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Oral Statement of

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Of the

Committee on Banking and Financial Services

of the

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Madam Chairwoman and members of the Subcommittee, I appreciate this opportunity to testify on bank examination and supervision systems at the OCC. Supervision is our primary tool for making sure national banks remain safe, sound, and competitive, and the industry continues to support the citizens, communities and economy of the United States. I commend you for holding a hearing on this important subject. I have a written statement I would like to submit for the record. In the interest of time, I will limit my remarks to key points in that statement.

Since the OCC was founded in 1863, the banking industry has changed dramatically in response to advances in technology, enhanced competition, and changes in consumer preferences. New risks have arisen, and traditional risks have re-emerged in new forms. As the industry has changed, the OCC has adapted its supervision to keep pace.

During the 1980s in particular, regulators learned some hard lessons about traditional credit risks. We learned just how critical regular, on-site examinations are to ensuring a safe and sound banking system. And we also learned that supervision is much less effective if it is based on looking only at the current condition of an institution -- in other words, what has already happened. What is needed is forward-looking supervision that identifies the problems that are emerging and how to manage them. Effective supervision cannot be limited to treating the disease. We also need to practice preventive medicine.

When I took office four and a half years ago, the banking industry was feeling the aftershocks of the 1980s and still going through some fairly challenging times. There were numerous bank failures, complaints about a credit crunch, and concerns about excessive regulatory burden. Community organizations were concerned about fair lending compliance, and both community organizations and banks agreed that the CRA regulations were not as effective as they should be.

Today, our banking system is not only highly profitable but also far better capitalized than at any time in recent memory. At the end of the first half of this year, the equity-to-total asset ratio for commercial banks averaged 8.44 percent -- its highest level since the 1960s. Bank failures in 1996 were at a 20-year low. Total commercial bank loans have increased nearly 39 percent over the four years ending June 1997.

Access to financial services at national banks has also increased. Beginning in 1993, the OCC strengthened its enforcement of fair lending laws, and working with the other regulators, we revised the CRA regulations in 1995. The increase in mortgage lending to low- to moderate-income individuals has been dramatic. Since CRA became law in 1977, we have witnessed over $215 billion in loan commitments for community development. Remarkably, $175 billion -- more than 80 percent of the total -- was made in the past three and one-half years alone.

This strong performance by the banking industry does not mean we can afford to be less vigilant. Bank regulators today face dramatic challenges because of the way the banking industry is evolving.

Technology has increased competition for banks from both traditional and non-traditional competitors. At the same time, the lines between financial products have blurred. This change is showing up in a recent wave of acquisitions and mergers. Banks are acquiring brokerage and securities firms. Several insurance companies and brokerage firms have acquired insured depository institutions.

And the structure of the banking industry itself is changing. Since I took office in April 1993, the number of commercial banks has fallen from more than 11,000 to slightly more than 9,300 as of June 1997. Consolidation also seems to dividing the banking industry into two segments -- community banks and larger institutions -- with fewer medium-sized banks left over.

All of these changes in the industry mean that bank supervision must also change. To that end, the OCC has revised both its structure and its supervision. More specifically, we have developed a supervision-by-risk system that is forward-looking and improves our ability to identify and address potential problems before they become crises. Risk-based supervision allows us to analyze and respond to risks across different financial products and activities, and across different banks with different specialties. To carry out this supervision, we have hired talented people from a variety of disciplines, such as capital markets. We have hired economists who work with examination teams to assess banks' risk management models. We have improved our examiner training to make sure we have the expertise to address industry changes in a timely manner. We have also restructured our organization to make it easier to respond to future changes in the banking industry.

And we have not forgotten the lessons of the past. We have increased the number of larger banks where we maintain a year-round, full-time, on-site dedicated examiner staff. As Congress has rightly required, all banks -- no matter how small -- receive on-site examinations at least every 18 months. In addition, each community bank has an examiner-in-charge who monitors the bank and regularly talks with bank management between on-site examinations. If a bank shows any indication of a problem, we step up the frequency of on-site examinations. And we are strengthening our quality assurance program to make sure these examinations are truly effective.

The continued overall health of the banking industry is good news for everyone, and we are proud of our contributions to banking's strong performance. At the same time, however, we cannot be complacent. Now, while the industry is healthy, we must remain vigilant to address emerging risks. That is why, this past Sunday, I announced initial steps designed to help banks address slippage in underwriting standards that could lead to future problems in their credit portfolios if not addressed now.

The maintenance of sound credit standards and supervisory vigilance today will have little or no noticeable impact on economic growth now and will avoid more serious consequences in the future. Working in close cooperation with other financial institution regulators, our goal is to ensure the banking industry is prepared to continue serving the diverse needs of American consumers, businesses, and communities in the next century.

I appreciate the opportunity to testify on this core issue, and I will be happy to answer any questions you and your colleagues may have.

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- Written Statement