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Remarks by Eugene A. Ludwig
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It is a great pleasure to be with you at your annual conference. Ever since its founding in 1966, the Institute of International Bankers has been an organization dedicated to serious discussion of the issues in which all of us here -- bankers, regulators, and other government officials -- share a common interest. Under the distinguished leadership of Larry Uhlick, the IIB has helped us to better understand the benefits of a free global financial marketplace. I am proud to be with you, and proud to follow in the footsteps of the many distinguished speakers who have addressed your conferences in the past.

Of course, our Office, the Office of the Comptroller of the Currency has a keen interest in international banking. The OCC, which I have headed for the past five years, regulates and supervises some 2600 nationally-chartered banks, which together hold the greatest portion of the total banking assets of the United States. As a group, national banks are extremely active in the international arena. As of late 1997, they held foreign investments worth more than 225 billion dollars. National bank subsidiaries of foreign banks, which the OCC also supervises, held total assets of 131 billion dollars, while their foreign branches held almost \$300 billion in assets. As these numbers show, the national banking system of the United States is a major force in the global banking picture.

As the supervisors of such globally active institutions, the Office of the Comptroller of the Currency is active internationally as well. For decades, the OCC has had an office in London, and has coordinated examinations all over the world. The OCC is a member of the Basle Committee on Banking Supervision. We have close and productive relationships with foreign financial supervisory agencies. We play an active role in advising foreign governments and supervisory agencies on issues of common concern. In the past year alone, bank supervisors from 29 countries around the world came to the United States to work with and learn from OCC staff, while OCC specialists visited 13 countries to provide technical assistance. And the number of governments with which we consult is growing.

Even if national bankers and this office were not so active internationally, we would still have to keep a close watch on financial developments around the world, recognizing that virtually every facet of domestic banking -- indeed, virtually every facet of our nation's economic life -- is influenced by

what goes on abroad.

What a far cry from the circumstances that prevailed when the OCC was created 135 years ago, in 1863! Back then, cables had not yet been strung between the New World and the Old, so that international communications moved little faster than they had a hundred or even a thousand years earlier. Information between the continents traveled under sail and, much less often, under steam. The fastest ships afloat took seven and a half days between New York and Liverpool, and 120 days from New York to Hong Kong. Under these conditions, with news often outdated before it arrived at its destination, investing abroad was largely an act of faith, as many ruined investors could attest.

The numbers reflected this. In 1869, all U.S. investments overseas totaled less than \$100 million -- about what Citicorp now generates in revenues on a bad day. Even in the 1920s and 1930s, when air travel was still a novelty, our physical isolation from Europe and Asia was an article of faith for most Americans, and only the most farsighted members of the banking fraternity recognized that the future of finance was in the international arena.

Today, I need hardly tell you, the world is a radically different place. The information super highway reaches into every corner of the globe. Sums that stagger the imagination travel tens of thousands of miles, instantaneously, with a single computer keystroke. Insomniacs can trade stocks or futures in real time at any hour of the day or night, for the markets never close. Where once there were only one or two financial nerve centers -- London or New York -- today there are many. The Financial Times tracks no fewer than 53 global stock exchanges, including bustling markets in China, Russia, Sri Lanka, and Zimbabwe. In the United States, global funds are one of the fastest growing segments of the mutual fund industry. In just one year, 1996, the assets of international equity and bond funds in the United States rose from \$230 billion to \$321 billion -- a phenomenal 40 percent increase. The speed, the stakes, the unpredictability of it all, can be exhilarating -- and intimidating.

Of course, with this greatly increased activity comes greatly increased risk. Technology and the sheer volume of global financial activity today have made multilateral supervisory concerns more important and more challenging than ever before.

Fortunately, the G-10 countries and international organizations such as the IMF and the World Bank are rising to the challenges of financial globalization. During my five years in office, we have seen exemplary intergovernmental cooperation at several levels -- including at the very highest level -- all aimed at enhancing the stability of the global economy. And what is really significant is the growing recognition -- again, at the highest level -- that the stability of financial institutions and the quality of their supervision are a critical element in the whole global financial structure.

It was in recognition of the importance of financial institutions

and their effective supervision that, beginning at their summit meeting at Halifax in 1995 and at every summit meeting since, the heads of state of the Group of Seven industrial countries have gone on record to advocate closer international cooperation in the regulation and supervision of financial institutions and markets. Financial supervision is again on the agenda of the 1998 G-7 Summit in Birmingham, England, as it was in Denver last year. Clearly, the international supervision of financial institutions has taken its place at or near the top of the world's economic priorities.

It is also encouraging that an international supervisory infrastructure is emerging that holds a great deal of promise for the financial world of the 21st century. In addition to expanded contacts on the bilateral level, there are three multinational organizations -- the IMF, the World Bank, and the Basle Committee on Banking Supervision -- that are playing and will continue to play a central role in improving international bank supervision.

Since its founding in 1974, the Basle Committee has taken the lead in formulating supervisory standards for supervising capital adequacy, derivatives activities, cross-border banking, and much more. Of considerable importance, the Basle Committee has endorsed a comprehensive set of core principles for adoption by bank supervisors globally.

As for the IMF, with its ready access to economic policy makers in host countries, it is particularly well positioned to assess the implementation of the Basle standards. And the World Bank, with its extensive on-the-ground development apparatus, is uniquely situated to assist in providing useful technical assistance -- for example, the training and education of bank supervisory personnel in host nations.

This collaboration among the IMF, World Bank, and Basle Committee is to my mind a very important development and should be commended. Too often, institutions find themselves doing someone else's job, and we get duplication and complication instead of progress and insight.

Notwithstanding the important steps that have been taken to date, the recent problems in East Asia show that there is still a considerable amount of work to be done if we are to achieve a more stable financial world. But the problems in East Asia also provide us with some important lessons from which we can all learn. Certainly, as scholars and practitioners pore over the East Asian situation, more lessons will be learned, but I do not believe it is too early to start to draw some conclusions. Where financial stability is concerned, the sooner we start, the better.

Before I begin my remarks about lessons learned, I should note that my comments will focus on the banking sector. This is by far the largest part of the financial system in East Asia, and it is the part where we have the most expertise. However, in talking about lessons learned, I would be remiss in failing to point out that the virtual absence of supervision of non-bank

financial intermediaries and the excessive loan-to-equity ratios of the business sectors in these countries certainly has played an important role in the problems.

Now for lessons learned in the banking area.

First, the Asian experience underscores the importance of greater transparency -- by which I mean improving the quality, quantity, and consistency of the information that governments, financial institutions, and financial regulators make available in the marketplace. The market can play a crucial role in disciplining the banking system, but this requires reliable information about banks' financial condition. In Southeast Asia, banks' balance sheets were telling us one thing and the reality was another. Greater transparency and reliability in the financial information that came from the affected countries of Asia, I believe, would have strengthened market discipline, which I also believe would in turn have prompted earlier -- and less onerous -- remedial action before problems ballooned to the extent they did.

The second lesson relates to the need for clear, consistent accounting standards. In many Asian countries, such standards were lacking, which had the effect of concealing problems in Asian bank portfolios. For example, although several of the affected Asian countries subscribed to the Basle capital standards, their accounting systems tended to give a different picture of their capital position than would have been the case under generally accepted accounting principles, or GAAP, in the United States.

Third, Asia teaches us that directed and connected lending have a corrosive effect on financial institutions. In Southeast Asia, too much lending was based on borrowers' business or political connections, rather than on their creditworthiness and ability to repay the loan.

Fourth, Asia highlights the importance of the fundamental principles of supervision, especially regarding loan concentrations, leverage and capital, collection practices, and the integrity of underwriting standards. For example, supervisory forbearance in some countries aggravated matters by inhibiting the identification of problems which might otherwise have been addressed in a comprehensive and timely manner.

Fifth, in addition to weaknesses in some relatively lax supervisory rules, supervisory services in those countries too often were hamstrung by too few examiners with too little training. In a number of cases, banks went four or five years without an on-site examination, and even when on-site examinations were conducted, they were less detailed and less thorough than is desirable.

Sixth, Asian developments speak volumes about the importance of risk-based supervision. Too little attention was paid to the inherent riskiness of the loans that banks were making, either in isolation or in the context of the entire loan portfolio. Recognizing that supervisory resources are limited makes it

doubly imperative that supervisors focus on the systemic impact of risk factors in their subject institutions.

Finally, the Asian story shows how important it is that bank supervisors have the will and the political authority to carry out their responsibilities in a professional, dispassionate, and resolute manner.

These are the lessons that the Asian experience seems to offer. I believe that from these seven lessons emerge a set of seven prerequisites for greatly improved worldwide bank supervision and with it, greater international stability. I mention these in no particular order of importance.

First, we must move rapidly toward achieving worldwide accounting standards that are at least as rigorous as the Generally Accepted Accounting Principles in the United States. It is hardly possible to have a meaningful evaluation of institutional risk unless a reliable and readily understandable picture of the basic economics of the institution can be obtained.

Second, increased transparency is necessary. At a minimum, this transparency should reflect what is currently required by the U.S. Securities and Exchange Commission. For supervisors, the transparency should be still greater.

Third, every country needs a high-caliber supervisory rule set. In this regard, the recently-announced Basle core principles, which I mentioned earlier, provide an important platform for quality supervision in any country. Their adoption by the Basle Committee represented an international endorsement of time-tested supervisory practice in G-7 countries. They should be adopted universally. They also should be elaborated upon by the Basle Committee.

Fourth, in adopting and implementing the Basle core principles, particular attention should be paid to the problem of connected and directed lending. When a loan arises because of connections, without independent credit evaluation, the likelihood that it is not an economically sound proposition for the bank and will result in some harm to the bank are significantly higher.

Fifth, bank supervisory services should have sufficient personnel to be able to provide an on-site, full-scope examination at least every 18 months. Sixth, supervision and examination should become even more risk focused. Examination and supervision are dramatically less effective when they focus on today's problems. They must focus on emerging risks before they become intractable problems. We at the OCC have spent a considerable amount of my five-year term developing a supervision by risk program, and although this program will be continually refined in the months to come, I am confident that it has already made a big contribution to a safer and sounder national banking system.

Finally, it is absolutely essential that bank supervisory bodies have the enforcement tools, the independence, and the political support to take tough enforcement measures when they are needed.

Everything else -- more uniform accounting standards, improved disclosure, and risk-based supervision -- will count for little if supervisors lack effective powers of enforcement and the will to use them.

As you can see, much remains to be done. However, I am optimistic that we will be able to accomplish the changes we need to make the economic world of the 21st century a stable and prosperous place. The world of the next century holds great promise for us all. Through continued cooperation among international agencies and the private sector -- and through organizations like the IIB that bring together people of talent and commitment -- I believe it is a world of promise well within our reach.

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The OCC charters, regulates and supervises approximately 2,600 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than 56 percent of the nation's banking assets. Its mission is to ensure a safe, sound and competitive national banking system that supports the citizens, communities and economy of the United States.