Speeches

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OTS-074 - Remarks by Ellen Seidman before the Government Affairs Conference America's Community Bankers, March 7, 2000

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before the

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Let me begin by commending Diane Casey and her colleagues at ACB for putting together an outstanding agenda of speakers at this year's Government Affairs Conference. Following Paul's able leadership, Diane has picked up the reins and is making the ACB an extremely active participant in the Washington scene on many levels. I very much appreciate the opportunity to add my thoughts to the body of knowledge you will take from this conference.

I also want to express my admiration for Diane's extremely sensible February 18, 2000 memo to mutual institution CEOs on the subject of OTS's intention to propose new regulations concerning mutual-to-stock conversions. Many of the ideas in the proposal come from our discussions with you. I hope all of you with any interest in the subject participate, whether through ACB or individually, by commenting on the proposal.

Well, January 1, 2000 and February 29, 2000 have come and gone, and we survived. You've probably had your fill of Y2K, but I can't let this occasion pass without noting the industry's outstanding success in dealing with the calendar rollover. Your success was the direct result of unprecedented cooperation among all thrifts, banks, other financial institutions, customers, trade associations, government agencies in general and, yes, regulators. Without such cooperation, we would never have made the transition nearly as smooth as it was. Thanks, to all of you.

Looking back at 1999, we are holding a press briefing tomorrow to report on the financial condition of the OTS-regulated thrift industry. I'll hold the precise numbers until then, but I can tell you that earnings set a record in 1999 for the third year in a row.

Industry performance stacked up favorably with previous years in most categories. Even where some fall-off occurred, there was nothing particularly alarming. And despite the merger of Bank of America's $28 billion thrift into its commercial bank at the end of the third quarter, net assets of the OTS-regulated industry actually increased above the 1998 level.

Financial results were all the more remarkable because the industry had to deal with the transition from a low, flat yield curve to rising interest rates with only a slight steepening of the curve. This meant a return to portfolio lending from the robust mortgage banking mode of 1997 and 1998. But industry managers adjusted to the changing mortgage market just as they rallied to the refi market more than two years ago.

There were a few warning signals as 1999 ended, including the industry's interest rate risk sensitivity, which has increased for several quarters as interest rates have risen. I don't want to overstate our concern. But history has taught us well that we have to be alert to higher risk levels and work together to monitor risk and map out appropriate responses.

Let's now turn to the future. The second millennium is history, and it's time to contemplate the role of thrift institutions in the financial services industry of 2000 and beyond.

Given the dynamics at work in the broad financial services industry, including the impact of the Gramm-Leach-Bliley Act on banking in general, the root question is whether there will be a role for community banks operating with the federal thrift charter.

My unequivocal answer is: Yes. First: Let's consider the nature of the thrift charter itself. Thrifts are traditionally community and consumer oriented, and dedicated to residential housing finance. Nearly half of the industry's assets continue to be made up of whole 1 to 4 family mortgages. By contrast, commercial banks hold only 12.5 percent of their assets in single-family mortgages. If you add in all mortgage-related assets held by thrifts, the percentage climbs to nearly 75 percent. Although commercial loan activity among thrifts is increasing rapidly, commercial and small business loans still make up only 2.4 percent of total assets.

While success as a mortgage lender is undoubtedly more difficult now than it was thirty years ago, hundreds of thrifts are proving every day that they can adapt to new challenges and continue to provide almost one in five new mortgages to the record number of Americans who have succeeded in achieving the American dream of homeownership. But the thrift charter also allows choices, and community banking is all about choice - choice for communities, choice for customers and choice for thrift management.

Take a look at some of the institutions in our Southeast Region: Ideal Bank serves a small, urban minority community in Baltimore; Desjardins focuses on the French Canadian community in South Florida and lends money to non-profits helping Hispanic communities there; G&L Bank serves the gay and lesbian community nationwide; NetBank provides deposit products to anyone with a computer wherever they live; First Federal of Charleston provides funding for low-and moderate-income multi-family housing and special services for the elderly; and PeeDee Federal has been a leader in bringing economic development to Marion, South Carolina. The thrift charter works for all of these `community' banks.

They can offer signature loans and small business loans, jumbo mortgages, conforming mortgages, credit cards and home improvement loans. The thrift charter is flexible enough to accommodate the choices of all these communities and managers.

My second point: In traveling around the country, I have observed that acquisitions of local banks and thrifts by large regional institutions often leave a void in banking services for groups of customers and even whole communities. Every month, we meet experienced bank and thrift executives displaced by consolidation who are thinking about creating new thrifts to fill some of these voids. Our regions also report continuing inquiries from other investors interested in starting thrifts in communities left in the backwash of consolidation.

One very real danger lurks where legitimate banking services are lacking. These situations are an open invitation to predatory lenders to move in, victimize their customers and threaten both the portfolios and the reputations of legitimate thrifts and other lenders. I think the very best way to combat these unscrupulous lenders is to provide direct competition to them.

I call on traditional lenders to market responsible credit and financial services in ways that actually reach those who need them. And I urge you to enlist the help of community groups. But I also think there are some regulatory improvements that can help legitimate lenders and communities win the battle. By the end of March, OTS will issue an Advance Notice of Proposed Rulemaking asking you and the public for your thoughts.

My third point deals with the question: What is the impact of the Gramm-Leach-Bliley Act on the thrift charter? This monumental piece of legislation, 20 years in the making, actually has limited direct impact on the thrift charter. While the Act prohibits commercial entities from buying or chartering thrifts in the future, only a small number of commercial companies--fewer than 30--actually own thrifts. And a mere handful of charter applications were filed by commercial companies before May 4, 1999, the cutoff date set by Congress.

A major challenge for us is to fully understand the legislation. There is a fair amount of regulation-writing and interpreting to be done, and OTS has been concentrating on privacy and CRA.

As you know, the privacy regulations are out for comment until March 31. I urge you to comment on both what you like and what you don't like. The Federal Reserve and OCC have other regulations out, and we hope to have a joint CRA Sunshine regulation out for comment shortly.

When you comment on the privacy regulation, I urge you to keep three principles in mind:

- The statute is the law; it's our job to implement. If you wish some part of the statute weren't there, that's an issue for Congress, not the regulators. If you think there's a better interpretation available that meets the goals of the statute while putting less burden on you and serving consumers better, that's what we want to hear about.
- Trust is your stock in trade. Consumers still think they can trust their bank in a way they don't trust their securities broker or life insurance salesman. Make the most of it.
- Remember that states have the right to pass tougher privacy laws, if they perceive the federal law--or the way we're implementing it--is too weak.

Similarly, on CRA Sunshine, I solicit your help to make this law work in a manner that does not disrupt the partnerships you have built up over the years not only to meet your obligations under CRA, but also to reach out into segments of your community from which you have an opportunity to draw many new customers.

And that's important because another outcome of Gramm-Leach-Bliley, you can be sure, is that competition in an already challenging market will increase. It is the rare thrift--or financial institution, for that matter--who will thrive in this dynamic environment simply by doing what you've always done with the customers you've always had. Yet, where there is change, there are new opportunities for the community and consumer-minded thrift.

Two of your strongest attributes are your knowledge of the community you serve and the high-quality service you can provide. The questions you have to answer are: Who will be your customers in the future; what products and services will they want; and how can you provide them--directly by yourself, in strategic alliances, through agency relationships, or as part of a larger corporate family?

One potential niche I think all community-based institutions must at least consider is extending your products and services to people in your community or those nearby who may be a little further down the credit scale than your traditional customers or who are entering the financial mainstream for the first time. There is a whole new customer base emerging in communities across the nation. It's in both the immigrant and the native-born American communities that are just coming into the mainstream for financial services. The record economy and special programs, such as the welfare-to-work initiatives, have given millions of additional Americans a reason to want the kind and quality of financial services you and I have taken for granted.

In many instances, these potential customers are concentrated in neighborhoods and communities that are truly being reborn. For example, an excellent article in The New York Times a couple of Sundays ago described the transformation of Hempstead, Long Island, from a once prosperous community that fell on hard times in the 1970s and 1980s to a rejuvenated, thriving community founded on a vibrant immigrant population that moved in from Central America. The article notes that similar transformations fueled by immigrants have occurred in the inner suburbs of other urban centers like Los Angeles, San Francisco, Chicago, Washington, Houston and Miami. What the article emphasizes is that while this transformation has started, additional, mainstream financial services are needed to continue the expansion. Our experience is that there is similar nascent vibrancy, and similar financial needs, in rural America and on tribal lands. Each segment presents its own unique circumstances, so it takes dedication, understanding and persistence to have an impact.

A senior ACB official told me a story at last year's convention, which he's probably shared with you, that is worth repeating here. He is the CEO of an ethnic thrift in a major urban center, where the ethnic characteristic of the neighborhood served by the thrift had changed dramatically in recent years. The institution wasn't doing as well as it had been, until the CEO focused on the fact that the neighborhood had become Hispanic. So he hired a staff fluent in Spanish, built a new facility to attract customers, and turned things around. At last report, the thrift was doing quite well.

There also are great opportunities for thrift institutions to serve the aging population. Many of the insurance companies we have granted thrift charters recognize that potential and are using the charter mainly to provide retirement products and services. You should keep in mind that baby boomers are going to be around for the next 20, 30 and even 50 years--at least I'm planning to be. During those decades, the boomers will trigger increased demands for wealth accumulation, for retirement services and for health care facilities. All these consumer and community needs will require financial services that thrifts can effectively provide.

Small business lending in the $200,000 to $400,000 range is another opportunity. This is a market segment the big commercial banks may not want to bother with. These loans certainly aren't thrifts' bread and butter, but then again they're not outrageously large for institutions that are used to financing multifamily and commercial real estate. They offer possibilities for community institutions. After all, small businesses are the backbone of the local economy.

In discussing new business opportunities, I am not suggesting that any thrift should abandon its current customer base. As you well know, keeping a customer is far less expensive than getting a new one. But to keep these customers, you need to consider strengthening and expanding your core business by making a conscious effort to find out what products and services your customers really want--what are the things that could drive them to the competition if you don't make a move?

For example, what customers want Internet banking privileges, and which ones really want to talk to a teller--or to some other service provider in the bank? Which are price-oriented, and which are more willing to pay up for service--and what services are they willing to pay for? And can you make your concern about their privacy into a competitive advantage? One very important lesson we all learned from Y2K is the importance of communicating with each other, including in particular communicating directly with customers. And, of course, as you move into new areas, don't forget to communicate with us too.

This morning I've touched on business opportunities, market dynamics and where you might want to take your respective institutions My comments are based on observations, discussions with many of you at town meetings, at conferences and one-on-one, and via input from our regional staffs who meet regularly with you. You may find some ideas plausible and reject others. You know best what your strengths are, who your customers are and where you want to be this year, next year, and years into the future.

The question is how to pull together a realistic game plan that will help your institution take advantage of opportunities and achieve the goals you have set. The answer, of course, is strategic planning. Done well, strategic planning is a demanding and rewarding exercise. I thought it would be helpful to share some views on the subject from another of our regions. Here's what they said:

> The need for an engaged, committed board and visionary management team has never been greater for community thrifts and banks, especially post-Gramm-Leach-Bliley. Effective strategic planning is absolutely critical to the future success and survival of your institutions.
>
> Identifying what you do best through the planning process, finding your niche in the local community and deploying capital effectively to these areas to provide superior customer service will give you a fighting chance against the big boys. Too many times we see the strategic planning process as a one- or two-hour meeting to set goals for the year. In today's financial services environment, that just doesn't cut it.

I think these comments are on the mark, and I offer three steps that may help you in the planning process - there no doubt are others:

- Identify what's happening in your market, including the market's risks and opportunities and their interactions. If you decide, for example, to get into sub-prime lending to reach new and underserved customers, you need to fully analyze and understand the risks involved and put in place policies, competent managers and back office systems suitable for the activity.

You should establish limits in line with the risk of the activity and the risk profile of your institution; monitor actual performance so you know what's going on; have sufficient capital to account for the greater risk; and you absolutely must have the active participation of a fully informed board of directors. The same goes for other new lines of business.

- Understand how technological changes are affecting the market as a whole, your competition and your customers. We know technology is now intertwined with everything we do, including everyday transactions, and it's expanding. For example, Grant Thornton reports that in a new survey of 638 community bank CEOs, 64 percent say they will offer Internet banking this year. If you embrace electronic banking, keep in mind that it requires extra controls and oversight on your part to protect the security of the system and preserve the sanctity of your account holders. And if you decide to stay away from the Web, understand the implications of that, too.

- Finally, determine what skills may be needed for different markets. For example, it should be obvious that successfully marketing to and meeting immigrants' needs for consumer and small business loans may require multi-lingual specialists and different skills than addressing the retirement needs of baby boomers. What may be less obvious is that your traditional business may need new skills. For example, as core deposits decrease, you need talent that can truly manage interest rate risk at a reasonable cost. And relying on those who are trying to sell you derivatives is probably not the best way.

Let me leave you with this thought. Any industry like the thrift industry, that has been to Hell and back, has a strong instinct for survival. The challenges before you in the marketplace may be as profound as they were during the dark days of the thrift crisis, but they are qualitatively very different. With effective planning and implementation and, yes, effective supervision, we know you can succeed.