

*REMARKS OF JOHN M. REICH, DIRECTOR  
OFFICE OF THRIFT SUPERVISION  
TO AMERICA'S COMMUNITY BANKERS GOVERNMENT AFFAIRS CONFERENCE  
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Good morning. This marks my second formal appearance as Director of the Office of Thrift Supervision (OTS) before America's Community Bankers (ACB). I am pleased to be here today at ACB's Government Affairs Conference to discuss some issues currently pending in Washington that I think are important to everyone in this room.

ACB is a strong and dynamic organization that has carried the voice of America's community bankers to Capitol Hill, the Administration, the federal banking agencies, and to other policymakers both inside and outside the beltway. Most importantly to OTS, ACB has been a solid partner supporting our efforts effectively to supervise and oversee the institutions and holding companies we regulate while also ensuring that we maintain the proper focus and perspective in carrying out our statutory duties and responsibilities. This is a delicate balance that ACB has admirably preserved in its efforts on behalf of America's community bankers.

Diane Casey-Landry and her staff serve you well. Diane is an effective leader and a worthy advocate for America's community bankers. Most recently, Diane, Bob Davis and the ACB staff have taken a prominent and visible role on an issue near and dear to my heart - regulatory burden relief, which I will discuss with you today.

I have also enjoyed my conversations with your Chairman, Weller Meyer. Weller is a man I can identify with—a community banker fed up with the accumulated weight of regulatory burden who is willing to do something about it. There are plenty of people who “talk the talk” in Washington, but Weller is also “walking the walk.” At a regulatory burden relief hearing before the Senate Banking Committee two weeks ago, Weller told me that regulatory burden relief is his personal mission and a top legislative priority for ACB and he then testified to that before the Committee. That is the kind of commitment needed to push regulatory burden relief through the Congress, and I applaud Weller for his dedication, enthusiasm and, most importantly, his follow-through.

As many of you know, regulatory burden relief is a subject near and dear to my heart. It is an issue that imposes tremendous burden on community banks and, as such, raises legitimate oversight concerns for community bank regulators. Both as a regulator and as a former community banker, I am concerned that the accumulated weight of regulatory burden threatens the competitiveness of the banking industry and falls particularly hard on community banks. This is not idle speculation – it is a fact.

Two weeks ago, I testified before the Senate Banking Committee that accumulated regulatory burden is suffocating the banking industry despite the fact that the industry seems to be doing so well. While regulatory burden impacts all institutions, I believe it has a significantly greater competitive impact on community banks and savings institutions.

There is considerable anecdotal evidence supporting the notion that regulatory burden is at the top of the list of reasons why these institutions sell out. Investment bankers at recent M&A conferences confirm this fact.

To those who say let market forces determine the future of community banking, my response is that our industry is not a free market. It is a highly regulated market and this fact is having great influence on the bottom line and market behavior of many community banks. Regulatory forces that unduly impact industry competitiveness are not good for institutions of any size when they skew market forces; and that is what we are faced with today.

I am deeply concerned that community banks will continue to disappear from our landscape, with local communities and consumers across the country being the ultimate losers. When community banks are absorbed by larger non-local competitors, I've seen firsthand what usually results. The absorbed banks lose their personal touch and their communities lose the leadership previously provided by senior bank officers and their directors who are business owners with vested interests in their communities. I will also tell you that I am concerned about the future of community institutions led by the current generation of community bank CEO's approaching retirement. What is the exit plan? Is it to remain independent and to pass the gavel along to a successor, thereby retaining the unique quality of your institution? Or is it to merge with, or sell out to, another institution?

The loss of these community human resources not only impacts local banking relationships with small businesses and individuals, it reduces human resources available for leadership of community service organizations on which senior bank officers and their directors serve. There is an unquantified social cost to industry consolidation that is attributable to the weight of accumulated regulatory burden. This is a growing problem in communities across the country, with implications that are largely ignored by policymakers.

Ten years ago, Congress enacted EGRPRA, which required the federal regulators to review all of their regulations in an effort to reduce regulatory burden on the industry. We have taken this mandate seriously and are approaching the conclusion of our effort in the next few months. I fear all of this work may be for naught if a regulatory relief bill is not enacted this year. And there has been a lot of work done!

When this project began in June of 2003, we began to increase awareness of the burden issues facing both large and small banks. We worked with the other banking agencies to publish more than 125 regulations for comment, and received more than 1,000 comment letters with suggestions for change. We held 16 banker and consumer group outreach sessions around the country, have given numerous speeches, offered Congressional testimony on the subject to both houses of Congress and, like your staff in Washington, we have met with many Members of Congress to discuss the importance of this issue.

In addition to building awareness in the marketplace and in Congress, we have worked to reduce burden where we can; that is, where we already have the authority to act.

Along with the other federal banking agencies, we have increased the small bank threshold under the CRA from \$250 million to \$1 billion, simplified application and reporting requirements, streamlined examination processes, and made other changes to our regulations and internal procedures to reduce burden. It will probably surprise you to hear that almost every new regulation, process, or procedure today includes a discussion among the FFIEC principals about burden and how to accomplish the objectives while minimizing the regulatory burden on the industry.

Now we must ensure that our recommendations lead to fruition with the passage of a significant bill in the Congress. There are skeptics - even with some people within the industry in Washington, DC who have the greatest ability and influence to get a regulatory relief bill enacted. But the House recently passed H.R. 3505, a comprehensive regulatory relief bill, by an overwhelming vote of 415 to 2. And the Senate Banking Committee is poised to take up a similar bill very soon. Thus, regulatory burden relief is very much in play.

This is the best opportunity in years to enact meaningful, balanced, regulatory burden reduction legislation. The list of recommendations before Congress is sensible, balanced, and will help address the problem of accumulated regulatory burden in this country. I believe we have a limited window of opportunity this year to move forward on regulatory relief legislation. There is much greater visibility and recognition of the problem now than in the past. Again, it is my hope that you will work with your representatives in Congress to respond positively with a solution to this significant problem before too many more of our community banks disappear from the landscape.

I will talk more about the importance of regulatory burden relief to the institutions we regulate in a few minutes, but I would like to take a few moments now to share with you some observations about my first six months at OTS.

When I came over to the OTS from the Federal Deposit Insurance Corporation (FDIC) last August, I wasn't sure what to expect. After a little more than six months on the job, I have learned much about OTS and its staff, and I have also learned a lot about you, the industry, and in many cases, the individual institutions, we regulate. I come to you with the impression that OTS and the charter we administer have unique and inherent strengths I have not fully appreciated heretofore.

OTS operates today with a minimum of overhead. A skilled staff with tremendous experience in nearly every sector of modern banking enables our agency to adapt quickly to market demands. And we are continually striving to improve our staff. This year, we will hire 60 new examiners, bolstering our exam staff by 11.5 percent. We are also boosting training and hiring in certain critical areas, including capital markets, economic analysis, and compliance management. And we are re-establishing at our Washington headquarters a centralized direction for Compliance, Community Reinvestment Act (CRA) and Consumer Protection – a function delegated to the regions in recent years, but one that I feel needs central policy direction and coordination from Washington, DC.

OTS oversees 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. A few weeks ago, we reported that for 2005, assets for the segment of the industry we regulate were up 12.0 percent from the prior year to a record \$1.46 trillion. And in the past five years, industry assets grew 57.7 percent, representing a robust average annual five-year growth rate of 9.5 percent. By any measure, these are excellent numbers.

Earnings, too, were strong last year, and have been strong and steady for the last five years. For 2005, earnings were up 17.6 percent from 2004, and industry earnings more than doubled the last five years, climbing from \$8.0 billion in 2000 to a record \$16.4 billion in 2005.

As the retail community banking sector grows, I believe our 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. Well-established and well-recognized powers of branching and preemption ensure 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. And OTS’s seamless supervision at all levels of an organization – at the bank level as well as at savings and loan holding companies – ensures a comprehensive supervisory regime with minimal regulatory overlap.

The charter we oversee is deployed in neighborhood community banks all across America. It is also 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 savings institution charter at different times and for reasons as diverse as their underlying businesses and the markets they serve. And the facts bear out that it has been a profitable decision.

As you know, the charter has adapted remarkably well to today’s financial services marketplace. But there is always room for improvement, particularly to address historical constraints that no longer serve a useful purpose or, more importantly, that frustrate legitimate business activities and operations of the charter as it and the marketplace have evolved. This is what a number of the items on the list of pending regulatory burden proposals are about. And the federal savings institution charter is among the greatest beneficiaries of regulatory relief under the proposals currently being considered by Congress.

But what will happen if nothing happens this year? After all, in the eyes of some, this is only regulatory burden—does it really matter that much? And how important is it in the big scheme of things? Let’s talk about this thought for a few minutes—specifically, what happens to OTS-regulated community savings institutions without regulatory relief legislation?

First and most obvious, savings associations will continue to operate under a duplicative set of regulations and oversight with respect to their investment advisor and broker-dealer activities that bank competitors are not subject to. Moreover, this additional layer of regulation and review by the Securities and Exchange Commission (SEC) yields no additional supervisory or consumer benefit since the activities are already subject to supervision by the banking agencies that is more rigorous than that imposed by the SEC.

Failing to enact regulatory relief legislation will also miss an opportunity to update statutory limits on the ability of federal savings associations to make small business and other commercial loans. We are aware of a number of institutions that are currently constrained or bumping up against the statutory 20 percent of assets commercial/small business lending limit, as well as the 10 percent of assets sub-limit on commercial (other than small business) lending imposed on federal savings associations.

Legislation removing the current limit on small business lending and increasing the cap on other commercial lending will provide savings associations greater flexibility to promote safety and soundness through diversification; more opportunities to counter the cyclical nature of the mortgage market; and additional resources to manage their operations safely and soundly. But, again, these important benefits require legislation.

Another lost opportunity would be eliminating a statutory anomaly that subjects the consumer lending authority of federal savings associations to a 35 percent of assets limitation, but permits unlimited credit card lending. This exists even though both types of credit may be extended for the same purpose. Removing the 35 percent cap on consumer lending will permit savings associations to engage in secured consumer lending activities to the same extent as unsecured credit card lending. This makes sense for regulatory burden reduction and for reasons of safety and soundness. Absent regulatory relief, savings associations will continue to be able to make all of the same loans that they can currently make, except some savings associations may make loans that are unsecured because of the current statutory anomaly.

An issue that has garnered recent attention is the so-called “federal diversity jurisdiction” amendment. Currently, a federal savings association may sue or be sued in federal court if the claim exceeds \$75,000 and the parties are citizens of different states. Whether a case may be transferred to federal court based on the diversity of the parties, i.e., their different state citizenships, hinges on the determination of the citizenship of the federal savings association. Some courts have determined that if a savings association conducts a substantial amount of business in more than one state, it is not a citizen of any state and, therefore, may not sue or be sued in federal court under diversity jurisdiction.

Failing to enact regulatory relief legislation misses the opportunity to implement a uniform rule governing federal jurisdiction when a savings association is involved, thereby reducing confusion and uncertainty. Absent legislation, federal savings associations will not have the same access to the federal courts as national banks were accorded in the Supreme Court’s recent decision holding that a national bank is a citizen of only its home state.

There are a couple of additional popular issues that I want to mention that will remain unresolved for all insured institutions in the absence of regulatory relief legislation. First, all institutions struggle with the existing requirements of the Bank Secrecy Act (BSA). While this issue is at the top of every banker's list – and without a doubt BSA is problematic for larger institutions - the impact of BSA is often most acute for smaller, community-based institutions that do not have the resources and wherewithal to implement the type of cost-effective program required to address the monitoring of activities under the law. This, in turn, imposes greater competitive stresses on community banks relative to their larger competitors.

Absent regulatory relief legislation, a provision such as that proposed in H.R. 3505, the regulatory relief bill passed by the House last week, to provide relief for certain currency transaction reports (CTRs) will fall by the wayside.

Finally, also lost will be an opportunity to provide relief to institutions, as proposed in H.R. 3505, under the annual privacy notice requirements. While some suggest that a number of items such as this are marginal, I believe the contrary is true. In the aggregate, H.R. 3505 and a similar Senate bill provide a tremendous opportunity to reduce the cumulative effect of regulatory burden on all depository institutions, but particularly on community banks and, especially, OTS-regulated institutions. Absent regulatory burden relief, nothing will be gained, and much would be lost.

Before concluding there is one “housekeeping” issue that I want to highlight. I believe my Deputy Director and OTS Chief Operating Officer, Scott Polakoff, may have addressed this yesterday but I think that it is important to raise again. Ironically, this is a problem that is not helped by the prospects of regulatory burden relief legislation, but rather is an issue that may be created by it.

Within the last several months, OTS has been asked to opine on several occasions regarding a proposal to amend the statutory and regulatory requirements applicable to mutual holding companies (MHCs). In particular, a request was made to alter the corporate governance rules for these types of entities in order to permit the minority shareholders of a savings association to override the interests of a controlling, majority MHC shareholder.

The proposal we were asked to review would provide the minority shareholders in a MHC structure greater control over the underlying depository institution than a majority and controlling MHC. In our view, this is inconsistent with U.S. corporate governance standards, and would undermine the interests of the underlying institution's depositors. I believe that any proposal that overrides the controlling interest of a majority MHC shareholder in favor of the institution's minority shareholders is inconsistent with good corporate governance and prevailing U.S. rules related to the rights of minority shareholders vis-à-vis majority shareholders in public companies. More fundamentally, the proposal poses significant safety and soundness risks in the operation of MHCs, and also risks the retention and future use of the MHC structure. Accordingly, we oppose inclusion of this proposal in any legislation considered by the Congress.

I am quite aware that a substantial portion of the thrift industry wants to retain the mutual form of ownership. We do not favor one form of ownership over another. Conversion to the stock form of ownership has raised considerable capital for the industry. But it has also heightened our resolve that depositors get fair treatment in the conversion process and that management not be unduly enriched. The mutual form of ownership continues to play an important role in many communities as evidenced by the fact we still have approximately 340 mutual institutions under supervision, as well as approximately 80 OTS-regulated MHC structures in place

In conclusion, I encourage you to take advantage of your time in Washington this week not only to enjoy our beautiful weather, but also to get involved and have your voices heard in the regulatory burden relief effort. I have said many times that my twelve years working for Senator Connie Mack were tremendously enlightening in understanding how important it is for community banks to get involved in the political process. You are the best ones to do this.

Thank you for the opportunity to speak to you, today. Again, I am honored to be here and I look forward to a continued, strong relationship with ACB. I will be happy to answer your questions.

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