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The Honorable Alfonse M. D'Amato
Chairman, Committee on Banking, Housing, and
Urban Affairs
United States Senate

Subject: Post-Hearing Questions on the Federal Deposit Insurance
Corporation's Year 2000 (Y2K) Preparedness

Dear Mr. Chairman:

In our February 10, 1998, testimony before the Subcommittee on Financial Services and Technology, we reported on the efforts of the Federal Deposit Insurance Corporation (FDIC) to ensure that the bank systems it oversees and its own internal systems are ready for the year 2000.¹ Attached are our responses to questions received from you and Senator Bennett for the hearing record.

A copy of this letter is also being sent to Senator Bennett. Please contact me at (202) 512-6240 or Gary Mountjoy, Assistant Director, at (202) 512-6367 if you have any questions regarding our responses.

Sincerely yours,

Jack L. Brock, Jr.
Director, Governmentwide and Defense
Information Systems

Enclosure

¹Year 2000 Computing Crisis: Federal Deposit Insurance Corporation's Efforts to Ensure Bank Systems Are Year 2000 Compliant (GAO/T-AIMD-98-73, February 10, 1998).

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RESPONSES TO QUESTIONS ON FDIC'S
YEAR 2000 PREPAREDNESS

QUESTIONS SUBMITTED BY SENATOR BENNETT

Comparing NCUA and FDIC Progress

Question: Last month you reported on the NCUA, can you compare the relative progress of the NCUA and the FDIC in both internal and external systems Y2K compliance? Do both these agencies have the resources to do the job, and if not, what are they lacking? Are they properly organized and are adequate resources committed to Y2K compliance efforts?

GAO Response: Comparing NCUA's and FDIC's progress is difficult because we reviewed their efforts at different points in time. We assessed NCUA's effort as of October 1997² and FDIC's effort as of January 1998,³ giving FDIC additional time to perform more Year 2000 preparedness work. Nonetheless, we found that both regulators recognized the severity of their Year 2000 problems and have developed action plans to address them. We also found that they had initiated action to (1) disseminate information and guidance about the problem to credit unions and federally insured banks and (2) incorporate the Year 2000 issue into their examination and supervision programs, including assessing Year 2000 compliance of key data processing service bureaus and software vendors. Additionally, to date, both have conducted high-level assessments of their financial institutions' Year 2000 readiness and are in the process of conducting more detailed, follow-on assessments with the goal of completing them by June 30, 1998.

Despite this progress, both NCUA and FDIC still face significant challenges in providing a high level of assurance that individual credit unions and banks will be ready for the century date change. For example, both regulators were late in addressing the problem and, consequently, are behind the Year 2000 schedule recommended by both the Office of Management and Budget (OMB) and GAO. Both also lacked the ability to report on individual credit union and bank status in preparing for the year 2000 due to insufficient information being reported by their examiners. Additionally, although under development by NCUA, FDIC, and the other members of the Federal Financial Institutions Examination

²Year 2000 Computing Crisis: National Credit Union Administration's Efforts to Ensure Credit Union Systems Are Year 2000 Compliant (GAO/T-AIMD-98-20, October 22, 1997).

³GAO/T-AIMD-98-73, February 10, 1998.

Council (FFIEC),⁴ critical bank guidance on contingency planning, assessing risks caused by corporate customers (borrowers), and assessing risks associated with third-party automated system service providers has yet to be issued. This guidance should have been provided earlier so that credit unions, banks, and other federally-supervised financial institutions would have had more time to factor the guidance into their own assessments and plans.

Regarding whether NCUA and FDIC are organized properly and have adequate resources, we found both regulators had established management structures to address the Year 2000 problems of the financial institutions they oversee as well as for their internal automated systems. We also found that accountability had been assigned for these Year 2000 responsibilities. With regard to resources, we found that both are devoting considerable effort and resources to ensure that the financial institutions they oversee mitigate Year 2000 risks. However, we had one area of special concern at NCUA. Specifically, we found that the agency lacked the technical resources (staff) to conduct Year 2000 examinations in complex automated systems areas. Although NCUA is responsible for overseeing more institutions than FDIC, NCUA did not have any technical examiners, while FDIC has over 100 information systems examiners. At the time of our review, NCUA was in the process of hiring personnel with technical expertise.

FDIC's Schedule for Internal and External Systems

Question: How many months behind is FDIC in each aspect of its Y2K project for internal and external systems?

GAO Response: FDIC is about 7 months behind in completing the assessment of its internal systems. FDIC is late because it (1) is still assessing 6 of its 40 mission-critical systems and (2) has yet to complete contingency plans for all of its systems in case system repairs and replacements are not in place on time or do not work as intended.

⁴FFIEC was established in 1979 as a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions and to make recommendations to promote uniformity in the supervision of these institutions. The Council's membership is composed of the federal bank regulators—FDIC, the Federal Reserve System, and the Comptroller of the Currency—plus the regulators for credit unions and thrift institutions—the National Credit Union Administration and the Office of Thrift Supervision, respectively.

Our Year 2000 Assessment Guide⁵ and OMB guidance recommend that agencies complete their assessments by mid-1997 in order to have enough time to complete the next three stages of correction—renovation, validation, and implementation. By taking additional time to complete its assessment, FDIC is leaving itself with much less time to complete renovation, testing, and implementation and, thus, it is increasing the risk that it will not complete its Year 2000 fixes on time.

FDIC is also late in completing the assessment of bank Year 2000 readiness. FDIC did not complete its initial assessment of its banks until December 1997. Again, this late finish will reduce the amount of time FDIC has to examine bank efforts to complete the remaining correction phases required to be prepared for the century date change.

Consequences of Year 2000 Problems

Question: In your testimony, you warn of possible "serious consequences ranging from malfunction to failure." Would you please elaborate and, if possible, assess the possible impact on bank customers and on the bank insurance fund?

GAO Response: Virtually every insured financial institution relies on computers—either their own or those of a third-party contractor—to provide for processing and updating of records and a variety of other functions. These systems depend heavily upon the use of dates in transacting business. According to FDIC, all its institutions are vulnerable to the problems associated with the year 2000. Consequently, failure to address Year 2000 computer issues could result in a range of outcomes from system malfunctions to failures. For example, bank systems may erroneously calculate interest and amortization schedules. In addition, automated teller machines may malfunction, perform erroneous transactions, or refuse to process transactions. Moreover, telephone systems, vaults, security and alarm systems, elevators, and fax machines could malfunction. Finally, bank systems may be unable to interface with those of payment system partners, such as 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.

At the least, system malfunctions or failures caused by the year 2000 would inconvenience banks and their customers. More significantly though, they could cause operational problems serious enough to bring about the failure of individual banks. If a significant number of institutions were to fail, depositor confidence could deteriorate and

⁵Year 2000 Computing Crisis: An Assessment Guide (GAO/AIMD-10.1.14, September 1997).

Published as an exposure draft in February 1997 and finalized in September 1997, this guide was issued to help federal agencies prepare for the Year 2000 conversion.

the entire financial system could be disrupted. We are concerned about this latter situation because FDIC alone has identified 700 banks that are at risk of not being ready for the century date change.

The exact impact on the Bank Insurance Fund is difficult to estimate at this point because FDIC does not yet know how many or which banks, if any, will encounter operational problems and fail. However, FDIC has actions underway to identify problem institutions and is preparing itself for handling them should they become inviable. First, through its on-site assessment process, FDIC is continuing to gather information on the Year 2000 preparedness of the financial institutions it supervises and expects to have a good understanding of their readiness by June 30, 1998. Second, FDIC is working to determine the impact that severe Year 2000 problems are likely to have on the viability of financial institutions. FDIC expects to have this work completed in mid-1998. Finally, FDIC is developing operational plans for resolving failures based on several post-Year 2000 failure scenarios. FDIC expects to have its plans in place by March 1999.

Relationship Between FDIC and FFIEC Efforts

Question: I notice that FDIC efforts seem to be correlated to a great degree with the FFIEC activities. Is the FFIEC dealing with this problem adequately? Will you be reviewing FFIEC's Y2K activities?

GAO Response: Part of our efforts to determine what federal banking regulators are doing to ensure that the institutions they supervise are ready for the year 2000 have included reviewing FFIEC's efforts. Many of the actions regulators have taken resulted from their work with FFIEC. For example, the regulators issued FFIEC-developed awareness letters and guidance that described the Year 2000 problem, highlighted concerns about the industry's Year 2000 readiness, and provided a structured means for assessing the Year 2000 readiness of financial institutions. In addition, FFIEC has ongoing efforts that include developing guidance for financial institutions on contingency planning, interacting with vendors, and assessing risk from corporate customers. Consequently, FFIEC continues to serve as a good mechanism for the regulators to coordinate their Year 2000 efforts.

At the same time, critical guidance, although under development, has not yet been released by FFIEC for banks and other financial institutions on contingency planning, assessing risks caused by corporate customers (borrowers), and assessing risks associated with third-party automated system service providers. This guidance should have been provided earlier so that banks would have had more time to factor the guidance into their own assessments and plans. Accordingly, in our testimony, we recommended to FDIC and the other FFIEC members that they, among other things,

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complete the guidance under development and prepare more explicit instructions to banks for carrying out the latter stages of the Year 2000 process, which are critical steps to ensuring successful conversion. FDIC has agreed to implement these recommendations.

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