Remarks by
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I want to thank Diane and the ACB leadership for inviting me to be with you today. While I know that ACB's membership includes commercial banks, this organization plays a tremendously important role as the leading representative of the thrift industry.

There. I've used the "T" word, in full understanding that it's a term that's largely been banished by the industry it once described. With your forgiveness, I will use it occasionally in my remarks, but only in order to make a couple of points: first, to distinguish the main body of ACB members from the financial institutions supervised by the OCC, and second, to aid in discussing the trend that has all but obliterated what were once key differences between the two types of institutions.

My involvement with your industry spans about 40 years. When I was a young associate at my old law firm, I cut my litigation teeth representing S&Ls in branch office hearings before the old Federal Home Loan Bank Board. And in the late 1960s I spent endless hours working on S&L holding company legislation. I came to value the thrift charter, and the unitary thrift holding company, as highly flexible formats for carrying on the business of a depository institution, and I still feel that way, even though savings associations and banks have come look much more alike.

In those days, the differences between commercial banks and savings institutions were still wide and fundamental. The two occupied very different niches within the financial services industry; they undoubtedly competed for some of the same customers, but generally not in ways that the other could have easily replicated. Regulation Q drew a significant line between banks and thrifts. Most people thought of the two as distant cousins rather than competitors. Bank and thrift regulators traveled in their own circles as did their respective trade associations -- and our interests diverged as often than they coincided.

What is remarkable is the extent to which the two industries have converged over the last quarter century. Today the public views savings associations as virtually indistinguishable from banks. Indeed, most savings institutions now explicitly hold themselves out as "banks," and -- for reasons we all understand -- their old identification as "savings and loans" has virtually disappeared – as has the "benefit" they enjoyed under Reg Q of being able to pay higher rates than banks.

Over the past several years, both sectors have seen significant consolidation and restructuring, significant growth of assets and deposits, and, most importantly, significant prosperity. Just since 1994, the number of federally insured savings associations has dropped by approximately 30 percent, commercial banks by about 25 percent. Total assets held by savings associations are up by a little more than 30 percent since 1994, commercial bank assets by just over 50 percent. Both industries today operate from strong positions of equity capital.

The trend toward convergence between the two industries is also evident from an examination of their respective balance sheets. At one time, non-mortgage consumer loans were virtually the exclusive realm of commercial banks. Today, consumer loans account for eight percent of the loans held by savings institutions. That compares to about 11 percent of all loans held by banks with under $1 billion in total assets.

In other words, the differences between savings associations and commercial banks – especially community banks – are increasingly hard to find.

The same trend can be viewed from another perspective. Commercial banks once held very few real estate-related loans, especially residential mortgage loans. Today, one-to-four family mortgages constitute 25 percent of loans held by banks, and many more mortgages are originated and then securitized.

Indeed, real estate lending is today a major pillar of the national banking system, and a significant source of its strength. Today, at a time when national banks are still making fewer non-real estate loans than they did a year ago, real estate lending is up nearly ten percent. Today, real estate loans constitute around 45 percent of total national bank loans – five percent higher than in 1994 and a whopping 20 percent higher than in 1984.

Moreover, the securitization of residential real estate loans plays a large and increasing role in the growth of noninterest income at national banks. As of the second quarter of 2002, residential real estate loans comprised nearly two-thirds of the total stock of securitized loans outstanding at national banks, and income from securitized loans rose by more than 30 percent – a big part of the reason why total noninterest income at national banks was up by more than 8 percent over the same period last year.

What all this means, of course, is that the operational concerns – and macroeconomic trends – that keep ACB members up at night are, increasingly, many of the same trends and concerns that preoccupy the average national bank. Indeed, the vast majority of the institutions supervised by the OCC – some 2000 of the 2200 banks that make up the national system -- are community banks, with under $1 billion in assets. Of those 2000, about half are under $100 million in assets. You can't get more "community" – or more like the typical ACB member -- than that.

More than 1300 OCC examiners – nearly two-thirds of our total examiner force – are dedicated to community bank supervision. The issues that our examiners focus on – and the perspective they bring to those issues – have also changed to reflect the changes that have taken place in the banks they supervise.

Two decades ago, for example, OCC examiners would almost certainly have criticized any national bank with the kind of concentration in residential real estate that is commonplace – and that usually passes without criticism -- today.

Two decades ago, OCC examiners would probably have viewed the consumer debt load and the condition of residential real estate markets as relatively minor risk factors for the national banking system. Today these are among the most important issues our analysts and examiners face, precisely because they have become so important to the safety and soundness of the institutions we supervise.

It's become a cliché in our present economy that the consumer is king – or queen. We can go even further: consumer spending over the last two years prevented what is so far the mildest recession in recent history from becoming much more serious. The willingness of American consumers to continue spending despite the dismal performance of many of their investments represents a vote of confidence in the fundamental health of our economy.

The combined effect of tax cuts and the dramatic decline in interest rates has been significant for the economy. Successive cuts in short-term rates – the Fed implemented 11 such cuts in 2001 alone – helped to keep auto sales brisk and to sustain one of the best housing markets in history. Fixed mortgage rates hit all-time lows this summer, and they have largely stayed there. New housing starts, sales of existing homes, and mortgage refinancing have soared to record levels, and property values generally risen with them. One estimate places the rise in property values over the past two years at $2.5 trillion – making up for no less than half the total loss in equity wealth over the same period. And mortgage refinancing has generated savings of about $150 billion in the form of cash-outs and lowered monthly payments.

That's $150 billion extra in the pockets of American consumers – a windfall that has until now helped keep our shops busy, our factories humming, and our employment stable.

The big question is whether we can sustain this level of activity. Is the consumer in a position to continue supporting the economy until business investment has rebounded to the point where it can bear its share of the economic load?

These days, the evidence is inconclusive. If it's good news that you're looking for on this front, you probably won't have trouble finding it. Indeed, many retail indicators continue to reflect strength.

But bank supervisors are professional worriers. Something in their DNA seems to cause them to find glasses half empty and to see dark clouds on every horizon. Even after adjusting for this somewhat dour outlook, we think there's legitimate cause for concern about whether consumers have the wherewithal to carry the load for the economy through these uncertain times.

A telling signal on the retail side is the drop in key indicators of consumer confidence. Last month the University of Michigan's Consumer Sentiment Index dropped to a nine-year low – the fifth consecutive monthly decline in that index. This appears to be no aberration; the Conference Board's Consumer Confidence Index has declined for five straight months, and is now at its lowest level since November 1993.

This trend has been in evidence in auto showrooms. Despite the renewal of below-market financing deals, auto sales pulled back 5.2 percent in September. Sales rose for durable goods, as consumers loaded up on appliances and furniture for all of those new houses, but not enough to offset losses in autos.

A particularly disconcerting fact is that despite rock-bottom interest rates, debt service as a percentage of disposable income is higher than it's been since the mid-1980s. That's partly a reflection of the rise of consumer credit outstanding, and partly due to the decline in median household income. In 2001, household income fell by 2.2 percent after adjusting for inflation, and the poverty rate rose for the first time since 1993. And there's little evidence of an impending turn-around, given rising unemployment claims and continued weakness in the job market.

It may be, in other words, that the consumer has already given about all that the consumer has to give. Indeed, debt load statistics suggest that consumers may have given too much, and that retail customers could be especially vulnerable to an unexpected economic jolt -- in the form, say, of a spike in interest rates or energy costs, or what some believe is a long overdue softening of the housing market.

There's widespread concern that in some parts of the country, the good times in housing amount to a bubble that cannot last. The implications for the issuers of high loan-to-value first mortgages and home equity loans – one of the fastest-growing categories of consumer loans by national banks – are obvious. Indeed, this summer, mortgage foreclosures rose to the highest levels on record.

What are the other implications of a weakening consumer sector for national banks and savings associations? More to the point, what is the OCC doing to help the institutions it supervises manage the special risks that this complex and sensitive situation present?

I say "sensitive," because, as I've emphasized, consumer spending – and borrowing – is crucial to the health of the banking system and the economy, present and future. Obviously, it's in our interest to preserve the ability of banks to continue making prudent loans to business and consumers alike.

Having said that, we know from experience that the best way to maintain credit availability and healthy economic development is to safeguard the safety and soundness of the institutions that supply it. And the way we do that as bank supervisors is to assist lending institutions to identify, control, and manage risk -- both new and existing.

As a case in point, we and the other FFIEC agencies, including OTS, recently issued proposed guidance on credit card lending. It was the outgrowth of recent examination findings of inappropriate or weak account management, risk management, and loss allowance practices at some institutions – practices that give us particular concern in today's uncertain retail banking environment.

For example, we found that some institutions have been extending credit, increasing existing credit lines, or issuing additional lines with insufficient regard to the borrowers' ability to repay. In some instances, issuers failed to evaluate and document the borrower's creditworthiness; in others, institutions lacked adequate management information systems to get their arms around borrowers' total exposure; and some issuers have clearly paid insufficient attention to their workout and collection arrangements.

We have been particularly concerned about subprime lenders, especially those that freely grant credit-limit increases to cardholders – or that implicitly grant such increases by honoring over-limit charges and carrying the excess forward month after month with substantial penalty charges. Too often that leads to negative amortization, a situation in which the minimum monthly payment is insufficient to amortize the debt, and finance charges pile up to increase the amount owed. Subprime borrowers frequently lack the financial capacity to service this additional debt and the high fees associated with being in an over-limit status. It's not uncommon for subprime borrowers to be current on their debt, and yet, when finance charges and over-limit fees are added in, to wind up owing their creditors more after making the minimum payment than they did before. This is obviously an untenable situation for borrowers, but it also exposes lenders to the possibility of large unsecured losses. The consequences for banks – and for the economy – could be serious.

As supervisors, we believe it is important to avoid such an unhappy outcome. The guidance put out for comment spells out our expectations for prudent risk management practices for credit card activities. We expect issuing institutions to manage credit lines prudently -- to fully test, analyze, and justify credit line assignment and line increase criteria. We expect that over-limit authorizations for subprime borrowers will be carefully considered, and that workout policies will be properly managed.

And while we recognize that it will take some time for financial institutions fully to phase in the policy changes that our guidance contemplates, we want to see financial institutions making an early and industrious effort to address those areas in which corrective action is most needed. Much rides on the outcome for national banks, for ACB members, and for all financial institutions – as well as for our economy.

That’s another facet of the convergence of banks and savings associations that I mentioned earlier in my remarks. During the early 1980s, while S&L losses multiplied, banks operated in relatively safety.

Those days, I suspect, are gone forever. Whatever happens tomorrow – good or bad – will undoubtedly affect ACB member institutions and commercial banks without distinction. Now we’re in it together.

That’s why it’s so important that we share views and insights across industry lines -- and why I so appreciate the opportunity to speak to you this morning.

Before closing, let me speak to an issue that I know is on your minds, and that is the future of the thrift charter and the Office of Thrift Supervision. If, as some suggest, thrifts and commercial banks have become increasingly difficult to distinguish from one another, then it’s logical to ask whether we need both charters. And even if the answer is that we should retain both, then it’s not unreasonable to ask whether we still should have two federal agencies to supervise the two industries.

As I said before, I am a strong believer in the charter you hold, and I want to see it preserved. Indeed, I had hoped that financial modernization legislation would use the thrift charter as the model for all depository institutions – a kind of highest common denominator -- and I regret that did not happen.

Some people have suggested that there is a compelling logic to merging OCC and OTS. There is no question, of course, that the crazy quilt of U.S. financial supervisory agencies offends some people’s rigid conception of bureaucratic orderliness. Contraction among savings associations and attrition at OTS have fanned the consolidation flames. Indeed, the most recently announced OTS staff reductions would bring that agency's workforce below 1000 for the first time. By contrast, in 1994, the number of OTS staffers stood at over 1700.

You have all heard the line attributed to Mark Twain: "the report of my death was an exaggeration." The same can be said of OTS. It's now going on 14 years that OTS has been said to be on the verge of extinction. Notwithstanding these predictions, OTS is fully discharging its responsibilities under the law in a highly professional manner and playing a very important role in the supervision of our financial institutions. After several years of budget deficits, OTS Director Jim Gilleran has not only balanced OTS's budget, but now projects a small operating surplus. OTS continues to have a critical mass of institutions to supervise, and I see no useful purpose to be served in merging the two agencies. While it is true that banks and savings associations are looking more alike than ever before, there continue to be significant differences in the charters, in their holding companies, and in the legal frameworks under which they operate. These differences also weigh strongly in favor of the continuation of strong and effective representation of this segment of the financial services industry in Washington, such as that provided by Diane Casey and ACB. Any effort to merge the regulatory agencies would not only be disruptive, but would have to come to grips with these differences. Perhaps that's why no significant public constituency seems to have developed in favor of an OCC-OTS merger.

So let's hope that the next time a Comptroller of the Currency is invited to address the ACB annual convention, it is as the supervisor of a vibrant national banking system, vigorously competing with an equally vibrant group of savings associations under the supervision of an independent OTS. Freedom of choice for financial institutions is a goal worth preserving; I assure you that the OCC is committed to working toward that end.