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Acting Comptroller Williams Addresses Bank Merger Issues in
House Testimony

WASHINGTON, D.C. -- The Office of the Comptroller of the Currency has undertaken a number of initiatives that will enable it to supervise large institutions such as those that would be created in a series of recently-announced mergers, acting Comptroller Julie L. Williams told a House committee Wednesday.

In testimony before the House Committee on Banking and Financial Services, Ms. Williams also said the OCC will carefully monitor the impact of mergers upon consumers. The agency will pay particular attention to privacy concerns, community development issues and the impact of consolidation on the fees banks charge their customers.

Elaborating on the OCC's response to the merger announcements, Ms. Williams said examiners assigned to each of the institutions involved in the proposed mergers have begun to coordinate supervisory strategies. They have identified strengths and weaknesses at each institution and will closely monitor the banks to ensure that appropriate risk management controls are maintained as the mergers are implemented.

The OCC has spent the last five years developing a supervision-by-risk approach that gives the agency the tools it needs to supervise bigger and more complex institutions, she told the House panel. Supervision by risk focuses examiner resources on those activities with the most potential to generate losses at a bank.

"Whereas our historical supervisory practices were essentially reactive, supervision by risk enables us to anticipate and deal with bank problems before they become entrenched," she said.

The OCC has mapped plans to convene a special meeting of examiners most experienced in big bank mergers to review issues they encountered in those transactions and to identify "best practices" that were employed to deal with those issues.

Among the issues the agency has identified as a potential problem is asset concentrations. To invest larger pools of funds efficiently, larger organizations tend to engage in bigger transactions. Those loans will be more visible and any problems that develop will have a more dramatic impact upon the reputation of the institution.

The OCC issued comprehensive Loan Portfolio Management guidance last month to promote more sophisticated evaluation of portfolio risk. In addition, examiners

will closely supervise efforts by bank management to identify and control loan and investment concentrations, and will ensure that appropriate contingency plans are in place. The agency is also using Ph.D. economists from the Risk Analysis Division to evaluate a bank's efforts to identify, measure, monitor and control asset and liability concentrations.

Ms. Williams also told the House committee that the OCC will closely monitor the impact of the proposed mergers upon low-income communities. However, she noted that large institutions interested in expanding through acquisitions have an interest in building a strong Community Reinvestment Act record, and the majority of recent CRA lending commitments to low-income communities were made by banks active in mergers and acquisitions.

The OCC will require acquiring banks to state whether they will honor CRA commitments made by target institutions. The OCC will deny expedited processing to those that do not, and will investigate the situation as part of the application process.

The OCC will also closely monitor the impact of the mergers on the fees that consumers pay for banking services. However, Ms. Williams noted that the pricing of bank services is complex and it is not always easy to identify the precise reasons for differences in bank product prices.

"This is an area where the OCC will remain vigilant, with a particular concern about access to financial services by low- and moderate-income individuals," Ms. Williams said.

In her testimony, Ms. Williams warned banks to pay attention to consumer privacy concerns.

"As financial firms get larger and engage in more types of activities, they also gain more and more information about their customers, including medical, credit and investment information," she said. "This is a critical area of focus for bank management and bank supervisors. Failure to deal responsibly with this issue risks a customer backlash that could disable the company from utilizing one of its most precious resources: its customer information."

Ms. Williams also told the committee that the mergers have heightened her concern about provisions in pending financial modernization legislation that would force activities out of banks and into subsidiaries of the parent holding company. Banks should be free to choose the organizational structure that best enables them to operate efficiently and compete effectively, she said.

"Particularly when faced with the prospect of competing against giant financial conglomerates, banks --- of all sizes -- should not be subject to artificial constraints on their ability to compete," she added.

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The OCC charters, regulates and supervises approximately 2,600 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than 58 percent of 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.

ORAL STATEMENT OF

JULIE L. WILLIAMS

ACTING COMPTROLLER OF THE CURRENCY

Before the

COMMITTEE ON BANKING AND FINANCIAL SERVICES

of the

U. S. HOUSE OF REPRESENTATIVES

April 29, 1998

Mr. Chairman and members of the Committee, I appreciate this opportunity to testify on the recent proposed mergers of a number of large financial institutions.

The size and scope of the transactions we will discuss today raise important questions about their impact on consumers and local communities; about the preparedness of regulators to oversee the resulting organizations; and about the implications of these combinations for domestic and international competition. I commend the Committee for convening this hearing to focus attention on these important public policy issues.

Impact on Communities and Consumers

Many Americans have a traditional fear of concentrated financial power -- and the more concentrated, the more it is feared. Yet, it is worth noting that even if the recently proposed mergers become reality, the United States will still have the most decentralized banking system among the advanced nations of the world.

Some consumers, however, worry that large banks are impersonal and indifferent to local financial needs, especially in smaller localities. A particular issue in this regard is the application of CRA to large, complex and

geographically diverse institutions.

CRA implementation does indeed become more logistically challenging for the bank and its regulators as a bank increases its size and branches across states. Congress anticipated this situation, however, in crafting interstate branching legislation, and we have revised our examinations and procedures accordingly. As a result of the Riegle-Neal legislation, the OCC rates multi-state banks not only for their performance overall, but also separately for performance in each state in which they are located, and each multi-state Metropolitan Statistical Area in which they operate. These safeguards assure that the CRA performance of large multi-state banks will be assessed across the entire organization and in more local markets.

Consumers also express concerns that some large banks charge higher fees for certain services than smaller, locally-based institutions. The pricing of bank products and services is complex, and it is not always easy to identify precise reasons for differences in bank product prices. This is an area the OCC will watch closely. We will pay particular attention to the impact of fees on access to financial services for low- and moderate-income consumers.

Finally, some consumers worry that cross-selling of products will not be conducted appropriately in large financial companies. They are also concerned about issues of personal privacy because, as financial firms get larger and engage in more types of activities, they also gain more and more information about their customers, including medical, credit and investment information.

Supervision Issues

The OCC's approach to regulating and supervising these proposed organizations is based on two things: our experience overseeing many large bank mergers in recent years, and our fundamental supervisory philosophy -- supervision by risk -- which we have developed over the past five years and which is uniquely suited to address the special challenges posed by bigger, more complex banks.

Our experience with previous mergers demonstrates the importance of several key elements. My written statement discusses these in detail. They include: a tightly controlled transition process that includes clear business plans, lines of authority, and accountability in the combination process; the need for bank management to assure that core business activities remain viable throughout the transition; and, plans to ensure that the merged institution is ready for the Year 2000.

If the announced mergers become reality, our ongoing supervision of these large organizations will be based on our supervision by risk approach. OCC examiners will assess

a banking organization's existing and emerging risks across product and services lines and evaluate whether management has effective, working policies to identify, measure, monitor and control risks throughout the entire organization. A particular focus will be to ensure that management efforts to cut costs to achieve post-combination operational savings not be allowed to weaken essential bank internal controls and audit functions.

The OCC's resident examiners at each of the institutions involved in the recently proposed transactions have already begun to coordinate their supervisory strategies, identifying each institution's strengths and weaknesses. We are also planning a special meeting of examiners who are most experienced in large mergers and combinations to review the issues they have seen in those transactions and identify "best practices" that were used by banks and the OCC to deal with these issues.

Ensuring the Competitiveness of Smaller Banks

Mr. Chairman, the third question raised in your letter of invitation was whether legislation is necessary to provide smaller banks and financial services firms with the ability to compete on a level playing field with these newly proposed entities. In order to compete effectively in the financial services marketplace of the future, banks of all sizes need to have the ability to choose the organizational structure that will best enable them to operate efficiently and compete effectively. Particularly when faced with the prospect of competing against conglomerate financial titans, banks -- of all sizes -- should not be subject to artificial constraints on their ability to compete.

This is a concrete illustration of why it is crucial that financial modernization legislation allow banking organizations the ability to conduct new financial activities in bank operating subsidiaries as well as bank holding company affiliates depending upon which is more efficient for the particular organization.

Conclusion

These mergers raise a number of important issues, including issues related to the regulator's ability to supervise effectively financial conglomerates and larger banks. I believe that we have the right approach and the right tools to supervise these large institutions -- and others that may be formed in the future. But we are not complacent. The scale of these transactions does present challenges -- real challenges -- as I have described above. We will need to be vigorous in our approach to supervision and very sensitive to the emergence of any familiar and certainly any novel supervisory issues. Given the size of the organizations being formed, problems must not be allowed to fester. One of the compelling lessons of the past is that we must never relax our supervisory vigilance.

Thank you for the opportunity to present the OCC's views. I will be pleased to answer any questions you may have.

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