY FOLLOW-UP

The Interagency Statement states that a banking organization's "mission critical systems should be identified and related priorities set for Year 2000 work by the end of the third quarter of 1997." Now that this time frame has passed, it is incumbent on the Reserve Banks and examiners to review a banking organization's Year 2000 efforts in this context to determine that mission critical systems have been identified and that a plan for their renovation has been prepared and approved by senior management. The Interagency Statement also calls for mission critical systems to be largely renovated with testing well under way by year-end 1998.

In the event that the supervisory process identifies any banking organization that does not now have such an inventory of mission critical systems and a plan that will enable renovation to be largely completed with testing

well under way by year-end 1998, a multi-stage process should be initiated by the Reserve Bank to ensure that the organization immediately starts receiving all appropriate supervisory attention. In addition to describing the nature and extent of any Year 2000-related deficiencies in a report of examination and at meetings with the board of directors and senior management, a Reserve Bank should send to the organization a notification letter fully describing the problem and requesting the prompt submission of a corrective action plan. The plan should satisfactorily detail the specific steps that the banking organization will take to address each deficiency and provide a realistic timetable for remedial actions. The notification letter should also require the banking organization to submit, on a monthly or other appropriate basis, a detailed written description of the actions that it is taking to comply with its plan, its progress towards achieving full compliance with the various parts of the Interagency Statement, and any impediments it is encountering in reaching complete Year 2000 readiness. (A sample notification letter was recently provided to each Reserve Bank.)

In addition to communicating with a banking organization facing Year 2000 readiness problems, Reserve Banks are asked to provide the Director of the Division of Banking Supervision and Regulation with a quarterly summary update on the progress being made by each of the banking organizations identified by the Reserve Bank as being deficient in this area.

If a banking organization's corrective action plan is inadequate and cannot be enhanced expeditiously, or an organization fails to submit any required remedial plan or fails to take actions to follow its already submitted plan in a satisfactory manner, the Reserve Bank should promptly consider the imposition of an appropriately tailored enforcement action. The failure to dedicate sufficient resources to solve identified problems and the adequacy of senior management's attention to Year 2000 compliance issues should be among the most critical determinative factors in deciding the nature of the follow-up enforcement action. Possible enforcement actions in the case of serious deficiencies could include written agreements, cease and desist orders and civil money penalties. Reserve Bank staff should contact the Division's Enforcement Section in the event it is concluded that an enforcement action is needed to address Year 2000 deficiencies.

INTERNATIONAL COORDINATION

The Federal Reserve is addressing international issues pertaining to the Year 2000, in significant part, through its

participation on the Basle Committee on Banking Supervision, which published a paper on Year 2000 readiness for banks and bank supervisors dated September 8, 1997, which was distributed to the Reserve Banks in AD letter 97-50. By working closely with other central banks and bank supervisors on an international basis, the Federal Reserve will seek to enhance the supervision of foreign banks operating in the U.S. and to address issues faced by U.S. banks' offices abroad.

Another international aspect of the Federal Reserve's Year 2000 supervision program involves on-going examinations of the U.S. branches and agencies of foreign banks in order to determine the state of the U.S. offices' readiness for the century date change. When deficiencies are identified, Reserve Banks should communicate in writing with the U.S. office and its foreign parent in order to develop a more thorough understanding of the ability of the U.S. office to prepare for Year 2000 and the foreign parent's plans in this regard. In some cases, discussions pertaining to the U.S. office's deficiencies may need to be held directly with the foreign parent's senior management. Such discussions will provide the Reserve Bank with an opportunity to emphasize the significance of the issue and the full extent of the Federal Reserve's concerns. Reserve Banks should also determine whether contact with the home country supervisor is warranted and coordinate such contacts with Board staff. Appropriate enforcement actions against foreign banking organizations and their U.S. offices for Year 2000-related problems should be considered in the same manner and using the same criteria as those used in connection with an evaluation of enforcement options involving domestic financial institutions.

The Federal Reserve will continue to work diligently to promote Year 2000 readiness in foreign banks that interact electronically with U.S. financial institutions and markets.

APPLICATIONS

As noted in the Interagency Statement, organizations considering mergers and acquisitions, or seeking other regulatory approvals, should take into account their ability to ensure Year 2000 readiness of the combined or expanded organization. In this regard, the Federal Reserve will consider an applicant's Year 2000 readiness and plans for ensuring the Year 2000 readiness of the combined organization as important factors in assessing financial and managerial considerations. In some cases involving critical Year 2000 compliance issues, the Federal Reserve may consider for inclusion in approval orders the imposition of written conditions relating to Year 2000 compliance objectives and

requirements. Less than satisfactory planning for Year 2000 readiness on a current and pro forma basis, or other significant supervisory issues pertaining to Year 2000, may form the basis for denial of an application or other regulatory request.

CONSUMER AFFAIRS

The Federal Reserve is also concerned that the state member banks and other financial institutions it supervises consider the needs of consumers as the institutions prepare to provide uninterrupted service to customers. Accordingly, a bank's mission critical systems should include those necessary to ensure that the institution can continue to comply with consumer protection laws and regulations. When utilizing examination procedures included in the Interagency Statement, examiners should include within the scope of their inquiry those information and operating systems that support compliance with consumer laws and regulations to ensure they are being prepared for Year 2000 compliance.

As an example of affected consumer oriented systems, banks operating open-end credit card systems should ensure that all date functions have been modified for Year 2000 so that the bank can continue to comply with the Truth in Lending Act (Regulation Z) subsequent to the century date change. Similarly, information and operating systems that support bank compliance with other statutes and regulations pertaining to consumer protection should also be subject to review¹.

Given that these consumer-related information and operating systems are ordinarily integrated into a banking organization's overall information and operating systems, it is anticipated that consumer-related operating systems are being prepared for the Year 2000 in a manner comparable to the organization's overall effort to prepare its total operating environment for the Year 2000. Nevertheless, it is requested that examiners incorporate specific Year 2000 consumer compliance statements and issues into their work papers. Further, substantive issues adversely affecting consumer compliance and protection should be included on the Examiner's Comments page, and considered when assessing the need for an enforcement action addressing Year 2000 readiness.

MULTIREGIONAL DATA PROCESSING SERVICERS (MDPS) SUPERVISION PROGRAM

With regard to the largest providers of data services to the banking industry, the Federal Reserve, along with the other FFIEC member agencies, are intensifying the MDPS program. Commencing immediately, the lead banking agency with responsibility for the examination of the MDPS will conduct quarterly visitations to update the agencies' assessment of the progress being made by the organization to provide Year 2000 ready services to its bank clients. These quarterly visitations are to be conducted as part of the FFIEC's "Enhanced Supervision Program" (ESP) for MDPS organizations, which calls for at least one interim visitation between bi-annual examinations, and more if considered necessary. (See FFIEC policy statement SP-11 in the FFIEC's IS Examination Handbook, section 25-43, for more on ESP processing of MDPS examination information.)

CERTIFICATION

Following the release of the Interagency Statement, which called upon banks to ask their vendors and service providers to certify the Year 2000 readiness of the product or service provided, the Federal Reserve and the other federal banking agencies received several requests for clarification of the terms "certify" and "certification." Many vendors and service providers are reluctant to certify or warranty their product line because of possible legal liability. Even if a bank or other financial institution were to obtain a certification from a vendor or service provider that a product is Year 2000 compliant, the certification alone would not ensure that the product or service will, in fact, be Year 2000 compliant.

For these reasons, the FFIEC will soon be clarifying the Interagency Statement's guidance and related examination procedures that call for vendor certification. The Federal Reserve expects institutions that use a product or service supported by a vendor or service provider to conduct appropriate due diligence and testing, if possible, which assesses the product or service to confirm that it will perform reliably in the banking organization's environment. Additional information on this subject will be issued by the FFIEC.

¹Such statutes and regulations would include the Expedited Funds Availability Act (Regulation CC), the Electronic Funds Transfer Act (Regulation E), the Flood Disaster Protection Act (Regulation H), the Home Mortgage Disclosure Act (Regulation C), Reserve Requirements of Depository Institutions (Regulation D), Consumer Leasing (Regulation M), the Truth in Savings Act (Regulation DD), the Real Estate Settlement Procedures Act (Regulation X), the Fair Credit Reporting Act, Unfair or Deceptive Practices Act (Regulation AA), and the Equal Credit Opportunity Act (Regulation B).

SIA'S TESTING SCHEDULE

The Securities Industry Association and a cross-section of market participants have been considering various approaches to testing.

The testing schedule proposed below is a preliminary assessment of what might be achieved. Although the exact dates for each product type may be modified going forward, these schedules provide a sense of how industry-wide testing might be coordinated.

MORTGAGE-BACKED SECURITIES POINT-TO-POINT

<i>TEST DESCRIPTION</i>	<i>CALENDAR DATE</i>	<i>FUTURE DATE BEING TESTED</i>	<i>COMMENTS</i>
MBSCC Test 1:			Weekends Only Except EPN - July 1998
Day 1	Sat., Jun 06, 1998	Dec. 30, 1999	Enter Trades
Day 2	Sat., Jun 13, 1998	Dec. 31, 1999	Netout Process
Day 3	Thur., Jun 24, 1998	Jan. 03, 2000	EPN- Allocation (after 7PM)
Day 4	Sat., Jun 27, 1998	Jan. 04, 2000	NOS - Notice of Settlement
MBSCC Test 2:			Weekends Only Except EPN - October 1998
Day 1	Sat., Oct. 03, 1998	Dec. 30, 1999	Enter Trades
Day 2	Sat., Oct. 10, 1998	Dec. 31, 1999	Netout Process
Day 3	Thur., Oct. 22, 1998	Jan. 03, 2000	EPN- Allocation (after 7PM)
Day 4	Sat., Oct. 24, 1998	Jan. 04, 2000	NOS - Notice of Settlement
PTC Eligible	Jul. '98 - Dec. '99	Schedule with PTC	Point-to-Point 2 Day test
Volume Test	Oct, 1998	TBD	Duplicate day's work
DTC Eligible			
Beta Testing	Mon., Jul 20, 1998	Fri., Dec 31, 1999	Part of Equity Beta Test
	Wed., Jul 22, 1998	Mon., Jan 3, 2000	Part of Equity Beta Test
Tier 1 - Industry-Industry-wide Test	Sat., Mar 27, 1999	Fri., Dec 31, 1999	Part of Tier 1 Equity Industry-wide Test
	Sat., Apr. 10, 1999	Mon., Jan 03, 2000	Part of Tier 1 Equity Industry-wide Test
Tier 2 - Pre-Packaged Tests	May '99 - Dec '99		
FED Eligible	Jul. '98 - Dec. '99	Schedule with Chase/BONY Tue = Dec 31, 1999 Wed = Jan 03, 2000	First 3 weeks/month 8:30 a.m.-12:00 p.m.

Futures/Futures Options 4-Day Test Designed in conjunction with FIA

<i>TEST DESCRIPTION</i>	<i>CALENDAR DATE</i>	<i>FUTURE DATE BEING TESTED</i>	<i>COMMENTS</i>
1998 Beta Test 1	Sat., Sept. 12, 1998	Fri., Dec 31 1999 Mon., Jan 03, 2000	Test 2 dates in 1 day
	Sat. Sept. 26, 1998	Tue., Jan 04, 2000 Tue., Feb 29,2000	Test 2 dates in 1 day
1998 Beta Test 2	Sat., Nov. 07, 1998	Fri., Dec 31 1999 Mon., Jan 03, 2000	Test 2 dates in 1 day
	Sat. Nov 14, 1998	Tue., Jan 04, 2000 Tue., Feb 29,2000	Test 2 dates in 1 day
Industry-wide Test	Sat, Mar. 27, 1999	Fri. Dec 31, 1999	Same as Tier 1 Equity Industry-wide Test
	Sat. Apr. 10, 1999	Mon., Jan 03, 2000	Same as Tier 1 Equity Industry-wide Test
	Sat., TBD	Tue., Jan. 04, 2000	
	Sat., TBD	Tue., Feb. 29, 2000	

EQUITIES, OPTIONS, MUNICIPALS, CORPORATES, UIT'S, MUTUAL FUNDS 4-DAY CYCLE

<i>TEST DESCRIPTION</i>	<i>CALENDAR DATE</i>	<i>FUTURE DATE BEING TESTED</i>	<i>COMMENTS</i>
Infrastructure Testing	April 1998	N/A	Establish Connectivity
Beta Test	Mon., July 13, 1998	Wed., Dec.29, 1999	Options Exercise and Assignments
	Wed., July 15, 1998	Thu., Dec. 30, 1999	Excludes Options
	Mon., July 20, 1998	Fri., Dec. 31, 1999	
	Wed., July 22, 1998	Mon., Jan. 03, 2000	
	TBD	Tue., Jan. 04, 2000	Mutual Funds Only
	Mon., Jul 27, 1998	Sat., Jan. 22, 2000	Options Expirations
Tier 1 Industry-wide 4-Day Test 4-Day Test	Sat., Mar 06, 1999	Wed., Dec 29, 1999	Options Exercise and Assignments
	Sat., Mar 13, 1999	Thu., Dec. 30, 1999	Excludes Options
	Sat., Mar 27, 1999	Fri., Dec. 31, 1999	
	Sat., Apr 10, 1999	Mon., Jan. 03, 2000	
	TBD	Tue., Jan. 04, 2000	Mutual Funds Only
Tier 2 Pre-packaged Tests	Sat., Apr 24, 1999	Sat., Jan. 22, 2000	Options Expirations
	May, 1999 - Dec, 1999		

U.S. GOVERNMENT SECURITIES POINT-TO-POINT

TEST DESCRIPTION	CALENDAR DATE	FUTURE DATE BEING TESTED	DAYS	COMMENTS
GSCC Testing	Jul 1998 - Dec 1999			First 3 weeks of each month 8:30 a.m. to 12:00 p.m.
		Dec. 30, 1999	Mon.	Recycles every week-3 day script
		Dec. 31, 1999	Tue.	Recycles every week-3 day script
		Jan. 03, 2000	Wed.	Recycles every week-3 day script
Volume Test	4 Qtr '98		TBD	Duplicate day's work

YEAR 2000 SUPERVISION IN THE INSURANCE INDUSTRY

Circular Letter No. 6 was issued by the State of New York Insurance Department on March 6, 1998 to its constituent institutions, referred to here as licensees, providing the mechanisms for disclosing progress on Year 2000 preparations.

Pursuant to Section 308 of the Insurance Law, each licensee is hereby directed to provide quarterly reports apprising the Department of the ongoing status of the licensee's Year 2000 initiatives. The reports are due no later than 15 days after the end of each calendar quarter (April 15th, July 15th, October 15th, and January 15th) and will be required for every calendar quarter in 1998 and 1999 and the first quarter in 2000. The reports shall be signed by a senior technology officer (e.g., Chief Information Officer). Failure to provide the quarterly reports will result in further regulatory action. In addition, the Superintendent may make public the names of those licensees that fail to provide the quarterly reports in a timely manner.

You are also hereby advised that a review of licensees' Year 2000 compliance procedures will be included in the Department's regular examinations and the Department may conduct target reviews of licensees that, in its view, pose particular risks.

The quarterly reports shall provide the following information depending upon your organization's situation.

If you responded to Circular Letter No. 11 (1997) indicating that your organization was:

- already Year 2000 compliant and your organization continues to be compliant, please confirm same;
- already Year 2000 compliant and such is no longer the case, please explain. In addition, please provide a Year 2000 plan;
- overview with key milestones and a budget breakdown of the cost components of such plan;
- not currently Year 2000 compliant and your organization provided a Year 2000 plan overview with milestones and a budget breakdown and your organization continues to be on target with its previously submitted plan, please confirm same. If your organization is on target with its plan but the budget has changed by more than 10%, please provide a revised budget breakdown of the cost components of your organization's plan;
- not currently Year 2000 compliant and your organization provided a Year 2000 plan overview with milestones and a budget breakdown and your organiza-

tion is no longer on target with its previously submitted plan, please explain. In addition, please provide a revised Year 2000 plan overview with key milestones and a revised budget breakdown of the cost components of such plan;

If your organization does not fit into any of the above categories, please apprise the Department of the ongoing status of your organization's Year 2000 situation.

If a licensee submits a revised plan overview or budget breakdown in any quarterly report, the revisions in such report become the basis for subsequent quarterly reporting.

A licensee using outside vendors for services is responsible for determining that the vendor's products or services, including telecommunications networks, are Year 2000 compliant. The quarterly reports from such a licensee shall encompass the status of its vendor's information processing and delivery systems with respect to Year 2000 compliance. Outside vendors providing services include, but are not limited to, hardware and software providers, service providers, reinsurers, reinsurance intermediaries, asset managers, agents/brokers/producers, managing general agents, third party administrators, affiliates and telecommunication providers.

Since computer systems and system applications are constantly evolving, it is necessary for all licensees, including licensees that have previously indicated that there are no Year 2000 issues or problems within its organization, to provide quarterly reports.

With the first quarterly report due April 15, 1998, every licensee is also required to provide a discussion of:

- its contingency plan(s) in the event that Year 2000 compliance is not achieved. This discussion should indicate what actions will be taken by your organization to continue operations if it fails to achieve Year 2000 compliance. The discussion should also indicate how such actions are intended to mitigate any impact on the organization, policyholders, members, clients, business partners, and personnel, etc. If at any time a licensee becomes aware that it will not achieve Year 2000 compliance, such licensee shall immediately notify the Department and indicate what contingency plan(s) will be put into effect;
- the nature and extent of its communications to policyholders, shareholders and customers regarding the state of its Year 2000 readiness.

In addition, at the point all information processing and delivery systems are determined to be Year 2000 com-

pliant, each licensee is directed to provide to the Department a certification from its chief executive officer attesting to such compliance. The certification shall be in the form attached hereto. A licensee that is currently Year 2000 compliant shall provide the required certification as soon as possible (including those licensees that reported to be Year 2000 compliant in response to Circular Letter No. 11 (1997)). After a certification has been provided, each licensee is to continue submitting quarterly reports indicating that its organization continues to be Year 2000 compliant or explaining any changes in the status of its Year 2000 compliance.

In order to encourage full and frank disclosure of an organization's efforts to address Year 2000 compliance, the Department has determined that it will treat all responses to the Circular Letter as confidential and exempt from disclosure under the Freedom of Information Law provisions dealing with imminent contract awards, trade secrets or involving information which if disclosed would cause substantial injury to the competitive position of the licensees submitting responses. Confidential treatment will be accorded to all responses without the need for the submitting licensees to claim such exemption(s).

The aforementioned exemption should not be construed as to prevent, limit or relieve any obligation of a licensee to appropriately disclose in management's discussion and analysis, the notes to the financial statements, or any other reporting or disclosure medium any items which have material or significant impact on its financial solvency or its ability to continue operations.

All licensed life insurers, fraternal benefit societies, charitable and segregated gift annuity societies, employee welfare funds, retirement systems, viatical settlement companies, governmental supplemental annuity funds, savings bank life insurance departments and accredited life reinsurers are to send their reports and direct any questions relating to this Circular Letter to:

Mr. Michael Maffei
Principal Insurance Examiner
New York State Insurance Department, Life Bureau,

25 Beaver Street
New York, New York 10004
Telephone (212) 480-4762

All licensed property/casualty insurers, co-operative property/casualty insurers, financial guaranty insurers, mortgage guaranty insurers, title insurers, reciprocal insurers, accident and health insurers, Article 43 Corporations, Public Health Law Article 44 health maintenance organizations, the State Insurance Fund, the Medical Malpractice

Insurance Association and accredited property/casualty reinsurers are to send their reports and direct any questions relating to this Circular Letter to:

Mr. Leroy Kaalund
Associate Insurance Examiner
New York State Insurance Department, Property Bureau

25 Beaver Street
New York, New York 10004
Telephone (212) 480-5198

All rate service organizations are to send their reports and direct any questions relating to this Circular Letter to:

Mr. Maurice Morgenstern
Supervising Insurance Examiner
New York State Insurance Department, Property Bureau

25 Beaver Street
New York, New York 10004
Telephone (212) 480-5583

www.ins.state.ny.us

ADDRESSING YEAR 2000 ISSUES IN FOREIGN BANKING ORGANIZATIONS

Circular No. 11005 was issued by the Federal Reserve Bank of New York to the chief executive officers for United States operations of all branches and agencies of foreign banks and for foreign bank holding companies in the Second Federal Reserve District.

This document describes the level of Year 2000 preparations expected from foreign banking organizations.

The potential disruption that the Year 2000 could have on normal banking operations in the United States can be significant. U.S. banking supervisors are taking this issue very seriously and are currently in the process of reviewing the readiness of every banking institution we supervise by the middle of 1998. While some of the reviews will be done as part of regularly scheduled examinations, most will be done as special Year 2000 target reviews during January and February 1998.

We are finding that these Year 2000 reviews are posing special challenges for foreign banking organizations (FBOs) that may be relying on head office led projects to address the Year 2000 issue. This circular provides guidance regarding what the examiners expect to see in their reviews and how we will follow up on these reviews.

BACKGROUND

The Bank Supervision Group of this Reserve Bank has previously issued five circulars on the Year 2000 issue based on the work of the Federal Financial Institutions Examination Council, the G-10 Governors, the Basle Committee on Banking Supervision, and our own concerns within the Fed-

eral Reserve². These circulars have established a number of key target dates for measuring progress on Year 2000 projects. Two dates are particularly important for assuring that the Year 2000 is addressed in a timely and effective manner:

September 30, 1997—when mission critical applications were to be identified and plans and priorities set for the Year 2000 project.

December 31, 1998—when financial institutions serving large numbers of other financial institutions by providing correspondent, clearing, or other services should be largely completed with their external testing with similar large institutions.

As part of this Bank's regular examination process and during specially targeted Year 2000 reviews, progress against these targets is being assessed by the examiners.

YEAR 2000 INFORMATIONAL NEEDS OF EXAMINERS

The principal focus of examiners during their Year 2000 reviews will be on the plan that has been developed to

address the processing, risk management, and informational needs of the U.S. business activities of the FBO. To the extent that the FBO relies upon applications that are developed, maintained, or run at the head office or other location outside the U.S., Year 2000 plans for these applications should be made available to the examiner.

Particular attention will be devoted to the schedules for applications becoming Year 2000 compliant and tested, both internally and externally. Examiners will also assess whether there are appropriate reporting systems in place to track progress and senior management review of progress to assure that schedules do not fall behind acceptable limits.

Examiners will want to meet with senior U.S. officials in the FBO to discuss Year 2000 efforts. Where FBOs rely on vendors, special attention will be devoted to assure that due diligence reviews are completed on the vendors in a timely manner and that their products are thoroughly tested within the FBO's overall plan³. Contingency plans will also be discussed. While these review activities are no different than those followed with respect to financial institutions headquartered in the U.S., reliance on the head office for elements of the overall plan may leave information gaps in the material that the examiner will need to render a judgment on the overall preparedness of the FBO regarding its U.S. business activities. Filling these gaps prior to a review may significantly simplify the review

process for both the FBO and the examiner. When the reviews are completed, the examiners will need to obtain progress reports at periodic intervals. Should the review identify areas of special concern, supervisory actions appropriate to the issues will be undertaken⁴.

FEDERAL RESERVE SYSTEM PLANS

The Federal Reserve has developed a comprehensive Year 2000 plan for its own systems. These plans are being communicated separately through circulars and Century Date Change Bulletins issued by our Year 2000 program office. Questions regarding these plans may be directed to Bruce Cassella, Vice President, Bank Services Office at this Bank or to Elaine Geller, Federal Reserve System Century Date Change Project Office at (415) 974-3148.

Questions or comments about Year 2000 issues more generally may be referred to George Juncker, Vice President, Bank Supervision Group, or to William Francis or Thomas Wines, Examining Officers, Bank Supervision Group, respectively.

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²These circulars are: No. 10878, September 27, 1996, "Effect of the Year 2000 on Computer Systems"; No. 10937, April 4, 1997, "Year 2000 Alert"; No. 10951, May 14, 1997, "Interagency Statement on Year 2000 Project Management Awareness"; No. 10981, September 17, 1997, "Year 2000: A Global Concern"; and No. 10996, November 24, 1997, "Year 2000 Supervision Program".

³Vendor relationship management has proven to be a particularly difficult issue for all financial institutions, and FBOs may want to attend the half day conferences sponsored by this Bank on January 6 and January 7, 1998, if this is an area where difficulties are being encountered. See Circular No. 10995, dated November 21, 1997, "Year 2000 Conferences," for the announcement of these conferences and to obtain a registration form.

⁴Letter SR 97-29 describes the type of supervisory responses that will be taken with respect to Year 2000 concerns. This letter was distributed with Circular No. 10996, dated November 24, 1997, "Year 2000 Supervision Program."

PROPOSED Y2K PROJECT TEAM CHECKLIST

The model checklist for Year 2000 project teams was developed by an industry task-force of which the securities Industry Association was a member. Although the checklist continues to be a work in progress and will be further enhanced in the coming weeks, it may serve as an effective guide for institutions as they assess their Year 2000 preparedness.

I. Process MANAGEMENT

1. Has a Year 2000 (Y2K) project manager been named?
2. Has senior management approved Y2K project plans?
3. Have clear lines of authority and responsibility been established for the Y2K effort?
4. What efforts are being made to ensure that key staff members are retained through the year 2000?
5. Is the project plan updated regularly and are cost-time estimates revised accordingly?
6. Is there a centralized repository for all technical and project-related information?
7. Have you assessed Y2K risk for individual business units?
8. How many other resources will be required from all business units, functions, and geographies? Are these costs built into business plans?
9. Have you considered the need for outside resources to ensure the timely completion of your Y2K project?
10. Do you have in place an appropriate level of management sign-off for each modified system?

COMMUNICATION

11. Is there a central function coordinating communication with customers, central banks, and regulators?
12. Have the Y2K issue, renovation strategies, and testing schedules been broadly communicated to all levels of staff?

II. Planning EXTERNAL RELATIONSHIPS

1. Do you understand the effect of Y2K on your payment systems providers, including wire transfer systems, automated clearinghouses, check clearing providers, credit card merchant and issuing systems, automated teller machine networks, electronic data interchange systems, and electronic benefits transfer systems?
2. Have you addressed infrastructure connections (telecommunications, electricity, water, and gas) to ascertain their Y2K preparedness?
3. Are you working with industry groups to coordinate testing, contingency plans, and regulatory matters?

HARDWARE / SOFTWARE

4. Have all essential software applications, including those that exist on desktops, been identified and inventoried?
5. Have you given special attention to cross-business applications (i.e., those used by you but supported by other businesses, and those supported by you but used by other businesses)?
6. Have you considered using commercially available tools for Y2K assessment and renovation? If you have elected to use an automated tool to help with impact analysis, has one been chosen?
7. Have you selected a renovation strategy (i.e., windowing, expansion, etc.)?
8. Have you documented and communicated this strategy (e.g., pivot date, if windowing is used) with information counterparties?
9. Have renovation plans for existing hardware and software been prioritized?
10. Have you assessed the extent to which your firm is vulnerable to third-party software?
11. Do you have processes in place to ensure that new or modified software and equipment is Y2K compliant?
12. Have all network components, data center components, desktops, and end-user applications been identified, inventoried, and factored into Y2K project plans?
13. Do you have adequate computer resources for both Y2K testing and day-to-day processing activities?
14. Are you making adequate use of information and best practices globally available from correspondents, vendors, etc.?

FACILITIES

15. Have you considered facilities controls and equipment (e.g., access security, heating and cooling, elevators, vaults, fire alarms, and telephone systems) in your Y2K project plan?
16. Have you considered facilities not owned/operated by you?
17. If you do not own the facilities, have the building owners been contacted to ensure compliance?
18. Has a survey been carried out to determine which critical small office equipment (e.g., fax machines, financial calculators, etc.) are date sensitive?

TESTING

19. Have you determined the extent of Y2K testing required for software applications?
20. Have you established a testing strategy?
21. Do you have plans to test all critical software, including software that has been certified by the developer as Y2K compliant?
22. Are you positioned to engage in external testing efforts?
23. Does your testing regimen include critical data other than the December 31, 1999 through the first business day in 2000 sequence (e.g., end of month, end of quarter, or February 29, 2000)?

III. Risk

COUNTERPARTY RISK

1. Have you considered the potential impact of Y2K to your major clients' businesses and creditworthiness using, for example, the set of questions outlined in Question 7 (a-g) below?
2. Have you ranked clients and counterparties relative to the impact to your firm in the event of default?
3. Will you adjust portfolio models to quantify counterparty risk to Y2K?
4. Have you amended business procedures (such as credit, mergers/acquisitions, and investment banking) to incorporate consideration of Y2K risk in dealings with counterparties?
5. Have you identified all external interfaces with customers (e.g., electronic banking, tape or diskettes, or inputs)?
6. Does your Y2K plan include renovation, testing, and implementation of these connections?
7. Have you considered gathering the following information about your major clients in your efforts to analyze Y2K impact on you and your customers:

EXAMPLE OF CREDIT RISK CHECKLIST FOR MAJOR CLIENTS

- a) To what extent has the customer considered the nature of Y2K and assessed its impact on business?
- b) Does your customer have any key customers and suppliers whose failure would have a material impact on the business? How is the customer managing this?

- c) Accurate inventories are the basis for comprehensive impact analysis. Have inventories been produced of the areas the customer needs to consider, such as (i.) software developed by the client, (ii.) third-party software, (iii.) hardware, (iv.) companies or customers with whom they exchange data, and (v.) service providers? What progress has been made to consider each of these in detail? Is prioritization necessary?
- d) Has the customer set a target date for full compliance? Is the target date reasonable? How confident is the customer of meeting this date? Is appropriate senior management commitment displayed?
- e) Has the customer made contact with its data partners and service providers to ensure that they are taking appropriate action? Are there any major problems with key partners/providers?
- f) Have comprehensive plans been drawn up to test all software, hardware, machinery, and data interfaces? Has sufficient time been allowed for this?
- g) Have contingency plans been established to ensure that, in the event of permanent or temporary loss or disruption to systems, the company can continue to function?

BUSINESS RISKS

8. Do you have in place adequate controls to ensure that data and systems security is maintained throughout the renovation, testing, and implementation process?
9. Have you included all operational subsidiaries, affiliates, and joint ventures in your Y2K project plan?
10. Have you taken Y2K into account when considering mergers, acquisitions, or business expansion?
11. Have you considered the implications of dealing simultaneously with Y2K renovation and conversion to the Euro common currency?

12. Have you considered the implications of dealing simultaneously with Y2K renovation and other national priorities or global initiatives, such as the implementation of the OATS order audit system in the United States, deregulation in Japan, etc.?
13. Have you considered your exposure to Y2K readiness in any particular country or region? Are regional efforts coordinated with those of global business lines?
14. Are key regulators in countries in which you operate working to minimize systemic risk from Y2K noncompliance? If not, are you making an effort to assist them in this regard?

CONTINGENCY PLANNING

15. Have you considered contingency plans to ensure your ongoing operations if any individual business function is not compliant?
16. Do you have a contingency plan for all critical internal and external dependencies that are believed to be at risk?
17. Have you sought alternatives in the case of existing vendors that are not Y2K compliant?
18. Have you examined business continuity plans (usually in place to help recover from losses in fire or other disaster) to ensure that they are Y2K compliant?

LEGAL ISSUES

19. Have you sought legal counsel relating to Y2K in all jurisdictions in which you operate?
20. Have you consulted legal counsel as to appropriate and proper documentation regarding your firm's Y2K efforts?
21. Are provisions ensuring Y2K compliance used in new contracts with external service providers, outside software developers, and suppliers?
22. Are you aware of, or preparing for any litigation related to Y2K?
23. Have you reviewed insurance policies to ascertain if they cover business losses and liability as a result of Y2K?

IV. Reporting

1. Is senior management receiving regular reports from the Y2K project leader, encompassing results from both the business units and from relevant oversight functions, and detailing progress against established milestones and business risks? Do these reports provide the level of detail needed to take action?
2. Are you aware of all regulatory reporting and public disclosure requirements on your progress in Y2K compliance in all jurisdictions in which you operate?
3. Have you considered the components of appropriate Y2K disclosure to/from customers, vendor, etc., that satisfy relevant due diligence requirements?

YEAR 2000 CONTINGENCY PLANNING

This article was prepared by George Juncker, Vice President, Federal Reserve Bank of New York. Mr. Juncker has been extensively involved in the New York Fed's Year 2000 effort and contingency planning, in particular.

The New York Clearing House (NYCH), the Securities Industry Association (SIA) and the Federal Reserve Bank of New York (FRBNY) have jointly formed a Contingency Planning Working Group (CPWG) to develop a common approach to Y2K contingency planning and to focus on areas needing special attention or cooperation among market participants and regulators.

In their discussion to date, a consensus has emerged that contingency planning for Y2K is very different than most contingency planning efforts which focus primarily on business resumption. Simply stated, the usual approaches for resuming business operations when a problem is encountered—revert to an early version of an application or relocation to another site—will not work for Y2K problems.

More significantly, business continuity is more than just an operational issue. If problems are encountered, there is at least the potential for credit, legal and market risks as well as legal and reputation risks if problems are not addressed in a timely manner. Recognizing that the broader range of risks must be addressed, it becomes apparent that contingency planning requires the active participation of business line management as well as the technical staff and those responsible for operations.

The CPWG has identified three different types of planning efforts that must be addressed:

- Plans for dealing with external dependencies;
- Business resumption or disaster recovery plans; and
- Plans for handling systemic problems.

Somewhat different approaches are necessary for handling each of these areas.

Financial institutions already should have identified their dependencies on external vendors and service providers as part of the assessment phase and their inventory process. In most instances they are well advanced in determining the Y2K readiness of these vendors. They should also have determined when compliant products are needed to fit into test plans in an

orderly manner. Where there are concerns about products being ready in time, contingency plans with clearly stated dates for decisions should be in place.

In some cases, financial institutions have identified external dependencies for which there is no meaningful alternative. Telecommunications and payment systems like Fedwire are examples of services that must be available if anything resembling normal business operations is to occur. For these dependencies, contingency planning efforts should be directed to rigorous testing programs that will assure the required capability will be Y2K compliant.

Business resumption or disaster recovery planning recognizes that some applications will not function as expected with the century date change. Contingency planning in this area must recognize both the risks associated with the application and the likelihood that a specific problem will develop.

Resource limitations make it impossible to plan for all possible "bad" things. Intelligent contingency planning requires that likely scenarios be developed of the problems that may materialize. Identifying likely scenarios requires more information on the readiness of counterparties, external dependencies, and customers than is currently available. Testing will be a key method to help to understand possible problems better. Designing tests to identify possible problems becomes a key element of the contingency planning process.

Once high risk, high probability areas are identified, two separate steps are needed. Ways to work around probable problems need to be identified and steps taken to put alternative approaches into place. This process will often include backing up files so they can be loaded into lower tech (PC based in many cases) applications that may well be spreadsheets. Manual alternatives should also be considered.

Perhaps more importantly, key personnel and technical SWAT teams need to be identified with clear priorities established on how they will be deployed and how decisions will be made. Because fixes must be developed quickly for mission critical applications, the staff necessary to make decisions and implement the

necessary changes must be deployed to the right places when problems are encountered.

While contingency plans for external dependencies and business continuity can be done within a business entity, systemic problems must be addressed on a cooperative basis. Systemic problems will arise when a financial institution is able to conduct business normally but external parties are unable to interact with it. In these situations, "work-arounds" must be found so that the institution and its counterparties that are also unaffected can conduct business on a relatively normal basis.

Two key aspects of dealing with systemic issues are cooperation among financial institutions and active involvement of regulators in the approaches adopted. First, it is important that market participants agree on the scenarios for systemic events occurring so that it becomes possible to focus on common objectives. Most solutions will not work unless institutions take a common and coordinated approach.

Second, regulators are key to developing an approach that will make sense. Uncertainties as to how regulators may react under particular scenarios will make the design of contingency plans for possible systemic problems difficult, if not impossible. While regulators are unlikely to commit to particular actions if problems develop, the advance agreement on market conventions to address certain types of problems will facilitate the ability to develop reasonable contingency plans in the systemic area.

Perhaps most importantly, contingency planning for the Year 2000 needs to be viewed as a dynamic process that will evolve as all financial institutions have a better sense of how century date change events might roll out. Some planning is clearly needed today, but much of the planning should be focused on how additional knowledge will allow resources to be deployed more effectively.

If today represents the peak of the renovation phase and the testing phase is nearly upon us, the contingency planning phase will begin in earnest late this year or early next.

IMPORTANT YEAR 2000 DATES FOR BANKING INSTITUTIONS

SEPTEMBER 30, 1997:

Mission-critical systems should have been identified and related priorities set for Year 2000 work.

JUNE 30, 1998:

Development of testing plans should be completed. A due diligence process that identifies, assesses and establishes controls for the Year 2000 risk posed by customers should be implemented.

SEPTEMBER 1, 1998:

All institutions should have commenced testing of internally-developed mission-critical systems.

SEPTEMBER 30, 1998:

The assessment of individual customers' Year 2000 preparedness and the impact on the institution should be substantially completed.

DECEMBER 31, 1998:

For the major players in the New York market, mission critical applications should be renovated and internal testing completed; external testing with major counterparts (clearing, correspondents, etc.) should be largely completed. For other players, testing of internally-developed mission-critical systems should be substantially completed.

JANUARY 1, 1999:

All institutions should have started testing of mission-critical systems with third parties.

JUNE 30, 1999:

Testing with third parties should be substantially completed.

THE NEW YORK CLEARING HOUSE—YEAR 2000 TESTING PROGRAM

On September 26, 1998, CHIPS will perform future date testing for January 3, 2000. Fedwire and S.W.I.F.T. will participate in this simulation. It is anticipated that a follow-up test will occur on November 21, 1998. In addition, the Clearing House has proposed a schedule for mandatory test dates for CHIPS participants during 1999:

<u>DATE</u>	<u>OBJECTIVE</u>
January 23, 1999	Disaster Contingency Test
April 24, 1999	Year 2000 Test
August 21, 1999	Rule 13 Test
October 23, 1999	Automated Recovery Test

FEDERAL RESERVE SHARED TESTING DAYS

In addition to individual application test schedules, the Federal Reserve has designated six weekends in 1998 as "Shared Testing Days." On these days, customers will have the opportunity to test century rollover with multiple Federal Reserve applications on the same weekend, test leap year 2000 and participate in an integrated test of major Federal Reserve payments applications with the Federal Reserve's accounting application.

1998 Shared Testing Day Schedule for Century Rollover and Integrated Tests

Future Date of:	December 31, 1999	January 3, 2000
Testing Weekends:	Friday, September 18	Saturday, September 19
	Friday, October 16	Saturday, October 17
	Friday, November 20	Saturday, November 21
	Friday, December 11	Saturday, December 12
Test Times (ET):	8:30 a.m.-10:30 p.m.	8:30 a.m.- 2:00 p.m.
IAS recon files available:	5:30 p.m.	

Information regarding shared testing day schedules for leap year 2000, as well as details on testing with the Federal Reserve's other services, can be found in the Federal Reserve's Century Date Change Bulletin No. 3 (March 1998) and on the internet at <http://www.frbsf.org/fiservices/cdc/>.
