

Introduction

Good afternoon. It is a pleasure to address this gathering today.

This conference aims to promote an EU/US dialogue on two very important issues – retail banking and financial regulation. These are topics near to my heart as Director of the U.S. Office of Thrift Supervision because they are at the core of what we do.

We are tasked with the regulation and supervision of nearly a thousand retail financial institutions and almost five hundred holding companies – several of which have extensive retail finance operations here in Europe and around the world.

So we have a perspective on your topic and I appreciate the opportunity to visit with you today.

My task is to provide the U.S. perspective as we consider the advantages and disadvantages inherent in the U.S. and the E.U. approaches to financial regulation. This is a timely question since the fundamentals of banking and bank regulation have changed in recent years – and the changes we have seen are leading us to a place of greater complexity in the industry, more cooperation among supervisors around the world, and significant challenges for both.

The US System

The system of regulation in the United States, like similar systems around the world, is rooted in our fundamental national character and in the history of our country. Our founders were skeptical of large institutions of any type using unfair leverage – whether in government or in the marketplace – to control the national agenda and thwart the will of the people. This concern about aggregation of power is apparent to readers of our Constitution, which mandates a government built on checks and balances.

There was a similar skepticism about a concentration of financial power. While recognizing the young nation's need for banks to support the growing economy and the commercial trades, the sector was mostly composed of small lending institutions chartered by special acts of the various state legislatures – interspersed with periodic and controversial attempts at federal involvement and control over the business of banking.

What followed, from the founding of our country to the present day, was vigorous debate about the role of banking in society and how the government should oversee this vital intermediary business. This debate – spurred on by the inevitable crises that accompanied the growth of our maturing economy – led to the system we have today: a patchwork of federal and state regulators, overseeing more than 8000 financial institutions that run from small specialty lenders to large global conglomerates.

Trends in the Industry

As we look at our system's evolution, some broad trends are evident.

First, financial assets, once the sole purview of institutions chartered, managed, and regulated at the state level, migrated over the decades toward federally chartered

institutions. Indeed, a system of unique charters and regulators grew as the market developed for more specialized lines of business.

Second, bankers and regulators seized on successive technological breakthroughs in transportation and communication to offer more sophisticated products to a broader base of customers – and to ultimately create sizeable international businesses that serve customers all over the world.

Next, as bankers marketed products to the masses, policymakers worked to limit risk to consumers through enhanced disclosure, fair lending laws, and deposit insurance.

Finally, an accelerating consolidation trend over the past decade led to a concentration of assets in a few, very large financial institutions.

Trends in Regulation

As these trends matured over the course of U.S. history, our regulatory structure responded to the changing financial marketplace.

The national banking system was created in 1863 out of the need for a single national currency and the need to develop a market for U.S. Treasury bonds during the American Civil War.

A series of systemic disruptions in the late 1800s and early 1900s led to the creation of the Federal Reserve System. This organization performs a central banking function and acts as a lender of last resort to banks during periods of temporary cash drain or rapidly increasing credit demand.

The Great Depression that followed the 1929 stock market crash led to a collapse of consumer confidence in the banking sector, bank failures, and a significant disruption in the availability of credit. The most visible of the reforms that followed was the creation of the FDIC – which provided for a nationwide deposit guarantee intended to draw consumers, and their household savings, back into the monetary system. As a result, the threat of a ‘run on the bank’ has been all but eliminated from our financial system.

Other reforms of that period had an equally lasting benefit. The U.S. regulators were given a framework of statutory factors to guide their work in chartering and regulating financial institutions. These factors are familiar to bank supervisors everywhere. They are capital adequacy, earnings prospects, the integrity and expertise of bank management, and the needs of the community. We continue to evaluate these factors, in one form or another, in every single bank and holding company examination performed on every regulated financial institution.

Congress enhanced and updated these depression-era reforms during the bank and thrift crisis of the 1980s and early 1990s. Our system of deposit insurance was strengthened, restrictions on mergers and acquisitions were relaxed in order to allow strong institutions to acquire weaker ones, and the Office of Thrift Supervision – my organization – was created to oversee the U.S. savings and loan industry.

The OTS adheres to the same basic bank supervisory framework as the other Federal and state regulators – including the FDIC, the Office of the Comptroller of the Currency which regulates national banks, and the Federal Reserve. We all build our conclusions from regular reporting data from regulated institutions, rigorous offsite reviews, and comprehensive onsite examinations.

We are required by law to develop and finalize an examination report on regulated entities every 18 months. In most cases, however, they are issued more frequently than that. We all evaluate institutions against the comprehensive CAMELS framework – capital, assets quality, management, earnings, liquidity, and sensitivity to market risk.

The OTS and its Role

The OTS differs from other regulators in the United States, however, in several important ways.

First, retail banking is the primary business of thrift institutions. In exchange for this restriction, these organizations are granted a broad exemption from local consumer lending laws – allowing thrifts to conduct business nationwide under a single set of rules rather than conform to regulations state-by-state.

Because our institutions are focused primarily on retail banking, we concentrate our organization's expertise in this sector – looking closely at home mortgage lending products, credit cards, consumer protection, and the behavior of consumers in local and regional economies. In order to perform more rigorous offsite analysis, we invest heavily in proprietary modeling to test the balance sheets of all thrifts and identify areas of risk – whether along product lines or geography.

Second, unique among U.S. supervisors, the OTS has strong statutory authority over the companies that own or control institutions it charters. Any company that owns or controls a thrift is subject to OTS supervision up to and including the top-tier parent company.

We regularly conduct onsite examinations of holding companies as well as the thrifts themselves. And our statutory enforcement authority allows us the latitude to ensure these holding companies structure and conduct their activities in a way that does not imperil or otherwise threaten the depository institution portion of their business.

Finally, the OTS has top-tier holding company supervisory responsibility over groups that contain both financial and industrial lines of business. Household names like General Electric, AIG, American Express, and GMAC are all thrift holding companies and are subject to consolidated supervision by the OTS.

Many of these groups are also subject to the recently implemented EU Financial Conglomerates Directive. We have worked hard over the past several years to improve and enhance our coordination and communication with the global supervisory community – and this will remain a priority for our organization.

Challenges for Supervisors

In many ways it is a good time to be bankers and supervisors. Despite the fears of those who decry consolidation and the creation of large-scale banking organizations, our industry is sound, a bewildering array of financial choices are available to consumers, and we still see new, community-based institutions chartered every day.

And despite our different mandates and occasional tensions, our regulatory system in the United States works well “in all its convoluted glory” – to quote my former colleague, Jerry Hawke.

But whether in the United States, here in Europe, or elsewhere in the world, we supervisors face some significant challenges and I’d like to outline a few of those.

First, there is the matter of talent. The institutions we supervise are becoming larger and more complex. The products and techniques of modern finance – as we have sadly seen over the past few years on both sides of the Atlantic – are prone to abuse and manipulation by the unscrupulous. How do we attract and retain the skilled personnel we need to keep pace with this complexity and continue to safeguard the common interest in stability, safety and soundness, and consumer protection?

Second, there is the question of refining our examination processes. In my view, we must continue to sharpen our focus on capital adequacy, good corporate governance and sound risk management. The trend in examination practice has been toward a more risk-focused approach and this trend must continue. This is especially true in large complex organizations. We cannot be everywhere – nor do we want to be. The responsibility lies with bankers to run their businesses responsibly and treat their customers fairly. And we must be positioned as supervisors to use our limited resources to perform a fair and thorough evaluation of this.

A third challenge is how to relieve the regulatory burdens faced by regulated financial institutions. This is especially true in the case of smaller community-based institutions – many of which simply do not have the resources to comply with myriad new laws, regulations, and guidance coming from the regulatory community. We supervisors need to identify what is important and consider the totality of the compliance responsibilities we place on industry. There is a point of diminishing returns in this area where all of our well-intentioned rules result in less choice for consumers.

Fourth, we must check our urge to control. We must recognize the value of the market in driving the future of retail banking. There is an almost irresistible temptation on the part of supervisors to manage the evolution of the industry by skewing incentives, controlling products and affiliations, and imposing burdensome regulations. History is not kind to this sort of heavy-handed government intervention – whether in the United States or elsewhere. Customer choice, as expressed in the marketplace, should drive the industry forward. We supervisors must work to ensure this evolution occurs with a strong underpinning of capital, within a framework of effective managerial control, and while protecting the customer from abusive practices.

Next, supervisors must work to strengthen the bonds between us regardless of national affiliation. As more financial firms engage in cross-border business, communication and coordination on supervision moves from important to imperative. Our EU colleagues have long dealt with the challenges of cross-border supervision, and many of your recent efforts – such as the conglomerates directive – attempt to address the need for coordination and cooperation so nothing falls through the cracks. This should remain a priority for us going forward.

Finally, we need to ensure we get capital right. In the U.S., as many of you know, we have struggled with Basel II, including the question of competitive equity between institutions, complexity, and challenges the new accord presents to both firms and supervisors. Bringing this new capital regime to a successful implementation will stretch all of us, but it will be a success if we are able to ensure better incentives for risk management in our regulated institutions and a better allocation of capital within these organizations.

Conclusion

As you can see, we do not lack for challenges. The overall soundness of the industry we supervise, and the multitude of choices available to banking consumers, are testament to the hard work so many have invested in this effort.

Whether here in Europe, in the United States, or elsewhere in the world, we must work to ensure our regulatory practices and policies are in alignment with the broad trends in the industry.

As the retail banking business becomes an increasingly global enterprise, supervisors should continue their efforts at cooperation and, where possible, harmonization. The result will be fewer burdens on the firms we supervise, more options for consumers, and a more effective stewardship of the public trust we have been given.

Thank you.