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Remarks by

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We are blessed in the banking world with many fine industry organizations, and over the past five years, I have had the honor of speaking to a number of these groups. But I have always particularly looked forward to speaking to IBAA.

Your accomplishments are impressive. You have developed products that help keep community banks on the cutting edge of the financial services industry. You have lent your voice -- clearly and forcefully -- to our national debate over financial services modernization. You have worked tirelessly with me and others to minimize regulatory burden and to ensure that community banks have the organizational flexibility they need to serve their customers well into the next century. Ken, to you and your hard working associates in the IBAA, let me say congratulations -- and thanks.

What I would like to do this morning is to draw upon the experiences of my five years as Comptroller and talk about the future of banking generally and community banking particularly. I do so in full awareness of the perils of the enterprise. Predictions that go awry can become a source of acute mortification. In 1901, less than two years before their historic flight at Kitty Hawk, Wilbur Wright told his brother Orville that it would be 50 years before man would fly. "Ever since then, " Wilbur said to an interviewer a decade later, "I have distrusted myself and avoided all predictions." Wilbur evidently concluded that it was safer to go up on that first rickety flight than it was to go out on a limb about the future. I can understand that. As investor Warren Buffet is fond of noting, "in the business world, the rear-view mirror is always clearer than the windshield." Of course, Buffet would not have gotten where he is today without some sixth sense pointing him in the right direction. The rest of us who lack that instinct will have to work at it, using whatever acumen and insight we can muster in our efforts to identify the signposts to the future.

Though the task may be daunting, I will try today to look through the windshield and shine the headlights on some of the changes, pitfalls and opportunities that I see for banking in the 21st century. I then want to suggest some steps that should be taken if bankers are going to avoid the pitfalls, seize the opportunities, and retain the important place they hold in supporting the people and the economy of the United States. Finally this morning, I will also take a look at the rear view mirror and say a word about what I have tried to accomplish during my term as Comptroller.

Changes Shaping the Financial Environment

First, where are we now, and where are we going?

We are living through a particularly dynamic and innovative period in our financial history -- the result, I believe, of the convergence of three important changes that have taken place in our lifetimes and will undoubtedly continue to shape the financial services environment for a long time to come.

The first is technological change. Finance is fundamentally an information-driven business, and the costs and speed of processing information have changed dramatically for the better. Over the past 20 years, computer costs have halved every 18 months -- which means that every 18 months, you can buy twice the computing power for the same dollar. In the early days of the computer era, this doubling transformed what had been a little more than a high-tech calculator into a management and information storage tool. Today, the increase in computing power can make for fundamental changes in businesses themselves. And the future seems to hold still more rapid improvements in computer power, with the advent of copper silicone technology. This should have at least as dramatic an effect on future business -- especially the information-driven financial services business -- as it has on business in the past.

The second major change affecting the financial services industry is the rapid globalization of the financial marketplace. Where once there were only one or two financial nerve centers, today there are many. The Financial Times tracks no fewer than 53 global stock exchanges, including bustling markets in China and Russia, Sri Lanka and Zimbabwe. Insomniacs can trade stocks or futures at virtually any hour of the day or night, for the markets never close. Problems in one part of the world affect markets almost instantaneously worldwide.

The final ingredient in the brew is the change in the tastes and attitudes of consumers toward financial

products. This is partly a function of our nation's changing demographic profile. By the year 2010, one-third of the U.S. population -- and more than one-half of the population of some states, most notably California -- will be made up of members of various minorities. This is a population group that, for various reasons, has traditionally been poorly represented among the customers of financial institutions. At the same time, the U.S. population is growing older. By the middle of the next century, one out of every five Americans will be a senior citizen -- more than 80 million strong. These older Americans will have financial needs and desires that are significantly different from those of their younger counterparts -- for example, for new insurance products and greater safety in their investments. And by the time today's technologically savvy young people come of age in the first years of the 21st century, shopping and banking on the Internet will be as common for them as writing a check is for us today.

Impact on Banking

What do these changes mean in practical terms for the banker of the 21st century?

First, banking institutions will have to be more nimble and innovative in order to meet the demands of a fast changing financial marketplace. That means, on the retail side, developing new products, services and delivery systems that appeal to a more diverse customer base -- a population that is older, more ethnically diverse, and technologically sophisticated. The financial consumer of the future will have a wider range of choices when it comes to spending, saving, and investing. For example, credit and debit cards will increase their already impressive penetration into the retail market, as will more sophisticated market-oriented savings vehicles, such as mutual funds and retail-oriented derivatives; electronic money and Internet finance will alter traditional modes of financial exchange. These changes pose both opportunity and challenge for financial institutions.

On the commercial side, with the continuing erosion of what once was the core business of banking -- lending money directly to business -- bankers will need to be even more innovative in finding ways to serve existing business customers, identify new business markets, control risk, and generate income. Already, bankers are relying increasingly on fee income as interest income declines. That trend will continue and accelerate; fewer and fewer loans will be held to maturity, as securitization, which increased five-fold between 1990 and 1997, becomes even more widespread. The increase in the volume and variety of derivatives, whose notional value increased by a phenomenal 158

percent between 1992 and 1997, to more than \$25 trillion, is likely to continue into the next century.

Certainly the future banker will face greater competition for the customer's business on both the retail and the commercial sides. Some of this new competition will be the result of the technological changes I mentioned earlier. Because of advances in data processing, the information needed to make prudent and profitable loans is now more readily available, and less costly to access, than ever before. Increasingly, competition will come from companies that have not been traditional financial services providers, such as telecommunications companies and software development firms.

At the same time, we will see a continuation of the trend toward more fully integrated financial services providers offering more diverse menus of products and services, including those traditionally provided by banks. Before long, it will not be unusual for consumers to obtain, say, a home equity loan from the securities firm with whom they do their stock trading or from the finance company that issues their credit card. In short, the lines will continue to blur among the various categories of financial providers.

Furthermore, bankers will face greater volatility in more areas than ever before, especially in the funding arena. All the data I have seen points to a growing gap between traditional deposit sources of funding and loan growth. As a consequence, community banks will become more and more reliant on other funding sources, such as brokered deposits and securitization. And these nontraditional funding sources will expose bankers to competitive pressures and volatility on the liability side that they have not experienced before.

Challenges for Bankers and Regulators

All of these changes and future trends portend challenge for bankers and bank regulators. What must we do to ensure that our banking system remains a robust contributor to our nation's well-being into the 21st century?

First, you as bankers must have the ability to compete on a truly level playing field. It is critically important that banks have the freedom to respond to the changing market of the future. If banks are unable to offer the products and services their customers want and need, they will be marginalized at best. At worst, they will be forced to go further out on the risk curve in declining sectors of the financial business and their very survival will be threatened.

But the freedom to respond to the demands of the marketplace is no freedom at all if banks are loaded down with so many restrictions that they cannot compete fairly with other market players. With your thin margins, small staffs, and low overhead, community banks especially have a low tolerance for inefficiency -- especially when inefficiency is the result of regulations that do not apply equally to your competitors. You have to be able to manage your business in the best way you know how, utilizing whatever corporate form best suits you. You should not be imprisoned in the holding company form or the op sub form or any other form unless it is absolutely essential for safety and soundness reasons. Absent proven safety and soundness concerns, our laws should be based on consumer well-being and sound business, marketplace principles -- not on regulatory convenience.

We simply cannot allow interest group politics and needlessly restrictive legislative language to deprive you of the right to operate your business your way. We must work to safeguard your basic right to operate productively in our free market economy. You cannot afford to take any steps backward where your organizational flexibility is concerned. To do so would jeopardize your very survival in the dynamic financial world of the future.

Second, and just as critical to the survival of banks in the 21st century, is a commitment to the fundamentals of safe and sound operation. Banks must focus resolutely on the measurement, management, and control of risk. You must never lose sight of the fundamentals of safety and soundness. You must never overreach for short term profitability or growth. The markets of the future will be unforgiving to those who stumble. Second chances will be harder to come by. You simply cannot afford to be lax in your underwriting or in your management of risk.

In this regard, let me emphasize that I consider the slippage we have seen in underwriting standards around the country and that I have been speaking out about to be a very serious matter. For some time now, we have been identifying worrisome trends in virtually all phases of the lending process and across the whole gamut of loan products. We see razor-thin interest margins, lengthening tenors, highly-leveraged transactions, and undue concentrations. Our examiners have heard too many bankers say that they were making loans which, in the best case, would yield little or no profit, but which they were making anyway out of fear a customer may be lost to the competition. And I am personally quite concerned about bankers going into new credit markets, such as subprime automobile finance or high loan-to-value home equity

lending, before they have acquired the necessary expertise to control potential risk to the bank.

While we are on the subject of safety and soundness and future risk, let me take just a minute to remind you once again about the risk posed by the century date change. I know that some people think of Year 2000 as a technology issue, and, narrowly defined, it is. But for banks, it is first and foremost a safety and soundness issue. All the experts tell me the same thing: a failure to deal now and deal aggressively with the Year 2000 problem could threaten the viability of your institution.

Especially among community bankers, our examiners are finding a worrisome reliance on the verbal assurances of outside contractors who service their information systems that all will be well when the new millennium arrives. To those who are tempted to rely on such assurances, let me say this: don't take anyone's word for it, any more than you would take the word of a borrower that a loan will be repaid on time. Get a plan and get it in writing. It's your responsibility to ensure that your systems are up and running to serve your customers when the calendar turns. If you fail to do this, the future of your bank is in jeopardy.

Third, for banks -- and particularly community banks -- to survive as robust players in the financial marketplace of the 21st century, they must stay connected with their customers and their communities. Even more than in the past, customer focus is the key to successful community banking. And that will not be easy in view of the changes in demographics and in customer needs and tastes that I have already discussed.

In this connection, let me make two points. Community bankers have a deserved reputation for individual personal service. Customers count on you for sound advice, a sympathetic ear, and products and services that meet their needs. But, in the light of the changes taking place in the financial world, you cannot afford to be complacent. The best way to ensure that your current customers will be your customers of the future is to build on the personal relationship that you have today. That might mean getting out from behind your desk and spending some time at your customers' workplace or business to learn first hand about the challenges he or she really faces and what your bank can do to help. It will take extra effort, but the payoff, in the form of a loyal lifelong customer, will be worth it.

The second point speaks to community outreach. Many of you do an outstanding job serving all segments of your community. But in many cases, there are

opportunities to do more to serve the entire community -- good business opportunities to provide credit and other banking services where such services have not been widely available in the past. This is not merely a matter of compliance with the law; it makes good business sense.

If all of this sounds like a tall order, it is. But you have resources at hand that can assist you -- your innate abilities, your strong institutions, and -- yes -- technology. So far, I have spoken of the information revolution primarily in terms of challenge -- as a source of new competition and as a clock ticking toward the Year 2000. Let me suggest that technology might also hold some of the answers. There is a natural tendency to think of our information systems as labor-saving devices that enable bankers to cut costs and achieve administrative efficiencies. But we should also think of technology as a labor-enhancing rather than a labor-saving tool. Technology is no substitute for personal service, but it can be an important adjunct to it. Contrary to conventional wisdom, the proliferation of technology can help bankers provide more personalized service by identifying changes in customers' personal or business situations and in reaching out to new customers in the broader community.

Lessons of the Last Five Years

Having described what I see through the windshield, let me close by looking into the rear view mirror and reflecting on my five years in office, in the hope that what I've learned can be of value to you and to others.

The year before I took office in 1993, 50 banks failed. Banking had suffered through more than a decade of decline and failure. We were in the middle of a credit crunch so severe that it threatened the viability of the small business sector in some parts of the country and denied many low and moderate income Americans the dream of owning a home or starting a business.

Strong medicine was needed, and so we launched the four-part program that became known as the OCC's Four Pillars -- a program to improve safety and soundness supervision, reduce regulatory burden, relieve restrictions that prevented banks from competing, and ensure that financial services were provided on a fair basis to all Americans, rich and poor alike. We have been able to achieve some successes in each of these areas. We have improved our safety and soundness supervision through supervision by risk and targeted guidance in such areas as derivatives and mutual funds. We restructured our supervisory program to better

differentiate between the supervisory needs of community banks and those of larger banks. By rewriting all our rules, establishing an Ombudsman, and reducing paperwork requirements and fees, we have achieved a significant reduction in regulatory burden that should help you succeed in the more competitive financial environment of the future. Through our legal interpretations, banks -- including community banks -- are in a better position to meet the needs of their customers by entering a variety of new business and taking new approaches to existing businesses. And we have worked to ensure that banks serve their entire communities, profitably and productively.

Certainly my five years as Comptroller have been busy and exciting ones. Many of the things we have done stirred controversy. That was never my intention -- but it was probably unavoidable. When you try to make changes, you're bound to make some people unhappy. And I firmly believe that you cannot be deterred from doing what you believe is right by a fear of opposition or unpleasantness.

For many years before I came to this office, there was a common assumption about the OCC: that it could take the side of the bankers or the side of the people, but it could not take both sides at once. When I became Comptroller, people were interested in what my choice would be. But that dichotomy always struck me as a false and pernicious one. I viewed my role not in terms of serving any single constituency, but, instead, in serving the public interest, and in so doing, having an opportunity to advance the well being of all relevant parties.

Let me explain. Too often, we look at a regulatory issue as if it were a football game in which one side inevitably wins and the other loses. I think this is a mistake. What we should do instead -- and what I have tried to do -- is to look for ways to ensure that, without compromising basic principles -- indeed, by holding on to basic principles for dear life -- all legitimate parties to a problem can emerge as winners.

For example, safety and soundness has long been viewed as an either/or proposition. In order to achieve a safe and sound banking system, it was widely believed regulators had to impose detailed regulations and narrowly restrict innovations that might expose banks to new kinds of risk. In other words, either the bankers win or the regulators win.

In fact, handled properly, achieving a safe and sound banking system can be a win/win for both parties. By focusing on strategies like burden reduction and supervision by risk, both sides win, and safety and soundness is strengthened. Indeed, I would go further

and say that by holding on to core principles and working to achieve a win/win, we have a much better chance to achieve our goal, and the public interest is better served, than if we pursued another strategy.

Although many things have taken place during my five years as Comptroller, I believe the win/win regulatory paradigm is worthy of particular note.

Of course, the idea that free market economics is a zero sum game, with a loser for every winner, was not unique to banking and finance. For many years, unfortunately, this adversarial mentality characterized labor relations in this country. In the consumer marketplace, mutual distrust between big business and consumers was pervasive, and consumer protections of any sort were seen as almost inherently hostile to the interests of business. In this emotionally charged environment, those who spoke out in favor of cooperation -- on either side -- were denounced as traitors to their cause. The middle ground became a precarious place. And this partisan approach to solving problems inevitably spilled over into government, which competing interest groups held to the same uncompromising -- and specious -- standard of loyalty.

It has taken a long time for us to free ourselves from the mind set of confrontation and polarization. Only of late have we begun to appreciate that, to be truly successful in the competitive global economy, all parties to the social compact -- business, government, interest groups, and individual Americans -- can and must work together for the common good. Only of late have we come to recognize fully the virtue of bringing the parties together -- helping everyone to recognize that what's good for one can be good for all.

That's especially true in banking and finance. When banks gained the ability to market mutual funds, everyone concluded it was a big setback for the securities industry, which would presumably lose customers to the banks. Instead, banks have attained a rather stable portion of the mutual fund business, but the mutual fund market has continued to grow, benefitting all sellers and buyers alike to a greater degree than might otherwise have been the case. Or, to cite another example, community groups, which long begrudged bankers their profits, discovered that a prosperous banking system is essential for socially desirable projects to be funded. Meanwhile, for their part, bankers are finding that such desirable projects -- affordable mortgages, small business loans, redevelopment projects, and the like -- are good business. In both of the instances I have cited, regulatory efforts have achieved results that are a win/win.

As I said at the outset, for all of our attempts to fathom it, the future is essentially unknowable. But I am convinced that the path on which we have set out together is one we can travel with confidence into the next century. It has been a very great honor for me to serve as Comptroller of the Currency. I have an enormous respect for the people I have tried to serve and for my colleagues in bank supervision. It is my hope that my efforts have helped to make things a bit better for you and for the people of this wonderful country.

Thank you.

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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 56 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.