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TESTIMONY OF

EUGENE A. LUDWIG

COMPTROLLER OF THE CURRENCY

Before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

of the

UNITED STATES SENATE

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Statement required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Mr. Chairman and members of the Committee, I appreciate this opportunity to discuss continuing regulatory burden reduction for the banking industry, and specifically to offer my views on S. 1405, the "Financial Regulatory Relief and Economic Efficiency Act of 1997". I commend you and Senators Shelby and Mack for your sustained focus on the issue of regulatory burden reduction, and for your leadership in proposing a bill that builds on prior successful efforts to provide prudent and effective regulatory relief for the banking industry.

When I became Comptroller almost five years ago, I sought to highlight the importance of regulatory burden reduction and increased supervisory effectiveness and efficiency for the economic health and well-being of the national banking industry. I made improving the efficiency of bank supervision by streamlining supervisory procedures and regulations one of the four pillars, or organizing principles, that have shaped my term as the Comptroller of the Currency. The Office of the Comptroller of the Currency (OCC) recognizes that effective bank supervision necessarily imposes a degree of regulatory burden to maintain the safety and soundness of the industry, ensure that the credit needs of the public are served, and protect the interests of banking customers. However, it is also our responsibility to identify and eliminate unnecessary regulatory and supervisory burden. Excess burden cannot be tolerated. It makes banking more costly and makes banks less safe and sound and less able to serve their customers.

Four factors motivate our efforts to eliminate unnecessary regulatory burden and to carry out our supervisory responsibilities more efficiently. First, unnecessary regulatory burden causes banks to devote precious resources to unproductive tasks. Those excess expenses ultimately force banks to assume more risk to maintain necessary levels of profitability. Second, unnecessary regulatory requirements divert bank management away from the critical steps that will most enhance safety and soundness toward policies and procedures that offer few or no safety and soundness gains. Third, a bank that is less safe and sound and less profitable is less able to provide critical services that customers demand.

Finally, the task of eliminating unnecessary burden and minimizing what is necessary for effective bank supervision is never finished. In our rapidly changing, global financial marketplace, there is bound to be a need for some new rules; at the same time, logic compels us to eliminate some rules that may have been appropriate for a bygone era, but now serve no purpose.

I support the Committee's continuing efforts to provide regulatory relief and promote economic efficiency in the banking industry as proposed in S. 1405. Although we have achieved much, we can accomplish even more.

This next section of my statement provides a description of the OCC's actions taken since 1993 to reduce regulatory burden for the national banking industry. Section III comments on specific provisions of S. 1405. Finally, the appendix contains detailed comments on the bill.

II. OCC Actions to Reduce Regulatory Burden and Increase Supervisory Efficiency

Since 1993, the OCC has undertaken three significant initiatives aimed at reducing unnecessary regulatory burden and improving the efficiency of supervision: the Regulation Review Program, the Supervision-by-Risk approach, and the revision of our assessments and fees. We designed each of those programs to ensure that the OCC focuses its regulations and supervisory resources on those bank activities and products that present the greatest risks to safety and soundness. Through these programs, we are seeking to reduce regulatory costs in three ways: (1) reductions in direct costs, such as fees and assessments; (2) reductions in regulatory compliance costs, such as reporting and record keeping requirements; and (3) reductions in the costs imposed by regulatory uncertainty, such as time spent by bank managers to determine what the bank has to do to meet regulatory and supervisory requirements. Let me now briefly discuss each of these initiatives.

Regulation Review Program. I initiated the Regulation Review Program at the OCC in mid-1993. The program involved reviewing all 29 of the OCC's rules and eliminating or revising provisions that did not contribute significantly to maintaining the safety and soundness of national banks, facilitate equitable access to banking services for all consumers, or accomplish the OCC's other statutory responsibilities. The Regulation Review effort -- the first of its kind in OCC history -- also included clarifying regulations to more effectively convey the OCC's standards. We designed the program to ensure that our rules are better tailored to the goals we seek to achieve. To guarantee that our regulations are less burdensome going forward, we also established standards for developing new regulations.

I believe that the Regulation Review Program has produced a more modern set of regulations that, without sacrificing safety and soundness, reduce unnecessary regulatory burden for banks and are clearer and more understandable. For example, our revised application processing regulation eliminated the need for banks to submit applications to engage in many routine and low risk activities; accelerated processing for many of the remaining types of applications for qualified banks; and simplified the application process for those preparing applications. Another key regulatory change revised the lending limit calculation, which slashed the number of times a bank had to calculate its lending limit annually from as many as 365 to 4. Additionally, the OCC revised the provisions governing national bank equity investments in community development corporations and projects by streamlining or eliminating certain application requirements and relaxing restrictions on the reinvestment of these funds in efforts to attract new capital. We completed this Regulation

Review program in December 1996 by clarifying and modernizing the fiduciary activities permissible for national banks. As I stated earlier, however, regulatory review is an ongoing process, and we will continue to issue revised regulations and guidance as necessary.

Last year, the OCC sought to build on the principles we had articulated in the program by issuing a set of Standards for Developing Regulations that apply to any new rules that the agency may issue in the future. These standards are as follows:

- Effectively target the areas of bank activity that present the greatest risk to safety and soundness, the payments system, or the long-term vitality of the National Banking System, or are required by statute;
- Eliminate unnecessary regulatory burden and minimize the burden resulting from requirements that are necessary for the effective supervision of national banks;
- Foster bank competitiveness and allow industry innovation;
- Adopt regulations that can be understood by a reasonably knowledgeable person;
- Maximize the opportunity for national bank and public participation in our rulemaking, including timing the effective dates of our regulations to facilitate national banks' planning processes; and,
- Encourage continual re-evaluation of the OCC's rules.

Following completion of this Regulation Review Program, we took another unprecedented step by asking publicly whether the Program had made a difference to those who are subject to or otherwise affected by our rules. For those who responded affirmatively, we asked whether the effect was, on balance, positive or negative. The OCC conducted this evaluation -- called the Regulation Review Assessment Project to measure the results of our work -- primarily by convening many focus groups across the country including bankers, private sector banking lawyers, community group representatives, and our own examiners and supervisory staff. The vast majority of those who participated in our evaluation effort thought the Program was beneficial; they noted a reduction in regulatory burden and no discernible impact on the safety and soundness of the industry.

For example, many participants thought that the new streamlined application process cuts costs and produces quicker results. A number of bankers and banking lawyers agreed that the new Community Reinvestment Act (CRA) regulations shifted the emphasis from paperwork to performance. Community group representatives applauded the process used to revise the CRA regulations as a good example of how the OCC should obtain community input into the regulatory process. Others complimented the new suspicious activity reporting system -- implemented jointly by the OCC and other agencies -- because it dramatically reduces the number of required filings. Virtually all of those who evaluated the Program could identify some tangible, quantifiable benefit arising from the changes that the OCC made.

Supervision By Risk. To achieve our supervisory objectives in the most risk-focused manner possible, we initiated the Bank Supervision Review project in January 1994 to direct more of our supervisory resources to those banking activities and those banks that pose the most serious threats to the safety and soundness of the banking system. This review led to the implementation of our Supervision by Risk program in December 1995, which outlined supervisory policies and processes that tailor our oversight to the key characteristics of a bank, including size,[1] products offered, markets in which it competes, and management's tolerance for and control of risk. This program also provides an effective means for the OCC to alert senior bank management to problems they need to address so they do not worsen.

One of the major goals of the Supervision by Risk program is to provide the highest quality supervision of the banking industry in the most efficient manner possible. Supervision by Risk requires examiners to determine how certain existing or emerging issues facing a bank or the banking industry affect the nature and extent of risks in that institution. Having identified the risks for an individual bank, we then evaluate and measure the quantity of risk and the quality of risk management to form an overall conclusion about the bank's risk profile. That profile serves as the basis on which our examiners structure supervisory plans and actions.

Just as our Regulation Review Program was designed to revise existing regulations to ensure that the OCC's rules focused on bank activities that presented the greatest risk to safety and soundness or the most significant threat to the long-term vitality of the national banking system, Supervision by Risk eliminated supervisory procedures unnecessary for maintaining the safety and soundness of the banking industry and refined the remaining procedures to be more risk-focused. This allows banks and the OCC to allocate more time and resources to the most significant sources of risk, increasing the overall quality of supervision.

For example, over the past couple of years, the OCC has expressed concerns about the trends in credit risk. Our 1997 Survey of Credit Underwriting Practices demonstrated a continuing slide in underwriting standards and a trend toward increasing credit risk for most commercial and consumer loan products. The Supervision by Risk approach enables

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[1]The OCC's supervision by risk examination procedures differentiate between large banks and community banks. The OCC defines a large bank as a national bank with total assets of $1 billion or more or a national bank that is part of a multibank holding company that has a national bank with over $1 billion in assets. We define a community bank to be a national bank with total assets of less than $1 billion or one that is part of a holding company where none of the individual national bank's assets exceed $1 billion.

examiners to pay particularly close attention to credit quality and credit risk management in our current bank examinations.

Following the implementation of the initial stage of our supervision by risk procedures for community banks, we received positive feedback from bank management on the resulting reduction in burden. In response to our post-examination questionnaires that we ask banks to complete following an examination, a number of bankers noted that the community bank procedures reduced the level of supervisory burden during the examination. Moreover, the vast majority also stated that the streamlined approach did not compromise the quality of the examination. Rather, it better focused attention on the riskiest areas of the bank.

Assessments and fees. In 1993, we initiated a review of our assessments and corporate fees. This review resulted in a series of reductions beginning in 1995 that scaled back charges for national banks and ensured that fees and assessments more accurately reflected the actual costs of supervision. In 1995 we rolled back assessments to their 1992 levels and reduced certain corporate and trust fees by 50 percent. In September 1996, the OCC waived application fees for new charter and branch applications in low- and moderate-income areas to improve access to financial services for low-and moderate-income consumers. Another change made in 1996 lowered assessments for national banks that are not the lead -- or largest -- bank in multibank holding companies by 12 percent. The fee reduction reflects the fact that it takes fewer resources to supervise the smaller banks in a holding company structure. This revision more closely matched banks' fees to the actual costs of supervision and ensured that the assessment schedule did not favor one form of corporate organization over another. The total reduction in fees and assessments instituted by the OCC between 1995 and 1997 will save national banks $88 million annually.

The 1998 assessment schedule lowered the basic rates for all institutions (following similar steps in each of the three previous years), but imposed a 25 percent surcharge on banks rated 3, 4, or 5 on the five-point CAMELS scale. This change is intended to ensure that healthier banks do not subsidize the higher costs incurred by the OCC in supervising less healthy institutions. OCC analyses have demonstrated that lower-rated institutions cost more to supervise than those rated 1 or 2.

III. Comments on S. 1405,"The Financial Regulatory Relief and Economic Efficiency Act of 1997"

Mr. Chairman, you requested that the OCC provide comments on S. 1405. Let me state at the outset of these comments that your Committee can be proud of the leadership it has shown over the last five years in the effort to reduce unnecessary regulatory burdens for the banking industry, while not compromising either the safety and soundness or the community and customer responsibilities of banks.

In 1994 and 1996 Congress passed two significant bills that, among other things, streamlined the legislative and regulatory infrastructure governing the banking industry.[2] Both bills increased the number of small banks that may be subject to an 18-month (rather than a 12-month) examination cycle. In addition, these bills reduced unnecessary regulatory burden in many other areas such as the notice and applications process, corporate structure, and call report requirements. The current bill seeks to build on the successes of prior efforts to reduce unnecessary burden, and the OCC supports continued efforts to reduce that burden and improve supervisory efficiency.

Let me first discuss one of the bill's most significant provisions, which would lift the prohibition on depository institutions paying interest on demand deposits to business customers. As stated in a 1996 interagency report[3], the OCC and other federal banking regulatory agencies concluded that the statutory prohibition against the payment of interest on demand deposits no longer serves a public purpose. The OCC continues to believe the prohibition is outdated in the modern financial services environment. Further, we do not believe that the repeal of this prohibition would result in any longer-term supervisory concerns. We recommend, however, that the legislation provide an appropriate transition period to allow financial institutions to make necessary changes in their funding sources and pricing.

The bill contains other important, burden-reducing provisions. I strongly support the provisions of the bill that enhance national banks' organizational flexibility. Section 110 expedites the procedure by which a national bank may reorganize to become a subsidiary of a holding company. Section 112 provides procedures by which a national bank could merge with nonbank subsidiaries or affiliates. Currently, to combine with a nonbank subsidiary or affiliate, a bank must use a more burdensome form of corporate transaction -- a purchase of assets and assumption of liabilities of the subsidiary or affiliate. Sections 110 and 112 enhance the ability of banks to organize themselves in a manner that is less burdensome and enables them to better execute their business strategies.

Similarly, section 111 provides national banks with the flexibility to stagger the election process of members of their boards of directors. Currently, national bank directors may hold office for only one year and must be elected annually. Conducting an election process for an entire board every year can be disruptive to business operations. This section would provide banks with the flexibility to choose a staggered election process as a means of

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[2]P.L. 103-325, the "Riegle Community Development and Regulatory Improvement Act of 1994" and Title II of P.L. 104-208, the "Economic Growth and Regulatory Paperwork Reduction Act of 1996".

[3]*Joint Report: Streamlining of Regulatory Requirements*, September 23, 1996, p. I-47.

ensuring that a board will at all times include experienced members, enhancing the banks' safety and soundness.

This section also will permit the OCC to allow a national bank to have more than 25 directors. Current law does not necessarily provide banks with enough seats to accommodate directors from both institutions in the case of an acquisition or merger or adequate geographic representation in the case of larger interstate banks. Both of these changes provide banks with the flexibility to ensure the highest quality boards thereby enhancing the board's oversight of the bank's activities. These are examples of just a few of the provisions in S. 1405 that may benefit national banks.

I am concerned, however, about the effects on consumers of certain provisions in S. 1405. While simplifying disclosure requirements is a worthwhile objective when they provide superfluous or unnecessary information to consumers, we must be careful to ensure that consumers have sufficient information to effectively evaluate the financial products in the marketplace. Section 402 proposes amendments to the Truth in Lending Act (TILA) that eliminate certain of the current triggers for additional disclosures in closed-end credit ads and key credit terms in radio and television ads. As a result of these amendments, consumers would be deprived of information that is crucial to making informed credit decisions.

In addition, while I appreciate the benefits of reducing paperwork and compliance costs, I fear the proposed removal of anti-tying restrictions in section 204 and certain proposed revisions to the Fair Debt Collection Practices Act (FDCPA) in section 207 could also be somewhat detrimental to consumers. The OCC believes that the anti-tying provisions that prohibit the banks from conditioning the availability of one product on the purchase of another remain important. These provisions increase banks' awareness of their responsibilities to customers as they expand the array of products and services they offer.

With respect to section 207, the OCC has concerns about allowing a debt collector to initiate any communication with the consumer at any time or place if the communication is made pursuant to a "nonjudicial foreclosure proceeding." This is not a defined term and has the potential to be construed broadly to permit a debt collector to harass consumers by, for example, calling a consumer in the middle of the night or at work about foreclosing on any debt that can be characterized as a "nonjudicial foreclosure," the type of action which FDCPA is intended to prohibit.

Conclusion

The OCC remains committed to the reduction of regulatory and supervisory burden. We must promote an environment where risks are prudently managed by banks and appropriately monitored. But we must do so without imposing unnecessary regulatory burdens that undermine the ability of these institutions to operate efficiently, compete vigorously, and provide credit and other financial products and services to the public. We applaud the Committee for its efforts, and support the provisions in S. 1405, with only a small number of exceptions.

Reducing regulatory burden is a cooperative effort. Continued reduction of regulatory burden, while maintaining safety and soundness, requires the type of ongoing, vigorous legislative effort on the part of Congress typified by this bill. It also demands the OCC and the other banking agencies continue to do their part in reducing burden as they carry out the mandates of Congress.