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Remarks by

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This morning, I'd like to offer a regulator's thoughts about where banking is going. In some ways, that's a presumptuous undertaking, because in many respects you are in a far better position than I to give a speech about the future of banking. You're out there every day in the market making business decisions for your bank and setting its strategic direction. But while I don't claim to have the best perspective on banking's future, I do have a unique perspective. As regulator of the national banking system, I see banks all over the country. I have the opportunity to talk to bankers who represent institutions of all sizes and strategies, get a sense of what is on the collective minds of banking's leaders, watch how the industry as a whole is meeting its challenges. Besides, I never met a captive audience I didn't like.

Banking today is truly at a defining moment in its history. And if the industry makes the correct strategic decisions, has the fortitude to fight for what it knows is right, develops the abilities necessary to see its strategies through, and continually brings new products and markets into its sphere, banking's future will be secure for decades to come.

Now, this belief -- that banking has a promising future -- would have raised quite a few eyebrows back when Bill Gates was talking about dinosaurs. But I never believed the banking industry was bound for extinction -- and I don't believe it now. I never believed it because I know the abilities of bankers like you in this room. And I know first hand the potential of America's banks to be leading players in the financial services industry of the future.

Gates had it wrong. Banks are not dinosaurs. If one is going to use any metaphor, perhaps a better one is that at least some banks had been sleeping giants. A combination of factors has awakened them to their potential.

Today, it is not the charge of being dinosaurs that should be ringing in bankers' ears. It is the Latin saying "Carpe Diem" -- seize the day.

Seize the day -- because a strong future in any business, and particularly in financial services, is earned, never guaranteed. Let us use this unique opportunity to move banking all the way back to center stage of the financial services, where it was for most of this century.

Let me explain why I believe now is the time to do that.

First, the banking industry today enjoys a regulatory environment that more than ever before takes into account the benefits of a competitive marketplace, the need for expanded bank powers, and the importance of removing unnecessary burdens on your businesses.

A second reason that now is the time to seize the day is that the banking industry is riding a wave of record profitability -- a tribute not only to a sound national economy, but to your ability to post strong growth in noninterest income and to control expenses. Banking's efficiency ratio is now 61 percent, an increase of 7 percent in the last five years. In the second quarter of 1996, the industry recorded the fourth highest return on equity in its history. Higher profits were propelled primarily by the increase in noninterest income -- 20 percent higher than a year earlier. Of course, net interest income, fueled by margins that widened for the first time in almost two years, increased as well.

A third reason bankers must seize the day is that you are indeed in the middle of a technological revolution where changes come rapidly, where decisions are being made that will shape the future, and where competitors are lined up -- ready, willing and able to take your business if you do nothing to stop them.

Clearly, the time to act is now. But what should banking do to seize the day and secure its future?

Banks must demonstrate energy and backbone. They must demonstrate energy in taking advantage of new market opportunities. The faster growth rate in noninterest income I alluded to a moment ago reflects the over-a-decade-long trend towards increased fee and trading income -- the fruits of our collective labors to bring greater competitiveness to the financial services industry and move banking into the future. And that figure is a testament to the fact that you have deployed considerable energy to develop the skills and marketing knowledge your banks need to excel in new lines of business.

But energy is not enough. The industry also needs the backbone to fight vigorously to hold on to its hard-earned gains. You're all well aware of the victories we've attained in recent years to expand bank powers and bring the benefits of a competitive marketplace to this country's consumers. Four times in the last two years the Supreme Court has unanimously agreed with the OCC's interpretation of the National Bank Act and our responsibility to apply it to the contemporary landscape. These victories were long overdue. But we've spent much of the last year and a half using our energies on the defensive side of the expanded powers line -- fighting legislative attempts to push banking backward.

All of those of us who favor a competitive marketplace were successful in keeping restrictions on bank insurance activities out of the banking part of the Omnibus Appropriations Bill -- now signed into law. The law does not contain any of the various provisions that were in play all year -- provisions that would have undercut the Barnett decision and opened the door to state licensing laws, some of which would have restricted national bank sales of insurance. The only provision that pertains to insurance in the Appropriations Bill says that tax-deferred annuities sold by insured depository institutions -- the so-called Retirement CD's -- are not deposits and therefore not insured. Of course, the IRS had already guaranteed that result in a recent tax ruling that effectively prohibits the sale of these products. All in all, I'd call the absence of anti-competitive insurance provisions in this legislation a clear victory for the banking industry.

When the 105th Congress convenes in January, I have no doubt that all of us who support competition will be required -- once again -- to stand firm for what we believe is in the best interests of American consumers and the banking industry that serves them.

But our fight cannot be only a defensive one. Even as we look back over our shoulders to fight off efforts to push banking backward, we must also look ahead to the future, see where we need to go, and keep moving toward that destination.

Treasury Under Secretary Hawke recently spoke eloquently of the need for a broader vision of financial modernization and his hope that the next legislative initiatives on financial services would move beyond intra-industry disputes and take a longer range approach that, in his words, "protects competition, and not competitors."

Moreover, we've already seen new momentum for positive change in the Federal Reserve's section 20 change -- an idea whose time had come and one that will increase competitiveness and bring great benefits to a number of you.

And, as you are well aware, at the OCC we have plans of our own in the works to bring greater competitiveness to financial services and enhanced efficiencies to banks -- plans that we have had to set aside in recent months. We have taken those plans off the shelf, dusted them off, and reexamined them. And I'm confident that decisions will be made on those plans within the next few weeks.

Our responsibility as regulators and policymakers -- in assessing these plans and in weighing future proposals -- is to strike the proper balance between allowing competitive market forces to prevail and ensuring that safe and sound business practices are adhered to and consumers treated fairly.

But how do we do that?

Let me share with you a set of principles that I believe must guide government's actions in determining which activities should be permissible for banks in the future -- both in the near term as well as in the decades to come.

First, we should assume that the "business of banking" is sufficiently broad and flexible that a bank can engage in any financial activity or activity incidental to financial services that benefits its customers -- unless that activity has fundamentally more severe risks than the bank's traditional and recognized business. Applying this principle, of course, requires a clear understanding of both the benefits and risks involved.

Second, in determining whether a new activity benefits bank customers, we should factor in the value of increased competition and the operation of free markets -- both of which tend to drive down costs, increase customer choice, and promote product and service innovation.

Third, in considering any new activity, we should conduct a rigorous and fact-based analysis of its risk, taking into consideration the inherent characteristics of the activity, the institutions that want to conduct the activity, and the volume of the new activity to be carried out.

Fourth, we should make certain that regulation and supervision are imposed when necessary -- but only when necessary -- to address safety and soundness risks or to achieve a clear and demonstrable public purpose -- for example, protecting consumers, including making sure consumers have the information necessary to make informed decisions; preventing financial crime; and ensuring adequate and fair competition. Further, the benefit of regulation and supervision must be carefully weighed against the burdens and expense to the banking industry and the economy.

Fifth, unless government action is necessary to preserve safety and soundness or to protect an important public interest, you ought to be able to run your businesses -- not the government. Barring these constraints, you should be able to decide the structure of your organization for the products and services you offer the public. You have to have the flexibility to run your businesses effectively and efficiently.

If we actively apply this framework, the result inevitably will be less burdensome regulation and supervision, and greater opportunities for bankers and consumers alike.

Realizing banking's future, however, also requires a firm commitment to the fundamentals.

We all know that the business of banking is evolving, but we must not forget that the basics of banking are etched in stone. None of us can afford to lose sight of the fundamentals of risk identification and risk management.

In today's changing marketplace, I believe that the strategic risk of missed opportunities is probably the greatest risk facing the banking industry. That includes failing to experiment with new products or explore new markets that might not have seemed profitable in the past.

But we must not forget more traditional risks. Traditional risks, such as operations risk, present new challenges as banks move into new areas and offer new products. And, of course, we cannot take our eyes off that old nemesis -- credit risk. Neglecting credit risk is still one of the easiest ways to set stock prices spiraling downward and throw you off course long enough that you can't get back on track in a fast-paced, competitive marketplace.

We've seen troublesome signs in this area. Consumer credit quality has deteriorated at commercial banks over the past few years. Net losses on credit card and installment loans have increased for five consecutive quarters, and -- while they account for only 20 percent of loan activity -- these trends are significant and of concern. Last month, as you know, we issued an advisory letter on preapproved credit card solicitations, reminding national banks of the risks some of these programs pose and identifying specific steps to address possible weaknesses in credit card portfolios.

In addition, we have seen a continued weakening in commercial credit standards; pricing is razor-thin, and terms at some institutions are lower than two years ago. We certainly don't want to overreact, and some deterioration is consistent with the maturation of the business cycle. But as a paid worrier, my responsibility -- and the job of the Office -- is to make certain that banks have sound risk management systems in place and are managing risks appropriately.

Last year, I announced the formation of the OCC's National Credit Committee in response to concerns I was hearing about erosion in credit underwriting standards at that time. This group of some of the OCC's best examiners is a valuable resource for the industry and for the OCC, helping ensure that fundamentals are not overlooked.

Conclusion

We have made tremendous strides in recent years, and banking's future is promising. Today, in the world of banking, A.D. -- After Dinosaurs -- I have confidence that banking will continue to move forward and seize not only today, but the next century. I have confidence because I know what all of us here have done in recent years to strengthen banking's hand.

So, yes, the future is promising, but it is not certain. The future requires action. The future will only be realized if we keep the momentum going. Working together this year, we were able to preserve the value of your banking franchise. Working together in the months and years to come, I'm certain we will be able to realize banking's potential and give this nation, its communities and its citizens the financial services industry they want and need.

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