Opening Remarks by

Eugene A. Ludwig
Comptroller of the Currency

Before the
OCC Conference on Foreign Banks in the United States
Washington, D.C.

July 13, 1995

I want to welcome you this morning to this conference on foreign banks in the United States -- the third in a series of conferences sponsored by the Office of the Comptroller of the Currency. It has become something of a cliché to talk about the globalization of banking and financial markets. But like most clichés, this one has a strong element of truth. One piece of evidence is the fact that banks operate outside their home countries to a significant degree in all the G-7 countries.

This globalization of financial activities has led inescapably to the need for greater communication, cooperation and coordination among supervisors of banks in different countries. In recent years, much of this international consultation has been effectively handled for bank supervisors through the Basle Committee. For securities concerns, the International Organization of Securities Commissions -- IOSCO -- has been the international focal point. Within the past several weeks, the G-7 ministers have heightened their focus on the important work of the Basle Committee and IOSCO, as reflected in the Halifax Communiqué.

This renewed focus reflects, in part, the fact that technological and computer advances have brought about changes in our domestic financial markets and the kinds of financial products and services banks provide, as well as in the operation of international markets. These changes have created new kinds of risks for banks and have made it more important than ever for supervisors to understand and anticipate problems in the banking system -- before those problems become disasters. And all this has been happening at precisely the time foreign banks have expanded their activities in the U.S. market.

Because of all these changes, U.S. supervisors have expanded the scope of their supervision to include these new kinds of products and risks. For example, we have worked closely with bank supervisors from other nations on the Basle Committee to develop consistent approaches for measuring interest rate risk and assessing capital adequacy to protect against market risks.

Within the next few days, the Comptroller's Office, the Federal Reserve, and the FDIC will publish in the Federal Register a proposed rule on capital requirements for the market risks in a bank's trading account. This proposal is based on a paper released by the Basle Committee this past April. The comments we receive on our proposed rule will be an important part of our discussions on this topic at the next Basle committee meeting in mid-September.

The proposal we are publishing reflects supervisors' efforts to balance the need to minimize regulatory burden against the need to measure and protect against market risk. The rule would
establish two alternative ways to measure market risk -- a bank's own internal value-at-risk model (subject to specific constraints on the parameters of that model), or a "standardized" model designed by the Basle Committee.

We are interested in hearing whether the standardized model provides an accurate and effective measure of market risk. We are particularly interested in comments from bankers on whether we have set appropriate parameters for qualifying internal models -- and whether those parameters would result in capital requirements that are significantly higher than those of the standard model.

We also encourage banks to comment on how the results of the standardized model compare with those of their own models -- particularly in light of the proposed multiplier or scaling factor of three that would be applied to internal models. This factor would be used to convert an internal model's estimate of value-at-risk to a capital requirement. One possibility suggested by the Basle paper would be to link this scaling factor to the accuracy of a bank's internal model -- that is, a less accurate internal model might require a scaling factor greater than three.

For all these reasons, examiners from the Comptroller's Office are currently in 20 national banks gathering information on their internal models and their ability to meet the requirements of the internal model alternative.

At the Comptroller's Office, we have devoted considerable effort to making sure banks have the ability to measure, monitor and manage their risks from new or expanded capital markets operations. Two years ago, we began providing more detailed guidance to banks on derivatives and other capital market activities.

We have also implemented a program of examinations focusing on risks for large banks. Part of this program includes sending quantitative analysts with our examiners to analyze interest rate and market risk models that the banks themselves use to measure risk. Based on the feedback we've received from these banks, they appear to find this new element in our examination useful.

The growing integration of foreign banks into the U.S. financial markets adds another dimension to our supervisory responsibilities, and that is why today's conference is so important. The agenda is designed to help all of us gain a better understanding of how foreign banks operate in the U.S., including the challenges faced by those banks, and the challenges we face in supervising their activities.

We will explore these issues in four sessions today. The first will be devoted to the results of recent research conducted by staff at the Comptroller's Office and the Board of Governors of the Federal Reserve on foreign bank operations in the U.S.

In the second session, you will hear from the four government agencies most heavily involved in supervising foreign banks -- the Comptroller's Office, the Federal Reserve, the FDIC, and the banking department of New York State, where the largest concentration of U.S. offices of foreign banks is located.
From my standpoint, this is an invaluable opportunity for us to hear from you what you think we are doing right and where we need to change to make our supervision more efficient and effective.

The third session will focus on the legal and regulatory framework that governs the operations of foreign banks in the U.S., as well as looking at the experience of a U.S. bank operating abroad. And, finally, in our concluding session this afternoon, we have asked four senior financial figures to step back and tell us their views of the system as a whole. I will be moderating that panel, and I'm looking forward to a lively discussion.

Now, I have the great pleasure of introducing our keynote speaker. I'm sure Bill McDonough is familiar to all of you as president and chief executive officer of the Federal Reserve Bank of New York. He is also vice chairman of the Federal Reserve's Open Market Committee and a member of the board of directors of the Bank for International Settlements, where he is chairman of its Committee on Payment and Settlements Systems. From all of his various responsibilities, it should be evident that Bill is closely involved in the workings of the U.S. banking system and its interaction with other major banking systems around the world.

Bill is also an experienced banker. He knows first-hand what it means to run a bank and deal with government supervision. Before he joined the New York Fed in 1992, he spent 22 years at First Chicago Corporation, where he rose through the ranks to become vice chairman of the board and a director of the bank holding company. He also served as advisor to the World Bank and the International Finance Corporation and as a special advisor to the president of the Inter-American Development Bank.

Please join me in welcoming our keynote speaker, Bill McDonough.