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Remarks by

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It's both a pleasure and an honor for me to have an opportunity to meet with this distinguished group of international bankers.

You have asked me to discuss three topics this afternoon -- financial modernization; electronic banking, which in many ways is part of financial modernization; and supervision by risk. These are all critical issues for those of you who operate in the U.S. financial markets, but they are even more critical in an international context. In the U.S., because of some historical anomalies, banks have only recently won the right to provide a broad range of financial services -- services that most banks outside the U.S. have provided for decades.

But financial modernization in the broadest sense is occurring in different ways all over the world, partly as the result of technological advances and partly as the result of the increasing globalization of financial markets. Technology is revolutionizing the financial services industry through such innovations as electronic money and electronic banking, and the volume of cross-border trading and other financial activities is increasing geometrically -- again, facilitated by technology. Technology makes possible the efficient generation, collection and processing of information about bank operations and bank customers. It provides the ability to create more effective systems of controls in individual institutions and in the markets themselves. In combination with increased competition from non-traditional competitors, technology is the driving force behind almost all the financial modernization occurring throughout the industrialized world.

This broad financial modernization requires all financial regulators, including those of us in the United States, to respond with modernization of our supervision -- including much more coordinated and cooperative supervisory efforts.

Financial Modernization

For me, financial modernization is not a single result. It is an ongoing process that uses new technology and other innovations to improve existing financial products and services and to develop

new ways to meet the needs of bank customers and the economies of our several nations. Financial modernization in the U.S. -- indeed, in virtually every industrialized country -- is hardly a new phenomenon. Since World War II alone, we have seen exponential growth in credit cards, more flexible consumer lending standards, the spread of electronic payments systems, and the widespread use of new risk reduction tools, such as derivatives and asset securitization. Given the continuing changes in technology, financial modernization is likely to continue at this rapid pace for some time to come.

To a great extent, however, financial modernization in many industrialized economies has been frustrated by outmoded laws and regulations that have often prevented banks from taking full advantage of new technologies and innovations. By their very nature, laws and regulation are static, while technological innovation is dynamic.

In the United States, until relatively recently, the financial system has been particularly burdened by laws and regulations that attempted to "protect" financial institutions from problems experienced in the 1930s by restricting them to a single function. Banks operating in the U.S. were severely limited in their ability to provide new products and services, while at the same time being smothered by excessive regulatory burden and red tape. For years, efforts to change these laws were defeated by special interest groups who wanted to protect their competitive position.

In addition, for many years, the debate over U.S. financial modernization was not particularly elevated. More recently, however -- partly as a result of analyses by Eugene Nelson White and by Randall Kroszner and Raghuram Rajan -- there has been a genuine change in discussions of this topic. White demonstrated that, contrary to traditional views, the fact that some banks combined traditional banking services with securities activities was not a material cause for the large number of bank failures in the 1930s. In fact, he showed that banks directly or indirectly involved in the securities business did much better during this period than banks who were not involved in securities. Kroszner and Rajan showed that the securities underwritten by banks or securities affiliates of banks were actually of a higher grade than those underwritten by non-banks.

To me, the significance of this work goes far beyond securities and banking issues. Even more important is that it demonstrates how policy makers with the best of intentions can be misled by relying on commonly held views rather than careful scholarship and analysis.

Moreover, the costs of being wrong are significant -- particularly at a time when technological innovation is continuing at such a rapid pace. Obviously banks or other financial services providers are harmed when they are unnecessarily restricted in their ability to meet market needs -- but our economies may suffer even greater harm.

Fortunately, many unnecessarily restrictive laws and regulations are now being modified or eliminated. Some banks operating in the U.S. are well on their way to establishing nationwide branch networks. Through a series of legal interpretations that have been validated by the courts, the Office of the Comptroller of the Currency has worked hard to expand the products and services permissible within existing law -- both for national banks and for federal branches and agencies of foreign banks. As a result, banks can now sell a wide variety of securities and insurance products, although the insurance agents still appear to be fighting a rear guard action to limit competition from banks in this area.

The good news is that both Congress and the regulators agree fully that the future strength of the U.S. banking industry depends on its ability to provide competitive products and services. All the bank regulators are working to reduce regulatory burdens and restrictions, and by the end of this year, the OCC expects to complete a revision of all our regulations -- the first such review in 130 years.

Electronic Banking

Surely one critical aspect of financial modernization is the development of electronic banking and electronic money. Experts disagree on how quickly e-money and e-banking will become a significant part of financial systems in the U.S. and other countries. My own view is that some system of e-money, whether over the Internet or in the form of stored value cards, will be relatively robust within the next three to five years. But while there is disagreement on the precise pace of change, there is clear agreement on the need to plan now on how to manage risk in e-money and e-banking systems.

A little over a week ago, the U.S. Treasury Department sponsored a conference entitled "Toward Electronic Money and Electronic Banking: The Role of Government." We heard from a variety of speakers representing consumers and industry, as well as from European and U.S. government representatives. I won't try to repeat all the information that emerged from this conference. But I would like to pass along three key points that seem particularly relevant for all of us who are interested in electronic banking.

First, although there were some strong differences of opinion about several issues at this conference, everyone agreed on one thing: the key to developing a robust electronic money system is trust. The new electronic marketplace offers businesses new opportunities for increased efficiencies, larger markets and greater profits, and offers consumers greater convenience and access to new products and services. Nonetheless, how useful this marketplace becomes will depend on how much confidence all participants -- businesses and consumers alike -- have in its dependability and integrity.

For example, participants in the electronic marketplace will have to confidence that e-money transactions are enforceable and

reliable -- a major challenge in light of the borderless nature of electronic commerce. They will want assurance that there is minimal fraud in electronic markets. At the same time, consumers and other market participants will want reasonable protection against abuse of privacy, including determining who has access to personal or business information and how that information is used. And consumers will need adequate information to make informed choices about electronic money and banking over the Internet, including information about potential risks.

Here in the U.S., the OCC is heading a new Consumer Electronic Money Task Force that will bring together all the relevant government policy makers to address these consumer issues. Our first meeting will be within the next several weeks, and we fully expect to rely heavily on input from industry and consumers as we tackle these issues.

Second, the presentations at the Treasury e-money conference made it clear, if there was any remaining doubt, that there is an international dimension to virtually all the major issues surrounding electronic money and banking. Electronic commerce is virtually borderless, and the resolution of many significant issues will require cooperation and coordination among financial institutions and governments throughout the world.

That is one reason the study sponsored by the G-7 that Secretary Rubin announced at the conference is so important. This study will, for the first time, bring together central bankers, bank regulators, finance ministries, and law enforcement authorities from each of the G-10 countries to address electronic money and banking issues from an international perspective. They will build on the work of other international groups that have already begun to study these important issues. And they will identify gaps -- areas where international cooperation is needed but where no action or study has yet begun. This is important because electronic money is truly an international phenomenon. The simple fact is that we cannot afford to have these new beneficial technologies disrupted by international pirates. Countries must find ways to cooperate to provide greater security and certainty to participants in electronic money and electronic commerce systems.

Finally, throughout the conference, speakers repeatedly urged government not to move too quickly to intervene in the development of electronic money and electronic banking. I agree. My own view is that we in government, at least in the U.S., must be guided by three principles.

We should work with the private sector and the public wherever possible. Electronic money and electronic payments are evolving so rapidly that government cannot possibly develop and retain all the expertise necessary to accomplish any of its objectives without the support and cooperation of industry.

We should also avoid premature regulation. We recognize the dangers of involving government too early in such a rapidly evolving area, and we do not want to chill or unduly influence

the market by encumbering it with regulation that may quickly become outmoded, inappropriate, or detrimental.

Finally, when action is required, we should be prepared to act quickly and expeditiously. While we should be mindful of the dangers of acting prematurely, waiting too long to address problems also will impede the full development of this promising market.

Supervision by Risk

The new products and services already being offered by banks both in the U.S. and overseas, as well as the many new products and services that may be offered through electronic banking outlets amount to something of a revolution in the way banking and financial services are provided. This modernization in financial services demands a corresponding modernization in the way government regulates and supervises financial institutions.

In attempting this modernization, as I mentioned earlier, we must move beyond piling on regulation measured by weight or inches of paper as a proxy for serious risk management. As supervisors, we have to answer the hard questions of how much is gained by changing or adding regulation, or how much value our efforts add to the operation of the financial system.

In the U.S., as you may be aware, the OCC and the other bank regulators have adopted a new approach to supervision called supervision by risk. Given the rapid development of new products and services, it is no longer feasible -- or even advisable -- to provide detailed supervision of individual bank product lines or bank activities. Instead, we have structured our oversight of bank operations to assess the risks different products and activities pose to banks, and to use that assessment to develop an overall risk profile of each bank and the banking system as a whole.

Because banks are moving into new products and services, the OCC has developed new examiner training and new methods of supervision for specialized areas such as capital markets and bank information systems. For example, risk management systems in banks are becoming increasingly sophisticated, so we've added Ph.D. economists to some of our examination teams, to help assess banks' risk-management computer models, including banks' internal value at risk models. We have also established a capital markets group that has become expert in a variety of emerging product areas, including derivatives. They have used this expertise to prepare guidance for banks and help improve supervision of this critical area.

In all areas of bank operations, we have increasingly emphasized the importance of banks having strong internal controls and information systems. As banking activities become increasingly complex, senior management in banks must have immediate, comprehensive information about their institution's risk position and strong controls in place to manage that exposure. These information systems and controls are particularly important for

financial institutions with international operations. In our risk-based supervision, we focus on banks' internal control systems and test individual transactions to make sure those controls are fully operational.

The core business of banking -- that of taking on and prudently managing risk -- remains the same, but the way in which banks carry out their business is undergoing a revolution. As bank supervisors, we have no choice but to modernize our oversight of bank activities in a corresponding manner.

International Coordination

Finally, I would like to emphasize that the challenges of financial modernization and effective supervision are not limited to a single country. As I'm sure we are all aware, a key element in modernizing bank supervision must be greater coordination and cooperation with our counterparts who are facing similar challenges in other countries. That includes not only other bank supervisors and central banks but also insurance and securities supervisors, as well as law enforcement authorities.

But this is preaching to the choir -- you're already aware of the need for international cooperation, or you wouldn't be members of this organization. From the OCC's involvement with the Basle Committee on Banking Supervision in developing value at risk models for assessing capital adequacy, I'm well aware that the IIF has cooperated with the Committee in testing this approach.

Let me assure you that I share your recognition of the importance of working through international organizations to resolve these difficult new supervisory issues. The OCC's supervisory work on derivatives has both contributed to and benefited from international efforts in the same area, most notably the Basle Committee's project.

In addition to the Basle Committee, I'm happy to say that we're also involved in other international bodies working on a different set of supervisory issues -- those related to changes in the structure of financial institutions. The Joint Forum on Financial Conglomerates, of which the OCC is a member and which met just this past week, has as its agenda how best to supervise internationally active financial conglomerates that provide a full range of banking, insurance and securities products and services. These firms are exploiting the new information technology to manage complex international organizations that provide multiple products and services in multiple jurisdictions.

The question of how to supervise these firms is important to U.S. supervisors because some of our own financial companies are prominent in global markets. But perhaps more important, as we begin to peel away the layers of restrictions on products and services that can be offered by U.S. banks, we banking supervisors in the U.S. will have to come to grips with the challenge of supervising firms that operate across the full spectrum of financial services.

The bottom line is simple: the revolution in banking and financial services calls for fundamental changes in supervision of those activities -- not only in the U.S. but worldwide. The modernization of financial supervision will require traditional banking regulators to work with insurance and securities supervisors and law enforcement authorities. And, because of the increasing international and cross-border nature of financial activities, modernizing our oversight of financial services will require increasing coordination and cooperation among supervisory authorities throughout the world. We have laid the groundwork for this cooperation. Now we must build on that foundation.

Thank you.

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The OCC charters, regulates and supervises approximately 2,800 national banks and 66 federal branches and agencies of foreign banks in the U.S., accounting for more than half 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.