

NR 98-104
October 16, 1998

Acting Comptroller Warns Against Lowering Guard Against Bad Loans

SAN FRANCISCO -- Acting Comptroller of the Currency Julie L. Williams said today that bankers and regulators "must not succumb to the temptation to declare victory over lax underwriting of new loans."

Although some recent reports have suggested that bankers have begun tightening standards, the conditions which led to lax credit practices -- a fundamentally strong economy, robust consumer spending and high levels of liquidity -- still exist, she said. Ms. Williams disagreed with those who have suggested that regulators should stop talking about lax loan standards for fear that credit will dry up at a time when the economy may need the stimulative effect of bank lending.

"Let me make this clear: our only interest in criticizing bad loans is to ensure that banks retain the strength they need to continue to make good loans -- loans that are crucial to maintaining a sound and competitive national economy," Ms. Williams said in a speech before a risk management conference sponsored by the Federal Financial Institutions Examination Council, which represents the federal supervisory agencies on regulatory issues.

The acting Comptroller added that the near collapse of a large hedge fund, Long Term Capital Management, or LTCM, offers a cautionary tale about the importance of sound underwriting, as well as the swiftness with which markets can penalize financial institutions that fail to protect themselves against excessive risk.

Ms. Williams said the lessons of the LTCM situation are just as meaningful for the community banker with a portfolio of small business and consumer loans as for the money center institution that deals in sophisticated hedging instruments and derivatives contracts.

"Money center bank or community bank, the principles of risk management are the same," she added. "Regardless of the size of the credit, the decision on whether to extend it must be made on the basis of the underlying risk of the transaction."

Ms. Williams also cautioned bankers against relying too heavily upon computer models that appear to eliminate risk. While valuable, risk modeling techniques may have been oversold in the case of LTCM, she said.

"Technology is just a tool; an adjunct to -- not a substitute for -- the sound judgment of bankers and basic techniques of risk management," she said. "The fact that a borrower or counterparty employs sophisticated modeling techniques in its business is no substitute for a lender having collateral to protect its position in the event that the borrower's financial condition comes under

stress. And, again, that applies to small banks as well as large ones."

Ms. Williams stressed that, "the strength of our economy does not depend upon bankers making bad loans. In fact, poorly underwritten loans are one of the best ways that I know of to weaken financial institutions and the communities that depend upon them."

"A healthy banking system will ensure that worthy borrowers never have to worry that the credit they depend upon will not be there when they need it," she added.

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