NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

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Forty-three years ago, I arrived in Washington from New York City, fresh out of law school, to serve a clerkship on the U.S. Court of Appeals. Washington has been my home ever since.

Washington has obviously changed over those four decades, but one thing hasn't changed: every time someone new encounters our Byzantine structure of financial regulation, they immediately want to overhaul it. As a result, we have seen almost a score of studies, commissions, proposals, and reorganization plans put forward over the past three or four decades.

Yet, as sensible and thoughtful as these initiatives may have been, they have uniformly failed to get any traction. Just why this is so is the main topic I want to discuss with you today. And if that doesn't get your pulse racing, I want to finish up with a few comments on another current topic – predatory lending and preemption.
So let me start by posing this question: why has there been so much chatter about our bank regulatory structure?

The answer to this is obvious: the current bank regulatory structure offends all of our aesthetic and logical instincts. It's complicated; it's irrational; it probably has inefficiencies; and it takes a great deal of explaining. It's a product of historical accident, improvisation, and expediency, rather than a methodically crafted plan. It reflects the accretion of legislative enactments, each passed at a very different time – and under very different circumstances – in our history.

Given all of these criticisms over the years, it's fair to ask why we have not seen any change in the structure. It's certainly not for trying. Major efforts were put forth in the Reagan and Clinton administrations to rationalize the structure, but they never got very far off the ground. Yet in a number of foreign countries – the United Kingdom and Japan, for example – we have seen in recent years the creation of strong, independent financial supervisory agencies, with consolidated jurisdiction over financial firms. Why haven't we been as enlightened?

There are a variety of very compelling reasons, I believe.

First, the system works. While it is far from perfect, at its best it works extremely well. A variety of formal mechanisms and external pressures have caused the agencies to work quite well together. To be sure, there are examples of interagency rivalry, turf protection, and even inconsistency that arise from time to time, but on the whole the agencies have recognized the need to work together, to avoid inconsistencies, and to respect one another's jurisdictions and responsibilities. We clearly have an example of a system that doesn't work at all in theory, but works well in practice.

Moreover, studies conducted over the years by the General Accounting Office and others have repeatedly deflated the proposition that huge savings would accrue from regulatory restructuring. Instead, researchers have concluded that while there are some redundancies and extra costs associated with multiple agencies, those costs are located primarily in such back-office functions as human resources and information technology, rather than in front-line supervision, where the lion's share of agency resources are spent. Accordingly, the savings that might be realized from restructuring would likely be quite modest.

Second, there has never been a public constituency for change. Neither the banking industry itself – which has learned to cope with and take advantage of the current structure – nor advocacy or interest groups that are stakeholders in the system, have mounted any case for change. And experience tells us that logic alone will generally not be enough of a catalyst for major reform legislation; a public and political constituency is almost always necessary.

But apart from these considerations, there have been, and continue to be, two major reasons why regulatory restructuring has not gained more momentum. The role of the Federal Reserve and the FDIC is one; the impact on state banking systems is the other. Time after time, well-meaning proposals for change have run into the intractable reality of having to deal with those concerns.

Right at the outset of any consideration of restructuring one must confront the question of what role the Federal Reserve should play in bank supervision. While the Fed's role as a supervisor was quite modest until the expansion of its bank holding company jurisdiction in 1970, the Fed has long and successfully argued that it must have a major presence in bank supervision in order to obtain a "window" into the banking system as an adjunct to its monetary policy and payments system responsibilities. Yet countries around the world – Great Britain, Japan, and now China, chief among them – have chosen to move precisely in the opposite direction, concluding that the central bank cannot provide objective, independent bank supervision while discharging its monetary responsibilities at the same time. Who's right? More importantly, what's right for the United States? My personal view is that we have it about right as it is – although I believe very strongly that bank supervision must focus on safety and soundness concerns, and bank supervisors should not be looked to for the conduct of macroeconomic policy.

The role of the FDIC in the supervisory framework is another perennial issue. The FDIC's role in insuring deposits and resolving failed banks has provided it with a strong argument for involving itself in the supervision of banks. But does the FDIC's legitimate interest in minimizing losses to the deposit insurance fund constitute justification for pervasive and continuous involvement in day-to-day supervision of banks that are not in the problem categories? Even more fundamentally, is the FDIC's paramount interest in minimizing losses – with the aversion to risk that interest encourages – consistent with the responsibilities of balanced supervision?

To be sure, some would resolve these conflicts by transferring all bank supervisory jurisdiction to the Fed or the FDIC. In fairness, I don't think either of those agencies has seriously suggested this. Without putting too fine a point on it, I'll just say that I do not share this view. It would probably be immodest of me to expand on that at this time.

It is obvious, I think, that the present distribution of bank supervisory authority creates some burdens for banks, not the least of which is having to contend with visitations by examiners from different agencies, frequently duplicating – or ignoring – one another's work. I believe this is a concern that needs continual attention, for if there was anything that might galvanize the industry to support restructuring, it is likely to be the annoyance and burden of such supervisory duplication.

Finally, there is the question of how any plan to rationalize bank supervision would comport with a strong dual banking system. If the federal bank supervisory agencies were consolidated into a single independent agency, as many scenarios envision, with the federal supervision of state banks being performed by the same agency that supervises national banks, charter choice might be rendered all but meaningless. Banks' ability to select the system of supervision they deemed best suited to their needs would be curtailed. Disparities in powers between state and national banks would become untenable with a single federal agency presiding over both types of institutions, and the pressure for uniformity would be very strong.

Perhaps the most significant question would be how such an agency would be funded. Today, national banks bear virtually all of the costs of their supervision, while state banks bear only about 20 percent of their supervision costs – the portion attributable to that supervision carried out by the states themselves. As we are all aware, this disparity arises because the Fed and the FDIC, with virtually bottomless pockets, subsidize the state banks they supervise by absorbing all of the costs of their federal supervision. This inequity could not possibly be perpetuated if all federal bank supervision were vested in a single independent agency that didn't have the resources of the Fed or the FDIC. Such an agency would either have to be supported by appropriations – which would be a bad idea, in my view – or it would have to assess all of the banks it supervised. Even if the agency for unified supervision were the Fed or the FDIC, it is inconceivable that the present subsidy for supervision costs could be limited to state banks. Since many supervisors of state banks – at both the state and federal levels -- have a pathological fear that equalizing supervisory fees would cause massive conversions from state to national charter, it is not surprising that they have opposed regulatory consolidation.

I recognize that some may view these remarks as a ringing endorsement of maintaining the status quo. That is not my intention. I share the intellectual interest in structural rationalization that the advocates exhibit. But I think that any proposal, no matter how logical it might appear, must address the fundamental political obstacles I've been discussing before we spend a lot more time spinning our wheels over still another iteration of an idea that is showing distinct signs of age.

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Now let me turn briefly to two related subjects that are stirring up a lot of comment these days: predatory lending and preemption. First, I want to state emphatically that there is no question that predatory lending is a real concern. We have ample evidence that people in many areas are being stripped of the equity in their homes by a certain subspecies – and I use that term in its most pejorative sense -- of subprime lenders, overwhelmingly unregulated nonbanks. Some 20 states have undertaken initiatives to address predatory lending, either through statute or regulation. In a case that's drawn considerable attention, a Georgia statute imposes severe restrictions on so-called "high-cost" mortgage loans, requiring lenders who offer them to comply with a range of substantive and procedural requirements.

Unfortunately, the passage of these laws has led to considerable uncertainty about their applicability to national banks, which, as you know, operate under a longstanding constitutional immunity from state laws that purport to regulate the manner in which they conduct their banking business – an immunity repeatedly reaffirmed by the Supreme Court of the United States, tracing back to the mid-19th century. The Office of Thrift Supervision has already determined that the Georgia law is inapplicable to federally chartered savings institutions and their operating subsidiaries, and the OCC is now reviewing comments submitted in response to a request for a determination of that law's applicability to national banks.

Unfortunately, the legal disputation over preemption tends to distract us from the real question: how best to deal with the problem of predatory lending in our communities, while ensuring that adequate credit remains available on reasonable terms to mortgage customers at all income levels. The nuances of preemption theory are unlikely to mean much to borrowers who either have been burned by predatory lenders or denied credit in the first place.

I have several concerns about the across-the-board approach that has been adopted, with the best of intentions, by some states. First, it would inevitably add significant costs to banks that operate in many jurisdictions, since they would have to bear the costs and risks of complying with innumerable local laws – costs that would ultimately be reflected in the cost of credit. But even more of a concern is that such laws may actually have the effect of making credit harder to come by for those who may most need it and deserve it.

Evidence increasingly suggests this might already be happening. Fannie Mae recently announced that it would not purchase mortgage loans subject to the New York State and Georgia anti-predatory laws – a decision that will undoubtedly cause some contraction in credit availability to subprime borrowers.

Recent analysis by economists, one of whom has been on the OCC staff, of anti-predatory lending laws in Chicago and Philadelphia and in North Carolina bears out this fear. In Chicago, a municipal law that applied primarily to banks had the effect of driving more subprime mortgage lending into the nonbank sector, which is precisely where predatory practices are most prevalent. And a Philadelphia law that applied to <u>all</u> financial services providers had the effect of reducing the availability of subprime mortgage money generally. Similarly, it appears that the North Carolina law decreased the availability of subprime credit in the state.

Subprime credit is not the equivalent of predatory credit. Indeed, the growth of our subprime credit market has made legitimate credit available to families that may previously not have had access to credit. Thus, any law that causes responsible lenders to exit the subprime market must be viewed as problematic.

I think that the OCC has a better approach. Rather than focusing on the features of particular loan products, we focus on abusive practices – on preventing them in the first place, attacking them out where they're found to exist, and providing restitution to those who have been victimized by them.

Our emphasis on prevention has taken the form of comprehensive guidance – the only such guidance that's been produced by any of the federal banking agencies -- instructing national banks on how to avoid engaging in abusive or predatory practices. Rigorous, ongoing supervision and oversight by OCC examiners is designed to make certain that this guidance is followed. But when it's not, we have not hesitated to use our enforcement authority to combat unsafe, unsound, unfair, or deceptive practices. Indeed, OCC enforcement actions have resulted in refunds totaling hundreds of millions of dollars to consumers.

I believe that the OCC's approach to predatory lending not only provides an effective remedy where abusive conduct has been found, but avoids the overbroad and unintended adverse effects of one-size-fits-all laws.

Quite apart from the question whether state and local laws threaten the unintended consequences of encouraging bank lenders to exit the subprime lending market, there is the question whether such laws can constitutionally apply to national banks. Since we presently have under consideration a request for a preemption determination with respect to the Georgia law, I will not discuss that issue directly. Suffice it to say that preemption is a doctrine with almost 200 years of history and constitutional precedent behind it. It is not an issue as to which we have a broad range of discretion.

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