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Remarks by
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I would be delighted to join the National Association of Affordable Housing Lenders under any circumstances, if only to pay tribute to the vitally important work that you do as individuals and as members of this fine organization. Individually and collectively, you are the reason why the 1990s has been a decade of breakthroughs in developing private sector solutions to our nation's critical need for affordable housing. I have watched your work with interest and admiration over the years, and so it's particularly gratifying to have the opportunity to play a small part in your proceedings today. Thank you for inviting me.

Your two-day gathering here in Washington will no doubt hear discussions of promising strategies for addressing our nation's housing deficit. But I think that you'd agree that the real test of what you accomplish here will take place when you return to your homes and communities and places of work and begin putting these ideas into action.

That is true in a general way about much that goes on here in the capital. As a lifelong resident of the Washington D.C. area and career Federal official, of course, you would hardly expect me to contend that what takes place in the halls of our national government is irrelevant to our national life. To the contrary, it matters profoundly. But there is, frankly, an unmistakable tendency in this town, among its permanent and transient residents alike, to view Washington as the hub upon which America, if not the world, turns. Certainly there have been moments in history when that has been the case. For the most part, however, Washington has not been the source of the major trends and innovations that shape American life. It responds to those trends and innovations, but rarely creates them. For the true source of our nation's political and economic genius, one must look to the private marketplace, state and local governments, and to the work that you do -- not to Capitol Hill, nor -- dare I say -- to the offices of Federal bureaucrats.

It is important that we keep this in mind as we consider the future of financial services in this country. During the last session of Congress, considerable attention focused on H.R. 10, the Financial Services Act of 1998, which, as you know, passed the House by a single vote and then stalled in the Senate. Still,

this was the closest we have come in years to a comprehensive overhaul of our financial laws.

As I have had an opportunity to reflect back on that legislative effort and to contemplate the financial modernization legislation beginning to percolate in the new Congress, it has struck me that H.R. 10 was premised on a fundamental misconception -- the same misconception that, as I have already suggested, is pervasive in Washington. In this specific case, it was the assumption that financial modernization in the United States was dependent upon federal legislation. This starting point then led to massive legislative proposals containing complex and elaborate definitions, redefinitions, and categorizations of financial products, mounted in new frameworks that allocated how and by whom those products could be offered. For the banking industry, and for consumers, communities, and businesses that rely on the role of banks in our economy, this approach has far-reaching consequences.

I would respectfully suggest that, regardless of what Congress does or does not do, financial modernization is taking place all around us, on every Main Street in America, as financial institutions are forced to compete and adapt to rapid social and economic changes. Some of those changes are demographic, as the U.S. population grows older, better educated, and more ethnically diverse. Technology continues to erode physical boundaries, bringing more financial choices than ever before to America's homes and desktops. And new financial products and services are constantly being devised, packaged, and repackaged to respond to these changes in the social and economic landscape.

Understanding this working dynamic between Washington and the financial system is crucial in shaping legislation and in defining an appropriate role for government to play as we prepare for the financial world of the 21st century. Rather than trying to paper over this reality, financial modernization should build on it.

And that leads me to the conclusion that the overriding objective of legislation must be to nurture -- and avoid obstructing -- the process of financial modernization I have just described -- the process by which financial institutions are responding creatively to demographic, technological, and economic trends. Financial providers must be free to market their products and services, and otherwise to organize and conduct their businesses in the way that maximizes their ability to satisfy customers and meet the competitive challenges of the global marketplace. If they cannot do these things, their businesses will suffer, their customers may be disadvantaged, and, ultimately, our whole economy will be weakened.

The goals of financial modernization legislation, therefore, should be to enable marketplace modernization to continue in a way that promotes competitiveness and free markets, ensures the safety and soundness of financial institutions, and affords protections to consumers against new risks that may arise from marketplace developments. This could be done, I believe, with

relatively straightforward legislation that simply eliminates antiquated and artificial market restrictions and restraints, addresses the customer protection issues that result, preserves the appropriate supervisory roles of all financial institution regulators, and allows all types of financial institutions to operate their businesses efficiently, safely, and soundly.

Obviously, among these goals, enhancing safety and soundness of insured institutions is a pressing public interest. Banks play a role in our economy unlike any other type of financial institution, and will do so into the foreseeable future. For most Americans, they are the gateway to the payments system. They provide the lion's share of the nation's consumer and small business credit. The taxpaying public ultimately stands behind their deposit liabilities. In return, banks are subject to the most rigorous government scrutiny and highest standards of propriety in the financial services industry.

And they have explicit consumer and community responsibilities under the law that apply to none of their peers -- not credit unions, and certainly not finance companies, insurance underwriters, and securities firms. People like yourselves in the affordable housing and community development arenas may find financing from these non-bank financial providers or maybe you won't -- it's a matter of chance as opposed to one of regulation and law. The banking industry, by contrast, does not have the option of turning its back on you.

It stands to reason, therefore, that one crucial test of proposed financial modernization legislation should be whether or not it is likely to enhance the safety and soundness and competitiveness of the banking system so that banks can continue to discharge their private responsibilities to shareholders and employees and their public responsibilities to customers and communities. To the extent that legislation does not advance these goals -- or tilts the balance in favor of non-bank financial organizations that face fewer public obligations -- it would not seem to be consistent with the public interest.

Let me give you an example -- one that I'm sure you'll appreciate. Fifty years ago, banks essentially did two things. They accepted deposits and made loans, mostly to medium- and large-sized businesses. Because the cost of these funds was capped by regulation and the borrowers had few other options, banks turned predictable profits. But when interest rate ceilings were lifted and the capital markets became more accessible, volatility increasingly overtook the banking business. Bankers were forced to step up the search for customers, and in many cases wound up replacing high quality loans lost to the capital markets with lesser ones. Indeed, the banking crisis of recent times -- especially that of the late 1980s and early 1990s -- resulted very largely from excessive concentrations of certain types of loans. It was a lesson that bankers -- and regulators -- were determined not to forget.

Our recent gains in affordable housing and community development are attributable in part to the health of the banks

to which many Americans look for financing. And that has been the result not only of a favorable interest rate environment and the general prosperity of our economy. Banks have learned their lesson. One reason they are stronger is that their income streams are more diversified. They have reduced their once near-exclusive dependence upon loans, with all of their ups and downs. Thanks in part to their own initiative and to changes in law and regulation that made it possible, bankers can now offer their customers a basket of products and services that yield both interest and fee income. Indeed, noninterest income has been rising steadily as a percentage of total operating revenues over the past 15 years, with especially dramatic gains registered over the past five. Banks today derive significant revenues from fees received for selling various types of financial products and such activities as mortgage servicing, securities processing, asset management, foreign currency transactions, and credit card operations. This activity not only produces steadier, short-term profits, but solidifies relationships with customers that can mature into profitable long-term relationships. And that means new and renewable resources to provide financial services to all Americans and to fund the rehabilitation and redevelopment of America's needy communities. Obviously, then, legislation that would constrain banks from entering new lines of financial business or prevent them from structuring these activities in a way that strengthens their balance sheets and their relationships with customers has profound consequences. Indeed, as finance increasingly requires the ability to respond flexibly and speedily to attract and satisfy customers, any legislation that hobbles banks by restricting their options, flexibility, and efficiency is effectively a blueprint for undermining their long-term safety and soundness and viability.

Yet last year's H.R. 10 envisaged doing just that. As part of its comprehensive approach to defining, redefining, and categorizing products and allocating how and by whom they could be offered, it would have required a whole range of activities, old and new, to be conducted by holding company affiliates -- not banks and not even subsidiaries of banks. The activities in question included a wide and potentially expandable range of insurance activities and such things as loan participations, underwriting certain securities, securitizing loans, acting as a custodian for managed accounts, offering self-directed Individual Retirement Accounts, arranging private placements, engaging in certain financial contracts, and offering employee and shareholder benefit plan services. Under the legislation passed by the House, none of these activities could have been performed directly by banks and many would have been barred for bank subsidiaries as well. And so the income derived from these activities would not have been available to the bank.

Only banks were singled out by H.R. 10 for these types of product restrictions and organizational limitations. The rationale given for this approach has been that the activities in question posed excessive risk to the bank's safety and soundness and, therefore, to the bank insurance fund. This is not the time to enter into a detailed discussion of the particulars of that

case. I will simply offer two points for your consideration. One of those I have made already. But it bears repeating: no type of financial provider is subject to more rigorous government scrutiny and higher standards of propriety than banks.

And the second is this. Back in the fall, when H.R. 10 was being debated in the Senate, an extraordinary op-ed piece appeared in the trade newspaper American Banker. It was signed by three former chairmen of the Federal Deposit Insurance Corporation: William M. Isaac, L. William Seidman, and Ricki Helfer. These distinguished statesmen and woman went on the record to declare their common conviction that Congress should not require expanded activities to be conducted within a bank holding company affiliate. Indeed, they declared the holding company inferior to the bank subsidiary as a safeguard against systemic risk. Current FDIC chair Donna Tanoue also has testified in favor of allowing banks to use their subsidiaries to conduct new financial activities. As the current and former heads of the agency that would pay the price -- literally -- if they were wrong -- their views should carry tremendous weight.

In short, if the H.R. 10 approach to comprehensive redesign of our financial services framework became law, the result would be that banks, alone among the financial firms affected by H.R. 10, would be told what financial products they could or could not offer to their customers and how they must organize as a corporate matter to provide these products. In light of the consensus among current and former leaders of the FDIC that this result would increase the risk to the federal deposit insurance fund, I think we must reexamine the basic approach to modernization legislation that was embodied in H.R. 10.

Consumers and taxpayers should care very much what approach Congress assumes in developing financial modernization legislation. And so should you. The public and private sector partnerships that have been so instrumental in the rebuilding of our communities depend upon strong banks and a robust banking system. Financial modernization legislation that weakens banks in the long run undercuts what you have been trying to accomplish. But, with a different, more focused approach to legislation, we may have the opportunity to consolidate and build upon the gains of recent years and enhance the ability of America's financial system to provide financial products and services that meet the needs of all of our people.

Thank you.

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