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Remarks by

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On a clear, crisp evening in March 1891, 94 bankers gathered in Los Angeles to pursue a common vision. California had just settled into a period of sustained growth after successive cycles of boom and bust, and the financial leaders who met that evening were determined to have a banking system worthy of the state's current prosperity--and future promise. Their meeting concluded with the formation of the California Bankers Association. Since then, for more than a century now, the CBA has been a leader in promoting responsible, creative, and innovative banking. I am proud to be with you this afternoon, as you meet to discuss how to continue to advance this role.

It's been said that the vastness of California merely brings into public view what other Americans have started elsewhere on a smaller scale. Still, this is the place to which the world has long looked for the trends that define the times. California and cutting edge are synonyms in almost all areas of human enterprise. It has often been so in the world of banking. California was where branch banking took root and flourished. California bankers--through the CBA and the Los Angeles and San Francisco Clearinghouse Associations--demonstrated the power of cooperation in building public confidence. California bankers, like California itself, led the way in bringing technology to the marketplace. It is no accident that both major credit cards in use today--Visa and Mastercard--originated in California.

For Californians, innovation was the product of necessity. In the early years, their isolation from the conventions of the Atlantic seaboard placed a premium on creativity. Californians had to blaze their own trails, and they did.

In building their state, they faced a demographic challenge that surpassed anything confronting their counterparts back east. When American citizens started moving into California, they found not only a Spanish-speaking majority. They also found dozens of native American tribes speaking 135 different languages, along with Russians, Britishers, and Frenchmen--all claimants to the riches that were already California. Since then, succeeding waves of immigrants have washed over your shores and borders. From this medley of languages and cultures came the Californian, sui generis: "a race of people," as O. Henry put it, "not merely inhabitants of a state." Together this unique population built an economy bigger by itself than all but six industrial nations. Today's Golden State is a polyglot place, an international hub of people, trade, and ideas, where ethnic diversity is a way of life.

California's diversity is increasingly evident all across our country. As a people, we are becoming older and darker-skinned. The 20th century has seen the ranks of older Americans--those aged 65 or over--increase five times faster than their younger counterparts. By the middle of the next century, one out of every five Americans will be a senior citizen--80 million strong. With more of just about everything than anywhere else, California today is also home to the largest population of seniors in America, some 3.3 million. At the same time, a dramatic change in the racial composition of our country is taking place, and taking place most prominently in your midst. By the year 2010, nonwhites will represent half of the population of California.

These demographics pose challenges and opportunities with which California bankers are more familiar than most. With rising life expectancies, not only will the elderly become more numerous, on average they will be older. As the population ages, it will become less mobile. More of life's activities will center around the home or local community center. Those prepared to deliver services to seniors and spare them the necessity of a trip downtown will be among the winners in the new, grayer America. Bankers who start now to build personal relationships with the seniors of tomorrow, bankers who make a genuine commitment to technology and allaying their customers' concerns about nontraditional delivery systems for financial services will be well positioned to thrive in tomorrow's marketplace.

The stakes in this race for older Americans' business are enormous. The baby boomers who start turning 65 in the year 2011 will be the most affluent seniors in history. Assets from their inheritances alone are expected to top $10 trillion. How they spend and invest this huge sum will have a profound effect on the economy and on the banking business. The affluent senior of the 21st century is likely to be a convenience user of credit cards and less likely to revolve balances. He or she is almost certain to need financial advice about asset management and trust services. Safety-minded seniors may well become the source of rising balances in FDIC-insured accounts. In addition, this group will almost certainly be in the market for new products tailored especially to them in the mutual fund and insurance areas.

Banking's possibilities are equally rich in our country's burgeoning immigrant and minority communities. Conventional wisdom about the residential real estate markets of the future has painted a bleak picture of declining household formation and falling demand. But these assumptions may have understated the importance of the minority and immigrant populations. In a 1993 survey conducted for Fannie Mae, more African-Americans and Hispanics said that home ownership is a primary goal in life than did whites and they were also more willing to make major concessions--taking on a second job or deferring current consumption--to obtain that goal. A 1995 study by the Federal

Reserve Bank of Dallas suggests that real estate is one area in which the interplay of demographic trends could produce some important synergies: just as older Americans prepare to give up their family homes in the suburbs and enter into retirement, a pool of potential buyers from the immigrant and minority communities should be poised to take their place.

Banks can and should play a role in helping members of today's minority population achieve their financial dreams. Unfortunately, many go outside the banking system for the help they need. Today more than 12 million American households do not have deposit accounts with a financial institution. The OCC is working hard to find out who these people are, why they are not participating in the banking economy, and what some of our most creative financial institutions are doing to reach out to them. Late last year, we launched a project called Expanding the Financial Frontier, one part of which seeks to collect information about the behavior and needs of the nonbanked. What we have already discovered suggests a multiplicity of reasons why banks are not part of their lives. Some people arrive in this country with a deep-rooted suspicion of banks, born perhaps of a less stable banking environment in their native lands. Once they are here, language or other cultural barriers can reinforce their aversion. In many cases, moreover, banking relationships may simply seem not to make economic sense. Although some people without deposit accounts wind up patronizing high-priced check-cashing services, others find it easy and economical to cash checks at local businesses where they regularly shop or to rely on family members who do have accounts. Similarly, people without checking accounts can use credit cards, money orders, or cash to pay their bills.

While there is much we do not yet know about the needs of the nonbanked, it is clear is that the decision not to use banks often comes at a price. The nonbanked expose themselves to risk in the handling and transfer of funds---risks which the owners of bank deposit and checking accounts can disregard. Many of them absorb transaction costs to cash checks and pay bills, and opportunity costs in the form of financial advice--and returns--foregone for lack of a banking relationship. Without secure rainy-day resources, they are more vulnerable to the vicissitudes of the economic cycle. Without a bank relationship, affordable bank credit is likely to remain out of reach.

Since becoming Comptroller in 1993, I have made this commitment: that no regulatory stone will go unturned in our quest to provide all Americans with fair and equal access to financial services. We have achieved some conspicuous successes in that arena:

- Our revision of Community Reinvestment Act regulations has contributed to an increase in the rate of home mortgage lending in low-to-moderate income census tracts more than twice as large as the increase in the rate of home mortgage lending overall.

- Thanks in part to the OCC's efforts to promote community development financing, national banks have made targeted "public welfare" investments totaling more than $4 billion.

- In the field of fair lending, we, along with the Departments of Justice and Housing and Urban Development, initiated the formation of an interagency task force on fair lending that agreed on a common set of principles to guide interagency efforts. In part as the result of this renewed focus on fair lending, between 1993 and 1995, mortgage loans to all minorities increased by a rate three times that of the overall increase in mortgage lending.

The progress we have achieved to date--and look forward to achieving in the months to come--would not have been possible had bankers and regulators not been prepared to break with the conventions of the past. One of the most striking developments in the whole history of American banking is the change in attitudes about what constitutes appropriate bank products and markets. In 1870, for example, one national bank sued another to stop it from offering customers certified checks! And it was scarcely two generations ago that bankers and regulators alike subscribed to the view that it was a prime responsibility of the banking business to discourage spending and consumption. Because consumer loans were thought to undermine the values of thrift and self-reliance, most commercial bankers would not touch them. The evidence of the Great Depression, when consumer loans (issued mainly by finance companies and retail merchants) outperformed commercial and industrial loans, convinced bankers and regulators that they had been wrong-- that lending to consumers not only was a potentially profitable line of business but also fueled consumption that was essential to a healthy, growing economy. Freed from their own biases and negative preconceptions, bankers were in a position to start building profitable relationships with long underserved segments of the financial services market.

Banking has never been pure science. It never will be. Banking is a career you were probably attracted to for just that reason. Banking is a "people business" in which personal service and individual judgment loom large. At the same time, as I mentioned earlier, banking is becoming, and must become, a more technologically sophisticated business. It must couple its traditional strength in personal relationships with the advanced tools that enable bankers to serve their customers more efficiently and equitably. Marrying technology to a traditional people business holds tremendous opportunity for growth. It also presents challenges. One of those challenges centers on the issue of credit scoring.

Credit scoring models are not new. First introduced more than 50 years ago, their use has increased steadily as a tool for underwriting and administering all forms of retail credit. As a safety and soundness tool, they can help control risk, reduce credit losses, improve profitability, help in the evaluation of new loan programs, and improve loan approval processing times. As a fair lending tool, credit scoring models can ensure that existing credit criteria are sound and consistently applied, and can improve compliance with the Equal Credit Opportunity Act.

Like all tools, credit scoring models can be used well or badly; and, as powerful as they are, their potential for good--or ill--is magnified. So they must be developed, implemented, tested, and maintained with extreme care. Bankers adopting credit models must ask hard questions: did the designers draw the model from a statistically-valid population sample? Is the population reflected in the model representative of the bank's current population? When populations change, scoring models must change with them. Then there is the problem of overrides--of bankers relying on their intuition or on information not available in the credit scoring model to arrive at a loan decision at odds with the model's evaluation. While a certain level of overrides is inevitable, too many overrides negate the scoring models and make it impossible to verify their accuracy and effectiveness.

The actual impact of score cards on credit access is a hotly debated question these days. Proponents point out that, by more accurately predicting the likelihood that borrowers will perform well, scorecards enable banks to approve more applications and still have the same level of losses--enabling bankers to service non-traditional customers who might otherwise get lost in the shuffle or fall victim to unwarranted preconceptions. By the same token, the concerns of some community advocates about the impact of credit scoring on potential borrowers without established credit records also deserve to be taken seriously. At this point, however, neither side's case can be regarded as definitive. At the OCC, we are planning to conduct research through our National Access Committee that will help us get to the bottom of this important question.

There is no question credit scoring models offer banks and their customers significant potential benefits. Nevertheless, the time has come, I believe, to call attention to the potential that also exists for significant problems from improper use of credit scoring models. This week, the OCC released a banking bulletin on that subject. The recommendations contained in that bulletin are based on the experiences of OCC examiners in dozens of banks around the country where scoring models are in operation.

- Whether purchased from third-party vendors or developed in-house, credit scoring models must be carefully monitored for accuracy and reliability by bank management. Banks need to be aware of the extent to which the predicted results of credit scoring correspond to the actual experience of real-life borrowers, and make appropriate modifications in their policies and systems to reflect any divergences. Bank staff trained for this purpose and upgraded management systems should work together to track and validate the reliability of these models.

- Bank managements needs to have policies in place to ensure that credit scoring models developed for a particular purpose are not used for other products or in other geographical areas.

- Bankers need to ensure that whatever score cards they adopt do not assign ratings points based on the applicant's race, national origin, or any other factor prohibited by fair lending laws.

- Once scoring models have been implemented and validated, overrides should be used with considerable caution.

With these and the other preventive measures outlined in this bulletin, credit scoring should become an increasingly valuable tool to bankers in serving their increasingly diverse market.

By harnessing innovation to a vision, the founders of California tamed a frontier and created a miracle which the world today beholds with envy and admiration. Tomorrow's frontiers will be different, though no less daunting. With the same application of creativity, commitment, and vision we will conquer those, too, and achieve great things for all our people. I look forward to continuing to work with you to that end. Thank you.

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