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Testimony of Eugene A. Ludwig, Comptroller of the Currency, before the  
Committee on  
Banking and Financial Services of the U. S. House of Representatives

Statement required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the  
Comptroller of the Currency and do not necessarily represent the  
views of the President.

Mr. Chairman and members of the Committee, I appreciate this  
opportunity to discuss with you the strategic plan of the Office  
of the Comptroller of the Currency's (OCC), and our planning  
process, in accordance with the Government Performance and  
Results Act (the Results Act). I am a strong believer in the  
importance of strategic planning, and I look forward to your  
comments on the plan, which provides direction to the OCC for  
fiscal years 1997-2002.

The OCC's mission since it was established in 1863 has remained  
constant -- to charter, regulate and supervise national banks to  
ensure a safe, sound and competitive National Banking System that  
supports the citizens, communities and economy of the United  
States. At the end of 1996, there were 2,726 national banks, a  
figure that represents about 29 percent of the total number of  
commercial banks in the United States. These national banks had  
assets of approximately \$2.5 trillion at the end of 1996,  
accounting for about 55 percent of the total assets of the  
commercial banking system.

Though the mission of the agency has remained constant over the  
years, changes in the external environment have required us to  
adapt the strategy we use to fulfill that mission. Through the  
years, the banking industry has faced numerous, increasingly  
rapid, changes, each resulting in new challenges to the long-term  
health of the industry. Currently, accelerating advances in  
technology are changing fundamentally the nature of how  
information is created, processed, and delivered -- the heart of  
what banks do. As a result, bank face competition from new  
participants that are able to target selectively segments of  
markets traditionally served by banks. Competition is not merely  
regional or national, but global. And, an increasingly  
sophisticated, aging population is demanding a different mix of  
financial products and services. Banks will be unable to remain  
safe and sound, or serve effectively the needs of consumers and  
businesses, unless lawmakers and regulators take a flexible and  
adaptable view of both the business and the regulation of  
banking.

Against this background, early in my term, our agency developed  
four strategic goals, which we call the four pillars, to provide  
a broad vision of the role of the OCC given our analysis of the  
dynamics of the banking industry:

- Ensure bank safety and soundness to support a strong national economy;
- Foster competition by allowing banks to offer new products and services to their customers as long as banks provide the necessary consumer protections and have the expertise to manage the risks effectively;
- Improve the efficiency of bank supervision and reduce burden by streamlining supervisory procedures and regulations; and
- Assure fair access to financial services for all Americans by enforcing the Community Reinvestment Act (CRA) and fair lending laws, and by encouraging national bank involvement in community development activities.

In the next section, I will discuss briefly how we have pursued the four pillars over the last several years. This discussion provides an appropriate context for understanding our vision and strategy as we move forward. I will then respond in turn to the seven items outlined in your letter of invitation:

- A review of the OCC's draft strategic plan;
- A discussion of the process by which the OCC is preparing its strategic plan, including our efforts to solicit and consider the views of key stakeholders as required under Section 306(d) of the Results Act;
- An assessment of the most important factors for the OCC to consider in developing a performance-based strategic plan;
- A review of the methods by which the OCC is prepared to measure the results of its outcome related goals and objectives;
- Estimates of the cost savings that the agency expects to achieve from the implementation of the proposed strategic plan;
- An overview of any potential difficulties the OCC may encounter in meeting its responsibilities under the Results Act; and
- The realignment of budgetary and other resources that will be required as a result of the agency's strategic plan.

#### The OCC's Pursuit of Its Strategic Goals

The OCC established the four pillars following a period of great stress for the banking industry. There had been numerous bank failures and complaints from small businesses and consumers about a credit crunch. There were significant concerns in the banking industry and Congress 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.

To address these issues, and to advance our strategic goals, the OCC undertook substantial changes in the substance and process of bank supervision. First and foremost, we recognized that ensuring safety and soundness requires our agency to identify potential problems in banking. To that end, we initiated a number of new programs and policies to increase the effectiveness of our hands-on, in-the-bank supervision. The most important of those new programs and policies is supervision by risk. Under this program, we have instituted a risk assessment system for both community and large banks. Supervision by risk focuses attention on the level of risk within banking organizations and, equally importantly, on the risk management systems and internal controls of the organization.

To further the goal of safety and soundness, we created a new position, the Deputy Comptroller for Risk Evaluation, to serve as our national risk expert and as my principal advisor on risks facing the National Banking System. That Deputy Comptroller helps the OCC identify risks, assists in developing timely supervisory responses, and monitors those responses to ensure that they are effective.

We have also upgraded our technical capabilities in the area of financial modeling. We created the Risk Analysis Division, which is devoted to the delivery of expertise in quantitative modeling of financial risks. Economists from that division assist our examiners in evaluating banks' use of quantitative models to measure, monitor, and control market, interest rate, and credit risk.

We have also been working hard to address the issue of credit quality. In 1995, we formed the National Credit Committee to address our concerns about erosion in credit underwriting standards. This committee continues to help the OCC identify and respond to changes in credit risk that could affect the safety and soundness of the National Banking System. Earlier this year, to address further the issue of credit quality, the OCC issued an advisory letter on credit underwriting standards and an OCC bulletin on credit scoring.

The OCC has cooperated with the other bank regulatory agencies to develop common policies wherever possible. For example, in the fall of 1996, we issued our final market risk rule. Last December, the regulatory agencies revised the bank rating system, putting additional emphasis on the quality of risk management practices and adding a new component on sensitivity to market risk. This new component rating reflects a combined assessment of a bank's level of market risk and the ability of a bank to manage that risk.

Our agency has also played a leading role in developing cooperation among banking regulators worldwide, and I envision these efforts expanding in the future. We recently created the Office of the Senior Deputy Comptroller for International Affairs. This office will represent the OCC in various international forums as well as improve analytical support for

international regulatory issues. The OCC's primary focal point for international cooperation will continue to be the Basle Committee on Banking Supervision, whose goal is to improve supervisory cooperation and the quality of supervision by exchanging information and expertise and developing improved supervisory approaches and guidance. Over the last several years, the Basle Committee has adopted a number of standards which directly or indirectly affect supervision in the U.S. For example, in 1988, the Basle Committee adopted international risk-based capital standards, which were later adopted in the U.S. These standards have recently been extended to cover market risk and permit the use of state-of-the-art modeling techniques to determine capital requirements. In addition, through the Joint Forum, an international body composed of banking, securities and insurance regulators, the Committee is currently developing principles for the supervision of financial conglomerates. The Basle Committee also adopted "sound practices" guidelines for the supervision of derivatives, that were based on guidance issued earlier by the OCC. Currently, the OCC chairs the Basle Committee's Information Subgroup, which focuses on the information needed by supervisors to supervise effectively and by market participants to improve market transparency and to promote market discipline. In addition, the OCC has organized and chaired the Basle Committee's meetings on electronic money and banking.

To foster competition, the OCC has worked to remove barriers to the ability of the banking industry to meet the evolving financial services demands of consumers and businesses. Our purpose is to ensure that consumers of financial services obtain the benefits of greater access and lower prices that derive from competition. In addition, allowing banks to prudently adapt to new market demands furthers the long term safety and soundness of the industry. Thus, the OCC endeavors to allow a bank to offer new products and services to its customers as long as these activities are part of or incidental to the business of banking, or otherwise permitted by law, and the bank is able to manage the risks effectively and complies with appropriate consumer protections.

When the OCC has allowed banks to expand the products and services they provide in response to new market demands, we have, as appropriate, required disclosures that these products are not federally insured. For example, the OCC has authorized banks to sell annuities, to provide Internet access to their customers in certain circumstances, and to sell computer services to other financial institutions. Allowing banks to conduct these activities enables banks to meet the diverse and changing needs of their customers and promotes the long-term health of the banking industry.

One of our efforts in this area has been the revision of our Part 5 regulations, which governs corporate applications by national banks. One provision in the revised Part 5 rule establishes a process under which a national bank may apply to the OCC for approval to establish an operating subsidiary to conduct activities that are part of or incidental to the business of

banking but may differ from those the bank can conduct directly. It is important to stress that the revised Part 5 rule does not authorize any new activity. Rather, it provides a framework within which the OCC will consider applications case-by-case, with public comment if the application involves an activity different from those the bank can conduct directly, and it provides explicit safeguards to maintain the highest safety and soundness standards and to protect the interests of America's consumers and communities.

The OCC has also taken a number of steps to improve our own efficiency and reduce regulatory burden. The cost of unnecessary regulatory burden ultimately falls most heavily on the consumers of bank services through higher costs of borrowing and higher fees. One highlight of our efforts to reduce burden was our Regulatory Review Program, which involved reviewing all of the OCC's rules and eliminating provisions that did not contribute significantly to the goals of bank supervision. To ensure that our regulations are less burdensome going forward, the OCC has issued a set of Standards for Developing Regulations that apply to all the new rules that the agency issues.

I am particularly proud of our efforts to advance our fourth strategic goal, ensuring fair access to banking services for all Americans. Under this goal, we have revised our CRA regulations to emphasize performance over process, encouraged national bank involvement in community development activities and eliminated regulatory impediments to bank involvement in these activities, stepped up our enforcement of CRA and fair lending laws, and issued various types of guidance to protect the interests of consumers. We have vigorously enforced the fair lending laws, referring twenty-three cases to the Department of Justice since 1993, as compared to only one referral prior to my term in office.

To solidify the OCC's commitment to fair access, we made organizational changes. We created the Community and Consumer Law Division in 1994 to provide a focal point for legal advice and interpretations with regard to consumer and community development laws and regulations and associated policy issues. We also created the Community Relations Division in 1995, which is responsible for the OCC's relations with consumer and community organizations, particularly national public interest organizations. In 1996, we named community reinvestment and development specialists in each of our districts to help foster national bank involvement in community development. And this year, we created the OCC's National Access Committee, whose purpose is to establish an institutional structure at the OCC to assist national bank exploration of new business relationships with small businesses and low-income individuals.

Our efforts to promote fair access to credit have contributed to real improvements in the lives of our citizens. Home purchase loans to all minorities increased 45 percent from 1993 to 1996, approximately 2.5 times the increase in overall mortgage lending of 18 percent during that period. (1) In 1996 alone, the OCC approved 187 national bank community development corporations and

projects, with investments for the year totaling \$1.4 billion. Home purchase loans to low-to-moderate-income census tracts increased 33 percent from 1993 to 1996, while there was a 23 percent increase across all census tracts.

While the vision and goals we established several years ago have remained fundamentally unchanged, we realize that there is a great deal more to be done, and that new challenges lie ahead. In the remainder of my statement, I will discuss how our strategic plan provides direction as we move forward.

I. A review of the OCC's draft strategic plan

The centerpiece of our strategic plan is the four strategic goals that I described above, which we adopted early in my term. In order to provide operational content to the four strategic goals, the OCC establishes yearly strategic objectives. These objectives help focus our efforts on particular programs and policies and provide a basis for allocating resources appropriately.

The OCC's Objectives -- Our Commitment to Meeting the Four Strategic Goals

In 1995, the OCC's Executive Committee established certain priority objectives for 1996 that supported the accomplishment of

(1) Source: FFIEC, Home Mortgage Disclosure Act, 1990-1996.

the four strategic goals. We modified these priority areas during the planning process for 1997, and, as part of the budget process, we allocated the resources necessary to support them. The Executive Committee then reviewed the total budget submission. The seven objectives in the plan for 1997 are as follows:

1. Implement Supervision by Risk
2. Improve Access to Financial Services
3. Monitor and Analyze Electronic Money and Banking Issues
4. Implement Effectiveness Measures for OCC Programs, Processes and Projects
5. Develop Technology to Support the Workforce
6. Enhance Workforce Skills, Abilities and Resources
7. Improve Internal Communications

A more detailed description of each objective follows. We anticipate that some of the objectives will continue through the next year and perhaps longer. Initially, we will perform an annual review to refine the objectives and make changes. The OCC then plans to transition to a two-year planning cycle with a longer-range focus.

#### (1) Implement Supervision by Risk

The supervision by risk objective supports the strategic goals: "ensure bank safety and soundness" and "improve the efficiency of bank supervision and reduce burden." As I have briefly described, supervision by risk focuses the OCC's resources on identifying potential problems in banking. Our objective is to enhance safety and soundness supervision by both focussing on the highest risk areas and getting the most from our historic strength: hands-on, in-the-bank examination and supervision. For example, we now have a dedicated examiner staff assigned to each of the 30 largest national banks. Most of these examiners are on-site full-time, giving their undivided attention to the affairs of the bank to which they are assigned. This program allows the assigned examiner to be more vigilant and to develop a more thorough knowledge of the bank, its activities, and risks than is possible under traditional periodic examinations. Moreover, under this program, our examiners are better able to identify increases in risk or deterioration in risk management so that we can act quickly to ensure that weaknesses are corrected. In both large and small banks, we still complete on-site examinations that include reviews of loan files and testing of transactions as important parts of our evaluation of risk, even in areas of low risk.

Under supervision by risk, the first step in our supervision of an individual bank or in evaluating a new product or activity is to identify the primary associated risks. The risks may include credit, liquidity, interest rate, price, foreign exchange, transaction, compliance, strategic, and reputation risks. Having identified the risks for individual banks, we measure and evaluate the quantity of risk and the quality of risk management to form a conclusion about the bank. In developing supervisory policies, we assess the potential for risk, and the types of risk

management systems banks need to identify, measure, monitor, and control those risks. Because market conditions and company structures vary, there is no single risk management system that works best for all banks. However, we expect each bank to have a system that is commensurate with the risks it assumes and that addresses each of the four aspects of effective risk management.

Our supervision by risk program allows us to apply a common and consistent supervisory approach across an increasingly diverse group of banks that engage in an increasingly diverse set of activities. Because the design of this approach focuses not on specific products or activities, but rather on underlying risk characteristics and elements, it allows us to tailor our supervision to new and changing products, and to direct OCC resources to the banks or activities exhibiting the greatest risk. Since the OCC adopted the supervision by risk approach, other U.S. regulators have embraced it, and the Bank of England and other international regulators are developing similar systems.

## (2) Improve Access to Financial Services

This objective supports the strategic goal: "assure fair access to financial services for all Americans." Under it, the OCC will focus greater attention on enforcing CRA and fair lending laws. The OCC will also encourage national bank involvement in community development activities and in providing financial services profitably to those currently outside the banking system.

One project under this objective aims to develop an understanding of the impediments that limit access to banking services for certain pockets of the economy, especially small businesses, low-income individuals, and victims of illegal discrimination. Hence, the OCC is conducting research to identify and address the reasons why many low-income individuals and households do not have banking relationships and to collect and disseminate information on innovative and profitable efforts by banks to reach these sectors of the population. In another project, the OCC is working to deepen and improve the timeliness of its analysis of Home Mortgage Disclosure Act, CRA and small business lending data. The analysis will permit better targeting of our examinations, enabling us to use our resources more efficiently.

## (3) Monitor and Analyze Electronic Money and Banking Issues

This objective supports the strategic goals: "ensure safety and soundness," "promote competition," and "assure fair access to financial services for all Americans." I serve as the coordinator for the development of the Treasury Department's policies in the area of Electronic Money and Banking. Building upon the outreach efforts with industry and governments and the Department-sponsored Electronic Money Conference last fall, the OCC's Executive Committee adopted the electronic money initiative as one of the seven objectives for 1997. The purpose of this objective is to develop a timely and appropriate response to the



introduction of electronic money and banking products and technologies. Our primary goals are to ensure the financial integrity of electronic money issuers, protect consumers, and deter financial crimes.

Under this objective, the OCC has implemented guidance on the supervision of stored-value systems involving national banks. That guidance also provides basic information about emerging stored-value card systems, and their associated risks, for bankers who need to make informed decisions about how to become involved in such systems. In addition, the OCC is developing guidance for examiners and bankers on responding to the most significant risks posed by the incorporation of new technologies in banking.

The OCC has contributed to the development of policy responses to the consumer issues raised by electronic money and banking products by taking a leadership role in the Consumer Electronic Payments Task Force, established last fall by Secretary Rubin. The task force has held public hearings on industry and consumer group perspectives on the challenges and benefits of wider provision and use of electronic payments. The findings from those hearings will be summarized in a report that will help to shape public policy on new electronic payment media and consumers.

We have also worked to establish a foundation for international cooperative efforts to address the cross-border issues posed by electronic money and banking systems. The OCC represented the Treasury Department on the U.S. delegation for a G-10 Working Party on electronic money. In May 1997, the G-10 released a report outlining a set of key considerations to help guide national approaches for overseeing emerging electronic money technologies. As I noted earlier, the OCC also regularly participates in deliberations of the Basle Supervisors Committee, and I chair a Basle group formed to consider risks that electronic money and banking pose for banks and responses supervisors might consider.

As well, the OCC has responded to national banks filing applications or seeking legal opinions in connection with electronic money and banking products. In December 1996, the OCC issued an approval letter permitting national banks to establish operating subsidiaries to acquire membership interests in limited liability companies (LLCs) that will operate the Mondex stored-value card system in the United States. The OCC imposed conditions on the LLCs to ensure they would be subject to OCC oversight. The OCC also issued a decision in December 1996, permitting a group of national banks to invest in a limited liability company, Integrion Financial Network, to provide electronic systems that support home banking and other electronic financial services.

Regarding financial crimes, the OCC has established a task force to help produce uniform anti-money laundering regulations for U.S. banks. As part of its work, the task force is evaluating new opportunities for financial crimes presented by electronic

money and electronic banking. In addition, the agency has issued alerts and shared information with other supervisory authorities on suspicious activities by entities offering banking services over the Internet.

(4) Implement Effectiveness Measures for OCC Programs, Processes and Projects

This OCC objective relates to one of the fundamental objectives of the Results Act: to be able to measure the performance of the agency in carrying out its mission. It supports the strategic goal to "improve the efficiency of bank supervision and reduce burden."

The OCC has included performance measures in our Chief Financial Officer's Annual Report since 1991, the first year measures were required by the Chief Financial Officer's Act of 1990. The initiative to measure performance in connection with the OCC's overall mission began about three years ago, when the OCC recognized the value of adopting specific goals, and of measuring the agency's success in accomplishing them.

We have a number of areas under consideration for performance measurement in future years. Work is under way to develop performance measures for the OCC's four strategic goals, which I will discuss in greater detail in my response to item 4, below. The development of meaningful performance measures is a difficult task facing the OCC and other federal agencies. Accordingly, the OCC will continue efforts to ensure that the measurements ultimately established provide useful assessments of how well the agency meets its objectives. As part of those efforts, we have worked to ensure that OCC employees have an understanding of and support the performance measurement process.

(5) Develop Technology to Support the Workforce

The OCC recognizes the importance of using technology to improve the efficiency and quality of bank supervision. Appropriate use of technology can produce several important benefits. Technology can enable us to use more sophisticated methods of analysis where appropriate and to focus our resources on areas exposed to the greatest risk once they enter the bank. The result can be less burden on banks and improvement in the quality of our exams. Hence, this objective supports the strategic goals: "improve the efficiency of bank supervision and reduce burden" and "ensure bank safety and soundness."

Of course, it is necessary to plan and to implement appropriate technological improvements to achieve desired outcomes. Our plan calls for continued development of the Examiner View automated examination system and calls for perfecting automated examination support systems such as the Integrated Bank Information System (IBIS) and the Industry Sector Information Service (ISIS). IBIS provides an extensive time series of financial, structural, and supervisory information accessible through a point and click system. ISIS delivers information on industries and individual companies for the primary purpose of supporting credit quality

analysis. These systems are designed to improve our examiner's abilities to analyze data, so that they can focus immediately on the areas exposed to the greatest risk once they enter the banks. Full implementation of these new systems will help make the examination process more efficient and more effective, and will thereby improve safety and soundness and lower regulatory burden.

(6) Enhance Workforce Skills, Abilities, and Resources

This objective supports the strategic goals: "improve the efficiency of bank supervision and reduce burden" and "ensure bank safety and soundness." The OCC is engaged in managing the evolution of its staff towards a smaller, more highly skilled, more effective workforce that is better organized to supervise the banking industry of the future. As part of this process, the OCC is aligning employee skills, knowledge, and expertise more closely with organizational needs, based on OCC priorities and the requirements of the Supervision by Risk objective. To this end, the OCC began implementation in 1996 of a process that identifies future knowledge needs and compares those needs to knowledge levels of employees. Any imbalances between the two can then be addressed by specific training or targeted hiring of outside expertise. Other programs are being piloted in 1997 with agency-wide expansion planned for 1998. These programs include developing and implementing training programs to cover new activities in order to ensure effective supervision, and will address, among other things, development of employee skills. In addition, we are evaluating and modifying the examiner training curriculum as necessary to ensure that examiners have the tools they need to examine banks effectively.

(7) Improve Internal Communications

This objective supports the strategic goal: "improve the efficiency of bank supervision and reduce burden." The successful accomplishment of the OCC's strategic goals and the objectives supporting them is closely tied to good internal communication.

Our Organizational Review Team, an interdisciplinary group that was formed to recommend changes in organizational structure and systems, first identified in 1994 the need to clarify for employees the mission and vision and overall direction of the agency. Since that time, we have worked to improve our internal communications. Executive Committee members have conducted "focus" groups to solicit ideas from staff across the country about what will be important for the agency to concentrate on in the next 5 years. We have also created a number of electronic conference and bulletin boards to solicit concerns and answer questions of our employees.

Looking forward, our objective for 1997 is to institutionalize further a coordinated and integrated communications process within the OCC. For example, we will improve the links among agency activities and the OCC's mission and operating plans; institutionalize accountability for consistent and cross-functional communication on the part of all employees; and

require that new policies and initiatives include communications plans.

II. Review of the process by which the OCC is preparing its strategic plan, including in particular our efforts to solicit and consider the views of key stakeholders as required under Section 306(d) of the Results Act

The OCC recognizes the need to integrate strategic goals and operating plans with the planning and budget process to make sure that we have sufficient resources in place to satisfy requirements and that we allocate resources efficiently. Consequently, the OCC has committed significant resources to enhance the agency's strategic and operational planning process. As part of its major organizational review process, the OCC made enhanced strategic planning and performance measurement key objectives. These efforts identified a number of steps the OCC should take in support of the strategic planning process, which include:

- Establishing both formal and informal methods for setting a proper historical perspective for planning, as well as for obtaining environmental information and customer ideas;
- Providing written guidance to coordinate the development of strategy with unit budgeting and staff planning;
- Setting up automated management information systems to monitor the achievement of short-term operational goals; and

Conducting quarterly reviews of project status, budget results, and performance against strategic goals and objectives.

Consulting with Stakeholders

I do not believe that the OCC can be successful in carrying out its mission and planning for the future without actively reaching out to and hearing directly from our numerous stakeholders. The OCC has a diverse group of stakeholders. In addition to national banks, these stakeholders include financial services consumers, who seek fair and equal access to credit and other financial services; other bank regulatory agencies; Congress and, in particular, the oversight Committees responsible for banking and financial issues; the Treasury Department and the Administration; and OCC employees. All of these stakeholders have a vested interest in the agency's strategic goals.

The OCC has made considerable efforts to consult with the banking industry, trade groups, consumers, and public interest organizations. Our outreach programs include one-on-one meetings, informal focus groups, seminars and open meetings. Shortly after being appointed Comptroller, I initiated annual meetings between myself and the 25 largest national banks. In addition, we have revived nationwide "Meet the Comptroller" sessions throughout the country. We have held 17 such meetings, which are widely attended by community bankers, over the last four years. I have also encouraged OCC senior management to

increase their meetings with bankers and bank customer groups. The Comptroller and OCC Executive Committee members meet with state chapters of national bank trade associations and bankers from all fifty states throughout the year to discuss trends and issues facing the industry. The Deputy Comptrollers that head our six district offices also conduct ongoing outreach programs to bankers and consumer and community organizations within their districts.

To improve communications further, and to give banks an opportunity to present concerns about their examination findings and other supervisory matters, the OCC created the Office of the Ombudsman in 1993. The Ombudsman and his staff are responsible for ensuring that the OCC appeals process provides a fair and speedy review of disagreements on agency findings or decisions. The Ombudsman has the discretion to supersede any agency decision or action during the resolution of an appealable matter. Since 1993, the office has resolved 110 formal appeals from national banks, and facilitated resolutions in 359 additional cases. The Ombudsman also recently assumed responsibility for the OCC's consumer complaint operations. Since June of 1995, after the completion of each examination, we have sent a questionnaire to the bank to measure the effectiveness of the examination just conducted. Our Ombudsman produces a semiannual summary of major issues raised in the questionnaire process.

I also meet regularly with community leaders all across the United States to learn about their concerns regarding OCC supervision of national banks. For example, I have met once a month with national community and consumer leaders, and have met with over 400 community development leaders as part of my visits to other cities in which we hold "Meet the Comptroller" sessions. In addition, we have worked to give the public greater access to information about the OCC through a special Public Disclosure room, through the OCC's consumer hot-line, and through our Internet web-site.

Our strategic planning process has included discussion with our fellow banking regulators. This spring, the OCC, the Federal Deposit Insurance Company (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA) established an interagency working group (The Results Act Banking Regulatory Working Group) to share products and processes relating to the Results Act. The members of the working group shared the strategic plans of the various agencies, including goals, objectives and measures.

The OCC has worked hard to consult with and communicate with members of Congress and their staff. I, along with our Congressional Liaison and other OCC staff, have had numerous meetings with members and staff of our Congressional oversight committees during which we have discussed our strategic goals and some of the objectives that support the realization of those goals.

Also, as part of the Treasury Department's responsibility under the Results Act, the OCC produced an early draft strategic plan

for the Treasury Department last fall. This draft was then passed through to OMB for comment. The substance of that feedback is reflected in the current draft presented to this Committee.

Finally, improving communications and consultation with our employees has been a high priority for me. As I have noted, we have taken numerous steps to improve internal communications.

III. Assessment of the most important factors for the OCC to consider in developing a performance-based Strategic Plan

To build our strategic plan, the OCC evaluates a wide set of external and internal factors. Relevant internal factors include the performance measures that best gauge how well the agency satisfies the strategic plan objectives and the role of the strategic plan in the agency's ongoing efforts to improve its internal planning process. There are also numerous external factors, which I mentioned earlier in my statement, including the rapidly changing structural, technological, and competitive conditions in the banking industry and the impact of the strategic plan on national banks, the banking public, OCC employees, and other agency stakeholders.

Changes in the banking industry

In developing its strategic plan, the OCC has taken into account the sometimes unpredictable nature of environmental factors, which can include structural changes in the banking industry, fluctuations in the economy, new technological developments, or other events, that could require the OCC to reevaluate its operational goals and implementation strategies.

One such factor is industry consolidation. Consolidation is reducing the number of national banks and increasing the size of the typical national bank. Over the past three years, over 500 small national banks merged or consolidated with other banking institutions, and the number of large commercial banks, i.e., those with assets in excess of \$10 billion, has increased by more than 25 percent. These trends are likely to continue, spurred by the lifting of restrictions on interstate branching which took effect on June 1, 1997. As I mentioned at the start of my testimony, in 1996, there were approximately 2,700 national banks. The OCC projects that the number of national banks will decline by about 300 in 1997, and that by the year 2000 there will be between 2,000 and 2,100 national banks.

The OCC estimates that continued industry consolidation will reduce its assessment revenue in 1997 and will constrain assessment revenue in the future. This downward pressure on revenue growth, coupled with the reduced number of national banks, has led the agency to reexamine its staffing levels and the distribution of workloads by geographic location. In March 1997, the OCC announced a new, more efficient organizational structure.

The OCC depends almost exclusively on assessments to fund its operations, and because of this national banks face higher costs for supervision than state banks. State bank regulators share their bank supervision responsibilities with the FDIC or the Federal Reserve. Because neither the FDIC nor the Federal Reserve charge exam fees, state-chartered banks pay substantially lower assessments than do national banks. The OCC is currently studying alternate assessment structures that would assure adequate revenues for the agency as the industry consolidates.

#### Technological Change

As I have stated above, analyzing developments in electronic money and banking is one of the seven objectives in the strategic plan. Technology is a factor that creates new opportunities and new challenges for the agency, and could require us to rethink our supervisory and operational goals and the way we implement them.

With regard to supervision, technological advances make it possible to deliver financial services in new ways -- electronically and remotely -- and make entirely new products possible, e.g., electronic cash. Not only might these developments improve the efficiency of finance and financial intermediation, they could also fundamentally alter the nature and production of financial services.

However, these advances also pose new challenges for financial markets and institutions, as well as for financial market and payment system supervisors. Electronic delivery places greater pressure on banks to maintain computer security, just as non-bank issuance of payment media potentially places a portion of retail transactions outside the reach of existing financial integrity safeguards. The challenge to supervisors is to identify and evaluate the risks that technology poses and to develop appropriate supervisory responses to those risks, either through existing regulations and guidance, or by developing new ones. We have already begun this process.

#### Changing Competitive Environment

As I described at the beginning of my testimony, banks face an increasingly competitive marketplace, and regulating banks in this changing environment may also affect the implementation of the OCC's strategic objectives. Global markets provide new challenges for banks, and consumer needs and demands are changing as the population becomes older, more ethnically diverse, and more sophisticated about financial products and services. Technological innovation allows banks to respond more quickly than ever to these new opportunities. However, banks are facing increasing competition from nonbank providers.

The OCC believes that the long term safety and soundness of the banking system demands that banks be able to engage in a wide range of financial activities that are both profitable and pose relatively low risk. Congress is currently considering legislation to modernize the legal and regulatory structure

governing financial services. This legislation offers the potential to remove constraints that prevent banks from offering the full range of financial products and services through which they can safely and soundly meet the needs of America's consumers and its economy.

IV. A review of the methods by which the OCC is prepared to measure the results of its outcome related goals and objectives

One of the fundamental purposes of the Results Act is to be able to measure the performance of the agency in carrying out its mission. To measure our performance in carrying out our mission, the OCC has included performance measures in its Chief Financial Officer's Act Report since 1991, the first year they were required. The measures included in the Annual CFO Act Report are listed in Table 1 below.

TABLE 1:

Measures Included in the Annual CFO Act Report

Measure	Indicator
Timeliness of Examinations	Number of examinations started on schedule Number of examinations started after date scheduled
National Bank Condition	Change in composite ratings (upgrades vs. downgrades)
Enforcement Actions	Comparative analysis of completed enforcement actions against banks
Licensing	Comparative corporate licensing activity Timeliness of processing applications
Consumer Complaints	Comparative analysis of consumer complaints using "average resolution time"
Prompt Payment	Prompt payment comparisons: Number of invoices paid late as a percentage of invoices paid Interest penalties paid as a percentage of total dollars paid Invoices paid on time as a percentage of total invoices

As I have stated, one of our 1997 objectives is to develop better effectiveness (i.e., performance) measures for the OCC. Our intent is to produce new measures that are more outcome-oriented than our existing measures.

Earlier, I mentioned our Organizational Review Team's (ORT) efforts to examine the OCC's organizational structure and



systems. One of the ORT's sub-teams recommended that quality assurance be implemented in a consistent manner throughout the OCC. Measurable objectives are an essential part of quality assurance. Therefore, the Quality Assurance Advisory

Team (QAAT) that was formed to implement quality assurance is also facilitating the development of measures for the four pillars and the seven objectives I described earlier.

Working with the QAAT, a team of senior OCC managers drafted a set of measures for the four pillars. These measures use a "Balanced Scorecard" (2) (See Robert S. Kaplan and David P. Norton, The Balanced

Scorecard, Boston: Harvard Business) -- a multidimensional set of measures encompassing four perspectives: customer, internal-business process, financial, and learning and growth. These measures carefully reflect the OCC's mission and goals. Ultimately, we believe that these measures will not only provide our senior managers and our stakeholders with a wide range of important information about our effectiveness in accomplishing our mission, but also help OCC employees understand why the implementation of effectiveness measures is important to the OCC's mission and to them individually.

Developing meaningful, quantitative measures is not an easy task. We have had to think about what it is we are really trying to measure -- our desired outcome -- and determine whether we have existing data or can get data to fit the measure. Our draft measures are currently undergoing additional refinements, and we anticipate that once implemented they will be revised on an ongoing basis as we gain experience in tracking our performance.

For example, with respect to our "assure fair access" pillar, one of our objectives is to encourage national bank involvement in community development activities. We propose measuring accomplishment of that objective by noting the percentage change in the number and dollar amount of community development loans. We also propose to measure the trend in the number and percentage of national banks making investments and the dollar amount of community development investments.

V. Estimates of the projected cost savings that the agency expects to achieve from implementation of the proposed Strategic Plan

Total expenditures have been declining at the OCC during the past several years, and the agency has passed these cost savings along to national banks in terms of lower fees and assessments. The OCC expects that total agency expenditures for 1997 will decline by nearly \$20 million, or about 5 percent below 1996 levels. These recent reductions in expenditures result, in part, from the OCC's strategic planning processes in earlier years.

VI. An overview of any potential difficulties the OCC is encountering in meeting its responsibilities under the Results Act

I foresee no significant difficulty in meeting our responsibilities under the Results Act. Of course, circumstances beyond the OCC's control might require the agency to augment or modify its strategic plan, its goals and objectives, and the methods it uses to meet those goals and objectives. Such circumstances could be triggered by unforeseeable changes in the structure of the banking industry, shifts in the macroeconomy, systemic events that threaten the banking or payments systems, or legislative initiatives that alter the competitive landscape in the financial services industry.

VII. Realignment of budgetary and other resources required as a result of the agency's strategic plan

Although the OCC projects lower overall expenditures in 1997, our strategic plan calls for spending increases of 10 percent or more in several different areas: examiner training, computer hardware, economic analysis, communications, and international affairs. These areas of increased expenditure reflect the goals and objectives of our strategic plan.

Increases in examiner training expenditures support the enhancing workforce skills and abilities objective. Our expenditures for computer hardware support the develop technology to support the workforce objective. For example, we are expanding the agency's local area network/wide area network (LAN/WAN), and we are purchasing higher capacity computer equipment to support our "Examiner View" project.

We are also increasing our staff of economists to support the bank supervision process, through direct, in-bank examination support and data-base development. Those increases are an important step in advancing the objective of enhancing workforce skills. Expenditures in our Department of Economics and Policy Analysis will also rise because of the addition of two new groups to this department to support the OCC's electronic money and banking objective.

Our plan also calls for a significant increase in expenditures on our Ombudsman program. Increases in this program reflect planned increases in personnel, increased travel to administer the national bank appeals process, and outreach.

We have added resources in the communications area because we believe effective communications with our various stakeholders is an important element in advancing the goal of improving the efficiency of bank supervision. For example, as I mentioned earlier, we created a public disclosure office to better respond to informational requests from banks and the banking public. We have increased expenditures for agency publications, including revisions to the OCC's Corporate manuals and various handbooks providing guidance to examiners and national banks. Finally, we have added resources to support development of the OCC's Internet

web-site.

The increased expenditure on international affairs is due to the addition of an Office of the Senior Deputy Comptroller for International Affairs. This new office will lead and represent the OCC in various international forums including the Basle Committee on Bank Supervision, and its new staff will increase our capacity to provide international economic and financial system monitoring and other supervision-related analytical support.

#### Conclusion

The OCC considers strategic planning to be important to our ability to advance successfully the mission of our agency. A strategic plan enables us to set goals and objectives that serve as a guide for determining priorities and allocating resources. In addition, strategic planning enables the agency to consult effectively and to communicate with our stakeholders concerning the mission of our agency. The strategic planning process also focuses our attention on the crucial and complicated issue of measuring performance.

Strategic planning is not new to the OCC, but I feel that we learn important lessons each time we engage in this process. This year's planning process has been particularly valuable, in large part because of the enactment of the Results Act. The obligations under the Act have generated increased awareness of the benefits of planning and the importance of the planning process. For our agency, this has meant greater internal and external discussion focussing on the strategic goals and objectives of the OCC.

I am pleased to have this opportunity to address the Committee on this subject, and I look forward to answering your questions and hearing your comments.