

Remarks by
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Let me extend a personal note of welcome to Washington to the members of the American Bankers Association. I think it's important for our nation's bankers to assemble periodically in the nation's capital -- not because this is the seat of all wisdom, to be sure, but because of the critically important relationship that we in government have with your industry.

Indeed, I can think of no industry that's borne a heavier burden of government involvement than banking. And although last year's landmark financial modernization legislation unshackles banks from many of the constraints of the past, the industry cannot be assured that tomorrow won't bring other burdens and impositions, enacted to achieve various public policy goals.

As professional bank supervisors, we're always looking for ways to make our supervision more effective and less burdensome. The effort can be summed up in terms of two fundamental challenges: first, how do we balance our responsibility under the law for ensuring the safety and soundness of the banking system, on the one hand, with the burdens of supervision on the other -- burdens that, if not carefully contained, can actually undermine safety and soundness?

I'm speaking now not only of the direct burdens of supervision -- the need to comply with a plethora of detailed regulations, and the intimate involvement in your business of platoons of bank examiners -- but also of the opportunity costs imposed by time-consuming procedural and paperwork requirements.

Few would deny that the burdens of supervision have contributed to the erosion of the banking industry's market share and competitive strength over the years. Although regulatory authorities on the state and federal levels have made tremendous strides in adding value to their supervision, I've long wished we could do more to tip the balance decisively into the plus column, so that we can all feel comfortable in the conviction that the benefits of supervision for banks outweigh the burdens.

Now, perhaps, with some of the new tools we've developed -- tools that I want to talk to you about this morning -- we finally can do just that.

The second challenge that supervisors have faced from the earliest days is one that's common to the human condition -- divining the future. Since the beginning of recorded time, we've read tea leaves, consulted the stars, and paid tribute to those who claimed some special gift of prescience about future risks and opportunities. In ancient times, oracles sacrificed a goat and sifted the entrails in search of clues to the future. In more recent times, coal miners used canaries, housed in cages fitted to their helmets. When the sensitive birds dropped from their perches due to lack of oxygen, the miners knew that danger lay ahead and that it was time to evacuate the shaft. We have long wished for an instrument of comparable reliability and predictive power in identifying the

potential dangers in our banks, so that we can react to rising risk before it becomes too deeply embedded.

Now, perhaps, we may be able to achieve that goal.

It would be presumptuous to suggest that we've finally lain to rest the longstanding supervisory dilemmas I've just described. But revolutions in practice can and do occur. And I believe that we're witnessing just such a revolution today -- one that will go a long way toward improving the cost-benefit ratio of supervision, reducing burden, and enhancing our ability to anticipate and control risk in the banking system.

It's part of the larger revolution in technology that's sweeping -- and transforming -- the globe. It's been underway for quite some time, and we in the regulatory community have long embraced its benefits. The OCC has been a government leader in automating its procedures, helping our examiners to work more effectively. But only recently have we been able to exploit the promise of the technology revolution in a way that provides material benefits for bankers.

A year ago, for example, the OCC unveiled National BankNet -- an extranet web site available exclusively to national bankers, which will, I believe, revolutionize the way supervisors and bankers communicate with one another. The first BankNet application, Comparative Analysis Reporting, or CAR, was quickly adopted by hundreds of national bankers, who have used its extensive database to generate reports on how their performance compares with that of their local, national, and regional peers. Based on the feedback we've received, we've updated and refined CAR, to make it more comprehensive and user-friendly. For example, users can now access total asset information on each bank and run comparative reports for different time periods.

But as we promised last year, CAR was just the beginning of what BankNet would have to offer. The brochure you found on your chair this morning provides more information on our recent enhancements to BankNet, and I would urge you to visit the OCC booth for a personal demonstration. I believe you'll be impressed by what you'll see, now and in the coming months: new analytical models, including early warning benchmarks and risk-based capital calculators, and new information sources, including internal OCC reports. It will include legislative and regulatory analysis, economic and risk updates, "best practices" presentations, consumer complaint analysis, and other national bank-specific information -- all designed to help you function more effectively in today's competitive financial services environment.

Other BankNet modules will drastically cut the processing time for corporate applications and produce big reductions in regulatory paperwork. Early next year, all national banks will be able to prepare branch and relocation applications on line, and submit them electronically. Not only will national banks save countless hours in the filing process; it will lead to significant economies and ensure greater consistency and responsiveness in our licensing decisions.

Over the next few years, in fact, I anticipate that the majority of routine transactions between the OCC and national banks will be capable of being conducted electronically -- and securely -- over BankNet. Examiners will exchange pre- and post-exam information and quarterly data with bankers on-line. Assessments and fees will be billed and remitted electronically. Bankers will have the opportunity to file electronic comments on regulatory proposals.

And the future holds stills greater promise. The day is near when I and other OCC officials will be meeting with national bankers on line -- to update you on regulatory developments, explain our policies, and answer your questions. As national bankers, you'll have access to our on-line staff directory, to help you identify the individual responsible for your area of concern. And when you have concerns -- with an application, a ruling, or an interpretation -- or when you need help picking your way through the regulatory thicket -- we'll be available, with a few keystrokes, to provide help and advice.

Bank supervision has never been like this before. Clearly, it will never be the same again. And that's all to the good.

Touting the value of technology to an audience of bankers is surely preaching to the choir. Yet your experience -- and ours -- argues for considerable care in the way we apply technology and assess its benefits. Even as we embrace technology, as your conference's theme says, we must work to "preserve trust." For banks, that means meeting customers' expectations for service and privacy. We know that bankers who have fallen short of these expectations -- for example, by forcing customers to deal with machines when they would have preferred to talk to bank employees -- later regretted it. Not only did they suffer in the marketplace; they became lightning rods for public criticism and even legislative action. For banks, preserving trust means maintaining consistently high standards of customer responsiveness.

For bank supervisors, preserving trust has different connotations. Supervision is not just about statistics. Sometimes the numbers don't tell the whole story -- or the true story, for that matter. No matter how sophisticated our automated systems are today or how advanced they may become, understanding a bank's true condition requires an examiner's insight and intuition. There's no substitute for the constructive interaction between bankers and examiners that can only take place across a table, face-to-face. Judging by what we hear from you about the value you place in the examiner's presence -- especially in smaller banks -- it's clear you wouldn't have it any other way. And neither would we. The knowledge and experience of the national bank examiner will always be the foundation of OCC supervision.

Making full use of the examiners' skill and judgment is the way that we "preserve trust."

Clearly, however, technology has a big and growing role to play in advancing the science of supervision -- in making it more valuable and less burdensome today, in the ways I've already discussed, and better able to anticipate tomorrow's risks.

We don't use canaries anymore to alert us to environmental hazards. But OCC's Project Canary serves the same purpose in the banking environment. It's the name we've adopted for the OCC's core set of early warning tools -- a package designed to enhance our identification of -- and ability to respond to -- emerging risks.

Canary gives us what no bank supervisor has ever had available before: a focused, concise, and technologically advanced early warning system that will allow us to zero in on those banks that have the greatest amount of financial risk and the greatest possibility of problems.

One of Canary's most important components is the system of benchmarks we've developed to serve as a kind of early warning tripwire. Let me give you an example of

what the benchmarks tell us and what role we expect them to play in our overall supervision.

The current set of benchmarks consists of 15 financial ratios and measures. At present, six relate to credit risk; four to interest rate risk; and five more to liquidity. By extrapolating from our supervisory experience, we've established a threshold in each case that represents the point at which we've found that risk tends to rise. For example, experience teaches us that credit quality problems often increase when a bank's loan-to-asset ratio exceeds 70 percent. So that's where we've pegged that particular benchmark.

The finding that a bank has exceeded one or more of the Canary benchmarks will not trigger automatic supervisory action against the bank or anything of the sort. It goes without saying that not all banks whose loans to assets exceed 70 percent become troubled banks. The benchmark is simply designed to alert us to banks with a pronounced risk appetite in that area, so that we can allocate sufficient supervisory resources to probe more deeply. For a bank with loans to assets greater than 70 percent, for example, we would go on to evaluate the composition of the loan portfolio, the quality of the bank's risk management systems, and other related factors. Only if our concerns were borne out by this more intensive analysis of multiple risk factors would we consider taking supervisory action against the bank. But we'd be in a position to do it before the bank's safety and soundness were significantly impaired.

It's important to note that the number of benchmarks, their distribution among risk categories, and the established thresholds are not fixed in stone. Canary is meant to be a dynamic system that will constantly evolve to reflect changing circumstances and improvements in our understanding of risk.

Individually, the Canary benchmarks may be more suggestive than conclusive about a bank's risk profile. But they unquestionably correlate with the likelihood of problems. Used judiciously and in combination, they point us to banks with higher than average risk appetites. Certainly they will help us allocate supervisory resources more effectively, ensuring that only those national banks that really need it receive high level supervisory attention. That means less supervisory burden on those institutions that don't.

As excited as we are about Canary and the benefits we expect it to deliver, we also recognize what it can never do -- and what it was never intended to do. What I said earlier about BankNet also holds true for Canary. These systems are meant to augment, rather than replace, the work that OCC's highly skilled examiners do day in and day out at each and every national bank. Although we're dedicated to continuous refinement of state-of-the-art technology to enhance the value of our supervision, our commitment to the support and development of the best bank examiners in the world is first and foremost.

We're also committed to ensuring that our examiners make the best use of their time -- and yours. Burden reduction is and always will be one of our top priorities. That's why we're working hard to find ways of improving coordination among the Federal banking agencies, to minimize needless duplication and overlap and complexity.

Clearly, we've only scratched the surface with respect to what technology can contribute to easing supervisory burden. At the OCC, we're hard at work in the early phases of a project that I call Examination in the 21st Century -- a project that looks to the day when examiners will have on-line, real time access to all of the information they need to perform the supervisory function. No longer will it be necessary for bank employees

to compile vast stacks of paper for examiner scrutiny, or for bank duplicating machines to churn out multiple copies of those records for the examiners' use. Our examiners will be able to sit at computer terminals at their duty stations and do the analytical work that needs to be done before meeting with bank management. To be sure, many technical and legal issues will need to be resolved before this vision becomes reality, and we will need to work closely with you to make sure that we are jointly using the new technology in the most productive and least burdensome way possible. But I believe that the vision of on-line, real time access to bank information holds the potential to further transform the supervisory process -- to reduce the burdens on you and to ensure that the time of our examiners is spent productively and well.

Sometimes small changes can produce dramatic results. I believe that even a marginal improvement in the comparative burdens and benefits of supervision can and will make a big difference in the health and competitiveness of the banking industry. That's the premise that's been driving the supervisory innovations I've discussed with you this morning. By leveraging the expertise we've been building at the OCC for more than a century, technology will enable us to better serve you, just as it enables you to better serve your customers.