Speeches and Congressional Testimony

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Of the Comptroller of the Currency

Remarks by John D. Hawke, Jr., Comptroller of the Currency, before the Independent Bankers Association of Texas, on the OCC's relationship to community banks, San Antonio, Texas, September 23, 2002

I'm sure that Independent Bankers Association of Texas (IBAT) was as relieved as any group in America when we heard the announcement that the players' union and the major league baseball owners had reached a settlement in their labor dispute. After all the work that had gone into developing this year's conference theme, it would have been a real pity had it come to stand as nothing more than a reminder that the national pastime had shut down for the season, disappointing millions of fans and putting thousands of people out of work. Thankfully, the games continue, the playoffs and the World Series loom, and I'm pleased to be joining IBAT once again, at its own annual fall classic.

As we contemplated the possibility of a baseball strike, I heard plenty of speculation that another strike might spell the demise of baseball as we know it—that this time, the fans might cast the final vote with their feet. Frankly, I never thought there was much chance of that happening. Despite the economic challenges that the game faces, it's always been part of our national identity.

Of course, people once said the same thing about cock fighting, corn husking, and minstrel shows—once popular pursuits that no one pursues any more. It reminds us tastes and habits change—that nothing is forever.

The question that has been much discussed of late is whether community banking will share in the fate of other venerable institutions overtaken by time and events—or whether it can marshal the endurance, adaptability, and political support necessary to avoid such a fate.

Certainly there's no shortage of pessimists about the future of community banking—and little dispute about some of the particulars of their basic argument. Community banks are disappearing at an alarming rate—nearly one a day, on average. Some have fallen to merger and acquisition, while others have succumbed to weak fundamentals, such as shrinking loan margins, a consumer mentality that focuses on small differences in price to the exclusion of all other considerations, and, above all, the absence of the economies of scale that might otherwise make the numbers work.

Let me give you an example I can speak to with some authority. In terms of your overall expenses, the cost of regulatory compliance ranks pretty far down the list. At least I hope it does. But it's a conspicuous cost because—to be frank about it—it's a cost whose benefits aren't always obvious.

Year after year, our friends in Congress add new mandates for consumer protection, community service, and more, and expect the regulators to enforce them. But the costs all come back to you, in the form of the people you have to pay to do the extra legwork and paperwork the law requires, and in the form of the supervisory assessments you have to pay *us* so that our examiners can certify that you're in compliance with the law.

Big banks don't like this any better than small ones do. They just don't seem to feel it as much.

Community banks *are* feeling these pressures more than ever before, partly because they are more exposed to big bank competition than ever before. There are no sheltered markets anymore—only places your competitors have chosen not to go. The advent of true nationwide branching is one manifestation of that; improvements in technology, which bring remote delivery of financial services within reach of millions, is another; and the removal of statutory prohibitions on the types of products and services that integrated financial institutions can offer is a third. Together, these market and regulatory changes add up to what is probably the most challenging competitive environment for community banking in decades.

A cursory look at the numbers here in Texas—one of the nation's traditional strongholds of community banking—seems to support what the analysts say about the unstoppable momentum of financial services consolidation and community bank evaporation. In 1998, there were 798 commercial banks in operation statewide. As of the middle of this year, the number was down to 675—a drop of nearly 15 percent. Roughly 13,000 fewer people work in Texas banking today than four years ago. Some of those same people might have once worked for you.

But to me the remarkable thing is not that there's been some contraction in the banking industry. Given the number of banks with which we began, contraction was a foregone conclusion, especially in a softening economy.

And the Texas economy, while no softer than most, has been affected by a variety of circumstances unique to it. I'm speaking now of the state's heavy reliance on agriculture, which has been buffeted by drought and low commodity prices; weakness in the Mexican economy, to which the state's fortunes are so closely linked; and fallout from the collapse of Enron and related businesses.

In light of these bumps and bruises, I think we should be focusing on a different set of numbers—the actual performance and condition ratios of Texas banks. They tell a story of resilience and underlying strength—notwithstanding the dire pronouncements of the industry analysts.

Consider *these* 2001 numbers, using 1998—a strong growth year—as a comparative benchmark. Return on equity, up. Return on assets, up. Net charge-offs, down. Capital, up. Noncurrent loans, down.

And the outlook for the near term is equally positive. Many of you have reported a recent surge in retail deposits, as individual investors seek sanctuary from the turbulence on Wall Street in banks on Main Street. Coupled with rising loan demand, which seems likely as the national recovery gains speed, community banks in Texas and throughout the country may be poised to realize major gains to the bottom line.

Some would have you believe that community bankers have done nothing more than to prove the importance of good timing, suggesting that you've been accidental beneficiaries of trends you've had no hand in shaping. I don't share that view. I believe, rather (and the numbers confirm this), that the community bank business model, with its emphasis on personal service, is fundamentally sound. I believe that the skill that bankers like you have brought to the business has been instrumental in proving the so-called experts wrong—at least so far. Most of all, I believe that the role you play in the markets you serve is crucial to the health of our communities and to the national economy. Your ability to react quickly and rationally to local credit needs, to price fairly, and to provide customers with a wide range of banking and related financial products, is indispensable—and irreplaceable.

I should hasten to add that while all of these factors have played a role in your past success, none of it guarantees that this success will continue. As I've said, people's habits do change—whether it's the games they watch and play or the way they save and invest.

In my view, the value you contribute is too important to be left to chance or to the sometimes-merciless whims of the marketplace. So I believe that the regulatory and legislative policies of our government must explicitly embrace the interests of community banks—much as we have embraced the interests of family farms or small business generally—as a matter of fundamental national importance. Without taking anything away from your great skills as bank managers, I am convinced that such an embrace is crucial to the continued success—and long-term survival—of our nation's community banking sector.

I am not in any way implying that the interests of community banks should prevail at the expense of large banks. Big banks make their own outsized contribution to America's international competitiveness and economic health. Supporting one sector of an industry is not equivalent to oppressing another. The goal of economic regulation, after all, is to achieve the appropriate parity between efficiency and equity—a goal that's consistent with recognition of the fact that our supervisory and regulatory policies have disproportionate impact on the well-being of community banks.

Some may accuse the OCC of being a latecomer to this view. There seems to be a notion out there—and it's nothing new—that we're "the big bank regulator," and that we're less attuned to the needs and concerns of community banks than, say, our colleagues at the state banking departments and at the Federal Deposit Insurance Corporation (FDIC). But let me ask you this: can we be accurately referred to as the "big bank regulator" when nearly 2,000 of the 2,300 national banks that we're responsible for are community banks with assets under $1 billion? And half of *that* number—1,000 national banks—holds less than $100 million in assets.

And is it fair to characterize the OCC as indifferent to the needs of community banks when more than 1,300 of our examiners—nearly 80 percent of the OCC's total examination force—is dedicated to community bank supervision? I'm referring to 1,300 highly trained professionals, men and women who are widely acknowledged to be the very best in the business at what they do. Most of them have deep roots in the communities whose banks they serve.

I should add that we restructured our procedures several years ago so that those same local examiners and front-line supervisors—we call them assistant deputy comptrollers (ADCs)—make 90 percent of the decisions that affect your institutions. That move was designed to take advantage of the depth of experience—averaging more than 20 years—possessed by our ADCs.

I don't think we can fairly be accused of being unresponsive to the banks we supervise when, in 2001 alone, the OCC sponsored nearly 200 outreach events around the country—a number that doesn't include the many events sponsored by others that we attend or the dozens of meetings that we hold with state banking associations delegations when they come to Washington. I was pleased to welcome a large IBAT delegation to our offices just a few months ago and look forward to welcoming you back. Let me assure you that there will always be an open door—and a warm spot in our hearts—for IBAT at the OCC.

In our case, numbers alone—the number of smaller banks that we supervise and the number of examiners assigned to them—tell only part of the story of our commitment to the health of community banking. It's reflected in our whole approach to supervision, which draws on procedures formulated especially for community banks. These procedures take a risk-focused approach that allows for streamlined, efficient examinations. We focus on practices and outcomes—an approach designed to get examiners in and out of your bank as quickly as possible with the information that they need to provide effective supervision.

Our commitment to community banks is also reflected in our sensitivity to regulatory burden—and an appreciation of how profoundly community banks can be affected by it. Today we don't issue a regulation without first conducting a community bank impact analysis. When we find that the costs of a given regulation to community banks are out of proportion to the benefits that regulation is likely to bring to the industry and the public, we'll step back and reconsider it.

Technology offers tremendous potential for reducing regulatory burden, and we're aggressively exploring possible ways to automate supervisory communications and the examination process itself. I believe that the day is not far off when most of the exchanges between bankers and regulators will take place through systems like the OCC's National BankNet. Before much longer you'll be able to comment on proposed regulations, pay your regulatory assessment, and file corporate applications—all on line.

And we're working to give examiners the ability to perform even more of their routine supervisory duties remotely. That will mean fewer burdens on you—less staff time preparing for exams, less time producing paperwork, and a less intrusive examiner presence on site.

Burden reduction was an important consideration behind the adoption of our "Canary" early warning system—a system that, as many of you have heard, is designed to enhance our ability to identify and respond to emerging risks. Canary enables us to zero in on those banks that have the greatest amount of financial risk and the greatest possibility of problems. By the same token, it also enables us to avoid imposing undue burden on well-managed institutions. If your bank is one of those—and the vast majority of community banks fall squarely into the well-managed category—Canary can result in real reductions in regulatory burden.

But I can assure you that whether yours is a troubled institution, a problem-free institution, or something in between, your examiner will be there for you. No matter how much technology enables us to conduct supervision remotely, an on-site presence will always be a central component of the supervisory relationship.

Many bankers prize that relationship. They tell me that they use our examiners like all-purpose consultants—and for good reason, because in the ranks of OCC examiners are men and women whose expertise on a whole range of banking subjects is recognized throughout the nation and around the world. I know that some banks opt for a national charter precisely because the organizers know they can count on expertise furnished by our examiners to help them make it through the always-challenging start-up period.

But community banks that are also national banks pay for the privilege—and pay more than they should have to, in my judgment. The unfair financial burden that you bear is the result of what I believe is a serious flaw in our whole system of bank supervision. Although the OCC assessment schedule is progressive—that is, large national banks pay more than their pro rata share of the costs of their supervision—the assessments you pay as national banks are still considerably higher than you'd be paying under a state charter. You know this, and so do we.

This fee disparity is the result of a system under which the Federal Reserve and the FDIC provide the federal supervision of state-chartered banks—indeed, they perform for state banks virtually every function we perform for national banks—but they don't charge those banks for their services. Instead, the resources used by the FDIC for this purpose are provided in large part by *national* banks, which account for more than half of the balance in the Bank Insurance Fund. In other words, national banks are effectively subsidizing the supervision of your state bank competitors.

And because the states themselves actually provide only a small part of the total supervision their banks require, the states can afford to charge less—much less—than a comparable national bank pays to the OCC, which provides *all* of its supervision.

We believe that this arrangement is patently unfair to national banks and harmful to the dual banking system, and I have repeatedly urged Congress to address this issue in the context of deposit insurance reform. Everyone agrees that banks should contribute to the insurance funds based on the risks they present, and that healthy banks should not be required to bear the costs and risks of providing deposit insurance to poorly managed institutions. We strongly believe that the same principle of equity should apply to supervisory assessments as well and that the fee disparity between national and state banks should be eliminated.

Let me emphasize that the OCC is not proposing—and never has, as long as I've been Comptroller—that the fee disparity problem be resolved by charging additional fees to state banks. Our proposed solution, which would draw on FDIC revenues to fund *all* supervision, would benefit state banks every bit as much as national banks.

Our commitment to community banks is also reflected in OCC policies designed to assist national banks in keeping up with the demands of a highly competitive financial marketplace. For example, we launched a pilot program that allows national banks with the highest supervisory ratings to exceed the customary 15 percent limit on loans to a single borrower where the limit is higher for state-chartered institutions. It was designed exclusively for community banks, which may now be in a position to compete favorably for larger borrowers who previously had to go elsewhere to meet their financing needs.

It's just another way that the OCC has "stepped up to the plate" to support the interests of community banks.

I opened my remarks by suggesting that the coming years would be decisive ones for community banks—and for the organizations, like IBAT, that speak for them. In that vein, let me offer one final thought. While regulatory sensitivity to community banking's unique needs is important, the future of community banking in America will not be determined by government action—or inaction. All the government support in the world won't be enough if your customers feel ill served or inadequately served banking with you. They will regret it if they have to go elsewhere to have their financial needs well and comprehensively met, but most of them will go nonetheless. The challenge for community bankers is to help your customers make the decision that's right for them—and right for you.