Remarks by
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I am really pleased to be here today – and really pleased not to be shuttling back and forth to the Treasury Department, which I've been doing a lot these last several weeks. Needless to say, the events of the last month have been both momentous and pressure-packed, and made more so since they came on the heels of the most stressful year in financial markets since the Great Depression.

Among other things today, I'd like to share with you some of my observations about these events. With that and everything that's going on, I have a lot to talk about, so please bear with me as I plan to take a little longer today with my prepared remarks than I normally do.

When I look back at all that's happened since last August, I'm struck by the sheer number of severe credit and market stress points – any one of these could have been the most serious financial problem of the year in the much quieter period before 2007. Not that you need to be reminded, but just naming the worst of them that occurred before Labor Day of this year is both telling and exhausting:

- the first nationwide annual decline in house prices;
- severe losses on subprime loans;
- record levels of foreclosures;
- the liquidity freeze for asset-backed commercial paper and SIVs;
- the shockingly large write-downs of concentrated positions in super senior tranches of collateralized debt obligations;

- sharply reduced liquidity in interbank funding markets;
- the sudden inability to sell mortgages to anyone other than the GSEs;
- the decline and fall of the nation's largest mortgage lender, Countrywide;
- the teetering of the monolines;
- the Bear Stearns run followed by its Fed-assisted takeover;
- the unprecedented opening of the discount window to investment banks;
- the most bank failures since the late 1980s;
- the FDIC takeover of IndyMac and the scary pictures of depositor lines;
- the huge stuck pipeline of leveraged loans;
- the implosion of the auction rate securities markets;
- the freefall in stock prices at distressed regional banks;
- and, more generally, the significant decline in credit quality of a broad range of assets, especially on the consumer side.

While all of these major financial events occurred in just one year, they almost pale by comparison to the even more seismic events of just the last month:

- the government takeovers of Fannie Mae and Freddie Mac;
- the elimination of the independent, less regulated investment banking industry with the failure of Lehman Brothers, the sale of Merrill Lynch to Bank of America, and the conversion of Morgan Stanley and Goldman Sachs to regulated bank holding companies;
- the government takeover of the nation's largest insurance company, AIG;
- the largest depository institution failure in U.S. history, with WAMU;

- Citigroup’s temporary government-assisted takeover of Wachovia, the nation’s fourth largest bank, that was superseded by Wells Fargo’s unassisted takeover;
- the government guarantee of money market funds;
- Congressional enactment of legislation to establish at the Treasury Department the Troubled Asset Relief Program, or TARP, to provide a $700 billion systemic response to the fundamental problem of illiquid financial assets;
- the unprecedented decision by the Federal Reserve to purchase and support commercial paper issued by nonbanks;
- the sudden, steep, and scary decline in equity markets combined with the near- total freeze of credit markets worldwide;
- the actions by governments around the world to make large investments in weak large banks and to make various kinds of government guarantees of bank liabilities; and
- finally, the dramatic announcement last week by the President of the decision by the U.S. government to invest $250 billion of the TARP money in the stock of banks and thrifts – beginning with infusions totaling $150 billion into the nine largest – coupled with a government guarantee of bank debt and bank transaction accounts.

By any measure, the scale and speed of these events have been stunning, mind-boggling, earth shaking, eye-popping – you pick the adjective, but to be honest, even these words of hyperbole don’t adequately capture what’s happened. Let me now provide a few observations on this 100-year flood, as our Chief National Bank Examiner likes to call it.

Our Contributions and Resilient National Banking System

First, I want to reiterate the all employee message that I sent out a couple of weeks ago: the OCC has been deeply involved in many of these events, and we all should be very proud of our many contributions. When I wrote that message, it was before all the work we did recently and continue to do on Treasury's new capital investment program and the FDIC's new guarantee. Tim Long and Kevin Bailey have been spearheading that effort, with important legal support from Julie and her legal team, and the Treasury Department has come to rely and depend on our strong contributions. They have been very appreciative of our efforts, and with good reason – they have been excellent.

Second, given all the body blows, the national banking system thus far has proved remarkably resilient. Yes, there have been scary moments; yes, profits and capital have really suffered; and yes, five national banks have failed to date, the most since 1993. But five is not a large number in relative terms, and the size of these banks has been relatively small. Meanwhile, larger banks in distress have aggressively raised capital to shore up their balance sheets, attracting well over $100 billion. As a result, virtually all national banks continue to satisfy the definition of "well capitalized," and banks of all sizes have rapidly increased loan loss reserves to address the spike in troubled loans – in some cases to unprecedented levels.

Moreover, as I've said before, national banks have been more a part of the solution and less a part of the problem in the events I mentioned above. With no cost to the FDIC, and no assets passing into government hands, national banks have acquired the nation's largest mortgage lender, the nation's largest failed depository institution, two of the nation's largest investment banks, and the nation's fourth largest bank. And through it all – which people sometimes forget – national banks have continued their fundamental job of making loans, although admittedly at a slower pace in the last two quarters. We should not lose sight of these very tangible positive signs despite the steady drumbeat of negative news. Moreover, I firmly believe that one of the main reasons that national banks have fared better than nonbanks is that they're regulated, and regulated better, than these other institutions. Let's not forget that either.

Anticipation of Problems

Third, despite the unprecedented nature of these events, I am pleased with the way in which we anticipated many of them before they occurred – and dealt with them once they arrived. In terms of anticipation, we sounded early public warnings in guidance and speeches about risk layering, payment shock, and declining underwriting standards for nontraditional mortgages and home equity lending – and we took these steps based on early feedback from many of you about problems you were seeing in the field.

Our higher standards for subprime mortgage underwriting caused most banking organizations to avoid originating these loans in national banks – which comprised less than 10 percent of the total in 2006 – and the ones that were originated there generally were of higher quality than those originated elsewhere.

For commercial real estate concentrations in community banks, we conducted rigorous horizontal reviews across the country starting in 2004; we pushed hard for the CRE guidance subsequently issued in 2006, over industry opposition; and we delivered our messages again and again in speeches, outreach meetings, and examinations all over the country.

Our annual underwriting surveys repeatedly spotlighted the trend of declining underwriting standards, and we particularly flagged that decline with respect to leveraged loans. We also recognized early on that community bank failures would accelerate in 2008; we talked about that publicly; and we planned for it.

In terms of dealing with the problems as they arrived, I am really proud of how all of you have stepped up to each unfolding event with speed, maximum effort, and teamwork. I know you have been both stretched and stressed, and the unrelenting nature of crisis upon crisis has been particularly wearing. But the fact is, we needed your best, and you have delivered.

Our market disruption procedures kicked into gear and have produced timely and critical information from institutions all over the country. Some of the market problems were new and complex – like those raised by CDOs, SIVs, and ABCP conduits – and our specialists, economists, and policy experts have repeatedly dissected them and provided me and others at the agency with cogent briefings and analysis.

Distressed institutions – large and small – have demanded far more attention and supervision than normal, and at times, tensions have run high. These situations require balanced, professional judgment, and I know from my own direct experience that that's exactly what you've brought to these matters. It's no accident that banks have gotten more realistic about recognizing delinquency and loss; raised a lot of capital when they could; aggressively built loan loss reserves; and agreed to tangible actions that would fundamentally improve their risk management. You have been there providing some very professional "nudging" – and at times more than nudging – to get them to take these sometimes painful steps to improve their safety and soundness. While that's your job, and that's what we expect, it has not always been easy.

I have also been very impressed by some of the new data gathering efforts that the agency has developed to help address the recent problems. For example, you've heard about our mortgage metrics, an unprecedented effort accomplished in record time to gather key, standardized, validated loan level data on over 40 percent of the mortgages serviced in the United States. We now know a lot more than we once did about trends in delinquency, modification, and foreclosure with respect to prime, subprime, and Alt-A mortgages, and we've begun to use that data in a variety of ways to support our supervision. We've also begun to develop similar metrics for home equity, and are planning to do the same with credit card lending and syndicated loans. We think that this data, too, will prove very important to our supervision over time.

Lessons Learned

Now here's my fourth observation about the last year: there were some problems we clearly didn't anticipate, and we need to learn some lessons and make some improvements going forward. I read a very good article recently about a report issued by the U.S. Army that dispassionately analyzed the invasion of Iraq to learn lessons about what it did right and what it did wrong; even the Army's critics applauded the candid self-analysis. Apparently, the Army has a long history of taking cold hard looks at each of its significant engagements. That strikes me as healthy for any organization, including ours.

So what are some of the lessons I think we need to learn from the last year? At the top of my list is liquidity. Both the industry and the regulatory community were surprised by the magnitude of the liquidity strains that resulted from the credit market disruptions. It started, of course, with the inability to sell mortgages or interests in funding vehicles invested in mortgages. But it spread quickly to the leveraged lending market and certain other securitization markets; to interbank lending; to secured lending to investment banks; and, particularly in the wake of the IndyMac failure, to uninsured deposit funding. A number of banks were not as prepared to deal with these liquidity strains as they should have been, thinking that their access to funding, even in times of stress, would be much better than it turned out to be. I think the regulatory community had that same misimpression, and a number of us have concluded that our liquidity metrics were not sufficiently robust. In the wake of all this, the Basel Committee issued a very thoughtful proposed paper on liquidity risk management, and we have spent a considerable amount of time developing a better template for gathering data to measure liquidity risk. At the same time, we have been working with banks all over the country to improve their liquidity positions in light of the ongoing strains. All of these liquidity-oriented efforts are worthwhile, and we hope they will produce real improvement over time. We have some breathing room now with the FDIC's temporary guarantee program, and we should take advantage of this period to improve our liquidity supervision.

A second lesson learned, this one for the very largest banks, was in the area of risk management for complex financial instruments. CDOs backed by subprime mortgages were the prime example. There, the triple A ratings for super-senior tranches lulled banks and their regulators into a false sense of security, notwithstanding the inherent risk of the underlying collateral. Some of the exposure was masked in off-balance sheet vehicles in ways that clouded the full extent of exposure for senior management, the Board of Directors, and us. Indeed, some senior bank management thought they had avoided subprime risk by deliberately choosing to avoid originating such loans in the bank – only to find out after the fact that their investment banks had purchased subprime loans elsewhere to structure them into CDOs. Compounding the problem, some banks that structured the CDOs for sale to third parties wound up holding large positions that no one wanted to buy, which the banks agreed to do because their triple A character supposedly made them so "safe." That resulted in huge concentrations, which in turn led to huge losses. The lessons to be learned from all this regarding complex instruments: too much reliance on triple A ratings; not enough transparency and risk aggregation; and too much tolerance for concentrations.

Risk concentrations in commercial real estate are another area that we need to examine closely. As I said before, I think that we and the banks we supervise did a tremendous amount to anticipate and address potential issues well ahead of problems occurring, and we have been especially proactive in squarely addressing these problems as they have emerged – all very sound actions that I strongly support. But I have also been troubled in looking at the banks that have failed thus far – both national and state banks – by some toxic combinations of real estate concentrations, rapid growth, extremely high levels of brokered deposits, and out-of-area lending. In the future, I think we will need to do more to hold these combinations in check before they cause unmanageable problems.

I would also add, however, that a concentration in one asset class can be so large that even the best risk management will fall short when an economic storm focuses on that same asset class. While the jury is very much still out, and the subject is controversial, regulators and policymakers in the future may very well need to revisit the issue of appropriate levels of concentration.

A Long Way From Over, and Still Much to Do

Now let me turn to my final observation about the credit and market crisis, which, I'm sorry to say, is this: it's a long way from over. While the recent dramatic actions have seemed to have some stabilizing effect on markets, the future is far from clear, and we all remain very concerned about declining credit quality. While deterioration continues to be most pronounced in housing-related credit – from mortgages, to home equity, to construction and development loans – the decline has spread to other asset classes, especially on the consumer side. Most signs point towards a more significant economic slowdown. At least in the near term, all of this is likely to mean more credit losses; more provisions to loan loss reserves; squeezed profits; strains on capital; and in some cases, more bank failures.

Facing all of this, I think it's critical that we continue to strive for the kind of balanced professional judgment that you've shown thus far. We have to be careful to be forthright in addressing problems as we see them, and leaning on bank management to do exactly the same. But we have to be equally careful not to overreact and make problems worse by acting too precipitously or being more stringent than we need to be. Striking that professional balance will not always be an easy task, I recognize, but that comes with the territory, as I know you know.

Compounding your challenge is the simple fact that, if you do your job right, we almost certainly will be criticized as being either too tough or too weak. That's only natural when dealing with stressful problems that require painful solutions; the people hurt most are most likely to complain. My advice to you in these circumstances is to stay on an even keel, do what you think is right, and develop a very thick skin.

That's just what I will be trying to do, because part of my job is to address these criticisms when they get leveled at the agency, in both public and private. In fact, we've already seen some of that in connection with the recent increase in bank failures caused by problem commercial real estate assets. On the one hand, some bankers and others have claimed that we're pushing too hard on delinquency and loan loss recognition, which risks choking off credit to creditworthy borrowers. On the other, some have argued that we haven't acted quickly enough to close banks that ultimately failed, with the result that costs to the deposit insurance fund have needlessly increased. (And as an aside, before responding to each assertion, the fact that we're getting criticized from both directions may just mean that we've struck the right balance in doing our job.)

On the first point, I've already given several speeches and you have already received detailed guidance aimed at producing realistic, fair, and consistent loss recognition, taking into account the different circumstances and different markets applicable to each individual bank. I won't repeat that here except to say that I believe our policies, implementation, and messaging have been appropriate and fair, and that we will continue to refine what we do based on the questions we continue to receive as new situations arise. In addition, my door is always open to listen to constructive criticism and take corrective action as warranted, and the same is true for our Ombudsman, Larry Hattix. Thus far, however, I have not seen the kind of specific evidence that leads me to believe that any significant changes are required; I think what we're doing is right.

On the second point, I think it's just wrong to say that <u>any</u> bank that fails and costs the deposit insurance fund money could have been closed sooner at less cost. I think it's also wrong to suggest that any bank that fails means that supervisors didn't do their jobs. While either assertion <u>could</u> be true with respect to a specific bank, it is just as possible – and frankly, more likely – that neither is true with respect to a particular failure. The fact is, banks take risks when they make loans, as they should, and sometimes they fail because the risks prove larger than they reasonably anticipated; or the local economy suffers severe stress that devastates businesses to which the banks lend; or extraordinary events like the ones we've seen in the last year put strains on banks that just couldn't be reasonably anticipated.

When banks like these suffer large losses, examiners have to make hard judgment calls about viability. Should the bank be closed immediately with a certain loss to the deposit insurance fund, and with the burden that a closure can impose on bank customers and others? Or does it have a reasonable prospect of raising capital or being sold, thereby avoiding those costs?

The latter option, of course, takes time. Sometimes that time produces a positive result that avoids failure and loss altogether, and sometimes it doesn't. But even when it doesn't, it's not at all clear that the ultimate loss is greater than it would have been had the bank been closed earlier. In fact, that shouldn't be the case if the bank is tightly regulated during the process to avoid excessive risk-taking, which is exactly what we do with a bank in these circumstances.

The bottom line is this: bank closing is an art, not a science; sometimes it's better to do it fast, and sometimes it's much better to take the time, in controlled circumstances, to try to find a less costly solution. Our most seasoned examiners make these kinds of viability determinations, working closely with the FDIC, and we think this is by far the best approach to least cost resolution.

Other Important Priorities

Now, I realize I've spent a lot of time today talking about the current crisis and safety and soundness supervision challenges – to be honest, given all that's happened, how could I not? But that doesn't mean for one minute that I or you should lose sight of all the other important priorities we face in the coming year. I'm sure we'll discuss these priorities in more detail in the Q&A and the Executive Committee panel discussion, but let me just mention a few here briefly before I close.

First, let me reiterate and reemphasize that, even as we focus as we should on safety and soundness, we simply cannot afford to ignore our important compliance and community development responsibilities, from BSA, to fair lending, to unfair and deceptive practices, to CRA. Yes, safety and soundness risks have come to the fore, and we need to recognize that, but there are also important compliance risks that we will continue to need to address. I emphasized this point when I gave a fair lending speech in New Orleans in September, in the middle of the market turmoil, and I'm glad I did – it's important to remind everyone – including the banks we supervise – that we simply will not set aside our compliance responsibilities.

Second, we all need to recognize that Basel II remains an agency priority. I've been asked whether recent market events mean that Basel II will be radically changed or not implemented at all. The answer is no. One of our "core banks" began parallel run implementation at the beginning of this month, and we expect most others to follow suit next year. That means we have a lot of implementation work to do, which we've been doing, and we need to stay very focused on that work in the months ahead.

Third, in answer to a number of your questions, I do expect there to be a push next year in Congress for regulatory restructuring. I will strongly advocate the need for a dedicated banking supervisor that has no other responsibilities, and the importance of a national banking charter that operates under one set of rules regardless of where the bank is located. I believe that message will resonate.

Last, and definitely not least, let me talk about the lifeblood of our agency: our people. Ensuring that the OCC has the staff it needs, with the right tools and skills, in the right places, to meet its rapidly expanding supervision mission, has been one of my primary concerns since arriving at the OCC. We've made a great deal of progress, but we need to do more. As managers, it's your responsibility at the ground level to hire, develop, and retain our workforce in the face of the enormous demographic challenges we face. To be honest, you have the most impact on individual employees through your ability to convey what a great place the OCC is to build a career, and I urge each and every one of you to take that responsibility very seriously every day. And while I'm at it, let me also put in a plug for the Specialty Skills program: we've done a tremendous amount of work to get this effort launched, and now we're in the all-important implementation phase when it is critical to the agency's future to get that implementation right.

Conclusion

I know I have gone on far too long, so let me conclude. I have been really proud of your hard work and dedication in meeting the extraordinary challenges of the last year. When I think about what that means for you in the coming year, I'm reminded of that old joke about the pie eating contest where first prize is . . . more pie! Many of you will continue to be at the epicenter of critical issues as we look over the horizon. You will be asked to do more heavy lifting; you will have more demands and more challenges; and you will feel more stress. But I also believe you will be stretched in the good sense, with really interesting work that will teach you more about your work in a short period than you would otherwise learn over a period of years. I urge you to make the most of it, both for your own sake and because we're counting on you.

One of my great comforts in serving as Comptroller is knowing that I can rely on such a strong corps of talented, dedicated people who are doing all they can to help ensure the safety, soundness, and compliance of our national banks. I am truly grateful, and my parting message to you once again is this: <u>don't</u> <u>let</u> <u>up</u>.

Thank you very much.