Remarks Prepared for

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Introduction

I would like to talk about the state of today's thrift industry, some of the charter application activity we are seeing and why we think this activity has increased recently, and OTS's approach to holding company oversight.

But before I get started, for those of you who are not familiar with the Office of Thrift Supervision, I would like to give you a little background about the agency and its responsibilities.

Background

The OTS is an independent agency under the U.S. Department of Treasury charged with overseeing the activities of federal and state chartered savings associations and federally chartered savings banks, which we generally refer to as "thrift institutions." If you hear me use the terms savings association, savings and loan association, or thrift institution, they are, for purposes of this discussion, interchangeable.

OTS was created in 1989 as the successor agency to the Federal Home Loan Bank Board out of the ashes of the savings and loan debacle. OTS's day-to-day examination and supervision operations are conducted out of five regional offices located in:

- Jersey City, NJ,
- Atlanta,
- Chicago,
- Dallas, and
- San Francisco.

In the aggregate, we have about 700 examiners stationed throughout the country. About 500 of these examiners are dedicated to performing what we refer to as safety and soundness examinations on-site at each thrift institution every twelve to eighteen months. The remainder of our examination staff conduct specialty examinations in the areas of:

- consumer compliance,
- Community Reinvestment Act,
- information systems, and
- trust or fiduciary operations.

Financial Marketplace

Like the banking industry, the thrift industry has witnessed large-scale consolidation in recent years. When the OTS was created in 1989 there were about 2,600 thrift institutions with $1.2 trillion in assets. We currently supervise about 1,200 thrift institutions holding about $780 billion in assets. Of these, about 1,000 institutions are federally chartered and about 200 are state chartered. About 700 thrifts or 60 percent of the industry are stock institutions and the remaining 500 thrifts are mutual organizations.

Unlike the period when the OTS was created, the thrift industry today is healthier than it probably has ever been. The OTS-regulated thrift industry had a banner year in 1997. The thrift industry set a yearly earnings record in 1997 by posting net income of $6.5 billion, while continuing to perform traditional thrift activities. Returns on assets are at historical highs and troubled assets are at all-time lows. Equity capital, hovering at about 8.4 percent, is at an unprecedented level. The industry's underlying strength, especially its high capital levels, puts it in a good position to respond effectively to future changes in the business climate.

In their continuing drive for success, many thrifts are seeking ways to further boost margins and fee income by expanding their product lines and cross-marketing to their existing customer base. The general school of thought that seems to pervade the financial services industry these days is that consumers are increasingly looking for ease of access and convenience in handling their finances.

Rightly or wrongly, the perception is that consumers are seeking ways to do "one-stop shopping" for their basic financial transactions and insurance needs and that they are more interested in what goals the financial product can achieve than whether the entity offering it is called a thrift, bank, insurance company, consumer finance company, or securities firm.

Changes in Business Structures

This cross-over of banking and insurance products is also affected by the trend toward consolidation in the financial services sector. Merged companies often can offer a wider array of products, tap special expertise in other areas, leverage resources, invest in technology, and create efficient, nationwide marketing and delivery systems.

With or without congressional action, financial modernization is unfolding in the marketplace - as we all knew it would. While Congress' ability to shape it remains elusive, we are getting closer to modernization after 20 years of debate. We need legislation that provides more choices for financial services, at competitive prices. We must reach the un-banked and the underserved, and maintain incentives to participate in community development. We want to promote innovation - the creation of new products and new ways to deliver them. We need to allow businesses choice on how financial institutions structure to serve their customers. And we need to do this while retaining both regulators' tools and industry incentives for safe and sound operation. Whether Congress will be able to put together legislation that meets these goals in what remains of this year's session is questionable.

Meanwhile, the thrift charter answers many of these challenges, with the functional capabilities and affiliations that appear to be those desired in a modern financial institution, for companies that have primarily a consumer, rather than a commercial, focus. There are adequate safeguards built in that limit, for example, transactions with affiliates. I will talk more about this in a moment.

The financial market is not waiting for Congress. As modernization unfolds within the financial services industry, we are presented with new challenges and opportunities; the need to adjust, invent and innovate; and an ever-greater need to work in partnership with everyone with a stake in our communities.

With today's changing marketplace, it is no surprise that insurance companies are responding by applying to charter a thrift. Many banks have been quite successful in moving into insurance companies' territory and expanding the boundaries of banking services. A number of insurance companies have recognized that the thrift charter offers substantial flexibility in structuring their operations.

Despite the hub-bub about recent applications for a thrift charter, it is not new for an insurance company to own a thrift. Fourteen thrift holding companies are either insurance companies or have had insurance subsidiaries for many years. In total, over 25 holding companies engage in insurance sales and underwriting. For example, some insurers with long-time thrift charters include:

- Acacia Mutual Life;
- Illinois Mutual Life;
- Prudential;
- Sunlife Assurance Co. of Canada; and
- USAA.

What is new is the recent increase in applications for a thrift charter by insurance companies and the variety of business plans contemplated by them. The proposals we have received to date have included business plans envisioning everything from limited purpose trust operations to far reaching enterprises using alternative delivery systems to market to a large audience. OTS recently approved four of these applicants:

- Principal;
- Teacher's Insurance Annuity Association;
- ReliaStar; and
- Travelers.

Currently, there are 46 pending applications for federal thrift charters. Of those, 16 are from insurance companies, 8 are for limited service trust only operations, and the remainder of the applicants are seeking full-service charters.

The perceived advantages derived from affiliation with a thrift, I think, include three features (based on feedback we have received from those looking at the charter):

- First, an insurance company can shape the business strategy of the banking operations of its subsidiary thrift. This control would allow the insurer to operate the thrift and to set up operating subsidiaries and service corporations in lines of business that would complement its insurance business.

- Second, in key areas such as lending, federal thrifts are subject to less state regulation than commercial banks because federal thrift preemption authority is somewhat broader. I think a key point here is, as you may know through talks with your state banking regulatory counterparts, to protect thrift depositors and the federal deposit insurance fund, federal banking regulators typically have broad preemption authority over state banking regulations. With respect to insurance holding companies and insurance companies, we are striving for cooperative functional regulation. We want to work closely with you. We recognize that, conversely to the federal deposit insurance fund, insurance company failures fall back to the state guaranty fund, and potentially ultimately to state taxpayers. We at OTS recognize how important it is that we work together to protect the interests of both thrift depositors and insurance policy holders. I believe that by drawing on our respective combined areas of expertise and sharing personnel and information resources, we can establish a mutually beneficial relationship that will ensure the safety and soundness of both industries.

- Third, federal thrifts are authorized to branch both interstate and intrastate free from state law restrictions. This, too, is somewhat broader than the authority of national banks.

<u>OTS Regulation of Holding Companies</u>

In addition to these favorable perceptions of the thrift charter, most applicants recognize that OTS generally does not regulate the way a holding company conducts its non-thrift business if fundamental safety and soundness objectives are being met.

The agency has traditionally focused most of its attention on the thrift in a holding company structure. Our examiners' regulatory posture has been to concentrate on the interaction between the thrift and its parent, seeking to ensure that the parent will have no adverse effect on the thrift. Similar to the way you approach your oversight responsibilities, I think, we look at areas such as:

- transactions with affiliates;
- whether the holding company has relied unduly on the thrift to upstream dividends to meet cash flow needs at the holding company level;
- whether fees charged by the holding company for services to its thrift are reasonable;
- whether tax-sharing agreements between the holding company and its thrift are fair to the thrift; and
- any signs that the holding company has usurped the thrift's corporate opportunities, or ability to offer new products and services.

The statutory and regulatory framework we rely on governing the interaction between thrifts and their affiliates is extensive. First, all transactions between a thrift and its affiliates are subject to the quantitative and qualitative restrictions of sections 23A and 23B of the Federal Reserve Act.

For those of you who are not familiar with them, in addition to their "arms length" requirements, these provisions limit to 10 percent of capital stock and surplus the amount of certain permissible transactions, including purchases from and loans to, any one affiliate. They also impose an aggregate 20 percent limitation on all affiliate transactions by a thrift institution.

Probably the most significant restrictions, however, establish an absolute prohibition on extensions of credit by a thrift to affiliates not engaged in activities permissible for a bank holding company under the Bank Holding Company Act. This bar serves as an absolute limitation on a thrift's ability to engage in the types of affiliate commercial lending that is at the heart of the concern with the mixing of banking and commerce.

The statutory anti-tying restrictions also prohibit a thrift from conditioning extensions of credit or the furnishing of services to a customer by requiring that customer to purchase products from an affiliate of the thrift. Lastly, unlike banks, thrifts are subject to commercial business lending restrictions. They can hold only 10 percent of assets in unrestricted commercial loans. An additional 10 percent can be held in small business loans. Thrifts also must maintain a high proportion of their assets in consumer-related loans, including mortgage loans, under the qualified thrift lender test in order to retain their status as a savings association.

Holding Company Examinations

To carry out our regulatory mandate, the OTS has been granted broad legal authority to conduct examinations. The OTS retains authority to examine all aspects of a thrift's affiliate structure, including the holding company and other holding company affiliates. As a practical matter, this authority is exercised only when it is necessary to make determinations related to the safety and soundness of the insured savings institution, or to monitor activities adversely affecting the institution's customers.

Notwithstanding the broad reach of our regulatory and oversight authority, I want to make it clear that OTS is not in the business of regulating or overseeing the insurance activities of insurance companies. As I mentioned earlier, in our view that is the regulatory jurisdiction of state insurance commissioners. This structure of preserving supervisory oversight to protect the safety and soundness of insured institutions while maintaining separate substantive oversight by the appropriate functional regulator is a unique aspect of the thrift holding company model. We do not engage in duplicative regulation. As we move forward, we fully intend to develop and maintain effective information sharing arrangements with state insurance commissioners that are mutually beneficial and that may be relied on when issues arise on consumer and supervisory matters.

OTS has already entered into 16 cooperative agreements with state banking regulators that have state-charted thrifts. These existing agreements are a model that works well on a routine basis to share expertise and resources and to coordinate joint examinations.

Conclusion

Regardless of whether financial modernization legislation moves this year, next year, or some time further into the future, convergence within the financial services sector is a reality in the marketplace. This convergence poses new challenges for regulators. To deal with the changing face of the industries we are all charged with overseeing, a greater level of cooperation and coordination will most certainly be needed.

OTS has recently opened a dialog in Washington and in some of our regions, with state insurance regulators and the NAIC. (The NAIC in Washington has been very responsive in getting the ball rolling and I thank Jack Chesson and Kevin Cronin for their efforts to date.) We are looking to cooperating on some current issues, such as information sharing and training. But perhaps most importantly we are seeking to develop a relationship such that if a problem arises with the thrift or with the insurance holding company, we can communicate easily and work closely together to get the problem resolved.

Thank you for inviting me to be with you today. I look forward to building a mutually beneficial relationship as we continue to work together.

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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' 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 and other documents, call PubliFax at 202/906-5660, or visit the OTS web page at www.ots.treas.gov.