Remarks by
Julie L. Williams
Acting Comptroller of the Currency
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Good afternoon. It is a privilege to address members of the Exchequer Club -- and a particular pleasure for me, since I have come to know so many of you, over the years, as friends and colleagues.

As many of you know, I have often spoken on the legal issues associated with the evolution of the business of banking. Today, I am going to discuss a more fundamental challenge the banking industry faces -- one that will either enhance or impede the ability of banks to positively influence the evolution of their business. That challenge is customer service.

To speak at all on this issue is a reflection of the changed and increasingly competitive financial services environment in which banks operate. Customer service is a key competitive intangible -- a factor that will profoundly affect the future of competition in financial services. It requires providers to deliver the mix of products and services that customers need and want, through convenient and accessible delivery mechanisms, and to be sensitive and responsive to customer desires and concerns. It also means the difference, long term, between a business that is robust and one that withers. And that is why, as a supervisory matter, the OCC cares about how well banks are responding to this challenge.

When I talk to veteran OCC employees, I am reminded of the extent to which the business of bank supervision has changed in our lifetimes. The concept of "bank supervision" is itself a product of our age. One OCC examiner who retired in the mid-1970s after more than forty years of service told an interviewer at the time that "our method changed very little" from his first day on the job to the last. Examiners of his generation counted the cash, balanced the ledgers, verified the bonds, reconciled correspondent accounts, and pretty much left it at that.

Things could scarcely be more different today. Today, although we perform many of the same types of tests and checks in the course of our regular examinations, that's just the beginning. Today, we recognize that the picture of a bank's health that emerges from a traditional examination is merely a snapshot of the bank's current condition, which may say little about how well that institution is prepared to face future challenges.

Over a period of years we have come to appreciate the importance of what now seems almost self-evident: first, that bank supervision must, to the maximum extent possible, be prospective as well as retrospective; and, second, that the safety and soundness of our banks depends to a significant degree on the larger environment -- social as well as economic -- in which financial institutions operate. Although some of these environmental factors may lie entirely or partially beyond the bank's control, they are no less crucial to its health. And that's why, under our supervisory regime, we not only evaluate the bank's current condition -- taking the snapshot, if you will -- but also try to assess its efforts to understand, anticipate, and plan for future contingencies. Thus, modern supervision is not simply a matter of applying sets of laws, rules, and regulations. It involves, on the one hand, supervisory strategies individualized to the risks presented by particular institutions or activities, and, on the other hand, industry-wide guidance and advice regarding emerging risks and challenges that may affect the business and health of many banks.

Over the last ten years especially, we have strived to develop a more sophisticated understanding of risk and its components, and to apply this understanding to our supervision of the National Banking System. In 1995, we introduced "supervision by risk," a framework that has been widely embraced by bank regulators in the United States and abroad. This offers a broader, more comprehensive view of the sources of risk in financial institutions.

Some of the nine risk factors we now consider in our supervisory activities -- credit and liquidity risk, for example -- would be entirely familiar to OCC examiners of old. And, as acting Comptroller, I have talked a great deal about credit risk and other core banking issues. I have repeatedly stressed the importance of bankers not making bad loans so that they can continue to make the good loans upon which their business -- and our nation's economic vitality -- depends. But, while sound loan underwriting is a necessary condition for success in today's banking world, it is not alone a sufficient condition. It is not simply the size or even the quality of the loan portfolio that separates today's market leader from the also-ran. Today, we know, risk takes many forms, and managing it takes multiple talents.

We find risk in omission as well as commission. Risk -- strategic risk -- exists in the products and services that bankers cannot or will not provide to their customers, as well as in those that they do offer. It exists in the spirit of compliance with laws and regulations, as well as the substance. And it exists, more than ever before, in the realm of public opinion, where decisions are made every day that affect the environment -- again, social as well as economic -- in which bankers operate.

We call this "reputation risk," and define it in our official guidance as "the current and prospective impact on earnings and capital arising from negative public opinion that may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk requires bankers to exercise an abundance of caution in dealing with customers and the community."

"Caution," in this context, does not mean timidity. Rather, it means that bankers need to weigh their business decisions -- decisions that might be perfectly above-board from a legal or regulatory standpoint -- against the reaction those decisions might elicit from the customers and communities they are chartered to serve. Customer perception is the relevant reality. Actions perceived by a customer to be unreasonable or unfriendly may trigger a backlash whose costs can easily exceed the narrow value of that customer's business. In short, when we talk about reputation risk, we are referring to how well bankers fare -- individually and as an industry -- at the court of public opinion.

I think we recently saw evidence of this process in action. Most analysts agree that the recently-concluded 105th Congress was tough on the banking business. Bankruptcy reform and regulatory relief, two measures much desired by the industry as a whole, failed to pass. Financial modernization legislation would have combined measures liberalizing affiliations between banks and securities and insurance firms, but also cut back on existing bank powers in important areas, and failed to provide banks with any "chartering up" to compensate them for their assumption of a portion of the FICO bond interest payments that had previously been the sole responsibility of the thrift industry. Most bankers came away from the 105th Congress disappointed.

This legislative parsimony did not seem to affect other types of financial institutions. Some -- most -- fared better than banks. Perhaps bankers were less adroit or less unified in presenting their case to lawmakers. Or perhaps others had worked more effectively at the court of public opinion, so that when all was said and done, lawmakers felt more inclined to take the positive action desired by an industry group held in higher regard by the general public. Put another way, it is possible that bankers came away largely empty-handed from the recent legislative wars because they had failed to convince the public of the importance to the public of issues deemed to be important by bankers.

Unfortunately, substantial evidence supports the view that bankers have suffered reputation risk because the public does not perceive banks generally as outstanding service providers. At best, bankers get average grades from their customers. In a recent Harris Poll rating customer service, banks lost ground, placing somewhere in the middle of the pack -- above the tobacco industry and the managed health care industry, but well below the airlines, telephone companies, and the producers of computer hardware and software. Another survey showed that nearly two-thirds of bank customers were dissatisfied with their bank's response when a problem was brought to the bank's attention. And a 1996 study by the American Bankers Association revealed a long, steady decline in virtually every benchmark of customer satisfaction -- both in absolute terms and in comparison to customers of other financial providers, including credit unions and savings institutions.

Nothing seems more responsible for bankers' poor showing in these surveys than the issue of service fees -- an issue that, frankly, has generated more heat than light of late. Noninterest income has certainly become a matter of growing importance to banks. In the last four years, it has increased from 36 to 41 percent of total revenue for national banks. The vast majority of this increase is related to asset management, trading activities, and fiduciary-type services increasingly performed by banks -- activities that have helped them stabilize and diversify their income stream, better control interest rate risk, and reduce their dependence on the more volatile market for loan products. Fee income has made and will continue to make an important contribution to the safety and soundness of the National Banking System.

Of course, the income banks derive from -- for example -- foreign currency transactions is not the source of the current controversy. Rather, what has consumers up in arms are the service fees that they pay directly, fees that seem to pop up where they never existed before. In 1996, one consumer organization counted no fewer than 100 separate fees being imposed on bank customers, and the evidence suggests that number has grown substantially since then. Not only has the number of fee-carrying services increased, so has their size. Recent surveys show that credit card late fees have risen 75 percent and safe-deposit box rentals 61 percent over the past five years. And ATM fees -- a matter of a few dollars to most consumers -- have become targets of state as well as federal legislation.

When passions are running as high as they are on this subject, it becomes difficult to evaluate the subject on its merits. In fact, the most recent data show that, while other categories of non-interest income have been rising steadily as a percentage of commercial bank assets over the past three years, service charges, the lightening rod for consumers, have actually declined slightly in percentage terms. Moreover, most of the fees banks charge can be easily justified. Bankers are entitled to recoup their investments in the technology and infrastructure that consumers increasingly take for granted. Bankers are entitled to make reasonable and equitable charges for services rendered. And, given today's vigorous competition in the financial services market, consumers who are unhappy with their bank can usually shop around in search of a deal they like better.

But it's also clear that, whether particular fees are justified or not, in too many cases, they have been imposed and raised without adequate explanation, without gauging their effect on public opinion, and without calculating the trade-off between short-term income and long-term reputation risk. In dealing with their customers and communities, in other words, some bankers have fallen short of the "abundance of caution" that is so crucial in protecting and enhancing their reputations and the value of the banking franchise over the long haul.

Greater judiciousness and discretion in the application of fees may help to ease the frustration consumers increasingly express about their banks. But I view the fee controversy as a subset of a larger challenge. The challenge is improving banks' overall reputation for customer service, so that banks are recognized as outstanding service providers. That means offering consumers convenient access to the products and services they want, at competitive prices. It means working to identify and develop new customers and new markets that offer new business opportunities, but which, in order to be successfully tapped, may require innovative, non-traditional approaches. It means improving communications to customers and communities, to let them know what banks have accomplished on their behalf. It means building customer relationships based on trust that will endure over time and serve customers' evolving financial needs over the course of their lives.

This is critical to the long term successful evolution of the business of banking.

Recent history offers poignant lessons in the perils of neglecting quality and customer satisfaction. We know that, during the 1980s, in key industries like automobile production, consumer electronics, and heavy machinery, such neglect led to catastrophic losses in market share and complete business failures when competitors, foreign and domestic, arrived on the scene and raised consumer expectations. As it is now, it was then unrealistic to expect that these competitors could be eliminated or simply excluded from the marketplace. As a matter of survival, some of the affected companies responded positively, reoriented their practices and priorities, and became successful competitors in the global economy. Others never did.

For a very long time and still -- but to a lesser degree -- today, banks have enjoyed a privileged place in our transaction-based economy. Their crucial role in the payments system has given them a built-in customer base -- business that came to them almost automatically. But that may be changing. Electronic payments, Internet commerce, smart cards -- these and other technological innovations may transform the payments system, redrawing the boundaries of the playing field, and eroding the dominance that banks have long enjoyed. Already, computer software companies are positioning themselves as financial intermediaries, where their experience in making technology user-friendly should stand them in excellent stead. It may be relevant to mention again the Harris Poll results that placed the computer industry well ahead of the banking industry in customer satisfaction.

In other words, although the last twenty years or so have posed serious competitive challenges for banks in this country, a greater test may be still in the offing. As providers in other key sectors of our economy have proved, change is possible, even when it involves modifying longstanding beliefs and behaviors. For bankers today, it is not only possible, but vital.

We in government have an abiding interest in your success. When President Abraham Lincoln created the National Banking System back in 1863, he saw national banks as the instrument through which the economic integration and prosperity of the United States could be achieved. That was a monumental challenge. But the challenge was met. Today's America -- and our banking system -- is the envy of the world.

Today's challenges in financial services are different. Today, to put it mildly, there is no shortage of viable financial institutions, as there was in Lincoln's time. But today, a financial institution's future in a highly competitive marketplace depends upon the degree to which it can successfully combine such things as sound lending standards, community involvement, outstanding customer service, and sensitivity to customers' concerns on issues such as privacy.

Those are the diverse challenges that will separate the financial services winners from those that lag behind in the new millennium. At the OCC, our interest is in seeing national banks emerge among the winners. A strong and prosperous America depends upon our national banks meeting the challenges of the next century as successfully as they met those of the last.