***R*EMARKS OF *J*OHN *M. R*EICH, *D*IRECTOR**
***O*FFICE OF *T*HRIFT *S*UPERVISION**
***TO THE A*MERICA'S *C*OMMUNITY *B*ANKERS *A*NNUAL *C*ONFERENCE**
***S*AN *D*IEGO, *C*ALIFORNIA**
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Good morning. Thank you for the opportunity to be with you again at the America's Community Bankers annual convention. When I spoke to you for the first time last year, I highlighted a number of important initiatives that I was pursuing as the recently appointed Director of the Office of Thrift Supervision. Today, I want to give you an update on these items and to talk to you about some other things that we are doing at OTS. I also want to give you a brief update on the current state of the industry. And I will conclude my remarks with a discussion of a number of pending policy issues that we are currently addressing that are likely to be on our collective agendas in the months ahead.

The New Face of OTS

Outside in the Exhibitors' Hall this morning you will notice a new face for the OTS. At booth space # 509, we have unveiled for the first time in a long time, if ever, an OTS booth at a financial services industry conference. This is an initiative that is part of a much larger effort at the OTS to highlight the unique aspects of our regulation and supervision as well as the benefits of the federal thrift charter. Many of you know firsthand about the OTS and the federal thrift charter. The OTS booth, which has been in production since this summer, highlights numerous aspects of our oversight program and details aspects of the charter that set it apart from other charter options.

While the federal thrift charter is not suited to every business strategy, it offers many advantages for entities engaged in retail banking. And, as highlighted at the booth, the charter has emerged in recent years as a viable option for larger, internationally active financial services providers. I encourage you to visit the OTS booth to explore these and some of the other aspects of the charter and OTS oversight issues that are described there, including our interest rate risk model and consolidated oversight of a thrift holding company and its thrift subsidiaries and affiliates.

The OTS booth is an initiative long overdue. As I discovered over the course of the past year, it is important for many reasons. Some of these reasons are relatively obscure and little understood except by the companies that currently benefit from them, while other benefits are widely understood by industries that have only recently discovered the charter, such as the insurance industry. In 2000, no major insurance carrier had a federal thrift charter in its structure; today, almost every major insurance company has adopted the charter as an integral part of its retail consumer outreach strategy.

OTS Update

Last year I made some observations based on my brief tenure at OTS. These included my initial favorable impressions of the thrift charter; the overall health and capitalization of the industry; our ability to assist you in operating safe, sound and profitable institutions that continue to serve local communities; and the competence and expertise of the OTS staff. I am even more confident of all of these things today. My confidence is bolstered by my experiences and a number of initiatives that we have pursued the past year.

First, I have had the opportunity to visit with staff at each of our regional offices the last year. In these meetings and visits, I have learned a great deal about the relative strengths and weaknesses of the OTS. And I have attempted to move quickly to address areas that required immediate attention and to formulate a longer-term strategy to address issues requiring that type of approach. An important aspect of my internal outreach efforts is making sure that I learn as much as possible about what is on the minds of our staff and making sure that they know what is on my mind and our other senior managers. Improving internal communication has been a key initiative.

Second, we have attempted to identify the areas of the agency where we lacked adequate leadership, vision, and in many instances, simply sufficient staffing to effectively implement and support important policy objectives. One area was our consumer affairs program. OTS's consumer affairs strategy today is integral to our overall success and effectiveness as a regulator.

Institutions that fail to implement and execute effective consumer affairs programs unnecessarily expose themselves to significant risks that would be easily manageable with a little effort and advance planning. Ironically, this is the state in which I found the OTS when I was appointed the Director. To remedy this deficiency, we reestablished OTS's consumer affairs program and recruited the talent to lead and staff it. A key hire was Montrice Yakimov, our Assistant Managing Director for Compliance, Consumer Protection and Community Affairs.

We also improved our leadership and focus in several other key areas. In particular, Grovetta Gardineer was hired as our Assistant Managing Director for Examinations and Supervision Policy, and C.K. Lee was promoted internally to become our Assistant Managing Director for Complex and International Organizations. And we significantly upgraded our capacity and resources in both of these areas.

In addition to these key hires and upgrades, we filled numerous other managerial and technical staff vacancies in the regions and Washington. We also significantly improved and expanded our examiner corps this year by hiring more than 80 new examiners and upgrading our training program for new and existing examiners.

While upgrading and filling out our staffing ranks is important, it is equally important that we take the steps necessary to promote a healthy and positive working environment for our existing employees. This means creating and maintaining a work experience that is operated in a highly skilled and professional manner with the highest degree of integrity and transparency. My goal is for the OTS to consistently provide a productive and engaging work environment, built on trust, respect, teamwork and communication, that recognizes and values the contributions of all our employees.

An important part of this effort is creating mentoring programs and new professional development opportunities for all of our staff, from senior management to support personnel. Again, we recruited and hired a key leadership person, Matthew Amato, to upgrade and implement this aspect of our program. In a few short months, Matt has entirely overhauled our professional development program, and is in the process of implementing numerous other changes to enhance the overall work and professional experience of our staff.

Finally, we have significantly upgraded all aspects of our internal communications structure and we are in the process of implementing numerous additions both to our internal and external communications framework. Two months ago, we reinstituted an employee newsletter. The first issue was a resounding success and we are about to issue the second issue, which I understand is even more comprehensive. In addition, we are in the process of developing a multi-pronged external outreach strategy that provides the industry better and more timely information on what we are doing in Washington, as well as developments that affect and enhance the thrift charter.

In connection with our multi-pronged outreach strategy, I want to let you know that the OTS will be sponsoring a National Housing Forum on Monday, December 11 at the National Press Club in Washington, DC. Our goal is to bring together well-known experts to discuss and debate some of the most critical housing finance issues in our current environment. We want to provide a national forum for some healthy discussion of the housing finance issues many of you may be concerned about.

By most measures, I believe the past year at OTS was an unqualified success. I hope you agree. While there may be some things that I did or decisions that I made that you did not like or agree with, I can represent to you that everything I did was motivated with the best long term interests of the industry and the thrift charter in mind. For example, while I understand that my recent decision to propose aligning the OTS with the other federal banking agencies on the Community Reinvestment Act was by no means popular, I believe it was the right thing to do.

Since joining the OTS, I have had many conversations and thought long and hard about the basis of our CRA rules. In particular, I continually questioned the rationale for having different procedures for evaluating CRA compliance by thrifts versus banks. In many respects, I believe this does a disservice to thrifts. Over the last year, I have come to appreciate that thrifts are the model for effective community development lending, investments and services in all market areas, particularly low-to-moderate income communities. I find quite disturbing the fact that our institutions have had to continually defend their programs and activities because of the OTS's differing CRA rules.

OTS-regulated thrifts are not only active low- and moderate-income community lenders; in many markets, thrifts are the leaders in this activity. For example, thrifts far outdistance banks and other lenders when it comes to multi-family housing loans — a key lending activity in many low- and moderate-income areas. In addition, thrifts are often at the forefront of innovative and creative lending to benefit the public welfare.

I came to the conclusion that thrifts are and will continue to be outstanding low- to moderate-income lenders regardless of the applicable CRA rules. And this formed the basis for my decision to propose aligning the OTS with the other federal banking agencies on CRA.

While I understand that my decision to propose modifying our CRA rules was perhaps not popular, I certainly hope that it does not overshadow many other positive developments at OTS the past year. These include:

- Adopting a vision for the OTS and initiating the strategy and goal planning required to achieve this vision;
- Effectively examining and supervising, with the minimum required regulatory burden, our continually evolving industry;
- Addressing industry and individual institution risks in a proactive, fair, and effective manner;
- Expanding our domestic footprint to better serve the needs of local community banking while also raising the profile of our international organizations program; and
- Simplifying our application and reporting requirements, streamlining our examination processes, and amending our regulations and internal regulations to reduce regulatory burden.

Finally, I want to take a moment to mention my work on the EGRPRA project and the recently enacted regulatory burden relief legislation. While this cannot be characterized exclusively as an OTS accomplishment, significant agency resources were brought to bear since I joined the agency in August 2005 to achieve meaningful regulatory burden reduction legislation. And I believe that it was a significant legislative victory for the OTS and the industry. While it would have been more satisfying to have several additional provisions in the final bill, including additional small business lending authority for thrifts, it included several important provisions, such as an exemption for thrifts under the Investment Advisors Act and the same treatment as banks under the broker-dealer provisions of the federal securities laws.

State of the Industry

The thrift industry includes a diverse group of institutions ranging from small one-office community banks to large complex institutions with a nationwide reach: Diversity is also evident in the ownership structure of thrifts, with 39 percent of thrifts in the mutual form of ownership and 61 percent stock held.

As of the end of the second quarter, 854 thrift institutions held combined assets of $1.5 trillion. In addition, there were 480 thrift holding company structures, including 82 mutual holding company structures. Thrift holding companies had aggregate consolidated assets of $7.7 trillion at mid-year 2006.

Profitability continues to be strong for the industry with record profits of $16.4 billion posted in 2005, and $8.4 billion recorded for the first six months of 2006, another record pace. Industry return-on-average assets (ROA) was 1.19 percent for 2005 and 1.12 percent for the first half of 2006. Thrift annual ROA exceeded 1.00 percent for the past five years.

Thrift capital levels are also very strong, with the industry's equity-to-assets ratio at 9.25 percent as of June 30, 2006. No thrift was "undercapitalized" as of that date and asset quality is sound. Problem asset levels are at or near record lows. And another measure of problem assets — the ratio of net loan charge-offs-to-average assets — also remains low, with net loan charge-offs at 0.18 percent of average assets for the first half of 2006.

Reflecting the industry's strong financial performance, the number and assets of "problem thrifts" — those with the lowest composite examination ratings of 4 or 5 — are also at record lows. At the end of the second quarter there were 4 problem thrifts with combined assets of $210 million, or less than 0.1 percent of industry assets.

Pending Policy Issues

Last year I talked to you about some of the pending policy issues we were addressing in Washington, including credit union issues and the Basel process. Since then, additional issues have emerged, including concerns with the proliferation of alternative mortgage products and increased concentrations in commercial real estate, or CRE lending.

I remain concerned about the state of policy development on charter flexibility for all depository institutions, including credit unions, to choose the operating strategy that best fits their ongoing and future business needs. Institutions that choose to break from the confines of a credit union charter should be permitted to do so. Credit unions serve a tremendous benefit to their members and I support that business model of serving a defined class of people with a common bond. This policy breaks down, however, where credit unions are permitted to compete directly with other insured institutions and operate with a wink and a nod outside of their common bond, or with no meaningful common bond.

No one can ignore the significant competitive advantages enjoyed by credit unions, including a tax-free operating strategy and the lack of a CRA requirement. However, these benefits are intended to be available to institutions that operate in a limited cooperative environment, not statewide depository institutions that open their doors to every citizen of the state. As a former community banker and current federal banking regulator, I am at a loss to understand why we continue to support a tax-free business model for institutions that compete directly—outside of any meaningful cooperative structure or common bond—with tax-paying retail banking entities delivering the same financial services to the same consumers.

Another issue on the horizon for banks and thrifts is the Basel process, including the development of Basel II and Basel IA. The recently published notice of proposed rulemaking, or NPR on Basel II provides an opportunity for advancing the dialogue on the implementation of Basel II in the U.S. There is much work to be done on Basel II, with many challenging policy issues to address. I am committed to working with the other federal banking agencies to resolve these issues, but we need your input to guide us.

In particular, we want to ensure that the Basel II rules do not competitively disadvantage U.S. institutions that may continue to operate under a Basel I based approach. To address this concern we are also working with the other banking agencies to modernize the existing Basel I rules via the so-called Basel IA proposal. A Basel IA NPR should be released in the near future. And, as I have stated before, I will also continue to support the preference of many highly capitalized institutions to continue to operate under the existing Basel I rules.

The other high profile project on the table today is the interagency guidance on commercial real estate lending. The proposed guidance was issued in response to the rapid growth in CRE concentration levels at insured institutions with assets between $100 million and $10 billion, which probably mirrors the profile of many institutions in this room. While there has been moderate growth in CRE lending by the smallest and largest depository institutions, annual growth in CRE lending by small-to-midsized community banks and small-to-midsized regional banks has risen dramatically the last eight years.

The draft guidance drew numerous comments, including concerns with the potential impact on community lending. Other comments were that it will impose additional burdens on depository institutions and that thresholds set forth in the guidance will be viewed as hard limits by examiners and the industry. As a former community banker, I am keenly sensitive to these issues. My expectation is that the guidance should be viewed only as a reference by the industry and our examiners. It is not intended to impose limits or thresholds above which CRE activity is suspect or barred. And, as I have testified before Congress, I remain uncomfortable with the particular numerical thresholds set forth in the proposed guidance.

In light of the comments we received, the CRE guidance is still under consideration and discussion by the agencies. It is my hope that we will modify the guidance to address the comments, to clarify the underlying theme of the agencies' risk management expectations for the industry, and to make sure the guidance conveys this intent more clearly.

As you are aware, a few weeks ago the banking agencies issued long-awaited guidance on alternative mortgage products. As with the proposed CRE guidance, the alternative mortgage products guidance was extremely controversial. While I cannot say that this is what we would have issued on our own at the OTS, I believe it is guidance that is largely beneficial in warning insured institutions about various aspects of the risks associated with the use and proliferation of alternative mortgage products. And I believe that it will be particularly effective if it is endorsed by the states in their consumer protection programs and oversight of state-licensed mortgage brokers and mortgage finance companies.

Thank you for the opportunity to speak to you, today. The OTS is proud of its relationship with America's Community Bankers. Diane Casey, Bob Davis and your industry leadership are strong partners with us, and I look forward to continuing and furthering strengthening this relationship.