Remarks
by
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SHOULD WE WORRY ABOUT THE THRIFT INDUSTRY?

I always enjoy the opportunity to talk with you and to share viewpoints and ideas. Communication between you and the OTS is crucial if we both are to do our best job.

Speaking of jobs, I don t worry about mine, which I ve now held for just over four months. As the debate continues on financial modernization and the possibility of eliminating the federal thrift charter and the OTS, I tell my staff, who have been living with this uncertainty for years, that we have a critically important job to do as long as we are here, and it s only getting more challenging. I like the work, I like the people at the OTS and in the industry, and I continue to believe that being Director of the OTS is one of the best public service jobs in Washington.

I am not a worrier by nature. I don't worry about whether my house is spic and span, or whether my 14-year-old son is doing his homework he does! As a pretty active and intense soccer mom, I do worry a little about whether we have a good soccer coach and I am pleased to report that we do!

Thrift Industry Is Doing Well

Given the performance of the thrift industry, it s a little hard to get too worried. Business is good. Later this morning, we will announce at our regular press briefing the financial results for the fourth quarter and full-year 1997 and assess the condition of the thrift industry we regulate. We will report specific numbers at the briefing, and they will show record earnings for the year. The financial underpinnings of the industry are strong capital, for instance, is at a record level; the number of problem institutions and troubled assets continue to decline, and the core return on assets is pretty darn good.

The thrift industry has benefited from a very favorable economy and, particularly, the low interest rates and the increase in home ownership that have prevailed for the past several years. There are obviously other factors in the performance as well, such as improvements you have made in managing and operating efficiencies and better oversight by boards of directors you and your associates deserve credit.

It's actually rather boring that things are going along so well quarter after quarter. The members of the fourth estate who regularly cover us are finding it rather difficult to get very excited about all this good news. But I'm sure we all share the feeling that it's better to be boring than to fuel the kind of headlines the industry was generating back in the late 1980s and early 1990s when the press was reporting failure after failure. The industry obviously has come a long way since those grim days. I can tell you that Jack Ryan, our Southeast Regional Director in Atlanta, doesn't miss those days. You may recall that Jack served for two years as head of the RTC. He's now back in Washington as the acting Executive Director for Supervision following John Downey s retirement at the end of last year.

But with all the good news, we need to guard against becoming complacent and taking for granted that the industry s performance, like the bull market, will go on forever. There are, in fact, areas of concern that we need to recognize and deal with.

As Regulators, We Do Have Some Concerns

Some of these concerns arise from our assessment of your financial reports on certain activities. We have seen a continuing runoff in deposits, which ultimately will increase thrifts cost of funds. There was some increase in these costs in 1997, even though treasury interest rates fell over the same period. Deposit runoff also can be indicative of a reduction in the customer base, which can lower the franchise value of an institution. In the end, as interest costs increase, thrifts may try to maintain their net interest margins by increasing interest earnings, and this implies acquiring more risky assets. We believe some of this has already started with the move toward subprime lending.

Another concern is tied to the current refinancing boom. While refinancings can provide some short-term gains through increased fees and other transaction costs as well as taking unamortized points and fees into income the longer term effects are less clear. Not only is purchased servicing at risk, refi booms typically result in a shift from ARMs to fixed rate mortgages, which are generally less profitable. Moreover, the credit history of the ARMs that have been written during refi booms is not all that promising.

It is gratifying that as the industry has consolidated, assets have remained fairly stable and actually grew in 1997 over 1996. What concerns us somewhat is where this growth is occurring. We are less troubled than we otherwise would be because the industry s capital also is growing. However, growth into unfamiliar product lines without acquiring the requisite expertise in those products and services poses potential supervisory issues. We know some institutions have internally built consumer and commercial portfolios while a few have taken on these assets by acquiring portfolios or whole banking institutions. We are analyzing sources of general asset growth to try to identify the fastest growers and how they are growing. I would be less than candid, however, if I didn t say that acquisitions of subprime portfolios, in particular, are worrisome and in some recent situations, with good reason.

A moment ago, I noted the importance of favorable economic conditions to the industry s sustained performance. I think we tend to connect the two only in a domestic way. However, I think Treasury Secretary Rubin is absolutely correct in warning that if the economic crisis in Asia persists, and especially if it spreads, it could have serious consequences for the U.S. economy. We are already seeing the impact in Hawaii.

That s why the Administration s top financial priority for this session of Congress is to replenish the IMF fund. IMF support isn t the final answer to Asia s problems, but both the financial and technical assistance IMF and the World Bank provide can perhaps soften the blow and help speed up the process of making the adjustments that are required to get their banking systems and economies back on track. Taking the narrow view, the thrift industry, having benefited from a strong and stable U.S. economy, doesn t need a threat to its current serenity posed by the Asian situation. I hope Congress will agree to the Administration s plan to support the IMF.

As Secretary Rubin has said, the key to the Asian problem is for those nations to reform their economic systems and, among other things, lay the basis for strengthening their financial systems. Not only has OTS donated one of my predecessors Jonathan Fiechter to that cause, but we ve also been available for consultation with officials from Asian and other countries that want to understand what happened to the thrift industry in the 1980s, how the nation dealt with the problems, and how we supervise the industry today.

Year 2000 Preparation

Let me now leap from Asia to the next millennium. I know for certain you are tuned into this topic. Right? Right! If you haven t already figured it out, you should expect that bringing your computer systems into Year 2000 compliance will raise your G&A costs. The accounting firm, Grant Thornton, recently ran up a red flag over the results of a survey it did. The firm says it found that community banks, including thrift institutions, may not be adequately budgeting for the Year 2000 changeover. ACB s own survey suggests similar cause for concern. My advice is that it s better to make a reality check on costs now than to get a shock when the full bill comes due.

I assume you all now know how serious an issue this is. Let me pose a couple of questions.

First, is your plan of action moving at a pace that will enable you to serve your customers without interruption and keep your business viable when the new millennium rolls in just under 21 months from now?

Second, are you as concerned about your service provider s rate of compliance as you are with your own internal systems?

I hope your answer to both questions is a resounding "Yes." The ACB survey, while finding that only 40 percent of respondents provided an estimate of the cost of remediation, also concluded that (quote) the overwhelming majority of community banks are focusing significant resources on resolving Year 2000 computer issues (unquote). I hope so. The pressure on you and on us as your regulator will intensify as we approach the switching hour. I'm sure you have read where so-called experts contend that the banking industry won't be ready with the changeover, and disaster will strike. We will have a much better picture of how well the industry is progressing toward remediation after completing the on-site examinations of institutions now underway.

I will warn you, however, that we are seeing more needs to improve institutions than we did the first time around. Indeed, we are seeing institutions that seem to have made <u>no</u> progress since last fall. That s totally unacceptable.

We will follow up on all unsatisfactory situations through various means, and for the more serious cases, we are contemplating appropriate formal enforcement action. In conjunction with the other regulators, we re also examining those that provide services to the industry. OTS relies on agreements with institutions for access to examine providers, but we have been urging Congress to give us the same authority to examine service providers as the banking regulators now have.

On February 24, the House passed a bill that gives us and the NCUA the necessary statutory authority, and a companion bill has been introduced in the Senate. We appreciate the leadership on this issue of Chairman Leach and Senators Bennett and dodd, as well as ACB s testimony in favor of the bill. We hope the Senate completes action on the measure quickly.

The FFIEC agencies have formed a multi-discipline working group whose task is to develop uniform approaches to contingency plans designed to mitigate systemic risks. The task force also is organizing a team of regulators with a variety of skills and perspectives whose goals are to gather potential work-around solutions in the event of technological failures; ensure consistent application of our supervisory and resolution strategies; and develop a better understanding of the interdependencies of depository institutions systems, as well as the likely consequences of encountering corrupt data. This effort will begin this month.

In addition to the direct exchange through the examination process, we are bolstering communications with you in other ways. I hope you have seen the newsletter we started in January called MMillennium. We send it to every institution we regulate and to each of our examiners to help keep you and them informed and thinking about the Y2K universe. We would appreciate your feedback. If you want more copies, let us know. We are posting the newsletter each month in the Year 2000 section of our Internet web page   at www (dot) ots (dot) treas (dot) gov.   You ll also find hot links to key Y2K sites of other sources, such as the FFIEC. I urge you to have your staff check all of these sites on a regular basis.

In another initiative, the OTS has joined with ACB and the FDIC in sponsoring three workshops on Y2K issues.   The first two were held recently in Washington and Los Angeles, and the feedback has been favorable. Another session will be in Chicago March 9 and 10. Our goal in all of these activities is to make certain you achieve compliance in good time. Failure to do so will hurt your customers, and think what it will do to your institution. We must keep at this task until the weakest link in the industry is renovated.

One other point I want to make about the Year 2000 is that we are well along in the process of getting OTS systems prepared. As of today, 13 of our 15 systems have been tested and are in compliance. We expect to have the other two systems fully tested and in compliance by November, if not sooner.

Before I move on to financial services modernization, I want to take a moment to thank Senators Shelby and Mack for their current work on a subject we fortunately don t have to talk too much about any more: regulatory burden relief. S. 1405, sponsored by Senators Shelby and Mack with 11 additional bipartisan co-sponsors, is a solid, responsible bill that will clean up anomalies and simplify regulation.

Status of Financial Services Modernization

If I were a betting person, I d wager that a subject very much on your minds today is the future of the federal thrift charter. I wouldn't be surprised if you have reached the point of exhaustion, or perhaps exasperation, over the debate on financial modernization. I don't know how many of you read the trade papers day in and day out, but we here in Washington do. Almost every day there seems to be a new wrinkle in the debate.

As you know, efforts in the House last year to bring a modernization bill to the floor for a vote failed. And although various Members of Congress have offered proposals to try to break the logjam, nobody has broken the impasse. We don't know, any more than you do, whether 1998 will be the year of modernization or not. The debate over reforming financial services has been evolving over the past 20 years, and now forces us to consider all aspects of financial services.

The marketplace isn t waiting for Congress. Market forces are relentlessly driving change in the industry. Consolidation is happening, and it s happening courtesy of the thrift charter among all financial service industries, as well as among and between thrifts and banks. Since the beginning of 1993, the thrift industry we regulate has had a net loss of more than 660 institutions either through merger with other thrifts and banks or by conversion to state or commercial bank charters. While we detected some slowing in the pace late last year, we don t know if that s trend-setting. The fact is we continue to see many more thrifts leaving than entering the industry, despite the recent interest in the federal thrift charter by several big-name insurance companies and others.

Behind consolidation is an evident desire of management like some of you perhaps to offer customers one-stop shopping and, thereby, gain a market edge. It's understandable that institutions want to make it easy for a customer to make a deposit, get a loan for personal or business use, invest in individual stocks or mutual funds, obtain a credit or debit card, buy life insurance and do it all by phone or personal computer on line. One thing is certain the way you deliver products and services is changing, and technology has helped make that possible.

Implications of One-Stop Shopping

One-stop shopping probably is good for most Americans, but the new dynamics present some very interesting challenges, both on the high-tech side and the good, old-fashioned safety and soundness side. You as the operator and we as the regulator have to anticipate where technology is leading and how these advances impact supervision. For example, are systems and customer accounts secure? Are they transparent to senior management, the directors and our examiners in the sense that we all understand how the systems work and how to manage them? And do you and your customers know the rules of the game, such as who has responsibility for smart cards and other instruments of the system?

We also strive to make certain our rules do not stifle development of improved services, and that they allow thrifts to compete effectively. These principles guide us as we work toward issuing a final rule on electronic operations by mid-year, which as proposed last year, would allow thrifts to do anything electronically they can now do by traditional means. But we are already coming face-to-face with some of these issues in dealing with recent applications for the federal thrift charter. Those providing products and services over the Internet, for example, must prove that hackers can t penetrate their systems. Those engaging in cross-marketing of bank and nonbank products, even over the telephone, must disclose the difference between insured and noninsured products.

And what are the implications for CRA compliance? How do your institutions continue to serve all of your community if you cut back on traditional product and service delivery systems? It is essential that less advantaged citizens and their communities are not left behind or ignored. So far, in dealing with the new charter applications, the CRA issue has been a relatively easy call because the initial CRA assessment area is geographically limited. But we are fast approaching the time when CRA compliance will present a bigger challenge as new applicants and institutions already chartered move more and more into nontraditional delivery systems. OTS, in conjunction with other regulators, is looking at the implications for CRA in an effort to develop guidance and to determine whether any regulatory action is necessary.

Another of our major tasks in assessing new applications, especially from financial services firms that are not subject to routine federal oversight, is to find out if they understand how seriously we take the consumer protection and fair lending statutes that exist to make certain consumer lending is fair and equitable. All of you know the weight we attach to these laws, and we re pleased that you take them to heart too. You have a right to be proud that 93 percent of the thrifts we supervise are rated 1 or 2 on compliance. We have worked hard together to build this strong track record, and we must maintain it. You realize that this takes a conscientious effort, particularly in an area where the contours of the law are sometimes evolving and not clearly defined.

So we will look closely at potential new entrants past records as we decide whether to approve their application and what conditions may be necessary to ensure that they will serve their communities and consumers well. These applicants must also understand that once they set up regulated institutions, we will scrutinize how they deal with consumers, and, just as we do with you, take action as appropriate to make certain they comply with the law.

Imposing conditions in the final orders approving charters is something we commonly do. With several new institutions and their holding companies recently, we put in conditions to address potential issues identified with cross-marketing, CRA and sales of non-depository products. Some of the planned activities are somewhat novel, but I think we have been very thorough in our analysis and fair about the requirements these new institutions will have to follow. We require institutions to obtain OTS approval for significant changes in their business plans, and how their CRA activities evolve with the changing business is part of our analysis.

Other Electronic Technology

The law and technology are coming together in another way that offers the thrift industry an opportunity to reach out to a segment of the community it may never have served before   the unbanked. As you know, beginning January 1, 1999, most federal payments, such as Social Security checks, have to be made electronically. Most individuals who do not do business with a depository institution will have to designate an account to receive the payments, or the government will designate one for them. For recipients who do not designate an account, Treasury will set up an Electronic Transfer Account, or ETA, at a federally insured financial institution in their name. These ETAs will be provided at reasonable cost and with the same consumer protections as any other accounts at the financial institution.

Keep in mind that many of these people may currently cash checks at your institution, but don t maintain an account. Thus, they are potential new customers for you. I strongly urge you to consider ways to bring these people into your institutions voluntarily through development of appropriate products, outreach and marketing. And I suggest you seriously consider whether partnering or subcontracting for the ETAs might be good business for you.

Thrifts Uniquely Qualified To Lead Community Development

Community orientation and service to the community are hallmarks of the thrift institution. In this era of expanding regional, national and multinational banks, thrifts have renewed opportunities to serve their communities. And they can to do so profitably. I don't have to tell you that thrifts have a heritage of serving the community, mainly through mortgage lending. This is your bread and butter, a line of business that dates back to 1831 and one that brought many of you through the thrift crisis. Your role is increasingly important today because of the need to house a growing population and overcome the lack of adequate housing in low- and moderate-income communities.

We have made considerable progress. For example, home ownership in America reached an historic high last year of 65.7 percent of all families. However, serious gaps still remain in home ownership between white families and minority families, as well as between the rich and the poor and between households headed by women and those headed by men. This industry is uniquely qualified to take the lead in providing housing in the inner city, and in a number of cities, it is. The problems of crime, housing, poverty and blight, of course, aren t confined to urban centers. They are evident in communities across the nation, including rural areas that have their own unique problems with economic under-development and depopulation. Thrifts in those areas have an opportunity to make a difference.

But what if making a difference is too large an undertaking for some individual institutions to go it alone? Well, we know from experience that economic development works well in partnership. Let s look for a moment at an example of institutions like yours working together to deal with housing and other community needs in their own backyards. Perhaps some of you here today are involved with this group, the Thrift Institutions Community Investment Corporation of New Jersey. Since its beginning in 1992, TICIC reports that today it has more than 60 participating thrift institutions that are active in a dozen New Jersey counties. It has funded multifamily projects providing over

1,600 apartments, financing the development with nearly $50 million in loans made available through the organization. These projects are located in urban as well as suburban areas. With changes in CRA regulations as well as growing competition, TICIC is expanding its scope. Activities now include day care centers, an office building whose tenants are mostly minority-owned businesses, and a workforce development center to train 250 people at a time in such skills as health care, computer and security services. TICIC is also working with the Small Business Administration to assess potential expansion into SBA-type projects. About 30 of its members have expressed interest in participating in SBA lending.

Small business lending is a relatively new business for most thrift institutions. With the additional authority granted by Congress in 1996 specifically for small business lending, it is a growing business and another way for thrifts to support development within their own communities, as TICIC and others are doing now. That s fine as long as you understand what you are getting into before you take the leap. Some of you may have attended one of the seminars we conducted last year in our five regions to provide some guidance in this type of lending. If you are interested in small business lending and looking for guidance, I suggest you contact your OTS regional office and/or the local SBA office.

There are many other cooperative programs under way throughout the nation in which thrifts participate. Many of you here today represent thrift institutions actively involved in or pursuing such opportunities. For those of you interested in expanding your activities, or not yet involved, there is a Community Affairs Liaison, or CAL, at your regional office available to help. Their job is to know about these organizations and how to get one going.

For our part, we are beefing up our community affairs programs this year. We are adding to the community affairs staff in each region and in Washington. We re not changing the direction of our program, but we are seeking to expand the work already under way and to provide continuity in our programs. For example, each of our regional staffs is looking at a specific areas where thrifts might make a difference. We plan a series of conferences on selected topics this year. Our Northeast Region will host a program on urban homeownership in New York City April 29, and our Midwest and West regions will join with the State of New Mexico to put on a conference on lending on tribal lands in Albuquerque August 4 and 5. That conference will focus on some of the barriers to homeownership on reservations and how to overcome them. The Southeast Region is planning a conference on rural community development, but has not set a date. We ll be talking more about these conferences in the near future.

Before I close, I want to say a word about mutuality and a new concept of community service growing out of the conversion process. First off, I know that a substantial portion of the thrift industry desires to retain the mutual form of ownership. Conversion to the stock form of ownership has raised considerable capital for the industry. But it has also heightened our resolve that depositors get fair treatment in the conversion process, and that management not be unduly enriched. We do not favor one form of ownership over the other, since both have advantages and disadvantages. But the mutual institution continues to have a role in the community as evidenced by the fact we still have more than 480 mutual institutions under supervision.

We also recognize that conversions to stock ownership will continue. If your institution s management is considering this option, you may want to think about creating a foundation as part of the conversion process. This idea arose about two years ago when Ocean Federal in New Jersey converted. It set up a charitable foundation with stock from the conversion to support charitable programs in its community. Since Ocean Federal made the first move, we have approved several other conversions that include the foundation provision. In early February, OTS hosted a one-day meeting of representatives of the FDIC, charitable foundations and thrift institutions to explore the foundation concept further. I think it was a useful meeting. At present, we look at the foundation concept in connection with conversion applications on a case-by-case basis. We are presently reviewing our conversion regulations in line with our overall regulatory burden reduction effort, and we are looking at the pros and cons of making the foundation idea part of a revised rule. It s only an idea at this time, and I m not at all sure we will incorporate it in a revised rule.

Concluding Remarks

A point I want to drive home as I conclude my remarks today is this: as we continue to debate issues of financial modernization and the merits of the federal thrift charter, let us recognize that the nation needs to allow financial institutions to have a community focused housing specialty. Such institutions thrift institutions, if you will have proved their value by enabling more Americans to own their homes, and by increasing participation in small business lending. Who better to understand and serve the needs of the local community than a financial institution that is focused on the community it serves, whose owners are for the most part members of the community, and that has shown initiative and creativity in devising new products to serve that community.

One of my primary goals at OTS is to make sure the industry is not only safe and sound, but also constantly improving its service to the communities upon which its business lifeblood depends. Working together, I believe this industry has a lot to contribute to the housing needs of America and to the development of our communities, large and small, urban, suburban and rural.

If we do this, do we really have anything to worry about? Will the thrift industry be around for the next millennium? What is your answer? As I said at the beginning, I m not a worrier!

Thank you.