Speeches and Congressional Testimony

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Of the Comptroller of the Currency

Of the First Senior Deputy Comptroller and Chief Counsel

Remarks by John D. Hawke Jr., Comptroller of the Currency, before a virtual conference of the American Bankers Association, on the banking system's commendable continuation of operations during and future banking challenges because of September 11 events, Washington, D.C., October 12, 2001

Among the millions of Americans who sat riveted to their radios on December 8, 1941 was Henry W. Koeneke, president of the Security Bank of Ponca, Oklahoma, who also happened to be president of the American Bankers Association. After listening to President Roosevelt's stirring address to Congress and the nation describing the Japanese attack on Pearl Harbor, Koeneke dashed off this message to the White House: "Deeply conscious of the import of your historic message to which I have just listened, on behalf of the American Bankers Association I pledge to you and to the people of America the complete support of the nation's banks."

Some skeptics doubted that this expression of support was heartfelt—or worth very much. The industry was still recovering from its near-collapse a decade earlier; its condition, reputation, and self-confidence were weak. But the industry rapidly revived in the face of the national crisis. Banks were instrumental in mobilizing the nation's savings and providing a ready source of capital to both government and the private sector in meeting critical wartime needs. Freedom triumphed in the end, and the banking industry made a key contribution to that success.

Today, our nation faces a new crisis, and the banking industry, led by the ABA, has again stepped forward to extend its support. We will need every ounce of that support, for the challenges that lie ahead for our nation and the banking industry are enormous.

In the days following the attacks on New York and Washington, the banking system continued to operate with only minor disruption. Some banks went to extraordinary lengths to meet their customers' needs for cash and other essential banking services. You provided reassurance that the financial system was still standing, still functioning, still capable of delivering virtually any service on September 11 that it offered on September 10. I applaud the steadiness and resolve that you demonstrated during those first frightful days. We all grieve for the victims, a disproportionate number of whom were at their desks at financial services firms when the terrorists struck.

But the response of the banking system was as much the product of preparation as one of character. You were able to carry on in the midst of crisis because you planned for it. Bank information systems continued to operate without interruption because they had been tested and upgraded and reinforced. It was partly the result of the time and resources invested in the Y2K effort—an investment that now looks especially prescient.

Many challenges lie ahead for our nation and our banks. But with challenge comes opportunity—the opportunity, for example, for banks to play a leadership role in the global effort to locate and cut off the money trail that sustains terrorist enterprise.

I have always believed that the privacy of banks' customer relationships is a value of enormous importance to the maintenance of confidence in our banking system. Recent events have demonstrated dramatically, however, that our banks can be used by terrorists to facilitate unspeakable criminal conduct. In the aftermath of September 11, we are seeing important efforts to strengthen the hand of law enforcement by imposing new requirements for banks aimed at the prevention and detection of international money laundering and the financing of terrorism. Now is the time for bankers themselves to demonstrate leadership in this area, to be vigorous and pro-active in assuring that their products and services are not used to facilitate unlawful conduct.

And there is rebuilding to be done. Billions of dollars of property have been lost, and the affected communities and individuals are already turning to the banking system for the wherewithal to start anew. The OCC and our regulatory colleagues are committed to supporting banks in these efforts, as evidenced by our decision to award CRA credit to banks that participate in recovery efforts in communities affected by the events of September 11.

In other ways, too, directly and indirectly, your customers will be affected by the changes that are taking place in our economy and in the world. Some businesses have been devastated by the terrorist attacks; others will feel the impact over time. Many Americans will be asked to put their civilian lives on hold in order to serve in uniform. We encourage you to continue to work with your customers to help them adjust to these changes and to ensure that credit continue to be available on reasonable terms. Where it can be done prudently, you should consider extending the terms of loan repayments, restructuring a borrower's debt obligations, and easing credit terms for new loans to certain borrowers. Such prudent efforts to work with borrowers will not be subject to criticism by national bank examiners.

Fortunately, national banks are well positioned to cope with the stresses that our national emergency may bring. Despite the economic difficulties of recent months, the industry is strong. Earnings actually rose in the second quarter of 2001, and capital remains high. National banks have done an excellent job controlling costs and managing problem loans. I would urge you to continue in that spirit.

And I would urge you once more to review and test your disaster recovery and business resumption plans, and revise them as needed. The events of recent weeks offer a sad reminder of the vulnerabilities of a free society. We will not abandon the values of openness and tolerance that are synonymous with America, but we must be vigilant and we must be prepared for any foreseeable contingency. And banks, which are so crucial to our economy life, must be more vigilant than most.

As in crises past, the country will look to you for financial strength, to rebuild where rebuilding is necessary and to provide the means to continue revitalizing our economy. I know the American banking system will again be equal to whatever challenges the future holds.

Remarks by John D. Hawke Jr., Comptroller of the Currency, before the New York State Department of Banking, on its 150-year history and the dual banking system, New York, N.Y., October 15, 2001

A few years ago Chairman Greenspan of the Federal Reserve remarked to a former Comptroller of the Currency that the OCC had an important but little recognized advantage in the bureaucratic competition that goes with the territory the banking agencies share. He was referring to our history. After all, the OCC has been around since the Civil War, eclipsing such newcomers as the FDIC and the Federal Reserve itself by 50 years or more. History *is* important to the OCC—important enough that we have been steadfast in resisting suggestions that we change our name to something more closely approximating our actual mission, which has had virtually nothing to do with the currency for roughly 75 years—something I am condemned to explain at every cocktail party I attend.

So I take special pleasure in recognizing the remarkable history of the only financial regulatory agency in this great country to which the OCC must defer in terms of longevity: the New York State Department of Banking, now 150 years old. And I hope that when the OCC itself reaches that milestone 12 years from now, in 2013, we will have the opportunity to repay the hospitality you have extended to me today. Needless to say, I am honored to be with you on this historic occasion.

It also gives me an opportunity to express our heartfelt admiration for the way you and all New Yorkers have borne up under the awful and unprecedented strains of the past month. The banking department deserves a large share of the credit for the way that the financial institutions that make this great city their home were able to bounce back as quickly as they did. It is exactly what we would have expected from the most venerable of our financial regulatory agencies.

By itself, of course, longevity proves little beyond an aptitude for self-preservation, but that is hardly the case with the New York Department of Banking. Indeed, New York State legislators and regulators have been responsible for many of the basic concepts upon which the structure of bank regulation in this country is based.

When the New York State legislature passed the Safety Fund Act (as it came to be called) in 1829, it broke ground in two essential ways. For one thing, it established an effective mechanism for insuring bank obligations. How serious a problem this had become is illustrated by this contemporary newspaper account of the scene that erupted when a Pennsylvania bank stopped redeeming its notes:

> Hundreds of poor laborers were running in every direction with their hands full of the trash and not able to induce a broker to give six-pence to a dollar for them. We passed in the market a woman who makes her living by selling eggs, butter, and vegetables, who had almost all she was worth, about $17, in the bank's notes. When apprised that it was worthless, she sank down in agony upon her stool and wept like a child. This is but one of a hundred similar cases.

Such poignant scenes prompted the New York law, requiring banks to pay an amount equal to one-half of one percent of their capital each year for six years into a fund, from which the obligations of failed banks would be paid out. A half dozen states adopted similar laws of their own. In New York, the Safety Fund worked wonders in restoring public confidence, and when the fund was liquidated in 1866, it even had a small surplus to show for it. But this happy experience was not universal. Losses had put the safety funds of states like Michigan and Vermont out of commission in short order. How can we account for this mixed record of success?

According to most historians, the answer lies in a key feature in the New York law that was missing in the others. New York provided for the appointment of three bank commissioners to examine the financial status of banks and report annually to the legislature. With that provision, professional bank supervision in the United States essentially began.

More than a century later, the safety fund concept came to the nation at large in the form of federal deposit insurance. But the FDIC is not the only federal banking agency inspired by New York. The OCC—and the national banking system—owe a similar debt to New York banking law and practice.

In the Free Banking Act of 1838, the Albany legislature—in an historic act of self-denial—sought to expand the availability of banking services for a rapidly growing economy by curtailing its own power to grant bank charters one at a time by legislative action. That requirement had inevitably introduced political considerations into the chartering process, and New York lawmakers wisely recognized that this was an area in which politics did not belong. So it decided that bank charters would henceforth be available to any qualified organizers who met certain standards and conditions. Among them was that the organizers deposit with a state official—the

Comptroller of the Currency—an amount of government securities, which would serve as the basis for the new institution's notes. In the event of insolvency, the securities would be sold to redeem the notes.

Congress adopted precisely the same provisions in the National Currency Act of 1863. In a real sense, the national banking system that the OCC supervises today was the banking system of the State of New York on a national scale. Again, what began in New York became a blueprint for the nation.

The history I've just cited certainly supports the argument we often hear in support of the dual banking system, namely that the states have been the main engines of the innovation in the banking industry. That argument has more than a grain of truth to it. But it lacks refinement and ultimately does not comprehend the real value of duality in our banking system. While the states have surely been innovators, national banks and the OCC also have a proud record of innovation. Just by way of example, national banks issued the first negotiable certificate of deposit in 1961, securitized loans for the first time in 1984, and introduced a whole range of new financial products and services to the banking public over the past several decades. The wild card statutes on the books in most states—which effectively tie state bank powers to innovation in the national system—testify to that leadership.

The fact is that innovation is inherent in the dual banking system—and perhaps the most powerful argument that can be offered in its defense. State banks led the way with new products and services in the nineteenth century because they had to do so as a matter of survival. In the National Bank Act of 1864, Congress had deliberately stacked the deck against them, fully expecting that state banking would succumb to the competitive disadvantages imposed against them in the law. Indeed, in 1865 Congress passed a "death tax" on state bank notes, intended to drive state banks to the national charter. Instead, state bankers proved resourceful in pursuing deposit banking and in developing new markets and new ways to serve existing ones. They ensured that they would be around for many years to come. By the same token, national banks, facing increasing competition from state banks and nonbanks in the 1960s and since, were obliged to come up with ways of reinvigorating the national charter—and they did, in the ways I've just mentioned.

In short, neither the state *nor* national banking systems have had a monopoly on innovation, at least not for more than a few years at a time. For no sooner has one side gained the lead, then the other has redoubled its efforts to take it back. The result has been a dynamic, competitive, and creative industry, responsive to the people and communities it serves.

This happy outcome could hardly have been predicted. Indeed, some people still scratch their heads in wonderment that the dual banking system, with its further division of *federal* authority among a number of agencies, has worked as well as it has. Its most ardent supporters concede that on paper, it probably shouldn't. The idea of duality has withstood repeated assaults—beginning with Congress in 1863—from those who saw it as unwieldy, if not irrational, that the banks of the country should be free to choose the regulatory regime under which they would operate. It is true—but not widely known—that the laws creating the Federal Reserve system and the FDIC had an ulterior purpose: the elimination—or at least the reduction—of state banking, which many thoughtful people saw as a less safe and sound brand of banking than the U.S. economy could afford.

How then do we account for the persistence of the dual banking system in America? Part of the answer, I believe, is that the dual banking system is a true expression of our national character—reflecting core national values of competition, federalism, and freedom of choice.

It took a while for this truth to sink in, but once it did, Congress reversed its opposition to the dual banking system and instead worked diligently to nurture it, intervening at critical intervals to ensure a healthy balance between the state and national bank charters. Through legislation, federal regulators and national banks obtained the authority to match innovations and incentives coming from their state counterparts. For example, following a Supreme Court decision holding that national banks did not have the right to branch, Congress, in 1927, passed the McFadden Act, granting national banks branching powers roughly equivalent to those already enjoyed by many state banks. And it relaxed other legal restrictions—such as those barring national banks from offering safe deposit boxes and making most real estate loans—which were eroding the value of the national bank franchise.

At the same time, Congress has been cautious about encroaching on the authority of the states to charter and empower banks. For example, excepting only insurance underwriting, the states have been left free to allow their banks to engage in activities not permissible for national banks so long as the FDIC determines the activity would not pose a significant risk to the insurance fund.

Let me add that this process has not been a one-way street. As I've already noted, many states have enacted "wild card" statutes—laws that allow state-chartered banks to exercise powers available to national banks.

More recent federal legislation has equalized many of the powers of state and national banks in the context of interstate branching. And working through the Conference of State Bank Supervisors, state authorities have been able to streamline the process of interstate branching by state banks.

Nor—despite what some critics say—has the process been a "race to the bottom." For example, in early 1960s, under Comptroller James J. Saxon, the OCC concentrated on upgrading the qualifications and skills of its examination force. This led to calls from state bankers and action by state supervisors to match these improvements. The quality of examinations improved significantly on both sides, and the whole dual banking system emerged the stronger for it.

In short, what former Federal Reserve Board chairman Arthur Burns called—in memorable, if misleading terms—"a competition in laxity" between state and federal banking authorities—has actually been a textbook case of federalism in action. The competitive tension between state and national authority has produced a safe and sound banking system, an efficient and effective supervisory regime, and regulatory structures capable of adapting to the demands of an evolving marketplace. The financial system's response to the events of September 11 offers the latest proof of its adaptability and strength.

One lesson we can draw from this history is that while the dual banking system today is healthy and strong, it requires care and feeding to keep it that way. Experience teaches us that the absence of needed legislation—or the enactment of the wrong kind of legislation—can do the dual banking system real harm.

For example, while Congress has not encroached upon the chartering authority of the states, the balance of responsibility for the supervision and regulation of state-chartered banks has steadily shifted toward their *federal* regulators. For more than 30 years, almost every time Congress has imposed new federal bank supervisory and regulatory responsibilities, it has parceled that authority and responsibility among the three federal banking agencies. That approach was originally shaped by concerns that some states lacked the resources to carry out Congress's mandates. As a consequence, the Federal Reserve and the FDIC today perform for state banks virtually every supervisory function that the OCC performs for national banks. The result has been to deprive the states of much of the opportunity to take full responsibility for the supervision of their own state-chartered banks.

A related issue concerns the funding of bank supervision. Today, the total cost of supervising state-chartered banks is significantly subsidized—not only by the two federal agencies that supervise such banks, but also by national banks, primarily through their contributions to the deposit insurance fund from which FDIC supervisory expenses are drawn. This anomaly has had the effect of magnifying the assessment disparity between state and national supervisors, encouraging many banks to make charter choices based on comparative costs, rather than on the values inherent in the charter or the quality of supervision. This has tended to undermine the substantive and qualitative competition between the charters that has always been our system's hallmark.

My hope is that this matter will be addressed—if not when Congress reconsiders the subject of deposit insurance reform, as it has pledged to do, then in the not too distant future. The preservation of a strong, competitive dual banking system is crucial to our ability to meet the very real economic challenges our country faces, and putting supervisory funding on a more rational basis, I believe, is crucial to the future of the dual banking system. Under a plan that we have put forward, the costs of both national bank supervision by the OCC and state bank supervision by our state counterparts would be paid out of the FDIC insurance fund, under a formula that made the allocations automatic and nondiscretionary.

In the meantime, we can never forget, particularly at this moment in our nation's history, that whatever differences may separate us are far, far less important than what unites us. In our case, it's a common commitment by federal and state regulators to a safe, sound, and competitive banking system—a commitment that has expressed itself through cooperation *and* competition. And I can think of no better model for that relationship than the one that the Office of the Comptroller of the Currency and the New York State Department of Banking have had for much more than a century.

Again, heartiest congratulations on your 150th anniversary.

Remarks by John D. Hawke Jr., Comptroller of the Currency, before a Symposium on Emerging Risks in Banking, on accountability, OIG oversight, risk, supervision, and resources, Washington, D.C., November 14, 2001

The law in ancient Rome required that when the scaffolding was removed from a completed arch, the engineer who had supervised its construction had to stand beneath it. It's no wonder that so many of those arches are still standing today.

We no longer take the principle of accountability quite to that extreme. Still, accountability is at the core of our system of government—in an obvious way for elected officials, and less obviously (but no less certainly) for those like myself who are privileged to hold appointed positions. We in the regulatory community are accountable to the public and to Congress, and you, in the offices of the inspector general, are the transmission belt for that accountability. We are, of course, also answerable to the institutions we supervise, who, under our unique system, are free to register their dissatisfaction with our actions by exercising their option to be supervised by another agency.

Those who persist in talking about the alleged tyranny of an unelected and unresponsive "fourth branch" of government have obviously never sweated under the spotlights of a Congressional oversight panel or been confronted by the probing questioning of OIG and GAO investigators delving into some aspect of our work.

Such demanding oversight can make for some awkward and uncomfortable moments. But we all recognize that oversight is crucial to upholding the public interest in effective regulation and a safe and sound financial system. The insight and perspective that you provide is invaluable to us, and I trust that you have found that appreciation reflected in the kind of cooperation you receive from us. That's the least you should expect from an agency that sounds off with what some view as tedious regularity on the importance of robust, independent audits for the banking organizations we supervise.

The relationship with the OIG has been a source of varied and tangible benefit to the OCC in recent years. We have worked together, side by side, in dealing with a variety of difficult cases. None was more difficult than the First National Bank of Keystone, West Virginia. You have just finished a panel discussion on this case, one of the costliest bank failures in recent history—and among the most traumatic ever for the OCC.

As you know, senior Keystone officials embarked on a quite unprecedented effort to block our examiners in their efforts to unravel that institution's finances—and get to the bottom of what turned out to be a massive fraud that proved to be the bank's undoing. Besides resorting to physical and verbal intimidation, bank officials manufactured evidence, altered documents, disabled microfilm readers, and buried documents. But the painstaking analysis conducted by OIG investigators exposed these efforts for what they were, and the case against the responsible bank officials proceeded. Two of them are now serving lengthy sentences in federal prison for criminally obstructing bank examiners. They have plenty of time on their hands to reflect on their crimes—while they await sentencing for their recent conviction for fraud and embezzlement.

Reflection, of course, is good for the soul whether you're a sinner or a saint, and, in the aftermath of Keystone, we were eager to reexamine the record and see what we might have done differently to achieve an earlier understanding of the bank's true condition—and its officers' true nefarious motives. The OIG auditors played an enormously important role in this process; the material loss review you conducted after the fact offered both thoughtful analysis and a series of recommendations for improvements in our supervision, many of which have already been adopted. I believe that our supervision has been significantly strengthened—and the risk of future Keystones significantly diminished—as a result of your insight and hard work.

There's something else I want to thank you for—a subtle thing, perhaps, but no less crucial to our ability to carry out our supervisory responsibilities. I'm referring to the sensitivity you've consistently shown to the supervisory relationship between bankers and bank supervisors. I know that you occasionally are petitioned to step into the middle of disputes between banks and their examiners. Yet you have steadfastly resisted becoming a court of interlocutory appeals in ongoing supervisory disputes. We have no reluctance at all to have our supervisory conduct evaluated by any appropriate oversight body after a matter has been concluded. But you have prudently abstained from becoming involved in ongoing matters, and we appreciate that.

We are also appreciative for the very constructive assistance the OIG has rendered in helping us improve the effectiveness of our compliance program. Over the past couple of years, OCC enforcement of the Bank Secrecy Act has come in for intensive OIG scrutiny—timely scrutiny, I should say, given the urgency that anti-money-laundering activities have taken on in connection with the ongoing war on terrorism. In your most recent audit report, you encouraged us to rely more heavily on risk assessments in determining where our limited supervisory resources should be deployed. We have taken that advice to heart not only in adjusting our BSA supervisory priorities, but also in reshaping our entire compliance program—a program that will increasingly embody the same risk-based approach that the OCC developed and implemented a decade ago for safety and soundness supervision.

Risk-based supervision was a response to some of the fundamental questions that have weighed heavily on bank supervisors almost from the beginning. How much supervision is enough? How much is too much? And where should it be directed? The U.S. banking system has always been a uniquely sprawling and diverse entity. Do we need—and can we afford—to have comparably large numbers of examiners nosing into every nook and cranny of each bank's operations in order to ferret out all possible acts of mismanagement and malfeasance? I suspect there is no bank in the country in which we could not find some violation of some compliance law or regulation, if we threw enough resources into the effort. But does it really make sense—is the public interest really served—when regulators play "gotcha" with the banks they supervise?

For most of the last century, there was thought to be no other way; bank examination was pretty much "by the book." But the question kept recurring—especially after banking crises—as to whether this kind of across-the-board, all-things-being-equal supervision made the banking system any more safe and sound. Indeed, it became increasingly clear that in many instances the burdens of supervision had become counterproductive—so intrusive, so costly, so lacking in discrimination, and generally so burdensome that it was becoming a drag on banks and their ability to serve customers effectively.

Timing and perspective have also been recurring problems in the supervisory process. An examiner identifies a problem in an otherwise healthy institution, and brings it to the attention of the CEO. Examiner criticism is rarely welcome; but it is most likely to be brushed off when the bank is riding high and its leaders are heady with their own success. And the examiner, understandably, decides not to force the issue, which can likely be rationalized as a minor one, preferring to avoid confrontation in order to preserve a trusting, harmonious relationship with that banker.

What we discovered anew during the banking crisis of the early 1990s is that the "relationship" must never stand in the way of frank and forthright action to identify and address problems early on in the supervisory process, while the bank has a cushion to help it absorb small setbacks and before its viability can be affected—and while corrective action may still be successful. Bankers may insist otherwise, but at the end of the day, frank and forthright is what they too expect from us. Unfortunately, back then we struggled—struggled with our conflicting urges and struggled to find the right balance between forbearance when problems first came to light, and abrupt and Draconian reactions when problems had matured to the point that they could no longer be ignored.

When banks showed reluctance to provide credit even to creditworthy borrowers, supervisors were blamed for creating a "credit crunch." Since this issue has recently resurfaced, let me state my firm belief that credit crunches are caused by conditions in the economy, and by banks that make economic decisions based on their own self-interest—not by bank examiners. I also recognize that regulators can become an easy scapegoat for bankers to point to when they have decided for their own reasons to tighten up, and a bank officer responsible for a customer relationship has to be the bearer of bad news.

Nonetheless, we learned a lot from the experience of the early 1990s, and we now recognize the value of a supervisory approach that is more selective and efficient and more attuned to the systemic risk that a particular institution or activity poses. And we have tried to make our supervision more modulated and predictable. Since becoming Comptroller, I've emphasized the importance of fashioning a carefully calibrated response to changes we see taking place in the banks we supervise. But that does not mean sitting by silently as conditions deteriorate. It means addressing problems as we see them developing—while we still may be able to do something about them—and doing so consistently and in a measured way. Both in public and in our private meetings with bankers, we have addressed issues of declining underwriting standards and eroding credit quality, and we will continue to address these issues, keeping in mind the need to do so in a balanced manner. The greatest contribution we as bank supervisors can make to the maintenance of a healthy economy is to do what we can to help preserve the ability—and the capacity—of our banks to extend credit to creditworthy borrowers.

Technology has also enhanced our ability to spot problems brewing in the banking system so that we can assess the risks they pose and target those problems in a timely and efficient manner. Early in my tenure as Comptroller, I initiated a major effort to improve our early warning tools. We dubbed it "Project Canary," alluding to the practice of coal miners who brought canaries down into the mineshafts with them to detect dangerous gases. Through this effort we have developed a series of financial ratios and measures that correlate with high levels of credit, liquidity, and interest rate risk. By applying these measures to our population of banks, we can make better judgments about what problems may arise and how we can deploy supervisory resources more efficiently.

I would like to think that the refinements we have made in both the practical and theoretical sides of our supervision have something to do with the current strength of the national banking system—strength that is being tested right now and will surely be tested further in the coming months.

When you prepared your agenda for this conference, you asked for a broad-brush overview of what we see as the emerging risks in the banking system. Since then, we have had the momentous events of September 11, with their profound impact on all Americans and on the economy. Many of the secondary issues that had previously absorbed us were suddenly eclipsed by the question that is now on everyone's mind: how will the economy—and the banking system—fare in the difficult weeks and months that surely lie ahead? Let me now turn briefly to that pressing issue.

We should remember that even before September 11, the short-term outlook for the economy was unpromising. The horrific events of that date were a disaster for all Americans. But in some already struggling industries, particularly travel and tourism, the effects have been particularly devastating. Thousands of jobs have been lost all over the country. Rising unemployment and the prospect of further layoffs ahead have severely damaged consumer confidence, put a crimp in consumer spending, and made it more difficult for consumers to service their debt—debt which remains at historic highs. Some institutions that specialize in providing credit to higher-risk consumers have already seen a sharp reversal in their fortunes, and others will almost certainly follow if distress becomes more generalized throughout the population.

Yet, although the Bear Market on Wall Street is now two years old and credit quality has been slipping in some parts of the portfolio for nearly that long, the national banking system seems to be holding its own. Certainly, the capital strength of the industry is now far better than it was at a similar stage of the last economic slowdown 10 years ago. Total equity capital today stands at more than twice what it was a decade ago, and the related ratios—capital-to-assets and capital-to-loans—are also much healthier. Clearly, bankers have internalized a key lesson of the 1990s—that it's possible to meet all the regulatory capital requirements and still not have the level of capital you need to weather a time of great stress. Indeed, at a recent OCC conference, the highly respected former CEO of one of our major banks said that one of the great lessons he learned over the past decade was the critical importance of maintaining capital ratios appreciably in excess of what we bank supervisors required. Never again, he said, would he let capital fall to even the highest level defined by the regulators. To the extent that view prevails industry-wide, it bodes well for the system's ability to ride out the storms we're facing.

We also believe that the industry is structurally stronger. Consolidation over the past 10 years has given us a banking system that should be more stable and more resistant to the current downturn. Certainly the whole industry is more diversified than it was a decade ago. Although community banks are still subject to some inherent limitations in this regard, the kinds of deep sectoral and geographic concentrations we saw in the early 1990s—concentrations that proved fatal for many banks—are much less evident today. In addition, noninterest income has come to play an increasingly important role in the composition of bank earnings. The industry has taken advantage of changes in the law and regulations to offer new products and services, thus diversifying their income streams and reducing their dependence on volatile net interest income.

This movement toward diversification has come as part of a dramatic overall improvement in most banks' risk management and mitigation capabilities. Bankers today—and not only the largest banks—are using more sophisticated analytical tools and computer models to manage increasingly complex risks. And bankers have far greater opportunity through the use of syndication and credit derivatives, and through the securitization markets, to design and structure the types of balance sheets and business franchises they desire.

Certainly there's basis for hope in all this that the national banking system will make it through the turbulent times ahead and continue to provide the credit that our economy so sorely needs to stage a full and timely recovery. Much will depend, of course, on how serious and protracted those challenges are. But at this stage, I remain optimistic—both about the fundamental strength of our banking system and the ability of the OCC to provide the right kind of supervision at the right time, to ensure that the public interest in a safe, sound, and competitive banking system is properly safeguarded.

If there is a potential risk in this picture, it's on the resource side. At the outset of my remarks, I alluded to the ability of banks to switch their supervision to another agency. Such accountability through competition can have the desirable effect of making the regulatory agencies leaner, more efficient, and more responsive.

But not all of the regulatory agencies are subject to the same incentives. The Fed and FDIC, who could charge for their examinations of state banks, as the OCC *must* do in the case of national banks, choose not to do so. Instead, they draw upon other funding sources to finance their supervision—funding, which in the case of the FDIC, is derived in significant part, perversely, from national banks. In effect, national banks pay not only for their own supervision, but for more than half of the FDIC's cost of supervising state banks.

The other problem with this arrangement is that is works pro-cyclically. When there is widespread stress in the banking system, as there was in the late 1980s and early 1990s, significantly increased supervisory attention is demanded and supervisory costs rise. As this occurs, healthy national banks, which already pay more than their state counterparts, face the prospect of substantial increases in assessments to pay the costs of more intensive supervision of problem banks. This creates a strong incentive to convert to a state charter. Such conversions, in turn, reduce the resources available to the OCC to fund increased supervisory needs.

We hope that this is one case in which history will not repeat itself.

Let me close by congratulating you on your decision to hold this event—an event in whose success I confess to having a selfish interest. For the better you understand what we do, the more likely you'll be able to assist us in doing our jobs better. In that way, we both serve the public interest.

Remarks by Julie L. Williams, First Senior Deputy Comptroller and Chief Counsel, before the McAuley Institute's 7th National Women and Housing Conference, on challenges faced by women in building and maintaining assets, Washington, D.C., November 9, 2001

I would like to thank Jo Ann Kane, a tireless advocate for low-income women and their families, for inviting me to speak here today. I am also honored to share the podium with two leaders in the community development arena—Sister Barbara Aires, a longtime advocate of socially responsible institutional investment, and Elsie Meeks, who has spent many years working to increase the availability of capital on Native American tribal lands.

I want to explore three related issues with you today. Where do women fit into the current financial environment? How do women, particularly low- and moderate-income women, successfully build and maintain financial assets? And how do women, as consumers and asset builders, *keep* those assets and avoid financial pitfalls such as predatory lending? I can think of no better venue to address these important questions than here, among a group of people who have dedicated themselves to improving the economic security of women and their families.

Women in the Financial Environment

Women have made enormous gains in the last 30 years on the political, social, and economic fronts. Women, as individuals, have the potential to become major financial players, and women, as a group, are a major economic force. Today, nearly 60 percent of all adult women are employed. While women made up 30 percent of the labor force in 1950, we now make up more than 46 percent, nearly half of the labor force today. The U.S. Labor Department reports that 99 percent of women will work for pay at some point in their lives. In recent years, retailers and financial services institutions have recognized the growing importance of women in the economy. Women spent $3.5 trillion on retail products and services in 1997, and advertising industry studies have found that women are the primary consumer decision-maker in more than *80 percent* of all households.

Homeownership rates among women are increasing. As of last year, 53 percent of women head of households owned their own homes, a figure that continues to show an upward trend. Thirty years ago, women faced tremendous barriers to purchasing their own home. However, the Equal Credit Opportunity Act, enacted in 1974, set the framework for increased access to home mortgages and other loans for women and minorities. For women, this legislation eliminated gender and marital status as factors that lenders could consider in the credit review process. Over time, this led to further changes by mortgage lenders to eliminate many of the historical barriers women faced when trying to obtain credit on their own. For example, mortgage lenders now treat as income the proceeds from part-time or multiple-job employment, alimony and child support, foster-care services, and rental payments received from boarders. In addition, mortgage products have been expanded to decrease the amount of savings required for down payment and closing costs.

On the commercial lending side, women, in increasing numbers, are gaining access to capital to start or expand their own businesses. Since 1987, the number of women-owned firms in the U.S. has more than doubled, with women-owned firms now representing 38 percent of all firms. Women-owned firms are found across all industries, and are experiencing the greatest growth in the construction, wholesale trade, and transportation industries. And while banks' market share of small-business loans has declined, the percentage of women-owned firms using bank credit has increased. As banks and other financial service institutions develop a growing recognition of the market opportunity of women-owned businesses, they are developing products and services geared specifically to women entrepreneurs. Banks and other companies are also increasingly recognizing women as investors, with marketing programs and investment products targeted toward women.

However, the challenge that women face in this new century is the need to maintain and build upon the economic gains of the last 30 years. The number and proportion of families in which a woman is the sole financial supporter of the household has grown. In 1996, nearly 20 percent of all families were maintained by women, up from 11 percent in 1970. Although the trend is encouraging, with the poverty rate for female-headed households dropping to a record low of 24.7 percent in 2000, women, particularly the elderly, are still disproportionately living in poverty.

The financial needs of women differ across economic strata, but all of these needs center on acquiring, expanding, and maintaining assets. And the ability to acquire and manage assets depends in a large part on education and access—being adequately informed as to how asset generation works, and being in a position to acquire and deploy assets. Naturally, there are a variety of financial products and services to fit the spectrum of women's financial needs—products that allow us to save, borrow, and invest effectively. Regardless of the need, whether it is opening a first savings account, putting away money for a down payment, investing in a new business, or planning for retirement, women need to gain a familiarity with financial products and services in the marketplace that will allow them to better handle financial needs.

Building Financial Assets

Asset creation can be viewed as a series of steps for the individual woman and her family, beginning with the need for short-term financial protection and then expanding to provide future financial security and financial opportunity. The starting point, and a difficult one for disadvantaged women, is a stable income flow to cover routine and expected expenses—the rent or the mortgage payment, the shoes and blue jeans, the utility bills, supper on the table, or a birthday celebration.

The first step consists of building savings and acquiring insurance to deal with next week's emergency or unexpected event, such as a health crisis or major car repair bill. With some protection against emergencies, a woman can then begin to think about her long-term future needs, including retirement planning. Today, retirement planning needs to take place many years in advance of a woman's actual retirement date, and means a lot more than depending on Social Security. Women need to take advantage of opportunities to participate in a pension plan at their place of employment or utilize Keogh plans and other options available to the women business owner, and make what personal investments they can, including investments in IRAs, or savings bonds, that will grow and provide future cash flows. But because they are often busy caring for others, women may have difficulty focusing on retirement planning. Social Security Administration surveys found that, as a group, women experienced the smallest gain in knowledge about Social Security following the annual mailing of Social Security statements. Women surveyed were interested in the statements, but did not read them carefully because they did not have the time.

The final step in building and maintaining assets is the acquisition of productive assets to expand future income and to leverage into additional asset growth. The major productive asset for most American families, including women-headed households, is ownership of a home, which allows the family to grow equity. Automobile ownership can be a vital asset, used to access a higher paying job, for the suburban or rural woman. Business ownership is a productive asset that is not limited to the wealthy. Finally, although it is a nonfinancial asset, investment in *human capital*, through the acquisition of education, is possibly the most productive asset of all.

How do women acquire productive assets? By leveraging their existing assets, whether tangible or intangible. By accumulating enough savings to make a down payment on a home. By developing a business concept and operating plan that will lead to financing from a bank, a loan guarantee by the SBA, or funding from a nonprofit organization. By having a stable enough environment, adequate childcare, the confidence, and the support to apply for a student loan or grant, and to attend classes. Through the assistance and caring of organizations such as the McAuley Institute, and the realization of profitable partnership opportunities between banks and community organizations.

Needs and Challenges of Low- and Moderate-Income Women

As women are now recognized as an established part of the financial landscape by the mortgage and commercial lending industries, greater attention has turned to the financial needs of low- and moderate-income women. As these needs gain greater attention from the marketplace, the availability of capital is expanding for low- and moderate-income women as well. Increasingly, low-income women are finding new products and services that are particularly relevant to their unique needs. These products may be provided solely by commercial organizations, or, as is often the case, provided through subsidy programs funded by foundations or the government, alone or in partnership with for-profit businesses. Some products are specifically tailored for women, while others are appropriate for the entire low-income market, in which women are, as noted, over-represented.

These products include individual development accounts, microenterprise loans, low down-payment, home-mortgage loans, and low-interest student loans.

It has often been said, in one form or another, that without assets, poor families are likely to remain poor. And while spending is unlikely to help anyone escape poverty, saving is the most common first step to economic mobility. But it is difficult to put away a portion of one's income when it seems like all of it, and more, is already allocated to paying for basic necessities. That is why programs and incentives to help people build savings, like those supplied by Individual Development Accounts, or IDAs, are critical. IDAs combine the incentive of matched participant savings with education and personal support from program staff and other account holders.

Low- and moderate-income women who operate their own small businesses out of the home, and have no banking history, may find that when they want to expand their businesses, banks may be unwilling to lend them money. Despite the ability of small businesses to create wealth and income for their owners, these microentrepreneurs drop through the cracks of conventional financing for a variety of reasons. They may have credit needs that are too small for a bank to profitably handle, flawed or no credit history, little collateral, incomplete financial records, or language barriers. However, partnerships between community organizations and banks have resulted in microenterprise programs that combine microlending with entrepreneurial training, mentoring, and on-the-job training to maximize the potential for self-sufficiency.

By far, owning a home is the primary means by which low-income Americans build long-term assets and increase their financial net worth. Homeownership is the primary means of accumulating wealth in the United States, and the most important financial asset that many women have is their home.

Through homeownership, women invest in an asset that can grow in value and generate financial security. As mortgage payments are made, the homeowner's equity grows and can serve as a financial base for other investments, including education. Homeownership programs targeted to lower-income individuals, such as the NeighborWorks' Section 8 Homeownership Program which allows section 8 vouchers to be used toward mortgage payments, are an important vehicle for expanding access to homeownership. Many of these programs, including NeighborWorks', report that a high percentage of their participants are women.

Along with the potential for asset appreciation, homeownership confers other benefits. It strengthens neighborhoods by increasing stability, keeping capital in the community, attracting outside investment, and raising property values. Homeownership is also positively correlated with civic involvement, self-esteem, and the sense of control that one has over her own life.

The Challenge of Maintaining Assets

Given how important home equity is as an asset for low- and moderate-income women, it is vital that once such a precious asset is acquired, it not be pirated away through predatory lending practices. We have seen tremendous advances over the last several years in credit availability. Not surprisingly, improved access to credit may mean higher loan prices for subprime borrowers whose credit profiles present greater risks. However, responsible subprime lending should not be confused with predatory lending. There are a great many responsible subprime lenders who make credit available at rates that reflect the costs and risks of such lending without engaging in abusive lending practices. But we do need to recognize that some of the characteristics that cause a borrower to be a subprime credit are also characteristics that may make that customer vulnerable to abusive lending practices.

Consider the example of the elderly woman whose home is badly in need of repairs. With not enough cash on hand to pay for them, the homeowner is steered to a lender who arranges a refinancing loan for debt consolidation and home repairs. The homeowner pays 3 points on the loan and the loan carries a prepayment penalty. A few months later the homeowner is convinced to refinance the loan again. The new loan is for a higher principal amount, and the borrower is forced to pay the pre-payment penalty on the original loan as well as another 2 points in fees in the new loan. This is the practice known as equity stripping.

Because of schemes such as these, the challenge of maintaining assets, especially for financially unsophisticated individuals, has become at least as important as the challenge of building assets. Elderly female homeowners are primary targets for predatory loans, as many of their homes have little or no mortgage debt. These women are likely to have incomes of less than $30,000 and equity of $100,000 or more. They are vulnerable to predatory lending because they face bills from medical expenses or repairs to their older homes. To pay off their debt, they have to tap into their home equity. However, their knowledge of financial alternatives is sometimes limited, and thus they may unknowingly replace unsecured credit card and personal loan balances with secured debt using their home as collateral. This is an attractive market for lenders as estimates based on the American Housing Survey suggest that elderly female single person households hold approximately *$570 billion* in home equity.

One of the most important ways you can make homeowners aware of predatory lending practices is to help them recognize a loan with abusive features. The term "predatory lending" is often used to refer to a wide range of practices and does not lend itself to a clear or simple definition. These practices include, but are not limited to:

- Loans made in reliance on the value of the borrower's home or other collateral, without a proper evaluation of the borrower's ability to repay;
- Pricing terms—whether interest rates or fees—that far exceed the true risk and cost of making the loan; and
- Inadequate disclosure of the true costs and risks of the transaction.

Other abusive features include the improper use of credit life insurance, balloon payment structures that leave the borrower owing most of the principal amount at the end of the loan period, and repeated refinancing which can occur from an inability to meet either the monthly or the final balloon payment. Each of these products has a place in mortgage financing, when used in an appropriate manner. For instance, while balloon payments make it possible for young homeowners to buy their first house and match payments with a rising income stream, they can spell financial disaster for those whose income is not likely to rise significantly. Likewise, refinancing enables borrowers to take advantage of lower interest rates, but they can be used inappropriately to repeatedly flip borrower's loan, resulting in high loan processing fees and other unnecessary costs.

Addressing the Challenge

Without a doubt, government has a role in addressing abusive lending practices, but by no means does it have the only role. The majority of these loans are made by lenders over whom the federal banking agencies have little control. Unlike regulated financial institutions, many nonbank lenders do not undergo periodic compliance examinations. I can report, however, on steps the OCC is taking to limit the involvement of national banks in these lending practices.

The OCC issued guidance directing our examiners to review bank lending policies to ensure that they do not permit loans to be made or purchased for which there is no reasonable expectation of repayment without resort to collateral. We have alerted our examiners to look for practices such as collateral or equity stripping and the use of pricing terms that far exceed the lender's true risk and cost.

Likewise, we have made it clear that national banks should not make or purchase loans having these characteristics. We have emphasized that such loans violate safety and soundness standards and increase the risks of unlawful discrimination. And indeed the industry has responded in a variety of ways. For example, several large lenders have discontinued offering single-premium credit insurance. We are also encouraged by lenders that establish "two-way" referrals in which an applicant who qualifies for a prime loan will be referred by the subprime lender up to the prime lender, rather than referrals only taking place in the other direction.

In the same vein, we encourage industry efforts to develop standards for best practices for the subprime lending community, in order to eradicate predatory lending at the source. I note that Treasury Assistant Secretary Sheila Bair just yesterday applauded this type of industry effort and commented that for regulated depository institutions, such best practices might be incorporated into bank supervisory standards and enforced through the supervisory process.

The OCC has also taken enforcement actions against banks that we believed were engaged in unfair and deceptive practices in violation of the Federal Trade Commission Act. Finally, we will continue using our chartering and licensing authority to ensure that subprime lending by national banks and their subsidiaries is conducted responsibly and with appropriate consumer protections.

Through education and counseling, organizations such as the McAuley Institute are playing a tremendous role in helping consumers recognize abusive lending practices. Financial literacy programs enhance consumer financial skills and provide individuals with a better understanding of the financial products and services that meet their needs. Understanding the range of available financial products and services enables consumers of all income levels to make better-informed choices in the financial marketplace.

Many of you here today are on the front lines in efforts to combat abusive lending practices. Those of you who support McAuley's Women's Homeownership Campaign are working with a program that includes many of the asset building and maintenance techniques I have discussed today. By providing technical assistance and training to local organizations, the McAuley Institute enables a large number of groups across the country to provide the counseling, educational services, and funding that can help low-income women obtain the benefits of stable, affordable homeownership.

Conclusion

Today, I've discussed the financial progress of women, outlined ways for low- and moderate-income women to participate in that progress through asset building and maintenance, and addressed the serious issue of abusive lending and its potential to rob low- and moderate- income women of the precious gains that they have made.

It is critically important that organizations such as McAuley continue teaching women the importance of building and maintaining equity in their homes. In addition, many banks have worked with community organizations and governmental agencies to develop financial literacy programs or provide employees to serve as educators and trainers. Others support financial literacy organizations through volunteer staff assistance, loans, and contributions. Building partnerships is what makes these programs work. The OCC will continue to allow our institutions to be flexible, innovative, and to try new products that help low-income individuals become part of the financial mainstream. Together, community organizations, banks, and government can draw the best from each other to help all of our Nation's residents build and maintain the assets that will provide financial security for themselves and their families.