New Factors Figure in Failures, but Regulators Addressing Them, Says Seidman

WASHINGTON, D.C., Dec. 15, 1999 - While Prompt Corrective Action (PCA) is a formidable tool with which to control risk among banks and thrifts, recent failures suggest "something else is at work," Director Ellen Seidman of the Office of Thrift Supervision (OTS) told Washington's Exchequer Club today.

"On a case-by-case basis, it's beginning to look like individual failures with significant losses are still a possibility. How could this happen?" Ms. Seidman asked.

Stating that even if fraud was involved in the recent failures, and "fraud is a risk all of us understood PCA could not guard against, there's something else at work." She cited the following factors:

- The accounting and regulatory treatment of residuals, which can be exceedingly difficult to value, and which regulators addressed in a joint policy statement issued Monday;
- High-risk, off-balance-sheet activities that sometimes are operated entirely outside of the institution and that can result in painful on-balance-sheet losses;
- Incentives created by the current risk-based capital system to move high quality, low return loans off the balance sheet, while retaining lower quality, higher return loans on the balance sheet;
- Increasing use of outside or affiliated parties to run operations formerly run by the institution, hampering oversight by the depository institution and its regulator; and
- Increasing aggressiveness against examiners by institutions engaging in high-risk activities and not doing very well at it, constraining regulators' ability to address problems quickly.

But on the up side, regulators are taking steps to address such issues by:
Placing increased emphasis on internal risk management and risk management systems, including internal modeling and stress testing;
Reviewing the need for additional financial disclosure and transparency;
Rethinking the risk-based capital framework;
Focusing increased attention on the operational and accounting risks of new on- and off-balance-sheet activities and new variations of old activities; and
Getting a better handle on technology issues and the technological vulnerabilities in our banking system.

Ms. Seidman said that she does not think the nightmare of systemic failure of banks and thrifts will happen. But she said regulators have an obligation to consider the possibilities and take steps to avoid serious problems.

What regulators need to do is "distinguish between events over which we have little control and the things we can do to deal with how regulations institutions fare as those events unfold. Looked at in that light, I believe that bank and thrift regulators already are doing many of the things we should be doing. In some cases, we may need to do them more forcefully, or more demonstratively, or simply better. But I think we're on the right track."

View the speech - Remarks of Ellen Seidman, Director, Office of Thrift Supervision, Exchequer Club, December 15, 1999

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The Office of Thrift Supervision (OTS), a bureau of the U.S. Treasury, regulates and supervises the nation's thrift industry. OTS's mission is to ensure the safety and soundness of thrift institutions and to support their role as home mortgage lenders and providers of other community credit and financial services. For copies of news releases or other documents visit the OTS web page at www.ots.treas.gov.