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Statement of

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I appreciate this opportunity to present the Office of Thrift Supervision's (OTS) views on the current federal depository institution regulatory system. The views I express today are those of the OTS and do not necessarily represent those of the Administration.

For the OTS and the institutions we regulate, the topic of federal banking agency restructuring is nothing new. The OTS was created in 1989 when Congress abolished the Federal Home Loan Bank Board. During our seven years, we have dealt with the challenges of starting a new agency and setting up a new regulatory structure, of downsizing to keep pace with thrift industry consolidation, and of being prepared to absorb future structural changes that could dramatically alter how we operate.

The primary regulatory structure concerns of the institutions we regulate are unexpected changes in regulations and examination procedures. This is particularly topical because of the question in the letter of invitation related to merging the OTS out of existence. Before addressing the restructuring issue, however, let me review the benefits and challenges of the current system.

THE CURRENT REGULATORY STRUCTURE

Description of the Current System

There have been many Congressional hearings over the years addressing the issue of federal banking agency regulatory consolidation. Generally, these have been prompted by the complex regulatory structure that has evolved over the years.

FDIC-insured institutions are supervised by one of four federal regulators -- the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC) and the OTS -- and, if the institution is state chartered, a state supervisor as well. As a result, most FDIC-insured institutions are subject to safety and soundness examinations by at least two separate supervisors.

In addition, the Securities and Exchange Commission (SEC) has jurisdiction over the securities activities of depository institution holding companies; the Departments of Justice and Housing and Urban Development (HUD) share jurisdiction with the banking agencies over issues arising under the Fair Lending Act; and HUD, along with the banking agencies, oversees institution compliance with the Real Estate Settlement Procedures Act (RESPA). Finally, the federal financial regulatory framework includes the National Credit Union Administration (NCUA), which supervises credit unions; the Office of Federal Housing Enterprise Oversight (OFHEO), which regulates Fannie Mae and Freddie Mac; and the Federal Housing Finance Board, which oversees the Federal Home Loan Bank System.

Benefits of the Current System

The current regulatory structure for banks and thrifts has two principal benefits. First, it fosters the development of diverse and innovative approaches to regulatory oversight that hold the potential for producing a better supervisory system for all insured institutions. Second, it encourages specialized regulation of institutions that have different operational emphases.

Regulatory Diversity

The principal benefit of regulatory diversity is that it encourages the development of new and innovative regulatory initiatives by the various banking agencies. The current system of four federal banking agencies has, arguably, produced a better regulatory product than if a single federal agency had regulated banks and thrifts. Giving institutions a choice of regulators has avoided monopolistic and unresponsive regulatory practices that could prevail if only one or two banking agencies were in place. Each agency has developed programs and pursued initiatives, based on its particular regulatory emphasis, that have often been adopted by the other agencies.

The ability of the banking agencies to pursue independent regulatory initiatives while maintaining frequent contact with their regulatory counterparts produces a type of regulatory competition that benefits the regulated institutions. It also retains certain checks and balances within the system that help to prevent an agency from becoming overbearing or lenient.

Regulatory Specialization

Regulatory specialization permits an agency to direct the bulk of its resources to the specialized lending, investment and other unique operating aspects of the institutions it regulates. Clearly, there is no one type of operation that is ideal for all institutions. Some may choose to specialize in commercial, consumer or mortgage lending, some may specialize in wholesale as opposed to retail banking, and others may place significant emphasis on international banking. A benefit of specialized regulation is that it enables the regulator to understand and address the intricacies of the risks and operations of the particular types of institutions it supervises. This is also a benefit of the dual banking system -- permitting institutions to choose their business structure and operational emphasis, whether to operate under the laws of a federal or state charter, and a choice of primary regulator.

Problems with the Current System and Existing Interagency Solutions

The problems identified under the current regulatory system generally fall into one of three categories. First, institutions may be subject to multiple regulators and, therefore, regulatory overlap. Second, inconsistencies can arise in the differing regulatory approaches of the four federal banking agencies or other agencies that have regulatory responsibility over banks and thrifts. Third, there may be inefficient duplications of effort in the current system.

All of the federal banking agencies are sensitive to the need to reduce the problems that arise as a natural consequence of multiple regulators. The consistent message from the industry, the Administration, and the Congress is to reduce unnecessary regulatory burden. The agencies have undertaken various interagency initiatives to achieve greater uniformity and consistency in their rules and practices. Many of these initiatives were developed under the coordination of the Federal Financial Institutions Examination Council (FFIEC), which was established in 1979 to promote consistency in federal examinations and federal banking agency supervision. The FFIEC, which is comprised of the four federal banking agencies and the NCUA, has provided a forum for addressing issues related to regulatory overlap.

Regulatory Overlap

Regulatory overlap occurs when two or more agencies share jurisdiction over a particular issue (e.g., fair lending enforcement at FDIC-insured institutions is shared among HUD, the Justice Department, and an institution's primary federal banking agency). Overlap may also arise when two or more banking agencies have jurisdiction over various entities within a single holding company (e.g., a bank holding company supervised by the FRB that owns a national bank supervised by the OCC.)

Regulatory overlap has become more prevalent as different types of institutions are joined in the same holding company structure. This may create regulatory burden if affiliated institutions and holding company affiliates are required to submit multiple applications, respond to differing requests for information, or undergo separate examinations by different agencies.

The federal banking agencies are committed to reducing the expenses and burdens arising out of overlapping jurisdiction. For instance, the OTS and the FDIC routinely conduct joint rather than separate safety and soundness examinations of troubled thrift institutions. Similarly, the OTS and FRB coordinate their oversight of joint bank/thrift holding companies.

The four federal banking agencies have also adopted a common examination rating system. This reduces overlap and redundancy when multiple examinations are conducted, preserves valuable agency resources and, most important, reduces examination burdens imposed on insured depository institutions.

Regulatory Inconsistency

Differences in regulations and supervisory approaches are an expected by-product of a system of multiple regulatory agencies. This may be both a benefit and a hindrance to an efficient regulatory system. Regulatory innovation may ultimately produce a better regulatory outcome. Until the divergent regulatory views are sorted out among the different agencies, however, inconsistent and sometimes contradictory regulatory approaches can result.

To minimize the problem of regulatory inconsistency, the banking agencies have carried out a series of interagency initiatives. The OTS's adoption in 1994 of the same examination rating system (CAMEL) used by the other three federal depository institution regulators was designed to promote regulatory consistency. The agencies also adopted a common report of examination that includes certain common core information.

Currently, the OTS is working with the other banking agencies through the auspices of the FFIEC to consider refinements to the CAMEL system. It is anticipated that all of the banking agencies will implement any recommended changes in order to preserve existing uniformity.

The federal banking agencies have also collaborated on the development of many regulatory initiatives, such as real estate appraisals, safety and soundness standards, risk-based capital standards, and the development of uniform practice and procedure rules in adjudicatory proceedings.

The banking agencies are also currently working, again through the FFIEC, to develop consistent interagency regulations and policies. These initiatives include the appropriate capital treatment for recourse obligations and mortgage servicing rights. In addition, the FFIEC is coordinating the implementation of various provisions of the Community Development and Regulatory Improvement Act of 1994 (CDRI Act) that call for regulatory streamlining and uniformity. Several of the more significant issues being considered are elimination of duplicative application filings, call report simplification, and greater coordination of joint examinations.

I specifically want to highlight the interagency efforts to implement section 303 of the CDRI Act. This section requires the agencies to work jointly to streamline and make more consistent regulations and guidelines implementing common statutory or supervisory policies. To date, the agencies have identified 65 regulations or policy statements to review. Several of the more significant of these regulatory review projects include adopting consistent agency standards for Bank Merger Act and Change in Bank Control Act requirements; adopting uniform rules for the treatment of management official interlocks; and implementing consistent Bank Secrecy Act requirements.

There is also a high degree of interagency cooperation in the coordination of compliance examination procedures and policies. The agencies have developed uniform examination procedures for a dozen federal consumer protection laws, including RESPA, the Fair Credit Reporting Act, and the Flood Disaster Protection Act. In addition, the agencies have developed uniform compliance examination and Community Reinvestment Act (CRA) rating systems. This interagency effort has contributed to the development of a meaningful, well-defined, and consistent national policy on sensitive consumer protection issues.

__Duplication of Agency Functions__

Duplication of agency efforts is another by-product of a system of multiple regulators. The OTS has worked closely with the other banking agencies to make certain we do not develop systems already in place at the other agencies. For instance, OTS decided recently to upgrade its administrative systems. Rather than develop a new system from scratch, OTS staff is reviewing the feasibility of adopting a new automated system for administrative functions (e.g., accounting, procurement, travel vouchers, and similar functions) being developed by the FRB.

Another fruitful area of interagency cooperation is the sharing of PC systems to improve the examination and supervision process. The OTS has benefitted from drawing upon the work of the other agencies in the use of this technology. This initiative has enabled us to evaluate and learn from the experiences of the other agencies, thereby reducing costs, and has facilitated information sharing among the agencies. We are also pursuing joint procurement opportunities and sharing of surplus hardware with the other agencies.

The agencies have also been active in sharing training classes, instructors and facilities. In addition, the FFIEC conducts many interagency training programs and seminars for the four banking agencies and the NCUA. Joint training is both efficient and promotes consistency among the agencies. For instance, in 1995, the FFIEC conducted five CRA seminars across the country for 1,100 compliance examiners from the four banking agencies. During the year, the FFIEC also offered a series of examination courses and conferences attended by more than 5,500 examiners and bankers. Instructors for courses and conferences include examiners and other staff members from the member agencies and the states.

STATUS OF THE OTS AND STATE OF THE THRIFT INDUSTRY

In your letter of invitation, you also asked that we address issues related to the restructuring of the four bank and thrift regulators. While past restructuring proposals have typically focused on the three agencies regulating commercial banks, recently, such discussions have centered on the Office of Thrift Supervision. This attention on the future of OTS has been driven in part by the reduction in the number of thrifts and a belief that the operations of the banking and thrift industries are becoming increasingly similar. One of the questions in the letter of invitation asks what issues would be raised by merging the OTS into one or more of the other agencies.

A review of the current state of affairs at OTS and the industry that it supervises may help put this question into perspective.

Overview of the OTS

When the OTS was created seven years ago, it inherited oversight of a thrift industry in the midst of a crisis. The OTS responded by overhauling key safety and soundness regulations in areas such as capital, transactions with affiliates, and loans-to-one borrower. Policies and procedures were revised to establish a more structured approach to supervision consistent with that of the banking agencies. The examination function was enhanced and a relatively inexperienced examination staff, which had been hired in the mid-1980s, received intensive training. Finally, an aggressive enforcement program was launched to identify and prosecute the thrift owners and managers that had contributed to the industry's problems.

During the early years of the agency, literally hundreds of nonviable institutions were closed and sent to the Resolution Trust Corporation (RTC). Solvent, but undercapitalized institutions, while closely supervised and monitored, were directed to enter into capital agreements that required them to seek new capital either through mergers with stronger banks or thrift institutions or through stock offerings.

I believe the OTS succeeded in carrying out the mission Congress gave it in 1989. Since then, the overall health of the industry has steadily improved. In 1989, the industry reported a net loss of $13.3 billion, a return on assets of negative 96 basis points, and 2% tangible equity capital. By contrast, in 1995, OTS-supervised thrifts earned $5.4 billion, a record for the industry. Tangible capital reached 8.03%, another record for the industry. Ninety-seven percent of the industry is now considered well-capitalized. The remaining challenge for the thrift industry is how to respond to the possibility that its federal deposit insurance premiums, and thus its cost of funds, will remain significantly higher than that of its direct competitors.

Accomplishing this turnaround and restructuring of the thrift industry was not easy. From the summer of 1989 through June 30 of 1995, more than 750 OTS-supervised thrift institutions, holding $405.6 billion in assets, were closed and sent to the RTC. When the number of failed institutions is combined with thrifts that merged or converted to banks, the number of institutions leaving OTS jurisdiction since 1989 totals more than 1,100 institutions. Today, OTS supervises 1,437 institutions with assets of $771 billion.

Because of the contraction of the thrift industry, the OTS has engaged in an extended process of downsizing and cost-cutting measures. The decline in institutions and industry assets reduced the agency's workload, and, consequently, our staffing requirements.

OTS funds its operations almost entirely from assessments imposed on the institutions that it supervises. As industry assets declined, OTS revenues also fell. This decline in revenue reinforced the need for OTS to ensure that its staffing levels, and overall expenses, remained in line with the thrift industry.

Cutting back and restructuring the agency was painful. Agency downsizing initiatives included a regional consolidation program that resulted in our moving from twelve to five regional offices, reducing management layers, cutting back on agency benefits and programs, and most significantly, reducing the number of staff.

To provide some sense of the size of this task, in March of 1990, OTS staffing levels peaked at 3,442 employees. Today, OTS has 1,427 employees, a reduction of over 58%, or 2,015 employees. The reduction in staffing was achieved through attrition, a series of employee buy-out incentives, and, as a last resort, a series of reductions-in-force in Washington and the regions. In just the last three years, the number of staff has dropped by more than 900 positions. Agency morale suffered as staff became increasingly uncertain over the agency's future.

Since the end of 1993, however, thrift industry assets have remained stable at roughly $770 billion. As a result, the OTS assessment base stabilized. The OTS is now in a much stronger financial position, our reserves are growing and agency revenues and expenses are in balance.

Despite the recent stabilization of the OTS assessment base, however, we continue to engage in contingency planning. We have learned, like the industry we supervise, to expect change.

In the face of such uncertainty, a key agency goal has been to maintain a strong supervisory oversight program for the institutions we regulate. We must avoid repeating past mistakes, such as occurred when the Federal Home Loan Bank Board found itself with inadequate examination staff resources.

While we have downsized, we have sought to retain a trained and experienced core staff. We have maintained the ratio of examiners-to-institutions and examiners-to-industry assets, and the frequency and thoroughness of our exams. Because of these efforts, I believe the OTS is prepared and fully capable of effectively carrying out its existing statutory mission.

Preservation of a Strong and Efficient Regulatory Presence

As I noted earlier, there have been many proposals in the past to restructure and/or consolidate one or more of the financial regulatory agencies. Optimally, changes in the industry structure should determine the composition of our regulatory structure. As industries evolve over time, expanding or contracting, and entering or exiting various lines of business, so the regulatory structure should adjust accordingly.

To the extent that industry changes are gradual, it may be possible for the regulatory structure to keep pace with its shifting responsibilities through administrative action. The recent restructuring of OTS in response to changes in the thrift industry demonstrates the capability of an agency to respond to major shifts in workload. On the other hand, there are limits to an agency's ability to maintain its continuity and focus when faced with an environment of sudden and fundamental changes to the industry it supervises.

If it is determined that the functions of the OTS should be merged into one or more of the other federal regulatory agencies, it is imperative that this process be carried out in a way that maintains a strong supervisory function over the institutions presently supervised by OTS. The restructuring of OTS should not be carried out in a way that sacrifices regulatory safety and soundness or which causes confusions and unnecessary costs for thrift institutions.

For instance, it should be a priority to maintain those tools developed to maintain effective oversight over the risks posed by specialized mortgage lending. Three-quarters of the assets held by thrift institutions are related to residential mortgages. Such assets, by contrast, make up less than a quarter of the typical commercial bank's portfolio. It would be also be beneficial to maintain the continuity of the examination process during any transistion.

To ensure that federal oversight of insured depository institutions is not compromised, any restructuring should be conducted so that core staff are retained. This can be achieved by ensuring that any restructuring proposal includes appropriate and specific employee protections for existing agency employees. Failure to include such protections in a restructuring proposal that eliminates one or more of the existing regulatory agencies could lead to widespread employee departures and undermine the effectiveness of federal oversight during a critical transition period.

I believe the single most important issue that must be addressed in the context of any regulatory restructuring is preservation of a strong and stable regulatory environment for insured depository institutions that is effective, efficient and responsive to the needs and risks posed by the supervised institutions.

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