

Remarks by
John D. Hawke, Jr.
Comptroller of the Currency
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In a speech just days before he left office and returned to private life, President Dwight D. Eisenhower warned his countrymen of the dangers of the “military industrial complex.” Considering that “the military industrial complex” was largely a creation of his own administration, it was a remarkable speech for the great general to make, and many historians regard it as the most important -- and most courageous -- speech of his life.

I was reminded of that speech recently by my good friend, retired Congressman John LaFalce. John suggested that I close out my term as Comptroller with a speech to the banking industry in Eisenhower’s bold spirit of telling it like it is. With only a bit more than a week left before I, too, return to private life, I’ve decided to take that advice. So I hope you’ll indulge me in a few frank comments about the state of the banking business, the nature of the challenges it faces in the years ahead, and what I believe must be done to meet those challenges. A word of caution: you might not like everything you hear.

Let me start on a positive note by saying that we can all take enormous pride and comfort in the health of the banking system today. Virtually every report one sees these days – including the recent findings from our shared national credit review – concludes that there has been a significant improvement in credit quality over the past two years and

that our banks are in great shape. This year, criticized loans are down by nearly half from a year ago. The reduced need for provisioning has meant big increases in income, as well as strong returns on equity. With fee income also continuing its robust growth, bank profitability is at a record high. These results are even more remarkable when one considers that they occurred over a period of downturn and general softness in the economy.

How can we explain the industry's resilience? The lion's share of the credit goes to you, our country's bankers. Capital is up industry-wide not so much because regulators have demanded it, but because bankers, having learned from the experience of the late 80s and early 90s, are no longer satisfied with capital that just satisfies regulatory minimums. They have learned the value of strong capital, well in excess of what supervisors require, and they have learned the value of strong reserves, as well.

Techniques of risk management and risk measurement also have dramatically improved, and the level of sophistication in using such risk mitigation devices as hedges and derivatives has increased significantly. Bankers have discovered – or more accurately, rediscovered -- the importance of diversification, not only to avoid undue concentrations in the types of credits they grant, but also to reduce the historical reliance on volatile net interest income.

Your regulators also learned important lessons from that experience of 15 or so years ago. We learned the importance of a balanced and well modulated approach to supervision—an approach that both avoids the kind of forbearance that was often based on the hope that things might get better on their own, as well as the resort to a draconian crackdown when that hope did not pan out. Today, it is our practice to identify and seek

solutions for problems at an early stage, when there is still the prospect for effective improvement, to work constructively and calmly with our bankers to address concerns – and to escalate the tone of our comments and our actions only where we are forced to do so because of management’s unwillingness or inability to take corrective actions.

We had a great example of the success of this approach during the last business cycle, when we began to flag the dangers of so-called enterprise value loans – loans whose repayment depended on the borrower’s success in realizing projected future cash flows, frequently from start-up ventures. We viewed these as no more than a very chancy kind of unsecured lending – or, perhaps more accurately, as a kind of equity investment without any upside. From our standpoint, it was reminiscent of the situation that caused losses for energy and speculative construction lenders in the 1980s – a situation we were determined not to repeat. We knew we were on to something when we heard loan officers refer to these credits as “airball” loans.

Instead of coming out with guns blazing, we issued several rounds of examiner guidance on this subject and worked with our colleagues at the Federal Reserve and the FDIC to ensure that concerns about loans based on overly optimistic assumptions about future cash flows received appropriate scrutiny before they endangered the safety and soundness of our banks. To be sure, even though we kept the dialogue at a relatively restrained level some bankers grumbled at us -- but no one is complaining now. In fact, several CEOs of very large banks have since told me that while they may have been unhappy with us at the time, they later felt very grateful that the OCC stuck to its guns, and they thanked us for helping them to avoid what might have been significant losses and damage to reputation at their institutions.

Today I think that our best bankers place a high value on excellent supervision. They know how to use it to improve their own performance and to protect their institutions against unforeseen or slowly percolating risks and dangers. I saw the supervision process from the other side of the table 12 or 14 years ago, as I was trying to help bank clients avoid insolvency -- unsuccessfully, in many cases -- and I can tell you from first hand experience over many years that the supervisory process has never been better than it is today.

Another side of the regulatory relationship, however, is less satisfactory. The banking industry is all too familiar with the burdens of complex federal regulation, especially in the area of consumer-oriented legislation. Study after study shows that the costs of complying with these laws, and the regulations promulgated to implement them, constitute a significant and growing burden for banks of all sizes, with community banks unquestionably feeling a disproportionately heavy burden. Some estimates show that compliance costs absorb as much as 12 percent of all noninterest expense, not to mention the hundreds of millions spent by the supervisory agencies to monitor and measure bank compliance. And that sum excludes other indirect and opportunity costs -- the extent to which, for example, the compliance burden discourages innovation and creativity in the development of new financial products and services and reduces competition among providers.

So we know that these laws are burdensome. But how necessary are they? And what benefits do consumers derive from them in return?

There's little doubt that the financial marketplace is far fairer and more rational than it was a generation ago, especially for women and minorities and other previously

neglected groups. Discrimination in the granting of credit has been significantly reduced, compared to that earlier time, and a great many borrowers who once were foreclosed from access to credit now have that access. And that has a lot to do with the advent of consumer protection laws. Today's consumers are better able to understand the true cost of credit and to do the kind of comparison shopping that was difficult before Truth in Lending went into effect, and there's much more transparency about mortgage closing costs with RESPA in effect.

But do these laws actually provide benefits to consumers that justify the cost burdens they impose? I am convinced we could substantially reduce the expense of compliance and at the same time improve the social and economic utility of these laws.

Two longstanding observations lead me to this conclusion. First, evidence suggests that many of the disclosure forms that find their way into our loan packages and credit card statements go straight from the printer to the landfill -- unread, unfathomed, and unappreciated by financial consumers. It could hardly be otherwise, given the miniscule print, abundance of complex sentences, and maddeningly obfuscatory vocabulary that characterizes most disclosures. One also needs to question the scope of the disclosures that have been mandated. Do consumers really need or use all the information they now must be given? Almost 30 years ago we heard great concerns expressed about "information overload" in the area of consumer disclosure, and I believe that problem is still with us today. Rather than loading up disclosure documents with all the information anyone might think a consumer could possibly want, we should be striving to give consumers the very basic information they need to make decisions, doing

so in a simple, user-friendly format, and then pointing them to web sites or 800 numbers where they can get all the further detail they want.

Second, bank consumers – the presumed beneficiaries of these disclosures -- still make uninformed and unsound financial decisions. To be sure, studies show that most bank consumers make what are for them economically sound decisions, but there is no question that the level of financial literacy in this country needs to be improved -- and there is no question that some financial institutions take advantage of some customers who do not have a high level of financial literacy. “Let the buyer beware” may be an appropriate motto for the hurly-burly marketplace, but our banking system is far too important for the nation’s economic well being for “Caveat Emptor” to become the banner our banks fly.

I have advocated that we have the kind of independent, well funded scientific and academic analysis that will tell us whether the benefits consumers realize from the two dozen or more compliance-type laws that banks must obey provide real benefits that justify the cost burdens they impose, and that will tell us further whether these laws address what consumers consider their most critical needs. I’d like to know whether our current laws and regulations are maximizing the ability of consumers to understand the relative costs, benefits, and limitations of financial transactions in a clear and easily understandable way, and we need to know how we could obtain improved benefits to consumers at less cost – recognizing that these compliance costs are ultimately reflected in an increased cost of credit and diminished return on savings and investments, and are thus borne by consumers themselves. Above all, we need better insights into what information consumers themselves believe is important to their decision-making. I

believe the ABA could take a leadership role in catalyzing such a study, and I urge you to put this high on your list of priorities.

Focusing on ways to make regulation and disclosure less onerous and more useful is no doubt a worthy and admirable exercise. But while we're in an analytical frame of mind, we would do well to turn back to the question of the causes of regulatory burden. Why has it been building over time? Why have banks become special targets for Congress and the state legislatures? More to the point, what will it take on the part of banks to bring the deluge to a halt?

Those of you who attended last year's conference in Hawaii may recall that I issued a challenge to the industry to take the initiative in creating a means for promulgating standards of professional behavior and best practices for banks. I suggested that such a demonstration would prove that the responsible members of the industry – far and away the largest number of institutions – really care about fair treatment of customers and are willing to speak out against shoddy and abusive practices rather than wait for draconian government remedies. I'm disappointed that there has been no movement in this direction, so I want to touch upon this subject again, for several reasons.

I am not the first to point out that regulatory legislation has typically come to pass because a few egregious offenders have shocked public opinion and galvanized lawmakers into action. Often times, as with the recent controversy over predatory lending, the bad apples are not even regulated depository institutions. Notwithstanding the inflammatory accusations of some, there is little evidence of predatory lending in the commercial banking system – a point that has been made repeatedly by the state attorneys general. But the sweeping laws that have been adopted in one state after another to deal

with predatory lending have not discriminated between the guilty and the innocent. This is the history of virtually all consumer protection legislation: the remedy for the misconduct of a few gets visited indiscriminately on the good and bad alike.

But many of the practices that are drawing increasing fire from consumers and lawmakers today are no longer the exclusive province of a few bad actors. Even some of our most respectable banks engage in some business practices that, if not currently illegal, seem quite readily to be susceptible of being considered inappropriate or sharp. They're not practices likely to make huge negative headlines or to shock people's consciences in the same manner that real predatory lending does, where people are victimized by unscrupulous loan originators whose interest is only in sucking the equity out of people's homes, through foreclosures if necessary. But they are nevertheless practices that should be shunned by a great and responsible industry. I have in mind such things as penalties for prepayments that lock consumers into a loan far longer and more rigidly than is justified by the risk of interest-rate optionality; and toxic combinations of terms, such as negative amortization, balloon payments, demand features, and default interest rates.

To be sure, there are some criticized practices that may well have a sound economic rationale. It does not seem unreasonable to me, for example, for a credit card issuer to raise the rate on a cardholder who becomes delinquent on other obligations, and thereby puts the issuer at a greater risk of loss -- provided the increase reflects legitimate risk-pricing and provided further that fair and meaningful disclosure is made in advance. But we'd be shortsighted indeed not to recognize that if unfair or unpalatable practices persist, they have the potential to embolden the industry's enemies and turn its friends

against it. Indeed, in the context of the current debate over national bank preemption we have already heard the argument that national banks should be subject to the consumer laws and enforcement authorities of 50 states in order to provide effective protections against abusive practices. I continue to believe those arguments are grossly wide of the mark, and that the OCC has the authority, commitment and will to deal with any real abuses they may find in national banks – and a track record of effective and innovative actions. But it is essential for the industry – particularly those who place importance on preemption – to recognize that by failing to adhere to the highest standards of conduct they endanger support in Congress and provide fuel for those who would add to regulatory restrictions.

I spoke to you at some length last year about practices in the credit card business – a business that, in its current scale and ubiquitousness, must stand as one of this industry’s greatest accomplishments. Our banks have led the world in developing this financial product of enormous utility and convenience for consumers. We may not be the “cashless society” that some predicted 30 years ago, but we can buy products and services of all sorts and withdraw cash from our bank accounts virtually anyplace in the world today with that modest little piece of plastic.

But industry practices in this area continue to generate more consumer complaints than in any other. And, regrettably, I see little evidence that the industry has embarked on a concerted effort to remedy these practices, something it should be doing if only to undercut those who have claimed that the only way to bring real reform to the credit card business is to subject it to more massive government regulation. Instead, we see more and more of what I suppose passes in some quarters as “innovation” – new and slippery

marketing and account management practices that presumably generate additional income to issuers but also generate plenty of ill will on the part of customers. We see offerings of so-called “secured” credit cards, marketed to people whose credit has been impaired, with the lure of “helping” them to restore their credit standing. In my personal view many of these products are just scams. Customers who are sucked in by the promise of credit repair in fact get very little real availability of credit, and when they realize they have been hoodwinked, they default in large numbers, only to further damage their credit standing. Vendors of such abusive products are a blight on the entire industry, and I think the best people and the best companies in the industry should speak out to condemn these practices.

Some problematic practices were addressed in the OCC’s recent advisory letter to national banks. We criticized the practice of increasing the cost of credit to individual cardholders without adequate disclosure of the circumstances that would trigger such an increase. We objected to issuers whose promotions mislead applicants with limited or poor credit histories into thinking that they might qualify for cards with high credit limits. And we targeted the use of promotional rates without clear disclosure about significant restrictions on the applicability and continuation of those rates.

The time has come for banks to abjure such practices – and for boards of directors and audit and compliance committees to become more active in informing themselves about such practices and to take steps to ensure that their banks are not engaging in them.

I believe that the failure of the industry’s leaders and the best of our banks to denounce abusive practices by those relatively few banks that engage in them has, and will continue to, cost the industry dearly. This cost can be measured not only in existing

and future regulatory burden, but also in terms of the industry's struggles to achieve its legislative and political objectives. I continue to believe that the formation of a commission comprised of highly respected and experienced individuals whose mission would be to articulate high standards of conduct for banks and to catalogue the best practices in the industry would serve the country and the industry very well, and I renew my challenge to the ABA to move ahead with such an initiative.

But we don't need to wait for a blue-ribbon commission to make progress. Much could be achieved if first-rate and respected bankers – and their trade associations – would only speak out, as your President, Ken Ferguson, did on the subject of bounce protection programs as he took over that position last year.

Standing at or near the top of the list of industry political and legislative objectives, I'm sure you'll agree, is the goal of leveling the playing field with credit unions, and I'd like to address some frank comments to this issue – some of which you may not find particularly agreeable.

As credit unions broaden their fields of membership and their product offerings, and continue to make inroads in markets that traditionally were dominated by banks, the industry's frustration is understandable. Bankers complain bitterly that credit unions have unfair advantages because they are not taxed and are not subject to many of the same compliance costs that banks are subject to, and that they have been permitted to expand their activities well beyond the original and traditional concepts of what credit unions should be doing. On the other hand, studies have consistently showed that credit unions offer their customers higher rates on deposits and lower rates on loans than commercial banks – a fact that accounts for the incredible customer loyalty that credit unions have

skillfully capitalized on in their legislative battles with the banks. Bankers respond, with some justification, that the reason the credit unions can offer such advantages is precisely because of the unfair advantages they enjoy

It is unquestionably true that because of their tax and regulatory advantages, credit unions have an advantage – perhaps even an unfair advantage – over their bank competitors. But what has the industry strategy been to deal with this? It's been to ask Congress to increase the tax and regulatory burdens on credit unions. Just think for a moment of the implications of this strategy: You are asking members of Congress to vote to deprive credit unions of the very advantages that you say enable them to offer services to consumers at better rates than you can offer. Not many members of Congress are likely to agree to such a proposition, and it's no wonder that you have been losing this battle on the Hill. You are not going to win this contest by hoping that Congress will cut back on the powers of credit unions or deprive them of the very benefits that may allow them to offer more advantageous terms to consumers.

Banks need a new strategy in dealing with the credit union threat. You will never succeed in trying to deprive them of advantages that translate into plusses for the consumer, but you may be successful in securing for banks – particularly community banks – some relief that will enable you to compete more effectively. I won't presume to dictate a legislative strategy for you, but certainly real regulatory burden relief should be at the heart of it, and perhaps it may also involve some forms of tax relief for those community banks that feel the impact of credit union competition most keenly, such as liberalization of the rules relating to Subchapter S corporations and limited liability companies. The banking agencies for their part are currently engaged in an effort to

reduce the burdens that many smaller banks encounter in trying to comply with the Community Reinvestment Act, and I am confident that we will be able to do so – and do it in a way that preserves the commitment of our banks to sensible and productive community development activities in their localities.

It's important in considering the credit union issue to keep in mind that this is not just a legislative battle. How does one explain the near-fanatical devotion of credit union members that makes them such a potent political force and that makes credit union powers one of the untouchable "third rails" of U.S. politics? For some I suspect the answer is philosophical. They have a commitment to the cooperative movement and to the concept of mutuality. But for most, the answer is that they feel more comfortable with their credit union, and they see a superior commitment to customer service. They see modest, low-cost, user-friendly facilities run by people whose motivation is not to maximize shareholder value, they frequently participate in the governance of the institution, and they like the lower costs on loans and the higher rates on deposits.

If that's the case, it suggests that the banking industry cannot hope to rely solely on a legislative strategy in competing with credit unions. The place to start may not be in Congress or state legislatures, but in bank lobbies and teller lines and telephone call centers, and in those offices where new products and services are developed. The more that banks try to achieve operating efficiencies by depersonalizing their service, the more attractive they make credit unions seem to customers

Banks and their trade organizations must recognize that they're fighting a high-stakes battle for the hearts and minds of customers, and that the outcome of that battle will determine to a considerable degree whether banks continue to operate at a

competitive disadvantage in the financial marketplace. Given the current state of affairs, it's hard to be optimistic. But the perspective of time teaches us not to lose hope – and not to draw sweeping conclusions from what may turn out to be passing developments.

I would offer the same cautious assessment about the current status of the dual banking system. Certainly the past several months have seen some notable movements of state banks into the national system, and some have viewed those conversions as harbingers of a fundamental shift, signaling the end of state banking – and the dual banking system – as we know it. But I don't see it that way. Banks make charter choices for a whole variety of different reasons, and every day there are comings and goings in both systems. The state charter remains a popular choice for many banks – and not only community banks. There are many larger banks doing a multistate business – who might be thought to have an incentive to secure the advantages of national bank preemption – who still find the state charter very much to their liking.

That's not to say that the dual banking system doesn't face some serious challenges. Banks generally don't like to deal with a multiplicity of regulators or a multiplicity of varying laws, for example, and for state banks doing a multistate branch business this can be a challenge. To its great credit, the Conference of State Bank Supervisors has worked hard to mitigate these problems, through parity laws and agreements among state supervisors, but the problems still exist. The solution to the problem is not, I should say, in attempting to deprive national banks of the benefits of uniform national rules under the long-standing preemption doctrine. That is about as misdirected as the bankers' strategy toward the credit unions. In fact, it really runs contrary to the interests of state banks – as I repeatedly hear from state bankers, who

applaud the OCC's actions on preemption, which, they say, provide real benefits to them. Clearly, there is a division of viewpoints here between state banks and their supervisors.

The states have always claimed to be “laboratories of innovation,” but the promise of innovation has not been fulfilled for a long time. Rather, the states have opted for a copycat approach that relies on wild card statutes and parity laws to assure state banks the same opportunities as national banks. In my discussions with state bank supervisors who are concerned about the implications of national bank preemption they frequently talk of the need to level the playing field, rather than the need to find new ways to innovate or add value to their supervision. Indeed, even the basic work of state bank supervision has been significantly outsourced, with the Federal Reserve and the FDIC carrying as much as 80 percent of the load of supervision – and picking up the lion's share of the costs of state bank supervision – costs that in the national bank system are borne by the banks themselves. This federal subsidy, which amounts to about \$1 billion a year, is at the heart of the furtive federalization of state banking. And while I really don't want to open up the issue today, it is this subsidy more than any other factor that has historically stood in the way of rationalizing the structure of federal bank supervision and regulation.

If we are to revive the dual banking system and ensure its long-term health, the challenge will be to restore a sense of purpose – and unique qualitative value – to state banking. That will involve making state supervisors a more dynamic and expert presence in the supervision of their own institutions. It will require a revival of the spirit of innovation that had long distinguished our state systems. It will mean reintroducing real supervisory competition, based not on cost or subtle suggestions of leniency, but on

competence, professionalism, and competition that benefits consumers and promotes safety and soundness.

I would urge state supervisors to embrace these challenges. As a soon-to-be former Comptroller, I am no longer in a position to commit anyone's support but my own. But I feel safe in saying that a serious initiative on the part of the states to rebuild a more competitive charter, under more competitive supervision, will receive the support of their federal counterparts – including those at the OCC. We know how critical a vibrant dual banking system has been to the past and present success of the national banking system, and we would be concerned if that same stimulus to excellence ceased to exist in the future. A strong dual banking system is a matter of importance to us all.

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I began these remarks with respects to General Eisenhower. In less than two weeks, I expect that my thoughts will be with another great general, who said to Congress in 1951: “Old soldiers never die; they just fade away.” I can tell you that old bank regulators, too, never die – most of them just seem to become consultants. Whatever the future may hold for me, I can assure you that I will remain keenly interested and involved in matters affecting our banking system– at least for part of the time. For the rest of the time I will be seeing more operas, doing more travel, spending more time with my grandchildren, and consuming as much barbecue as my cardiologist and nutritionist will tolerate – assuming they can find out about it.