STUDY PROJECT

THE DOD OVERSEAS MILITARY BANKING PROGRAM

A COST OF DOING BUSINESS

BY

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2 APRIL 1990

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SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

REPORT DOCUMENTATION PAGE

READ INSTRUCTIONS BEFORE COMPLETING FORM

1. REPORT NUMBER	2. GOVT ACCESSION NO.	3. RECIPIENT'S CATALOG NUMBER

4. TITLE (and Subtitle) "The DOD Overseas Military Banking Program A Cost of Doing Business"	5. TYPE OF REPORT & PERIOD COVERED Individual Study Project 6. PERFORMING ORG. REPORT NUMBER
7. AUTHOR(s) LTC Billy R. Barker	8. CONTRACT OR GRANT NUMBER(s)
9. PERFORMING ORGANIZATION NAME AND ADDRESS U.S. Army War College Carlisle Barracks, PA 17013-5050	10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS
11. CONTROLLING OFFICE NAME AND ADDRESS Same	12. REPORT DATE 30 March 1990 13. NUMBER OF PAGES 47
14. MONITORING AGENCY NAME & ADDRESS (if different from Controlling Office)	15. SECURITY CLASS. (of this report) Unclassified 15a. DECLASSIFICATION/DOWNGRADING SCHEDULE

16. DISTRIBUTION STATEMENT (of this Report)

Approved for public release; distribution is unlimited.

17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)

18. SUPPLEMENTARY NOTES

19. KEY WORDS (Continue on reverse side if necessary and identify by block number)

[illegible] Overseas Military Banking Program, Cost of [illegible], Economics, [illegible] Analysis, Military Personnel [illegible], Finances, [illegible] (JG)

20. ABSTRACT (Continue on reverse side if necessary and identify by block number)

Since the inception of the overseas military banking program, the Department of Defense has attempted to reduce continuous subsidies in support of overseas military banking operations. Emphasis on improving effectiveness and reducing costs for services provided has been their primary objective. In a period where funding reductions and budget decrements are more common, the need to reduce the cost of military banking overseas is even more appropriate now than ever before. However, opportunities to reduce costs in an expanded
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SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

20. ABSTRACT--Continued.

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UNCLASSIFIED

USAWC MILITARY STUDIES PROGRAM PAPER

THE DOD OVERSEAS MILITARY BANKING PROGRAM
A COST OF DOING BUSINESS

An Individual Study Project

by

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2 April 1990

UNCLASSIFIED

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AUTHOR: Billy R. Barker, LTC, FI

TITLE; The DOD Overseas Military Banking Program
A Cost of Doing Business

FORMAT: Individual Study Project

DATE: 30 March 1990 PAGES: 44
CLASSIFICATION: Unclassified

Since the inception of the overseas military banking program, the Department of Defense has attempted to reduce continuous subsidies in support of overseas military banking operations. Emphasis on improving effectiveness and reducing costs for services provided has been their primary objective. In a period where funding reductions and budget decrements are more common, the need to reduce the cost of military banking overseas is even more appropriate now than ever before. However, opportunities to reduce costs in an expanded operating environment without reducing banking services are rare. Studies have been conducted in the past to identify ways to reduce costs associated with overseas banking, but recommendations have not been effective despite direct government involvement in the program. In examining this dilemma, this paper will focus on core problems inherent to the banking contractor as a result of regulatory and program imposed requirements. These requirements, coupled with the bureaucratic operating environment, have contributed significantly to banking inefficiencies and contractor failure to meet acceptable banking industry standards. An understanding of these problems may result in improvements to the operating environment and lead to maximizing the benefit from each program dollar subsidized by Congress, thereby lowering costs and improving efficiency.

TABLE OF CONTENTS

THE DOD OVERSEAS MILITARY BANKING PROGRAM:

A COST OF DOING BUSINESS

CHAPTER I

INTRODUCTION

Commercial banks are at the heart of the U.S. financial system.[1] They act as depositories for the funds of individuals, government bodies, and business establishments. They serve as a payment function to facilitate money payments and transfer of funds into the economy and make funds available through their lending and investing activities.

Many banks have trust departments, serve as correspondent banks, and are involved in international banking, as well as even more specialized activities. Banks must carry on these activities under heavy regulation and supervision, while operating profitably. The challenge of creating an adequate return is complicated by increasing competition and the variety of financial services offered by other commercial banking activities.

The Department of Defense (DOD) Overseas Military Banking Program (OMBP) provides many of these banking services overseas to authorized persons and organizations through contracts negotiated with U.S. commercial banks and with foreign banks where host countries do not allow the use of U.S. commercial banks. The OMBP contract is designed to allow commercial banks to exercise their professional bank management skills to operate a world-wide network of bank branches on overseas military installations. The establishment and operation of these branch banks is governed by a host of DOD and Army regulations, activities, and special interest groups. Each one adds yet another dimension to an already overwhelming plethora of requirements, oversight and supervision.

Given these operational constraints, and the basic premise that commercial banks must operate profitably, it is often difficult for the DOD to attract competition into the overseas military banking market. This is mainly because the market is not financially attractive to commercial or retail banking firms. For example, there is the perception in the military banking industry that once a bank enters into contract, it is besieged at all levels with requests to expand and improve services, renovate facilities, upgrade ADP equipment and software, install automatic teller machines, procure "direct-line" transaction processing capabilities with CONUS-based facilities to enhance timeliness, or other costly improvements. Often, these requests are unaccompanied by corresponding resources or other forms of compensation by the DOD to defray the additional costs. Unless recognized by the DOD as a bonified operating expense, the contractor is likely to incur the cost of such improvements and absorb the loss without any hope of future capital gains.

These perceived pressures, coupled with annual DOD budget scrubs, which are designed to cut costs and reduce the banks operating budget, create, perhaps mistakenly, the perception that the DOD is unwilling or unable to back up its program with the resources necessary to achieve its objective through acceptable industry standards. Conversely, it is unreasonable to expect the contracting bank to absorb these costs outside of the contract while continuing to incur a reduced operating budget due to these annual budget scrubs. This kind of situation does not promote, or assist in producing, favorable results, and worse, improvement is almost nonexistent and the operating environment remains status quo. The bank continues to operate inefficiently and customer dissatisfaction continues to grow.

STUDY OBJECTIVE

The objective of this study is to examine the DOD/contractor relationships from the contractor's perspective and focus on core problems inherent to the contractor as a result of regulatory and program imposed requirements.

SCOPE OF STUDY

This paper is aimed at a relatively narrow, but critical aspect of the DOD Overseas Military Banking Program. Its intent is to focus on the operational environment of the contracting bank and analyze some of the areas in which potential inefficiencies exist. Many of the observations and comments are based on the author's personal experience while serving as Chief, Banking and Systems Office, Resource Management Directorate, The Office of the Adjutant General. The aim is toward improving the operational effectiveness of the program while maximizing the benefit from each dollar spent. Information regarding the evolution and expansion of the program is provided to facilitate a better understanding of the size and complexity of the operating environment. The desired result is to improve the operational efficiency of the program and make it more attractive to professional banking organizations.

ENDNOTES

1. Brantly, William, "Basic Concepts of Banking", USACFSC-RM, Banking and Investment Division, Alexandria, VA (undated and unpublished).

2. Banks and Credit Unions on Army Installations, Army Regulation 210-135, Headquarters, Department of the Army, Washington, D.C., p. 9.

CHAPTER II

OVERVIEW OF THE MILITARY BANKING PROGRAM

PROGRAM INCEPTION

Overseas military banking had its beginning with the stateside mobilization during World War II.[1] Early in 1941, officials in the War Department realized that some form of financial service urgently was needed by military and civilian employees on Army installations.[2] Initially, the solution was to permit installation commanders to negotiate with nearby local banks to establish branches on their installations. However, most of these institutions were unable to fill the void due to personnel shortages from the war effort and restrictive state or Federal banking laws.

Officials in the War Department eventually requested assistance from the Treasury Department. The Treasury subsequently requested Congress to enact legislation that would have authorized the Comptroller of the Currency to license national banks to operate on Army and Navy installations. Senate Bill 1603 passed on April 3, 1942; however, before the House of Representatives could act, Treasury officials determined that they had existing statutory authority under the National Bank Act of 1864. Consequently, the Military

Banking Facility (MBF) program came into existence on June 30, 1942. Shortly thereafter, the very first MBF opened at Fort Sill, Oklahoma. By June 30, 1943, some 155 Treasury designated depositaries and financial agents had made agreements to operate MBFs at approximately 160 Army and Navy installations in the U.S.

The legality of designating MBF operators has been questioned on several occasions over the years. In response to a War Department request for a military opinion, the Attorney General of the United States stated that continuation of the MBF program was authorized; MBFs clearly furthered Government operations by promoting the morale of personnel and reducing time lost in obtaining necessary financial services.[3] A further test of Treasury authority occurred in 1961, when the Attorney General of Texas sued two national banks, operating on Air force installations under Treasury designation, for violating the state prohibition on branch banking. The case, settled by the Fifth Circuit U.S. Court of Appeals, with further appeal refused by the U.S. Supreme Court, affirmed Treasury's authority to establish MBFs without concern for state branch banking statutes.[4]

OVERSEAS EXPANSION

Overseas MBFs first were established to serve U.S. occupation forces following the end of World War II.[5] In February 1947, the Treasury Department authorized the American Express Company to accept deposits of military payment certificates, U.S. dollars, and U.S. financial paper for U.S. forces stationed in Germany and Austria. That authorization also permitted the company to act as a general depository for public and quasi-public funds and establish limited depository accounts for military disbursing officers. American Express opened its first MBF in Frankfurt-am-Main the following month, with offices in Berlin, Bremerhaven, Heidelberg, Munich, and Nurenberg opening soon thereafter. In addition to some 120 locations in the Federal Republic of Germany, American Express subsequently operated MBFs in Greece, Iceland, Japan, Republic of Korea, the Netherlands, Okinawa, Republic of Panama, the Philippines, and the United Kingdom. In FY 1987, American Express provided service in all of these countries except Japan and Okinawa.[6]

The other operator in FY 1987 was the National Bank of Fort Sam Houston, an affiliate of First Republic Corporation. It began operating the MBFs on Guam on November 1, 1981 and operated MBFs in Iceland and the United Kingdom from that date through FY 1984. Since January 1, 1987, it also operated MBFs in Japan, to include Okinawa.

Other financial institutions have participated in the overseas MBF program. The Chase Manhattan Bank, N.A. opened its first MBF in Germany in May 1947. Over the years, it also managed MBFs in the Netherlands, Japan, Thailand and Republic of Vietnam. It ceased operations upon expiration of its contract for Japan on December 31, 1986. Citibank, formerly the First National Bank of New York, operated MBFs in Cuba, Japan, and the Philippines for a number of years prior to October 1977. The Bank of America, NT & SA, formerly operated MBFs on Guam, the Republic of Korea, Thailand, and Vietnam. The MBF at Guantanamo Bay, Cuba was served by the Central Fidelity Bank of Portsmouth, Virginia.[7]

On August 21, 1987, Merchants National Bank of Indianapolis, Indiana was selected to manage all the MBFs in the Federal Republic of Germany, Holland, and Greece for FY 1988 and FY 1989. Their contract specified a three year renewal option, subject to approval by the Office of the

Secretary of Defense (OSD). Merchants' selection was protested by the American Express Bank, but was adjudicated in Merchants' favor on November 16, 1987 and the MBF contract was awarded to them on November 20, 1987. On January 14, 1988, a transfer of operations agreement was signed by Merchants National Bank and American Express Bank. Operating transition began in April 1988 and American Express Bank terminated MBF operations in every country except Panama effective October 1, 1989. American Express Bank agreed to operate the MBF in Panama through September 30, 1990 until the Office of the Assistant Secretary of Defense, Comptroller could find a suitable replacement.[8]

Today, the OMBP serves four customer groups: individuals (military personnel and DOD civilians and their dependents); custodians of nonappropriated fund instrumentalities (officers' club, NCO club, billeting, etc.); other organizations composed of or supporting DOD personnel (i.e. other contractors); and military disbursing officers. Services offered to this customer base include: checking accounts, savings and deposit accounts, cashiers checks, money orders, travelers cheques, savings bonds, IRAs, local currency sales/repurchases, signature loans, NOW accounts, and automatic transfers between account holders.

These services have been expanded to over 204 full and part-time MBFs world-wide and they are supplemented by well over 120 automatic teller machines (ATMs). Approximately 65 percent (131) of the MBFs in the program are at Army sites. Of the MBFs located on Army installations, 86 percent (113) are in the Federal Republic of Germany. Approximately 64 percent (76) of the ATMs are at Army sites of which approximately 96 percent (73) are also located in Germany. The cost of the OMBF in FY 1990 is expected to exceed $35 Million.

EVOLUTION

The early years of the OMBP were characterized by a lack of governmental consensus regarding program responsibility. While it was agreed that Treasury had the authority to establish MBFs and, through compensating balances, underwrote any net costs, no agency had overall concern for cost benefit considerations. From the early 1950s through the end of the 1960s, the working relationship between the Treasury Department, DOD, and the banks appeared mutually beneficial. The Treasury supervised the program and underwrote the costs with compensating balances.[9]

The program expanded rapidly in the years following the Korean conflict. The expansion of service eventually led to significant program cost growth. The Treasury was concerned with rising labor costs and found it difficult to fund needed improvements to the program, especially in the areas of automation and premises improvements. The DOD objected to the Treasury's refusal to improve facilities and expand service locations. Customer complaints were numerous enough to warrant Congressional investigation.[10]

Congressional review of the OMBF began in early 1975 and ended late into 1976. As a result of almost two years of study, the responsibility for the program was transferred from the Treasury Department to the DOD. Management responsibility was transferred to the Office of the Assistant Secretary of Defense (OASD) during 1977. The transfer resulted in a significant increase in reporting requirements by the banks, more audits, and a host of government regulations that were strictly enforced. From 1978 to the present, military banking services have been provided on a contractual basis between participating financial institutions and the DOD.

From the inception of the contractual relationship, the contracting office for the program has been the Defense Supply Service Washington (DSS-W). DSS-W assumed both procurement and administrative contracting roles. The Office of the Assistant Secretary of Defense (OASD), Comptroller serves as the Contracting Officer's technical representative. OASD is responsible for developing overseas military banking policies and procedures. In addition, they make the actual award decision as to which financial institutions will manage MBFs and where they will be allowed to operate them. Both the DSS-W, as well as the OASD, work with the Defense Contract Audit Agency (DCAA) to ensure compliance with the Federal Acquisition Regulations (FAR). In essence, with the advent of the contract, contracting banks became government defense contractors and are therefore subject to the same rules and regulations that govern purchases for supplies and services in the FAR.

The introduction of the FAR, plus DCAA review of expenditures, created a new situation of cost questions, cost disallowances, and technical irregularities that had not been experienced by banks in their previous operating environment. The switch to a contractual relationship also ended the compensating balance method of reimbursing the bank for losses incurred in managing the program. Now, contracted banks are on a cost reimbursement plus a fixed fee arrangement. The bank is reimbursed for approved operating costs and a fixed fee payment is established for each transaction. These fees are established and controlled by the banking contract. DCAA auditors regularly perform on-site verifications to ensure the adequacy and accuracy of accounting records; to certify the reasonableness of costs expensed to the government; and to ensure compliance with prudent banking practices and applicable cost accounting standards.

Under the guidance of the DOD, the period 1972 through 1986 was one of expansion and new services in the OMBP.[11] New MBFs were opened in areas such as Panama and Diego Garcia. Automatic teller machines (ATMs) were proliferated throughout the MBF network and mobile banking vans were even introduced into service. Data processing capabilities were still inadequate and needed to be expanded to accommodate the increasing number of transactions brought about by the expansion. Program expansion and resultant expanded staff costs increased the overall operating expenses which the banks claimed were only partially offset by the revenue growth. Additionally, the program became even more sensitive to interest and foreign exchange rate fluctuations. The impact on net program costs was significant and made management of the MBFs even more difficult.

As the cost of the program began to escalate, a conflict in program philosophy appeared to develop between the OASD and the branches of the military services (Army, Navy, and Air Force). The military, who actually pays for the program at rates of 50%, 30%, and 20% respectively, desired more services at more locations.[12] However, the combined services did not want to pass the cost of additional expansion along to the customer. OASD, while sensitive to the needs of the military, did not want to increase the cost of the OMBP and would not support pricing changes for services to offset concomitant costs.

In making that decision, OASD became, in effect, the "board of directors" for contracting banks and had the task of balancing the inherent conflicts of managing costs, satisfying the military's need for additional services, and being responsive to requests for the needed resources required to properly expand and improve the OMBF. However, the end result has been the uneconomical and costly expansion of services and locations with a reduction in the amount of money invested by the DOD to upgrade the MBFs automation capabilities and make much needed improvements to military banking facilities.

ENDNOTES

1. Much of the information used in Chapter II was taken from a paper by Adolphi, Ronald L., entitled Military Banking: Its Past and Promise. The paper was published as a series of four articles in the Armed Forces Comptroller, Fall 1981, Winter 1982, Spring 1982, and summer 1982.

2. A few financial institutions previously had been operating on military installations in the U.S. as duly chartered independent or branch banks.

3. The opinion of the Attorney General was rendered on January 20, 1948.

4. State of Texas vs. National Bank of Commerce of San Antonio and Broadway National Bank, 290 F2d 229 (5th Cir. 1961).

5. The first overseas military bank was operated by the Navy on Guam under authority of an Executive Order that gave Navy responsibility for effecting U.S. sovereignty over Guam. The institution was closed when Japan occupied Guam and reopened after the U.S. recaptured the island. It was subsequently sold to the Bank of America NT&SA before responsibility for the island passed from the Navy to the Interior Department in 1950.

6. On August 21, 1987, DOD selected and entered into a pre-contract cost agreement with Merchants National Bank and Trust Company of Indianapolis, Indiana to operate all contract MBFs in Germany, Greece, and the Netherlands for FY 1988.

7. DOD Study of Financial services (Washington, D.C.: Deputy Assistant Secretary (Management Systems) Study Group Report to OASD, Comptroller; November 1987), pp II-11 and II-12.

8. Keneipp, John, et al., "The Overseas Military Banking Program Briefing Notes," (Office of the Director of Finance and Accounting, SAFM-FAP-B, Indianapolis, Indiana; unpublished and undated).

9. Keneipp, Ibid, p. 3.

10. Ibid, p. 6.

11. Ibid, p. 9.

12. Ibid, p. 11.

CHAPTER III

THE BUREAUCRATIC ENVIRONMENT

REVIEW AND OVERSIGHT

A contracting bank's ability to manage the business of overseas military banking is materially affected by the divided, and sometimes uncoordinated, responsibilities of the many government agencies who are involved in the overseas banking program. The primary government groups with review and oversight responsibilities are: The office of the Assistant Secretary of Defense, Comptroller (OASD,C) who is responsible for providing technical day-to-day guidance to the Contracting Officer; The Defense Supply Services - Washington (DSS-W) which is the department that is delegated legal authority for procurement decisions; The Defense Contract Audit Agency (DCAA) which is an independent entity that reports directly to the OASD,C and is responsible for reviewing the financial results of the contract as well as basic operating procedures to ensure compliance with the Federal Acquisition Regulations (FAR). The Departments of the Army, Navy, and Air Force are the actual recipients of the services provided and, through their respective banking officers, they are responsible for reporting on contract performance and program funding costs.

Each of these special interest groups have different purposes and goals. DCAA seeks to uncover contractor abuse and ineffectiveness. Military commands seek to maximize levels of service. DSS-W seeks to ensure compliance with government procurement standards. OASD,C seeks to determine overall requirements for financial services and coordinates the services provided. Therefore, sensitive or complicated decisions are sometimes shuffled back and forth between separate government groups which tends to cause frustration and promote inefficiency.

LOGISTICAL SUPPORT

Under the terms of the banking contract, funding for military banking facilities is the responsibility of the post or base commander. Although some contractors could advance the benefits from such a requirement, others would argue that this constraint impedes the construction or rehabilitation of suitable MBF premises on at least two counts. One, in an era of auster resources, commanders tend to give funding priority to operational readiness and training requirements, i.e. equipment, command operation centers, airfields, training facilities, etc. Morale and welfare projects such as banking facilities fall low on the priority list. Two, even when funding is given some priority, the contracting bank has to follow complicated funding approval procedures which usually involves a multitude of government forms, additional requirements, estimates by post engineers and various approval levels for each phase of construction.

The lack of adequate funding for facilities has resulted in inferior premises at most installations overseas which is usually perceived by the customer as the responsibility of the bank. This situation often detracts from the customer's perception of the bank as a professional organization. The inadequate facilities also affect staff efficiency and morale, work flow, and sometime results in the bank's inability to comply with prescribed safety and environmental standards which affects both customers and employees.

SYSTEMS TECHNOLOGY

In the early years of the contractual relationship with the DOD, funding for major technological advancements was given to contracting banks whenever possible. However, with the rising costs of the OMBP, efforts to obtain state of the art automation for MBFs have not been fully successful.

Until very recently, little funding was made available to contracting banks to allow them to automate branch banks and establish integrated branch networks. The inability of contracting banks to meet acceptable banking industry standards leads customers to the perception that MBFs are outdated and behind the times. Further, it inhibits the MBF's ability to handle customer transactions in volume without incurring significant backlogs. This, in turn, causes commanders to believe that MBFs are uncaring and non-responsive to the needs of its customers. Moreover, banking staff morale continues to decline and customer satisfaction remains low.

LEGAL FRAMEWORK

The legal framework for contracting banks is one of significant complexity. In dealing with the government, whether it's a submission of proposal in response to a Request For Proposal (RFP), contract negotiation, performance under the contract, or negotiation of audit issues, the bank is subjected to a plethora of federal statues and regulations. Some of these include the Truth in Negotiations Act, the Armed Services Procurement Act, the False Claims Act, the Program Fraud Civil Remedies Act, the Federal Acquisition Regulations (FAR), and supplemental Department of Defense (DOD) regulations. These banks are also subject to annual appropriation laws which means the funds must be earmarked for government contracting.

As for bank customer transactions that occur outside of CONUS on OCONUS U.S. military posts and bases, there are competing U.S. and foreign laws and regulations that may apply to any given transaction. The DOD contract does not specify a governing law for military banking transaction. While most contracting banks attempt to obtain formal exemption from these laws in the interest of eliminating some of the bureaucracy, such attempts are not uniformly successful. In an effort to impose a degree of certainty and uniformity in its dealings with customers, and as an additional basis for seeking exemption from foreign regulation, most contracting banks attempt to comply with federal consumer laws and regulations as well as applicable states laws in which its CONUS-based headquarters is located.

In addition, there is an overlay of multilateral conventions, international treaties, and foreign government licensing requirements which affects the contracting bank's ability to operate MBFs in foreign countries. These include, as examples, the NATO and SEATO Status of Forces Agreements as well as country-specific supplementary agreements.

It is not difficult to understand why these multiple and diverse legal issues cause confusion and difficulty in the operating arena. Few have the legal expertise or the appreciation for the complex legal environment in which the OMBF operates. OASD,C is responsible for providing the technical advice and assistance required to operate in this environment, but some banks feel that resolution of these varied and complex issues is beyond OASD-C control.

PROCUREMENT PROCESS

The procurement process used to acquire banking contractors is also complicated and cumbersome. The same process used for purchasing spare parts and screwdrivers is also used to obtain these complicated and highly technical services. Although the description that follows is an over simplification of the process, the procedure is geared to accomplish only one objective and that is to award the contract to the lowest bidder. Consideration is given to the bidders technical competence and previous business history, but the bottom line is cost and it is always the prevailing factor.

The government issues a Request for Proposal (RFP) requesting bids for banking services. The contract period may vary, but it is generally for a three year period. Responses are due to the OASD in 90 days after acceptance of the RFP by the bidder. The RFP specifies the services to be performed, customer charges and fee rates, the facilities to be managed and operated by the bidder, and the regulations that govern the operation of the MBFs. The RFP usually asks for specific first year costs. Bidders provide proposals which are audited by DCAA. DCAA reports are forwarded to the Contracting Officer and generally, no copy is provided to the bidder. DOD invites each bidder (separately) to negotiations. During these negotiations, a committee, comprised of OASD personnel, questions the nature of items included in the bidder's initial proposal. Although overseas command representatives are often present, they are generally prohibited from directly participating in negotiations. The questions are asked by OASD personnel who are not professional bankers and have very little "hands on" banking experience.

After the first round of negotiations, bidders are usually requested to submit revised proposals. After submission, a second round of negotiations is often held. The government awards the contracts and has been known to further "scrub" the awarded submissions by deleting projects or activities which were subsequently considered too costly given the fiscal funding constraints. After all the deletions are made, the OASD Contracting Officer and successful bidders negotiate their MBF management fees. Emphasis is always on cost reduction.

This procedure results in a resource driven contract which rarely takes into consideration all of the proposed factors related to providing services at a level commensurate to that expected by the customer and the military services. OASD efforts to reduce the costs often results in the bank's inability to adequately provide the required services and meet acceptable banking industry standards. It could be argued that, given this methodology, there is insufficient structure within the OASD to properly evaluate the technical feasibility and the cost justification of the bidder's operating proposal. The right mix of expertise becomes critical when evaluating the bank's need for operating systems, staffing requirements, and acceptable banking practices.

CHAPTER IV

THE COST OF DOING BUSINESS

Since October 1, 1977, banks in the Overseas Military Banking Program (OMBP) have operated Military Banking Facility (MBF) networks under a cost plus a fixed fee contract. Cost is defined in the contract as the net profit or loss resulting from banking operations, i.e. the excess of operating expense over the contract generated income. The fixed fee is an annual amount paid to the bank for operating the MBFs. The intent is that the fee should represent the total income earned by the bank.

All revenues, expenses, assets, and liabilities held on the military bank's books are fully incorporated into the bank's published financial reports. These banks are therefore legally responsible for all assets and liabilities of their MBF network. At the end of each month, the bank "bills" the government for operating losses by country and fee on a global basis. These "bills", called public vouchers, are paid by U.S. Treasury check.

The contract document itself consists of approximately 60 pages of text incorporating by reference endless numbers of procurement regulations, which affect practically every activity performed under the contract. These regulations include the Federal Acquisition Regulations (FAR) and FAR Supplements applicable to specific government departments, cost accounting standards, Public Law, and decisions handed down by the Board of Contract Appeals, the United States Claims Court and the United States Court of Appeals for the federal circuit. Therefore, running the military banking program not only requires prudence in the business, but also an awareness of, and the ability to work within, the regulatory network. At its most basic, the contract covers who is serviced; with what products; at what charge; with what staff; at what locations; with what equipment; on what days and what hours.

Though the overall contract may be awarded to a single bank or to multiple banks, the OASD may reject any part of the proposed operating plan based on cost constraints and/or other considerations. This practice limits the bank's ability to effectively service its customers whenever selected portions of its operating budget are cut. One past banking contractor perceived that their initiatives to improve service levels and ultimately reduce contract costs were often discounted by the government for reasons they could not understand. The feeling was that governmental decisions were not always made on the basis of what constitutes good business. Therefore, the effects of limited service and rising costs were often attributed to the contracting bank's inefficiency or lack of concern rather than to government imposed cost reductions.

These perceptions are further complicated by the Defense Contract Audit Agency (DCAA) audits which are performed to ensure that revenues are maximized, that costs are reasonable, and that contract performance is satisfactory. Certain costs, which may be regarded by some as reasonable in a normal course of business, can be either unallowable or curtailed in the government contracting environment. Unallowable costs generally include such things as entertainment costs, advertising and public relations expenses, fines and penalties, reorganization costs, and costs of alcoholic beverages. Costs that may be specifically limited include cost of travel and lodging, relocation expense, professional fees, and costs of services provided by affiliates.

Regulations pertaining to intercompany transactions are particularly stringent and costs transferred to the contractor are subject to the same regulatory restraints and audit determinations as the contractor's own costs. Therefore, such transactions open the affiliate's books to government audit as well. One opinion is that most of the regulations and guidelines that govern the management of MBFs are oriented toward manufacturing or processing banking concerns and do not clearly address technical banking and operational issues such as revenues or balance sheet items. The DCAA and the OASD have therefore had to independently interpret large areas within these regulations. Some would say that their interpretations are often arguable, but none the less final.

CHAPTER V

OPERATIONAL AND STRUCTURAL ISSUES

CORE PROBLEMS

Beginning in the early 1980s, movements in currency exchange rates and interest rates, coupled with expanding services and subsequent higher volumes of bank transactions, resulted in increased OMBF operating costs. This situation precipitated a conflict between the Department of Defense's (DOD) desire to contain program costs, and at the same time, maintain customer pricing subsidies. Attempts by the DOD to increase competition to reduce costs and increase customer service rather than focusing on structural problems within the program resulted in significant service disruptions and huge termination costs.

The most blatant example of this was the 1986 award of the Japan/Okinawa MBF contract to The National Bank of Fort Sam Houston. At the conclusion of negotiations in August 1986, The National Bank of Fort Sam Houston was awarded a three year contract to manage the MBFs in Japan, Okinawa, and Guam for fiscal years 1987, 1988, and 1989. Fort Sam's bid included a provision to eliminate all local national employees and use only American dependent employees. The acceptance of its bid by the government led to paying each local national, of which there were 141, a severance of approximately $270,000 each. This unconscious act cost the overseas banking program approximately $38 Million in additional operating costs. What appeared at face value to be the lowest contract bid turned out to be a taxpayer's nightmare.

The irony is Camp Zama is the only Army installation in Japan. The number of Japanese employees severed at the Camp Zama MBF was only three (3 out of 14). These employees worked for Chase Manhattan Bank who had lost their MBF contract to the Fort Sam Houston Bank. The rest of the Japanese employees were located on Navy or Air Force installations. However, because of the terms of the payback agreement in the OMBF charter, the Army paid for 50 percent of the approximate $38 Million cost. The inequity issue aside, it would appear that the department responsible for program management was suffering from a general lack of legal expertise and program knowledge.

Current OMBF costs can be linked to the fact that MBFs are government-owned and contractor-operated facilities, and to an attitude, which exists within some DOD agencies, that the sole responsibility to direct bank policies and allocate resources with regard to the operation and management of MBFs rests with the DOD program managers. For all practical purposes, this situation has resulted in the DOD's continuous attempts to manage retail banks. This is something that is unique to that agency of the government and may not be within the scope of its expertise. In fact, it gives rise to the issue and begs an answer to the question of why the government is in the business of administering these banking services? A 1987 DOD study of overseas financial services proposed that the Army/Air Force Exchange Service (AAFES) assume the administration of the overseas program. Such a proposal is generally viewed by the banking industry as ill-advised and shortsighted. The use of a military exchange service to provide sophisticated banking services could be the subject of yet another MSP, but suffice it to say, AAFES does not possess the requisite expertise nor the internal organizational structure to function as a banking institution.

This situation is exacerbated by the current DOD management structure which apparently lacks human resources, like many government agencies, with the necessary expertise to evaluate

properly the technical feasibility and the cost justification of contractor's proposals in critical areas such as banking systems, staffing, and corporate banking practices. In addition, the Federal Acquisition Regulation (FAR) complicates the DOD's management of the OMBP. The FAR is designed to address typical government contractors and does not
specifically lend itself to the providers of banking services.

It could therefore be argued that because of these circumstances, practices and policies have evolved which are at variance with acceptable banking industry standards and do not properly allocate DOD's funding resources. Consequently, some banking contractors may feel compelled out of necessity to provide services which do not generally meet minimum banking standards.

SUMMARY

The primary goal of the Overseas Military Banking Program is to ensure that U.S. military servicemembers and authorized DOD employees and their dependents overseas receive essential banking services at acceptable standards and reasonable costs; and, that any subsidy funded by the DOD be justifiable to the taxpayer. In fact, the opposite is occurring. Service levels are below acceptable industry standards, and the cost to the taxpayer has dramatically increased. Overall, there appears to be a lack of strategy on the part of the DOD program managers, and actions to date have resulted in a more costly program. The OMBP is overshadowed by constant change, service disruptions, and difficulty in attracting major financial institutions as contractors.

To ensure a more effective and cost-efficient program, at a minimum, the following areas should be addressed:

1. DOD Oversight/Management - A cohesive structure should be designed which definitively establishes roles, responsibilities, and authorities for the various DOD participants charged with the management of OMBP. As an essential part of this management restructuring, personnel resources with requisite expertise in the fields of law, finance, and systems should be devoted to this process. In addition, the overseas U.S. military commands should be given a more active role in the contractor selection as they, the recipients of these services, are more often better equipped to assess the contractor's performance.

2. Contract Structure - The existing contract mechanism should be redesigned to establish ground rules and eliminate ambiguities and contradictions between the Federal Acquisition Regulations and the business practices unique to the banking industry. The contract should allow for efficient and effective management of the various functions within the bank. Selected operational reductions in MBFs result in dysfunctional and disruptive customer service and should therefore be avoided. Further, the contract should clearly delineate the obligations of each party, and to the degree possible, should avoid placing DOD personnel in the position of having to render judgment calls on day-to-day MBF banking practices.

3. Subsidy - A policy should be developed that clearly establishes the products and services that should be subsidized by the DOD to ensure the welfare and morale of the U.S. servicemember overseas, and to ensure that the policy is explainable and totally justifiable to the taxpayer.

4. Market Practices - Taking into consideration the OMBF's philosophy regarding reasonable subsidy, existing policies and practices should be modified to reflect more closely current market practices. Specifically, product pricing, product

variety, and the resources necessary to perform should be systematically designed, and meet industry standards. Particular emphasis should be placed upon ensuring that contractors are provided the required funding to meet the program's objectives wherever and whenever possible.

5. Contractor Needs - A "can-do" attitude should be cultivated within the DOD to ensure that contractors are able to meet their stated objectives, particularly in areas of product sales, customer and employee satisfaction, and promoting the bank's corporate image. Additionally, an institution's utilization of its own internal resources should be encouraged, not discouraged, to the maximum extent possible.

CHAPTER VI

CONCLUSIONS AND RECOMMENDATIONS

CONTRACT STRUCTURE

ISSUES;

* Inadequacy of procurement regulations to provide for this unique revenue producing contract.

* Involvement of DOD personnel in day-to-day banking operations.

PROBLEMS CAUSED TO MBF CONTRACTORS:

* Absence of agreement among DCAA, OASD, and the Contracting Officer on which regulations apply to revenue generating transactions.

* Standard bank practices sometimes result in audit claims because they are not specifically covered by government regulations.

RECOMMENDATIONS:

* Modify the regulations to encourage participation in the program by major financial institutions, e.g., five year contracts and use of affiliates.

* The contract language must permit the contractor to operate in accordance with standard, prudent banking practices.

* Clear delineation of roles and responsibilities of DOD personnel and contractor to eliminate DOD involvement in day-to-day program management.

SUBSIDY AND MARKET PRACTICES

ISSUES:

* Lack of clear DOD program objectives, i.e., the extent to which reasonable market practices apply to generate revenue versus subsidization by taxpayers.

* Sometimes, DOD decisions on services appear to be made with minimal regard to cost and revenue.

PROBLEMS CAUSED TO MBF CONTRACTORS:

* Basic services are often priced at less than break-even, particularly when many customers fail to maintain balances sufficient to cover account maintenance costs.

* Loans are priced such that MBFs cannot effectively compete with overseas credit unions (i.e., rates are generally an average of credit union rates which are traditionally lower than banking institutions.)

RECOMMENDATIONS:

* DOD needs to clearly define the extent of program subsidization.

* DOD needs to develop a pricing strategy that balances subsidization objectives and acceptable U.S. banking market practices.

CONTRACTOR NEEDS

ISSUES:

* There is a negative impact on the image of the contractor as the provider of banking services.

* There appears to be some objection to allowing banking contractors the full use of their corporate resources in executing program requirements.

PROBLEMS CAUSED TO MBF CONTRACTORS:

* Contractors are not provided with the necessary resources to conduct business at a level comparable to that found in other business activities and affiliates outside the OMBF.

* Staffing is not addressed uniformly. Facilities and automated systems are inadequate resulting in a deterioration of contractor image and an inability to perform services to acceptable standards.

* Although DOD decides who offers what services, to whom, and at what price, the customer perceives the contractor as the decision maker and therefore holds him totally responsible for any and all customer dissatisfaction.

RECOMMENDATIONS:

* Adequate program funding is needed to ensure efficient, professional delivery of required program services. Funding can either be through a greater government subsidy or, more logically, through the introduction of standard market pricing for services provided. Regardless, appropriate levels of funding would ensure that adequate operational requirements in systems, facilities, and staffing are met.

* Where available and when proven to be both economical and efficient, a contractor should be able to use any and all applicable corporate resources in order to execute program requirements.

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