

Enhancing the Value of the Federal Thrift Charter

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Good morning.

Let me add my welcome to you on this beautiful Washington Spring day. I hope you'll have a chance to see the cherry blossoms around the Tidal Basin that are in full bloom before you leave.

As you so well know, they are not the only things in full bloom in this town. So is the 107th Congress.

Today, I shall refrain from a full discussion of the proper fertilizer required to make that particular Capitol Hill garden bloom. But one thing I do know is that nothing will grow up there without the steady rain of informed opinion and well-prepared facts.

I know Diane can't wait to get you all up to the Hill this afternoon to till the ground for community banks and the customers that you serve.

You have asked me to speak to you today about the value of the federal thrift charter and how it can be enhanced. A few weeks ago, on Bloomberg TV, I had the opportunity to discuss the state of the thrift industry. Let me share a two-minute excerpt of that with you.

[A brief excerpt.]

That's what I'm telling the world about this industry.

As you so well know, there is no question about the top priority of our agency - ensuring the safety and soundness of the thrift industry. My job as a regulator requires me not only to recite those words over and over, but also to take actions to assure that they are embedded into the very fabric of the industry.

The good news, I'm pleased to report, is that the industry today is, on the whole, operating safely, soundly, ... and, let me add, profitably. It is poised to take advantage of the next refinance boom.

As I reported at OTS's most recent quarterly media briefing on thrift earnings and conditions about a month ago:

- Industry assets grew to \$929 billion at the end of 2000, up 7.5 percent from a year earlier.
- The nation's thrift industry recorded net income of \$8 billion in 2000, down only \$200 million from the record set in 1999.
- Last year, when the industry operated for an extended period under an inverted yield curve - an environment that, as you know, places greater stress on the industry - the industry was in sufficiently good shape to handle that extra pressure. In fact, return on assets in 2000 was a strong

90 basis points.

- For the year, one-to-four family mortgage originations totaled \$201 billion, the third best volume ever, and the industry originated about 20 percent of all mortgages - the most since 1996. In fact, the percentage of industry assets invested in whole one-to-four family residential loans actually increased last year to 48.3 percent.

And, from a safety and soundness standpoint:

- The number of problem thrifts - those with a composite examination rating of four or five -- stood at 15 at the end of the year, or 1.4 percent of all thrifts. They had assets of \$7 billion, constituting only eight-tenths of a percent of total thrift assets.

Of course, we remain vigilant for any signs of thrift industry weaknesses and will move swiftly to tackle emerging problems as they arise, but so far problems appear to be largely under control.

We are also taking steps to streamline our examinations to make them both more efficient and more effective. We are working with examiners to find ways to reduce burdens while, at the same time, focusing on risks that could present the greatest problems.

Approaches that we're exploring include:

- Changing our pre-exam practices to improve the focus of our examinations. It is our goal to do more work off site so that we're better prepared and less intrusive when we arrive at your bank.
- Focusing less on following detailed exam procedures and more on allowing experienced examiners the latitude to conduct a review that makes sense for the risk profile of the institution.
- Conducting paperless examinations.
- Reducing the minimum required exam report content. And ...
- Streamlining current loan sampling requirements and providing for more examiner discretion so examiners can focus on what's important and get out of your institutions when that work is completed.

I hope you will be enjoying the fruits of our improving examinations during the coming months and years.

I know that those of you with thrift charters already know that it is the premier retail banking charter with:

- an OTS examination corps that understands your work and your needs,
- a single regulator supervising the thrift and the thrift holding company as well as subsidiaries,
- one set of rules that applies to your institutions no matter how many states they operate in,
- easy branching, and
- its focus on one-to-four family housing, the solid cornerstone of our economic system.

As good as the thrift charter is, however, there are steps we can take, both at OTS alone and by working with Congress, to make the charter even more valuable, and to do it in a manner consistent with maintaining both safety and soundness and the industry's community focus.

This morning I would like to discuss some proposals that will help make the industry more competitive and that Congress can help make happen. In the post-Gramm-Leach-Bliley environment, it is essential that financial industry competitors be regulated in an equitable manner consistent with their charters'

basic grants of authority.

Let me just point out a few restrictions that the law imposes on thrifts that it doesn't impose on commercial banks. None of these is life threatening, but eliminating the disparities would certainly level the playing field and help thrifts better serve their customers and their communities. If you operate a thrift today:

- You must abide by geographic restrictions if you want to invest in service companies.
- You must artificially structure a merger with a nonthrift affiliate as a merger between an affiliate and a subsidiary and then liquidate the subsidiary into the thrift.
- You must limit certain community development investments to geographic areas or neighborhoods receiving concentrated development assistance from HUD under Title I of the Housing and Community Development Act of 1974, a section of the statute repealed 20 years ago!
- You must adhere to the registration requirements of the Investment Advisers Act. And ...
- You must adhere to the broker-dealer registration requirements under the Securities Exchange Act of 1934.

Under Gramm-Leach-Bliley, while commercial banks lost their blanket exemption from broker-dealer registration requirements, they are exempt from a long list of activities that could otherwise trigger registration. And as in each of the other examples cited here, commercial banks have the right to conduct these activities or take these actions without restrictions that apply to thrifts.

Fixing the first three of these problems will require legislation, and OTS recommended the changes to the House Financial Services Committee staff earlier this year.

First, we recommended that Congress give thrifts authority equivalent to bank authority by removing the requirement that a service company must be organized under the laws of the state where the home office of the thrift is located.

This geographic restriction was imposed before interstate branching and technological advances, such as the Internet and telephone banking, and today it simply serves no useful purpose. It is particularly a problem for thrifts in multi-state areas, or those who have a wide geographic reach, who want to partner with banks for community development activities.

Thrifts should be allowed to participate in community development activities wherever their businesses are located. This will also cut red tape by eliminating the need to set up second-tier service corporations not subject to geographic restrictions.

Second - Congress should conform thrift authority to bank authority for merging with nonthrift subsidiaries and affiliates. Today, a federal thrift may only merge with another depository institution, even if the prospective merger partner is owned by the thrift and only does activities the thrift itself could do.

Under current law, if a thrift wants to merge with a nonthrift affiliate, it must artificially structure the transaction as a merger between an affiliate and a subsidiary and then liquidate the subsidiary into the thrift. We propose that Congress reduce regulatory burdens on thrifts by permitting mergers with non-depository subsidiaries and affiliates where appropriate for sound business reasons, and if otherwise permitted by law.

If our proposal were adopted, thrifts, like banks now, would be able to merge with nonthrift affiliates

and subsidiaries and continue to have the authority to merge with other depository institutions, but could not merge with other kinds of entities.

Third - We need to get rid of obsolete restrictions on thrifts' ability to make certain community development investments and replace them with the same flexible authority national banks have to make investments that are designed primarily to promote the public welfare, including the welfare of low- and moderate-income communities or families, such as by providing housing, services, or jobs.

The obsolete provision of the Home Owners' Loan Act restricts certain investments to geographic areas or neighborhoods receiving concentrated development assistance from HUD under Title I of the Housing and Community Development Act of 1974. Though it has been obsolete for 20 years, this provision of HOLA was never changed.

The new authority we have proposed tracks the existing authority for national banks. Under the proposal, thrifts would be able to make investments primarily designed to promote the public welfare, directly or indirectly, by investing in an entity primarily engaged in making public welfare investments.

There would be an aggregate limit on investments of five percent of a thrift's capital and surplus, unless the OTS Director determines by order that a higher amount - up to 10 percent - poses no significant risk to the deposit insurance fund and the thrift is adequately capitalized. We would define "adequately capitalized" the same as we do for "prompt corrective action" requirements, just as the OCC does for national banks.

Thrifts would be able to use this new community development investment authority without regard to the prohibition against acquiring or retaining corporate debt that is not investment grade. This change would enhance the ability of thrifts to improve the economic vitality of the communities they serve, and thus their own financial well-being.

The fourth and fifth changes could possibly be accomplished through SEC administrative action, but I think legislation would be cleaner - and may even be quicker. I support extending to thrifts the bank exemption from Investment Advisers Act registration requirements.

In addition, there is no reason not to extend to thrifts Gramm-Leach-Bliley Act's broker-dealer registration exemption under the Securities Exchange Act of 1934 that banks enjoy when engaging in specified activities. This provision of Gramm-Leach-Bliley is set to take effect in May, although the SEC has announced a delay in implementation.

The permitted activities include third party brokerage arrangements, trust and custodial activities, offering sweep accounts where the balance is swept directly into a money market mutual fund instead of through a registered broker-dealer, and effecting transactions in municipal securities. My staff has had conversations with the SEC about these issues and plans to meet with the SEC in the near future to discuss them further. We hope we can obtain the SEC's support for parity with banks.

Thrifts make a unique and valuable contribution to the nation's financial health by enhancing the wealth of their communities through savings and investments, including investments in residential, community, small business, and consumer lending. To achieve this, the HOLA also authorizes thrifts to engage in trust and related activities that would promote the creation and preservation of wealth within their local communities. There is no reason to treat thrifts and banks differently.

The overriding purpose of all of these measures is to help you better serve the communities in which you

operate. At OTS, we look forward to working with you to make certain the thrift charter continues to evolve without unnecessary statutory and regulatory burdens.

And, of course, we also support some legislative changes that would benefit thrifts and banks alike, such as allowing interest on checking accounts and responsible deposit insurance reform. Both the FDIC staff and the ACB have done a good job of outlining the what is needed: making the system counter- rather than pro-cyclical; more effectively tying both the level of the fund and individual institution premiums to risk; dealing with the problem of excessively fast deposit growth; removing the 23 basis point "cliff"; and, as part of this, merging the BIF and the SAIF.

In that context, I would like to discuss one last item with you - the way in which the thrift industry is assessed to pay for regulation. Again, the central issue is equity. As you all remember only too well, the current healthy state of the Savings Association Insurance Fund reflects your significant contribution in 1996. And Bank Insurance Fund members capitalized their fund through the first part of the 90's.

Earnings on those funds are now being used for two purposes - to further build the fund (and finance losses) and to cover the operating costs of the FDIC, including the cost of federally supervising state-chartered non-member banks and savings banks.

This is not about federal versus state charters. However, the issue can be seen as a threat to the dual banking system in two ways. First, we know that several times a year, thrifts switch from a federal to a state charter and they cite lower assessments as the reason. Second, and perhaps more importantly, a fee-based assessment system is also hurting many state bank supervisors as they lose assets to other states through roll-ups, and, occasionally, to national or federal charters.

The current system is simply not fair to federal thrifts, nor to their customers, nor to regulators, nor - ultimately - to the American people.

I believe that the current discussion about deposit insurance reform provides us with a good opportunity to rethink the entire system for paying for bank supervision - including supervision by the states. We can frame three important questions:

1. Is it time to cover the entire cost of federal and state supervision of all charters from the deposit insurance funds' earnings?
2. Should we keep the two separate, but bring sunshine to the costs of supervision by having consolidated supervision and insurance billing for all institutions with separate line items for each state or federal regulator's supervision costs on a bill that also includes the cost of insurance?
3. Should we recognize that more intense supervision of troubled institutions costs substantially more but can protect the insurance funds, so those incremental supervisory costs incurred by OTS, the OCC, or the states should be deducted from the increased insurance assessment on those troubled institutions?

I don't have an answer today, and of course to a large extent the answer will be yours to develop, but, as we embark on this new venture in deposit insurance, and as the industry itself continues to change, we would do well to take the opportunity to think though how we want to pay for effective bank supervision in the future.

As you walk through the Halls of Congress and meet with your representatives this afternoon, I know that you will be forceful in your discussions about the growing need for financial equity for the thrift industry, and how that will translate into improved economic opportunities for you. Even more

important is how your customers will benefit. And most important of all, how Congress' constituency, the American people, will benefit, since the end product, I believe, will be a safer, sounder and more robust thrift industry, and that is a keystone of our nation's economy.

Thank you.