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**REMARKS BY  
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**VITALITY OF THE THRIFT CHARTER**

**I. Introduction**

It is an honor and a pleasure to speak before the Exchequer Club. Thank you for inviting me. I especially appreciate the opportunity to extol the virtues of the thrift charter. Since becoming Director of OTS in December 2001, I have had first-hand experience in observing the strength of the thrift industry and its regulator. I am pleased to report that both the industry and OTS are doing well.

We often hear about the American dream of homeownership. Sometimes it is in a pitch accompanied by soft music, a comforting voice, and children playing inside a white picket fence. That is how we are conditioned to think of it. The reality, of course, is that our homes come in many shapes and sizes. There are homes in neighborhoods predominated by multi-family housing complexes, homes in sprawling suburbia, many homes in large cities and small towns, some in odd places that you would not expect, and, yes, some with white picket fences.

While the American homeownership dream means many different things to many different people, the common thread is that you need to have money to buy one. For most of us that means a mortgage loan, often obtained from a local financial institution. Yes, of course, you're thinking about that television commercial, again, and what would we do without those wonderful people who make it possible for that dream to come true. They are very important, but for many years we stumbled by without them. There was a time, way back when, when it was the community banker who not only made the mortgage loan but also raised the money to fund it. While today's process is certainly more efficient and clearly has saved American homebuyers millions upon millions of dollars as a result of the secondary mortgage market and its dominant players, the community banker continues to play a crucial role in the mortgage markets and home buying process.

The American dream of homeownership has been around for a long time. I think that a convincing case can be made that the thrift industry has played a major role in

nurturing that dream. Financing the construction and acquisition of homes has been the focus of thrift institutions throughout their history, which dates to the first half of the 19<sup>th</sup> century. Today, thrifts remain a major player on the front end of the mortgage process—the “touch” part, as I like to refer to it. In this capacity, thrifts continue to do an excellent job of promoting homeownership by making residential mortgage financing readily available. In addition, the charter has evolved into more than just a vehicle for residential mortgage lending. Today, the charter is used extensively by some to make small business, automobile, and consumer retail loans. This builds on the charter’s strength and versatility as the preeminent retail banking charter.

The thrift charter’s flexibility has allowed it to be in the forefront in various situations. In the early 1980s, OTS’s predecessor, the Federal Home Loan Bank Board (FHLBB), was the first at the federal level to permit adjustable rate mortgages (ARMs). Thrifts used these extensively to expand the availability of housing credit. In the early 1990s, OTS permitted interstate branching for federal thrifts, which still have the strongest authority to branch. As a practical matter, many thrifts also retain a broader ability to affiliate with other entities, even after the Gramm-Leach-Bliley Act (GLB Act), because most savings and loan holding companies have grandfathered authority for unlimited affiliations.

I attribute the vitality of the federal thrift charter to three factors. First, the charter meets the demand for a broad range of consumer lending products. Second, it permits thrifts to operate nationally through uniform standards and one organization. Third, it allows the thrift and its subsidiaries, as well as its holding company and other affiliates, to operate under a single consolidated regulator. I will discuss each of these factors after I describe the characteristics and current condition of the thrift industry.

## **II. Characteristics and Condition of the Thrift Industry**

### **A. Characteristics**

What does the thrift industry look like today? At the end of the first quarter of this year, there were 958 thrifts with more than \$1 trillion of assets. Even after years of consolidation, about 40 percent of thrifts have assets of less than \$100 million, and almost 40 percent of thrifts remain in the mutual form of ownership.

The thrift and bank industries are remarkably similar in terms of concentration. Both industries have a large number of small community institutions and a few very large institutions holding a predominant share of industry assets, though the thrift industry is somewhat less concentrated. For example, about 2 percent of OTS-regulated thrifts (19 out of 974) and the same percentage of national banks (43 out of 2,078) have assets exceeding \$10 billion. These largest thrifts account for 62 percent of the industry’s assets while large national banks account for 82 percent of national bank assets. A similar comparison with all (national and state-chartered) large commercial banks also shows less concentration for the thrift industry (71 percent of commercial bank assets held by

the 80 out of 7,887 commercial banks—about 1 percent—having assets exceeding \$10 billion).

Thrifts hold almost 58 million deposit accounts worth over \$600 billion. Thrifts operate approximately 8,500 branches throughout the country. There are 10 thrifts with more than 100 branches, and almost 100 branch interstate. By contrast, about 285 thrifts have no branches at all, operating only from their home office.

When we look at savings and loan holding companies (SLHCs), we also see a wide range of structural and operational variation. OTS supervises approximately 530 corporate structures (with one or more thrift holding companies) owning about 490 thrifts. While most SLHCs are “shell” holding companies with no significant operations beyond ownership of the thrift, more than 100 engage in significant lines of business other than banking. Many financial services firms own thrifts, including insurance companies (Allstate, State Farm, Northwestern), broker-dealers (Merrill Lynch, Morgan Stanley, Lehman Bros.), and others (E-Trade and American Express). Under authority grandfathered in the GLB Act, SLHCs also include retailers (Nordstrom, Federated Department Stores, and the Hy-Vee grocery chain) and manufacturing firms (John Deere and GM). OTS also has experience with foreign holding companies, including ING (Netherlands), the Prudential Life Insurance Co. (Great Britain), AXA Sun Life Holdings (France), and the Toronto Dominion Bank (Canada).

## **B. Condition**

What is the condition of the thrift industry today? Since FIRREA, the thrift industry has staged a remarkable recovery. A strong economy, a generally hospitable interest rate environment, a return to sound lending and investment practices, and more effective regulation, including strengthened capital standards, have aided this comeback. The overall financial condition of the thrift industry and its performance are strong. Thrifts reported record earnings and capital for 2002. Net income reached an annual record \$11.8 billion. Profitability, as measured by return on assets (ROA), reached a 1.21 percent, breaking a record set in 1946. The equity capital ratio for the industry was a record 9.2 percent. Thrift industry assets increased to over \$1 trillion by the end of 2002 (a level not seen since the end of 1990).

The thrift industry's record-breaking results for 2002 continued in the first quarter of this year. Net income, ROA, and equity capital all set new records. Net income in the first quarter was \$3.33 billion, up 9 percent from the previous record set in the first quarter of 2002 and only the second time quarterly income has topped the \$3 billion mark. The ROA set a quarterly record of 1.30 percent. The industry's equity capital ratio stood at a strong 9.1 percent, and in dollar terms is the highest ever at nearly \$95 billion. Over 99 percent of the industry was well capitalized, and for the first time since we began calculating capital requirements under FDICIA in 1992, no thrift was less than adequately capitalized. The industry's asset quality and interest rate risk positions remain very strong. There are only 12 problem thrifts (with a CAMELS rating of 4 or 5) holding

combined assets of 0.2 percent of thrift industry assets, the lowest since OTS was founded in 1989.

The industry's high volume of mortgage originations in recent years—\$536 billion in 2002—has been largely responsible for the unprecedented levels of thrift earnings and capital. For the first quarter of 2003, total mortgage originations topped \$161 billion, down from last quarter's record volume of \$177 billion, but still the second best volume ever. The greatest risk facing the industry is the possible slowdown in mortgage originations stemming from higher interest rates. Both the industry and OTS are alert to, and prepared to address, this challenge with our advanced interest rate risk modeling system.

### **III. The Thrift Charter is the Preeminent Retail Banking Charter**

There are several reasons why the federal thrift charter has thrived. Most importantly, the charter provides flexibility to engage in a wide variety of activities, while focusing primarily on housing, consumer, and small business lending. As I will explain later, the ability of thrifts to operate regionally or nationally under one set of rules greatly simplifies their operations. In my opinion, the federal thrift charter is the preeminent vehicle for institutions that focus on providing home mortgages, consumer loans, and other retail banking products.

#### **A. The Housing Industry and Thrift Mortgage Lending**

Housing is one of the principal drivers of the American economy. According to the Bipartisan Millennial Housing Commission's report in May 2002, the housing sector accounts for more than 20 percent of annual gross domestic product (GDP). Thrifts are major players in this arena and, thus, make a significant contribution to our nation's bottom line GDP. In 2002, the thrift industry set a record with \$536 billion of mortgage originations, easily eclipsing the 2001 record of \$456 billion. These mortgages include multifamily, single family, and nonresidential mortgages. Thrifts accounted for almost 20 percent of single family originations for the nation last year—with single family loans of \$472 billion. For ARMs, a very important affordability product for first-time and low-income homebuyers, thrifts play an even larger role. In 2002, for example, thrifts originated more than 45 percent of all ARMs.

The business focus for most thrifts remains residential mortgages and supporting the nation's housing market. As of December 2002, thrift investments related to residential mortgages accounted for 67.5 percent of industry assets. For large thrifts, residential mortgages accounted for nearly 70 percent of their assets.

#### **B. Other Thrift Lending Activities and Services**

While mortgages are the driving and stabilizing force for most thrifts, the federal thrift charter offers considerable flexibility to serve other market niches. Thrifts can offer a full range of lending products, including small business and other commercial, farm,

construction, land development, credit card, education, and auto loans. While some lending options are unrestricted, such as credit card and education loans, other categories are limited. For example, thrift commercial loans may not exceed 20 percent of assets, and amounts above 10 percent of assets may only be for small business loans. An overarching focus on residential and consumer lending is maintained by the qualified thrift lender (QTL) test. The QTL test requires 65 percent of thrift assets to be in qualified thrift investments, including residential mortgages, home equity loans, education loans, small business loans, and credit card loans.

Looking only at lending statistics tends to obscure the picture of the broad range of activities within the industry. While maintaining a mortgage lending focus, a large majority of thrifts offer many other products to meet the particularized credit needs of their customers and communities. A number of thrifts specialize in credit card, auto lending, or trust operations. A breakdown of the more significant lending activities of thrifts, other than single family lending, is as follows:

- **Consumer Lending.** More than 95 percent of thrifts make consumer loans, but only 43 institutions make consumer loans that account for more than 20 percent of their assets.
  - **Consumer Auto Lending.** Almost 75 percent of thrifts make consumer auto loans, but only 12 thrifts make auto loans that account for more than 20 percent of their assets.
  - **Credit Card Lending.** Almost 52 percent of thrifts make credit card loans, but only 6 institutions make credit card loans that account for more than 20 percent of their assets.
- **Commercial Lending.** Nearly 72 percent of thrifts make commercial loans, but relatively few engage to any significant extent in this activity.
- **Multifamily Residential Lending.** Almost 80 percent of thrifts make multifamily mortgage loans, but only 27 thrifts make multifamily mortgage loans that account for more than 25 percent of their assets.
- **Fiduciary Accounts.** Almost 10 percent of thrifts currently provide fiduciary accounts, but only 42 thrifts have fiduciary accounts totaling more than 25 percent of their assets.
- **Mutual Funds and Annuity Sales.** About 22 percent of thrifts are involved in the sale of mutual funds and annuities, but the activity of only seven institutions exceeds 5 percent of their assets.

As you can see, while single family mortgage loans account for nearly half of thrift assets, the industry provides a wide variety of other loans and financial services that are not only important for the communities they serve but promote safety and soundness through diversification.

### **C. Comparison to Commercial Bank Charter**

I am often asked what is unique about the thrift charter and whether there is a valid rationale for continuing its separate existence from the bank charter. From a public policy perspective, thrifts make loans and investments that support and promote homeownership to a much greater degree than commercial banks. Comparing the balance sheets of both types of institutions, we find that thrifts focus much more on residential mortgage lending. Residential mortgage investments account for 67.5 percent of thrift assets but only 27.3 percent of commercial bank assets.

From my perspective as a former State banking regulator and commercial banker, the different purposes and features of the various charters—State/federal, bank/thrift, stock/mutual—continue to play a significant role in distinguishing our financial services industry as the most versatile and successful in the world. The federal thrift charter is an important element of our banking system because of its overall economic contribution as well as its unique focus on helping American families attain their dream of homeownership. Diversity in charters has meant more responsive and less expensive financial services.

### **IV. Ability to Operate Nationally Under Uniform Standards**

Another reason that the federal thrift charter has thrived is the ability to conduct banking operations on a national or regional basis through one charter via interstate branching and subject to uniform standards of operation for all offices.

#### **A. Preemption**

A uniform federal system is one of the hallmarks of the federal thrift charter. HOLA authorizes OTS to charter and supervise federal thrifts giving “primary consideration of the best practices of thrift institutions in the United States.” This authority permits federal thrifts to operate under uniform nationwide standards that promote an open and competitive mortgage market. This, of course, is intended to encourage thrifts to make residential mortgage loans—wherever and whenever institutions are able to identify a need for mortgage lending that they can prudently satisfy.

Many courts have interpreted the “best practices” standard as providing OTS (and its predecessor, the FHLBB) wide and exclusive latitude with respect to overseeing the operations of federal thrifts. A United States District Court concluded, in Glendale Federal Savings and Loan Association v. Fox, that Congress delegated to the agency “the authority to select from the prevailing practices in all the States what it deemed the best practices and to prescribe a nationwide system of operation, supervision, and regulation which would apply to all federal associations.”

The United States Supreme Court, in Fidelity Federal Savings & Loan Association v. de la Cuesta, quoted the best practices clause and concluded “Congress

plainly envisioned that federal savings and loans would be governed by what the [FHLBB]—not any particular State—deemed to be the ‘best practices.’” In other words, federal law “occupies the field” when it comes to the regulation of federal thrifts. Notwithstanding suggestions otherwise, the plain language of the courts, including the United States Supreme Court, incontrovertibly supports this view.

In chartering and supervising federal thrifts, OTS has adopted regulations that establish a uniform framework governing thrift operations. HOLA and OTS regulations, adopted after full public notice and comment, preempt State law for the core operations of federal thrifts, including lending, deposit taking, subsidiaries, trust activities, and operations generally. OTS regulations provide clear standards governing OTS opinions on whether State laws are preempted by distinguishing between the types of State laws that are preempted, and of equal importance, those that are not preempted. The latter include State contract, tort, criminal, and other laws that further a vital State interest, provided a State law has only an incidental effect on core thrift activities or is not otherwise contrary to the purposes of enhancing safety and soundness and enabling federal thrifts to operate according to best practices. We apply these principles whenever considering a preemption issue.

Let me emphasize that OTS has and will continue to solicit the views of the States about regulations that may have an impact on their laws. We send advance copies of proposed regulations in which the States may have an interest to a variety of State organizations depending on the issues involved, including the Conference of State Bank Supervisors (CSBS), the National Association of Attorneys General, the American Conference of State Savings Supervisors, the American Association of Residential Mortgage Regulators, and the National Association of Consumer Credit Administrators. We are pleased to see an increase, in recent years, in comments from CSBS and other State organizations on our proposed rules.

As part of our effort to understand the impact of preemption on the State system, OTS also has notified State Attorneys General and/or State bank regulators when we are asked for our opinion on the relationship between HOLA and a specific enforcement action by a State. We recently adopted a policy of notifying the State in all instances before issuing an opinion affecting a State’s interests. This provides an opportunity for direct discussions before we issue an opinion. Once issued, we send all opinions to the relevant State and to CSBS and also make them available on our website.

Although thrifts operate under uniform national standards and State laws do not apply to core thrift activities, thrift customers are nevertheless well protected under federal law. OTS inspects each thrift every 12 to 18 months to assure that the thrift does not engage in activities that adversely affect its safety and soundness or otherwise compromise the interests of its customers. For example, OTS carefully monitors the potential for abuse with payday lending, and we issued a CEO letter in 2000 to communicate our concerns. The few thrifts interested in payday lending at the time could not alleviate our concerns with the risks posed by payday lending, including credit,

counterparty, operational, reputation, compliance, and legal risks. Today, we believe that no thrifts are involved in this activity.

OTS examinations cover numerous federal laws explicitly designed to protect consumers, including the Truth in Lending Act, the Home Ownership and Equity Protection Act, the Real Estate Settlement Procedures Act, the Equal Credit Opportunity Act, and the Fair Housing Act. In addition to the examination process, OTS has a consumer complaint system to enable consumers to alert us to abusive institution practices so that we can investigate and take corrective action when necessary to address a problem.

Close supervision enables us to direct thrifts to steer clear of predatory lending practices or, if they stray, to quickly implement needed reforms. We have received high marks in this area. For example, in a recent amicus brief supporting OTS in a legal challenge to our Alternative Mortgage Transaction Parity Act regulation, 22 State Attorneys General stressed that it is not federal thrifts (or other supervised depository institutions) that are responsible for predatory lending activities. In particular, the brief states:

Recent major State Attorneys General and Federal Trade Commission enforcement actions and settlements targeting predatory lending activities have all involved State housing creditors—namely, non-bank finance companies—and not supervised depository institutions.

### **B. Interstate Branching**

Another aspect of the ability to operate under uniform national standards is the ease with which a federal thrift may branch. Subject to a few statutory restrictions, thrifts may branch within their home State and across State lines. State laws purporting to restrict thrift branching are preempted. In this way, a thrift can conduct its banking operations with one board of directors, one back office, and one set of operating standards.

By contrast, banks are subject to State law limitations that make it more difficult to set up a single bank with multiple state branches. For example, approximately two-thirds of the States have not enacted the legislation necessary to permit banks to open a new branch in another State. While all States permit banks to expand across State lines through mergers or acquisitions, some States prohibit an out-of-state bank or bank holding company from acquiring an in-state bank that is not at least five years old. This restriction is designed to prevent banks from circumventing restrictions on de novo branching.

## **V. OTS Holding Company Jurisdiction**



Another attractive feature of the federal thrift charter is that it offers a single, consolidated regulator from top to bottom of the financial holding company structure. In this respect, OTS is unique among the federal banking agencies.

OTS has broad supervisory authority over the entire SLHC structure with a few exceptions. Companies owning both a bank and a thrift are deemed BHCs regulated by the Federal Reserve Board (FRB). While OTS regulates the thrift and its subsidiaries in a BHC structure, it does not oversee the activities of the BHC. Our ability to view all aspects of the SLHC structures we oversee offers a unique perspective and opportunity to supervise from top-to-bottom and from side-to-side within an individual structure as well as within the industry.

Before enactment of the GLB Act in 1999, a SLHC owning a single thrift could generally engage in any legitimate business activity. In fact, for over 30 years, OTS and its predecessor regulated SLHCs engaging in a wide range of activities, including companies with insurance and securities affiliates. This historical authority has enabled OTS to amass a breadth of experience in supervising a wide range of SLHC structures. Our experience, in turn, benefits the institutions and SLHC structures we regulate by allowing us to reduce unnecessary and excessive regulatory burdens, saving both time and money for the industry.

While the current regulatory system is questioned in many quarters as too complicated, our system still works well. In particular, the presence of several federal banking regulators, including the availability of more than one option for a financial holding company supervisor, assures that all agencies are motivated to provide the best service, in the public interest, at the lowest cost to our regulated institutions. This aspect of our financial system has produced a significant legacy of which we can all be proud. A monolithic federal banking regulator would not produce better financial services for the public.

## **VI. OTS Seeks Membership on Basel Committee**

An issue that has assumed increasing importance for thrifts in recent years is the development of capital standards by the Basel Committee on Banking Supervision. With this in mind, I recently attended a meeting of the Committee in Basel. As you know, there is considerable concern about the capital standards being developed by the Committee. This concern involves the potential impact of the standards on our largest institutions, particularly on the appropriate risk weighting of mortgage loans, as well as the possible adverse competitive impact on our community banks. Getting the risk weighting right for particular assets also is important because it affects the availability of capital for acquisitions. Given these concerns, I have initiated efforts to secure an official seat—and a vote—for OTS at the table. OTS has been actively participating in domestic discussions on implementation of the Basel capital rules, but it is important that it have direct input on the formulation of those rules.

Some may question what we can add to the Committee given that the United States is already ably represented by the FRB, Federal Reserve Bank of New York, OCC, and FDIC. This is a good question, for which there is a good answer. Internationally, OTS is one of the preeminent regulators of residential mortgage lenders; no other United States representative on the Committee has expertise comparable to OTS in regulating depository institutions that specialize in residential mortgage lending. An OTS voice will help assure that international bank supervision policies do not inadvertently harm residential lending, here or abroad. OTS is also particularly skilled at assessing interest rate risk, and this experience will be a valuable addition to the Committee for all depository institutions. Finally, I believe our historical experience and perspective in regulating many different types of SLHC structures is also an important addition to the Committee.

## **VII. Conclusion**

The federal thrift charter authorizes a full range of banking products, an unequaled ability to conduct seamless operations on a nationwide basis, unparalleled authority for interstate branching, and the only comprehensive regulatory structure for financial services holding companies and their subsidiary insured institutions. For institutions whose business plans focus on home mortgage, consumer, and small business lending, the federal thrift charter offers a compelling array of features. This, I believe, underscores the reason the thrift charter remains vital and a tremendously valuable operating structure bringing better financial services to the American public.