REMARKS OF JOHN M. REICH, DIRECTOR
OFFICE OF THRIFT SUPERVISION
TO THE NEW JERSEY LEAGUE OF COMMUNITY BANKERS
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Good morning, and thank you for inviting me to join you today at the 99th Annual Convention of the New Jersey League of Community Bankers. Ninety-nine years is quite impressive – it speaks to the importance of community banking in New Jersey a century ago and today. While I presume the founding fathers of the New Jersey League have long departed, I suspect you continue to struggle, 99 years later, with many of the same issues that motivated them to start the League in the first place. Perhaps some of these issues, such as reducing regulatory burden, effectively serving your communities, and addressing unfair competitiveness issues, will be topics that a future Office of Thrift Supervision (OTS) Director will address with the New Jersey League a century from now. If I have my way, both of our organizations will be strong and thriving, and continuing to carry out our respective missions.

Some of you may be aware of my own passion about community banking. You may have heard me speak, or possibly read of my comments about it on a number of occasions. Yet, I continue to believe that I cannot spend too much time on this important topic. The future of community banking is at a crossroads. Its future is by no means certain and I believe few outside this room and industry truly understand the cost to our communities from the loss of this important resource.

While I served as a community banker in various positions for over 20 years and continue to identify myself as a community banker, my experience and familiarity with the thrift charter is relatively recent. Nonetheless, since joining the OTS in August 2005, I have come to appreciate the unique advantages of the thrift charter. I have also used my position to highlight the peril that is currently present with respect to the future of community banking. I will address both of these topics this morning, and will conclude with some observations on current issues in the housing and mortgage markets involving subprime lending.

The Future of Community Banking

Why does community banking matter? Community banks matters for one very important reason – your customers and the millions of other Americans who depend on their local community banking organization every day. Community banking matters because you provide the most personally effective service to your customers. You know them personally; you know firsthand their families, their problems, their challenges, their frustrations, their activities, and their organizations. You live with them. You know what is important to them at the most local level – the price of milk, the cost of gasoline, the cost of a lot on which to build a home, who the best builders are in your community, the best doctors, lawyers, CPA's, schools and schoolteachers, the best service clubs.

Many of you are probably members of the Kiwanis, Lions, Rotary, Civitan, Optimists, or various other local service and community clubs that I have neglected to mention. When I was a community banker, I was involved with several of these community-based organizations in Champaign-Urbana, Illinois, where I began my career, and in Fort Myers and Sarasota, Florida, where it continued for over 20 years. Like my father, I was a Kiwanian, and I also was a member of a Moose Lodge; and later in my banking career, a Rotarian. I have been a Mason for 44 years, including a 32^{nd} Degree Mason for over 20 years, and I am also a Shriner.

Like many of you, I am also active in my church, serving as a Presbyterian deacon, trustee, and elder. As a community banker, I served as Treasurer of a Boy Scout Council, Chairman of a public hospital board, and Chairman of a YMCA Board. I was also active in the United Way, served on the Board of a Drug Abuse Program for teenagers, a Symphony Orchestra Board, and a Little League Baseball Board. For 7 years, I was the coach of a Babe Ruth Baseball team for 13 year olds while I was the CEO of my bank in Sarasota, FL.

And I know that many of you have very similar credentials. I tell you these things not to fan my own resume, but to let you know that I know and understand what you do in your lives every day of the week – the pressures under which you live and work. Community banking is about service, belonging, and doing something to make a difference in people's lives. What you and your banks do in your communities matters, perhaps more than you realize.

Community banking matters because of the opportunities you have every day to make a personal and significant difference in the lives of your customers, their families, and your community. I understand this and want to do everything I can as the Director of the OTS to preserve community banking in America. We cannot and must not allow community banks to disappear.

While I do not believe community banking will disappear entirely, at least not in our lifetime, industry consolidation continues to takes its toll. Much has been written about community banks selling out to larger regional and national banking organizations that have little presence in a community beyond their branch offices. While this is not the case for all larger institutions, it is a perception that is backed up by the experiences of many Americans.

Particularly troubling is the notion that bigger is both necessary and better. More often than not, economies of scale do not materialize to the degree originally anticipated with a merger or acquisition. In addition, cultural differences often sabotage the expected synergies of the resulting organization.

Mergers and acquisitions are motivated by real market pressures – including regulatory burden and unfair competition – that are squeezing community banks. Among the issues that we in Washington need to address is unfair competition in local markets for deposits and loans from organizations that have artificial, government-sponsored economic advantages, including credit unions and the Farm Credit Administration. These unfair public policies ought to be changed. You have my word that I and my colleagues at the OTS are sensitive to these issues and will work to reduce unfair competition and regulatory burden on community banks.

A final observation worth noting is that you can do your part to protect and preserve community banking. In your own institution you can provide greater assurance for the future of community banking in your community by planning for succession and continuity of management when you are ready to retire. If you have not already done so, I encourage you and your Board members to address this issue. My fear is that the exit plan for many community bank CEO's is simply to sell out. This rarely a desirable outcome for the communities and customers you now serve.

The Thrift Charter

Moving on to my views of the thrift charter – the OTS and the charter we oversee have unique and inherent strengths that continue to reap rewards for the industry we regulate. The OTS operates with a minimum of overhead. We continue to operate with a budget surplus and, by the end of the current fiscal year, we will have increased our overall staff by more than 15 percent since I joined the agency less than two years ago. By September 30, 2007, we expect to have a professional staff of almost 1000 people who are dedicated to the mission of maintaining the safety and soundness of the thrift industry, and improving the regulation, oversight and flexibility of the charter.

Our staff is tremendously skilled, with experience in virtually every sector of modern banking. We are able to adapt quickly to market demands, and we are continually striving to improve. With the addition of 100 new examiners by fiscal year end, and additional training and hiring in certain critical areas, including capital markets, economic analysis, and compliance management, we are further improving and upgrading an effective and efficient supervisory structure.

Our priorities include incorporating greater structural and processing consistencies in our Regions. I believe more centralized direction is necessary to assure nationwide consistency in areas such as examination and compliance policy and supervision oversight. In addition, we are placing greater emphasis on outreach and visibility for the OTS at state and national conferences and conventions, such as yours. We oversee an industry and charter that is primarily engaged in retail banking or, more precisely, retail community banking. You already know firsthand that this is a rapidly growing segment of the financial services world, yet its story does not have the visibility it deserves.

As the retail community banking sector grows, I believe the thrift charter is well positioned to provide a structural and regulatory alternative both to established financial services businesses and to new entrants that are working to grow market share in this area. The combination of branching and preemption powers, coupled with seamless consolidated institution and holding company supervision, ensures savings institutions are able to follow their customer base and the growth of their business from one end of the country to the other – all with minimal regulatory burden.

Currently, there are 845 OTS-regulated thrifts, holding assets of $1.4 trillion. We also oversee 475 thrift holding company structures with consolidated assets of approximately $8.0 trillion. While financial services consolidation has reduced the overall number of savings institutions, industry asset growth remains strong. In fact, in the past five years, industry assets grew 53.4 percent, representing a robust average annual five-year growth rate of 7 percent. This is due to growth within existing thrifts and to the fact that various financial institutions continue to choose the thrift charter for the reasons I just mentioned.

The thrift charter is deployed in neighborhood community banks all across America. It is used by leading nationwide lenders, by investment banks offering a full array of financial services, and by global conglomerates involved in a wide array of diverse businesses – to name just a few. These organizations have all come to the thrift charter at different times and for reasons as diverse as their underlying businesses and the markets they serve. And the facts seem to show that it has been a profitable decision.

The more I learn and the more I know about the institutions we regulate, the more I am convinced the charter is quite unique. It is an outstanding structure for conducting community-based retail banking activities and it offers sound opportunities for community banks. I note no small irony in the fact that, after many years as a community commercial banker, I now understand that there is an alternative model for community retail banking that may be – depending on the institution – preferable from a business standpoint. The thrift charter offers a viable business model for *de novo* institutions and a number of groups in the process of organizing new banks are giving it consideration, and some existing institutions have chosen to convert to the thrift charter.

Subprime Lending Concerns

The final topic I want to discuss with you today is the debate about subprime lending issues in our current mortgage market. I read with much interest last week the observations of Senator Menendez regarding a federal fix to combat predatory lending. There is much appeal to the Senator's suggested approach of a uniform national standard for predatory lending; a continuing concern, however, is enforcing such a standard against largely unregulated or lightly regulated mortgage brokers and bankers. In addition, as I noted several weeks ago before the House Financial Institutions Subcommittee, it is critical not to assume that all subprime lending is predatory.

There are a number of options available for addressing existing subprime loan issues and the predatory lending aspects of some subprime loan products. In considering options to curb predatory lending, the issue always comes down to enforceability. Similarly, workouts of troubled subprime loans first require buy-in with respect to the role of mortgage bankers, servicers and investors in connection with foreclosure avoidance. How can we make this happen and, more importantly, how much should we really be doing – or not doing – to assist or avoid interfering in this process?

Clearly, some of the numbers regarding existing problems in the subprime and Alt-A markets are daunting. By some estimates, more than 20 percent of the $567 billion of subprime hybrid mortgages that are scheduled to reset this year will involve a serious delinquency that could lead to foreclosure. There have been many high level meetings the past several months among regulators, industry participants, legislators and administration officials about how to address this problem and the potential fallout on the mortgage markets. Generally, the consistent theme that has come out of all of these discussions is that a foreclosure is in no one's interest. Rather, all agree that we collectively need to identify solutions and ways to avoid foreclosing whenever possible on borrowers who are struggling to stay in their homes.

I am committed to working with our regulated institutions to provide the supervisory flexibility and regulatory encouragement to address problems that were created by a breakdown in the proper underwriting of numerous mortgage loan products in the subprime market. However, as I and my colleagues at the other federal banking agencies have noted, the bulk of the problem lies outside insured depository institutions. This relates to my earlier observations – while federal standards and guidelines may be helpful, we need a way to ensure that the net we cast is inclusive of all participants in the mortgage process.

In this regard, the intersection of preserving sound subprime lending and shutting down predatory lending abuses in the subprime markets is particularly troubling. It goes to the very heart of affordable housing. We need to weed out predatory lending, and particularly the potentially predatory features of certain lending products in the subprime market, without shutting down the availability of credit to subprime borrowers.

In addition, what can and should we be doing to address the problem of key participants in the mortgage process escaping accountability? One obvious solution is imposing regulation where it is needed; but it is equally important not to interfere where market solutions can be more effective and efficient – and impose less regulatory burdens that run counter to the efficient allocation of credit in the housing markets. Again, too much government can create inefficiencies that run counter to the best interests of the mortgage market, including the subprime market. It can also shut down credit and make matters worse all around. We have witnessed this phenomenon several times within the last several decades.

As you aware, the federal banking agencies issued proposed guidance on subprime lending on March 8 of this year, and the comment period for that proposal closes in a few days, on May 7. I encourage you to share your thoughts with us on the proposal, particularly with respect to your views on the appropriate underwriting standards that should apply in the subprime markets.

I am also interested on your views regarding the application of similar subprime lending standards to state-licensed mortgage brokers and other state-regulated and/or unregulated mortgage bankers and lenders. Of particular note on this latter point, it is estimated that between 70 to 80 percent of subprime loans are originated through mortgage brokers. Thus, oversight of this segment of the mortgage pipeline is critical to the success of preserving and promoting sound subprime underwriting and lending activities.

Unfortunately, there are wide variations in estimating the number of licensed mortgage brokers in the U.S. Of the estimates available, often the numbers do not include individuals who work as loan originators for and/or under the direction of a licensed mortgage broker; nor do the numbers identify mortgage brokers operating without any type of license or registration. In addition, while mortgage brokers are typically required to obtain a state license, in many cases there are no testing or education requirements that are part of that process. Complicating the picture is that background checks may be run only against a state's own criminal database, but not against the FBI's national criminal database.

The scope of regulation, oversight, and supervision of mortgage bankers and lenders in various states is also uncertain. While some states license mortgage brokers with respect to the activities involved in originating a loan, the entity that funds the loan, i.e., a mortgage banker or lender, may not be regulated. Underscoring the importance of this oversight is the fact that two states that do not regulate mortgage bankers also happen to have the highest delinquency rates for subprime hybrid ARMs, with delinquency figures substantially above the national average. New Jersey is not one of these states.

I understand that the Conference of State Banking Supervisors (CSBS) and the American Association of Residential Mortgage Regulators (AARMR) are currently coordinating on a nationwide residential mortgage licensing program to address part of the problem with state mortgage brokers and bankers. We have been advised that the initiative will create uniform national mortgage broker and lender licensing applications and a centralized database to house relevant information regarding mortgage brokers and lenders. We applaud this initiative and encourage all States to participate in the CSBS/AARMR program. It is critical to the success of addressing the problem that arises when bad actors move from state to state with no accountability for their prior predatory and abusive lending tactics and activities.

Again, however, this is only part of what is required to address the existing problem with the activities of state regulated mortgage brokers and lenders. More rigorous oversight and enforcement of the mortgage origination process may be the best prescription for addressing predatory lending abuses and poor underwriting practices that have created problems in the subprime market.

The OTS will continue to be an active participant in many aspects of subprime mortgage market issues as they unfold over the next several months. For example, we are currently considering a more prominent role in directly assisting borrowers in addressing potential foreclosure problems. We are also partnering with community groups and industry participants on a host of housing-related issues involving affordable housing and addressing predatory lending. We will also continue to explore the appropriate use of various industry, community and regulatory forums to increase awareness and discuss solutions for the subprime market and address predatory lending abuses.

Conclusion

Thank you for the opportunity to speak with you, the New Jersey League of Community Bankers, today in beautiful Scottsdale, Arizona. I want you to know that my door is always open to you if you have a question or there is something that the OTS can do to assist you. We will do our best to provide you with prompt and responsive feedback to your inquiries. I will be happy to answer any of your questions this morning as time permits.