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Remarks by

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Good morning. It is indeed a pleasure to open this National Issues Forum devoted to assessing the impact of the Federal Deposit Insurance Corporation Improvement Act of 1991 five years after its enactment. I want to commend both the Chicago Clearing House Association and The Brookings Institution for assembling this program and bringing together an impressive array of speakers and commentators. I'm very honored to speak here at Brookings, an institution that has an impressive legacy of shedding light on some of the more complex issues of importance to America. This legacy -- of providing a forum for thoughtful analysis as opposed to heated rhetoric -- has served all of us who care about addressing the nation's challenges in a productive, collaborative manner. I hope I can contribute -- in some small way -- to this legacy today as we discuss the importance of safety and soundness legislation and the contribution FDICIA has made to a goal we all share -- a stronger American financial services industry.

FDICIA has been called by some the most important piece of bank safety and soundness legislation since the Great Depression. Of course, its critics -- during the legislative debate and since FDICIA became law -- have also called it other things . . . things that decorum does not allow me to repeat publicly. The question I'd like us to consider this morning, as we recognize FDICIA on its fifth anniversary, is this: one cheer, two cheers, or three cheers for FDICIA?

In the best traditions of Brookings, let us begin by careful consideration of what we know based on our experiences living with FDICIA over these past five years.

First, we know that the banking industry today is quite strong. Notwithstanding dire predictions by some that FDICIA would over-burden the banking industry and send it into a sharp decline, the last five years have seen record bank profitability and increased vitality, as the number of failed or assisted banks dropped from 82 in 1991 to just five in 1996. Commercial bank earnings in the third quarter of 1996 made it the third most profitable quarter ever recorded, with earnings over $13 billion and a return on assets of 1.26 percent. Bank earnings for all of 1996 are projected to exceed $50 billion. Given the sound economy, it

almost certainly is a stretch to claim that FDICIA caused this improved picture, but it is fair to say that the law did not set off the downward spiral feared by those who believed it would be too onerous.

Second, we know that the banking industry is better capitalized than at any time in our professional lifetimes. The most recent data show that the country's commercial banks are capitalized to the tune of over $423 billion, with an equity-to-asset ratio of 8.3 percent, the highest level in decades and 160 basis points higher than the 6.71 percent when FDICIA was signed into law. Even if FDICIA cannot plausibly be credited with the industry's record profitability, I think it must be credited -- at least in part -- with this noteworthy increase in capital. FDICIA required each federal bank regulatory agency to biennially review its capital standards for insured depository institutions and to revise its risk-based capital standards to ensure that those standards take adequate account of interest rate risk, concentration of credit risk and the risks of nontraditional activities. As our Office noted in its response to GAO's audit report, Bank and Thrift Regulation: Implementation of FDICIA's Prompt Regulatory Action Provisions, from the passage of FDICIA through the end of 1995, equity capital at commercial banks increased from $231.7 billion to $349.9 billion -- an increase of 51 percent in only three years. During this same period, the aggregate commercial bank equity-to-total asset ratio increased from 6.75 percent to 8.11 percent -- its highest level since the 1960s -- while the risk-based capital level increased from 10.67 percent to 12.78 percent. A number of studies have found that increases in bank capital levels and capital-to-asset ratios in recent years have been a response to regulatory changes -- including FDICIA -- and the greatest response has come from previously undercapitalized institutions. There should be little doubt that FDICIA is part of the reason for the positive capital picture we see today.

Third, we know that the FDICIA of today has benefitted from some fine-tuning. Congress recognized that some parts of FDICIA could be amended in a way that provided greater flexibility without sacrificing the law's intent. For example, changes to FDICIA since its enactment have (1) permitted CAMEL 1 and 2 institutions with less than $250 million in assets to be examined on an 18-month cycle rather than annually; (2) eliminated the requirement that independent auditors attest to an institution's compliance with safety and soundness rules as part of the annual audit; (3) removed the banking agencies' authority to set compensation levels for insured institutions, and (4) exempted some branch closings from FDICIA's requirement of 90-day prior notices.

Fourth, we know -- or at least, based on my observations as Comptroller, I believe -- that FDICIA has advanced the banking industry's safety and soundness focus by encouraging bank management to better identify and control risk. To put a fine a point on it, the knowledge that reductions in capital will trigger the prompt corrective actions required by FDICIA creates a healthy caution within the industry.

That is a relevant part of the picture of banking over the last five years, but I believe that the jury is still out on FDICIA's long-term significance for bank safety and soundness. FDICIA may be a step forward, but how great a step is uncertain. For although the emphasis on capital is clearly positive -- as is much of the impact of the prompt corrective action rubric -- two factors remain unclear. First, it is not clear to what extent the strong economy has masked some of FDICIA's downsides. And second -- a related point -- it is simply not clear whether FDICIA will tie the supervisors' hands too tightly in a period of genuine crisis.

It must be remembered that FDICIA -- or any law -- cannot by itself guarantee the safety and soundness of the American banking system. Safety and soundness demands continuing, forward-looking supervision. FDICIA sets benchmarks, strengthens capital and creates a prompt corrective action framework. But prompt corrective action is something of a blunt instrument. The responsibility falls to the supervisor to work -- in a preemptive, rather than merely a corrective capacity -- to ensure that institutions are well managed and risk-focused so that FDICIA's blunt instrument is less likely to be put to use.

This has challenged the regulatory community to change along with the evolution of the financial services industry. Since FDICIA, the OCC has strengthened and modernized its supervisory program to help us better detect problems before they can infect the overall health of the banks we regulate. Most importantly, we have adopted Supervision by Risk. Supervision by Risk uses risk as the organizing principle for all of our safety and soundness supervision. To do this, we defined a set of nine risks for our examiners to focus on: strategic risk, reputation risk, credit risk, interest rate risk, liquidity risk, price risk, foreign exchange risk, transaction risk and compliance risk. Using the Supervision by Risk method, our examiners can gauge the quantity of risk exposure across the entire spectrum of a bank's activities and assess bank management's ability to identify, monitor and control risk. While this program is still being refined, it has been copied widely by other financial services supervisors, particularly by foreign regulators as they seek to improve the effectiveness of their supervision.

In addition to Supervision by Risk, over the last several years, the OCC has taken a number of other steps to strengthen its supervision.

We have placed heightened emphasis on economic analysis -- both in public policy debate and in supervision. It's my belief that to be a responsible regulatory agency, the OCC must energize and contribute to the marketplace of ideas. Our Bank Research Division has hosted several conferences in recent years. George Kaufman -- one of the organizers of today's conference -- helped organize our conference on systemic risk. We also formed a Risk Analysis Division within the Economics Department to build additional expertise in financial risk modeling and to share that information with examiners and policy makers within the OCC.

Further, we pioneered the use of economists' expertise in bank examinations. For selected examinations, the OCC teams bank examiners with economists who have expertise in the quantitative models used by banks. This year, for example, economists have contributed to over 40 national bank examinations. Most of that work has been done by members of our Risk Analysis Division in the evaluation of financial risk -- particularly interest rate risk and market risk in derivatives activities. In addition, economists have helped evaluate bank models used in the fair lending area.

We have developed new computer tools for risk analysis and enhanced supervision. Just last week, we began test piloting a new software system called "Examiner View" to increase the quality of our bank supervision and reduce burden for institutions. Further, we are providing OCC examiners, analysts and managers a greater array of technology tools. Our Industry Sector Information Service (ISIS) database provides fundamental business information on 28 major industries, including recent trends and future forecasts. A separate database, our Integrated Banking Information System (IBIS), provides time series data from the FDIC and the Fed, supervisory data on national banks and structure data on mergers and acquisitions. These two information systems make it possible for our examiners and economists to do statistical modeling and analysis as part of their supervision of both individual institutions and the banking system as a whole.

We have created the position of Deputy Comptroller for Risk. This position, filled today by one of the OCC's most seasoned examiners, helps us identify and respond to new risks arising from the evolving business of banking. The OCC is the first agency to assign a senior official full time to look for emerging risks in the banking system. Working closely with other units within the OCC, the Deputy Comptroller for Risk identifies potential risks in the banking system and recommends actions both for banks and for the OCC to better manage those risks. This week, for example, the OCC released the results of our survey describing how large national banks are using capital allocation as a tool to measure risk vis a vis reward for specific bank activities and products. While capital allocation techniques are still evolving, the survey helped us identify seven characteristics of effective capital allocation programs to help large banks decide how they should use this tool in their risk management programs.

CONCLUSION

All of these actions are logical next steps to build on the supervisory framework established by FDICIA. And that brings me back to my initial question: one cheer, two cheers, or three cheers for FDICIA? To make that assessment, we need to first answer some additional questions.

Has FDICIA -- as amended since its enactment -- made the banking system safer?

And second, how will history ultimately judge FDICIA?

In answer to the first question, I would say yes -- FDICIA has contributed to making the banking industry safer than it was in 1991. But I also believe that what we have done in supervision has gone beyond FDICIA to improve our ability to identify and respond to problems in banks before these problems lead to the kind of losses that ultimately could trigger prompt corrective action. When this improved supervision is wedded with FDICIA, as in fact it already is, I believe we have made a big step forward in safeguarding bank safety and soundness.

In answer to the second question, regarding how historians will view FDICIA, I have to say that five years is too short a time to be certain of its true impact -- particularly when those five years have been characterized by continued strengthening in the general economy. Today, five years after FDICIA's enactment, the only thing we can say with certainty is that time and experience will be the ultimate arbiter of whether FDICIA is viewed as good, bad or neutral.

From what we know today, I would not give FDICIA the three cheers its most ardent advocates would prefer, but I would suggest that it is deserving of at least one cheer -- perhaps even two. And I am hopeful that if regulators continue to take a balanced approach to FDICIA and continue to strengthen supervision, we will be able to say with confidence -- at a conference of this sort sometime in the future -- two and possibly even three cheers for FDICIA.

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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.