

Statement of

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before the

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Mr. Chairman and members of the Committee, I appreciate the opportunity to testify on issues relating to over-the-counter derivatives.

Recent years have seen important changes in the financial marketplace. Stimulated by competition and innovation, banks today are increasingly well positioned to serve their customers' needs for quality financial products. And we, as financial supervisors, have worked to create a consistent, predictable, and responsive environment in which banks can operate without excessive regulatory burden and which is conducive to the safety and soundness of the banking system.

Among the most important of these recent product innovations are over-the-counter derivatives. The first quarter of 1998 was the ninth consecutive quarter of growth in the notional amount of derivatives activities at all U.S. commercial banks. As of March 31 of this year, the figure stood at \$26 trillion, compared to just over \$20 trillion at the beginning of 1997.

Such growth cannot be ignored, and the Committee is to be commended for its continuing efforts to monitor the derivatives market and its system-wide implications. The Committee has recognized that, properly used, derivatives can be an effective and flexible risk management tool. You and others have noted that derivatives can contribute to the viability of banks by allowing them to diversify their revenue sources and thus improve their ability to withstand downturns in the business cycle. Using derivatives, banks also can perform an important service to business customers searching for ways to better manage their own risk exposure. That's a "win-win" for banks and their clients.

But you have quite properly asked questions about the supervision of these powerful instruments. My written statement provides a detailed summary of the supervisory measures implemented by the OCC over the past several years to ensure that the small number of national banks that currently participate in derivatives activity do so in a safe and sound manner. Our examination findings suggest that the participating banks are doing just that. And we are committed to ensuring that our basic supervisory system provides effective and appropriate safeguards against the risks associated with derivatives activities going forward.

As I said at the outset, a regulatory regime must be predictable and consistent to be truly effective. That is why we have misgivings about proposals to alter the regulatory structure governing derivatives activities.

The possibility raised by the recent CFTC concept release that certain types of derivatives -- namely swaps and hybrids -- might henceforth be considered as futures contracts and regulated as such has already raised unsettling questions about the legality of existing transactions. Such concerns may discourage some banks from using derivatives to manage risk. That would undermine safety and soundness. If such a change in the regulatory regime were to take place, it might well have the effect of driving derivatives transactions outside the United States and diminishing the competitiveness of U.S. banks while lessening the effectiveness of U.S. financial supervision -- clearly undesirable outcomes.

Such potentially far reaching regulatory changes should not be undertaken lightly. The OCC believes that the President's Working Group on Financial Markets is the appropriate forum for the discussion of this issue, which cuts across markets and regulatory jurisdictions. It is also appropriate that this multi-agency body comprise the Principals from the key regulatory agencies that supervise the major firms engaged in derivatives activity.

Mr. Chairman, we at the OCC are committed not only to working with our colleagues at the other federal regulatory agencies but also with you and other members of Congress to ensure that the dynamic over-the-counter market for derivatives continues to enhance the safety and soundness -- and the competitiveness -- of our banking system.

As one further example of the way the consultative and cooperative process can and should work, let me say just a few words about HR 4239, the Financial Contract Netting Improvement Act of 1998. This bill, which you and other members of the Committee introduced last week, was drafted with the assistance of staff members of the agencies represented on the President's Working Group, including the OCC. This bill would provide significant benefits to the financial markets by reducing systemic risk and providing greater legal certainty to commercial banks and their customers. The OCC fully supports HR 4239, and we commend you, Mr. Chairman, and the Committee for your prompt and statesmanlike action to see that this important bill becomes the law of the land.

Mr. Chairman, that concludes my statement. Thank you.