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ORAL STATEMENT OF

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Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND
REGULATORY RELIEF
of the
SENATE BANKING, HOUSING AND URBAN AFFAIRS COMMITTEE

May 1, 1997

Mr. Chairman and members of the Subcommittee, I want to commend you for holding this oversight hearing on the OCC's supervision and regulatory activities, and in particular, the recent revision to Part 5, which governs corporate applications from national banks. In light of the significant changes in the banking industry today, this is a particularly appropriate time to focus on these important issues. I welcome this opportunity to answer your questions, and I have a detailed statement for the record. I would like to briefly summarize the key points in that statement.

Since the mid-1970s, banks have increasingly faced numerous changes that have challenged the long-term health of the industry. Increased competition from market participants operating under a different regulatory structure, changing consumer needs, globalization of financial markets, and -- most significantly -- increasing technological change all have irrevocably altered the competitive environment in which banks operate today.

In this environment, the status quo is no longer an option for ensuring a safe and sound banking system to serve the American economy. Both the industry and our supervision must keep pace with a changing environment. That has been a guiding principle of OCC supervision over the past four years, and the results speak for themselves.

When I took office in 1993, there were numerous bank failures ... small businesses, consumers and members of Congress were complaining about a credit crunch ... and banks and Congress were concerned about excessive regulatory burden. Community organizations raised concerns about fair lending compliance, and everyone agreed the Community Reinvestment Act regulations were not getting the job done.

Today, the banking system is healthy, profitable and far better capitalized than at any time in recent memory. Bank failures in 1996 were at a 20-year low. Credit is flowing smoothly, and

small business loans increased 31 percent over the three years ending June 1996.

To make sure the performance of national banks continues to be healthy and strong, we have strengthened our supervision of high risk areas and focused on getting the most from our historic strength: hands-on, in-the-bank examinations. For example, we now have dedicated examination teams assigned full-time to each of the 30 largest national banks. We have pioneered supervision guidance on issues such as bank derivatives activities that have become the standard for other regulators, both in the U.S. and overseas.

The OCC has also stepped up its enforcement of fair lending laws. To date, we have completed more than 3,000 fair lending examinations with revised, state-of-the-art procedures. Before my arrival at the OCC, the OCC had referred only one fair lending case to the Department of Justice. Since 1993, we have referred 23 cases.

We also spearheaded the interagency effort to revise the CRA regulations to focus less on process and more on actual loans, investments, and services. One result is a dramatic increase in mortgage lending to low- to moderate-income households. In the past 20 years, banks have made \$140 billion in loan commitments for community reinvestment. Fully 70 percent of that amount -- \$100 billion -- was committed in the past three years alone. Before 1993, national banks had invested less than \$1 billion in community development projects. Since then, national banks and their community development partners have invested more than \$4 billion.

Although the situation clearly has improved, we cannot be complacent. Now, while the industry is strong, we are keeping a vigilant watch for emerging risks and working with national banks to make sure they manage these risks appropriately.

In my written statement, I have detailed the OCC's actions to carry out its mission: to charter, regulate and supervise national banks to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States. While these actions are important, by themselves they are not enough. In today's changed and changing financial environment, banking cannot stand still. If we deny banks the chance to pursue opportunities in evolving financial activities that they can undertake safely, they will be pressured to move further out on the risk curve -- to squeeze more profit out of their traditional activities and reduce costs by cutting internal control systems. Indeed, that is precisely what led to bank losses from loans to LDCs and highly leveraged transactions in the 1980s. And losses such as those have a direct impact on banks' ability to meet the needs of their customers and the nation's economy.

By contrast, creating a process through which banks can prudently meet new market demands will enable banks to achieve greater balance in their operations, diversify their sources of earnings,

offset downturns in their traditional lines of business, and expand their ability to meet the financial needs of businesses, consumers, and our national economy. Part 5 is one step in that direction.

We did not rush headlong into revising this regulation. We first proposed changes to Part 5 in November 1994, and over the next two years, we thoroughly reviewed the many comments we received on the proposal. Only after long deliberation did we issue our final rule in late November 1996.

Part 5 lays out procedures for filing and processing the full range of national bank corporate applications. The part of the regulation that has generated the greatest controversy deals with the new process under which the OCC considers an operating subsidiary application for activities different from those permitted for the parent bank itself. Because there has been some confusion about this provision, I want to be absolutely clear about what the regulation does and does not do.

First, the revised Part 5 does not authorize any new activity. Instead, it lays out a public process under which banks can apply, one at a time, to set up operating subsidiaries to engage in activities that are part of or incidental to the business of banking.

Second, activities in a national bank operating subsidiary must be part of or incidental to the business of banking. Part 5 does not breach any separation between banking and commerce.

Third, Part 5 lays out explicit firewalls to ensure that any new activities are conducted safely and soundly to protect the interests of America's consumers and communities. In addition, the OCC can and will impose additional safeguards that may be warranted by a particular activity a subsidiary proposes to conduct. Let me assure you, taxpayer funds will not be put at risk.

Fourth, because these activities are being conducted in a bank subsidiary, the earnings from these activities will strengthen the bank itself and increase its ability to provide greater access to financial services. As FDIC chairman Ricki Helfer said in recent testimony, allowing a bank to put new activities in a bank subsidiary "lowers the probability of failure and provides greater protection to the insurance funds."

Fifth, in many cases, activities in an operating subsidiary will be regulated on a functional basis by another regulator, as well as by the OCC. For example, today most national banks sell securities through operating subsidiaries that must be registered broker-dealers and are subject to SEC regulation -- in addition to oversight by the OCC.

Finally, despite assertions to the contrary, there is no evidence of a net subsidy from the federal safety net that would provide an unfair competitive advantage to activities conducted in a bank operating subsidiary as opposed to a holding company affiliate.

Conclusion

At my confirmation hearing in 1993, I said that focusing on the structure and function of the banking system over the long term was critical to ensuring a truly safe and sound banking system. Everything I have learned since that time has only strengthened my belief in that statement.

The OCC has changed significantly over the past four years. We have implemented many improvements to maintain bank safety and soundness and increase access to banking services. I am proud of OCC employees for their hard work and dedication in effecting these changes.

My goal for the remainder of my term is to ensure that the national banking system remains healthy, stable and able to serve the diverse needs of American businesses, consumers and communities. Part 5 is one step toward achieving that goal. Congress in its wisdom created a National Banking Act that was designed to allow the national banking system to evolve prudently over time. The Supreme Court has affirmed this congressional intention four times in just the last three years. The banking system did evolve throughout the 19th century and has continued to this day. Given the rapid changes in the financial services industry today -- changes that will certainly continue into the next century -- not to allow this evolution to continue would be unwise, unsafe and unsound. I assure you that, in making decisions under Part 5 or any other area of my responsibility, we will act with the greatest prudence and care to assure the continued safety and soundness of the national banking system.

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The OCC charters, regulates and supervises approximately 2,800 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than half the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.

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