Remarks of John M. Reich, Director
Office of Thrift Supervision
to the Louisiana Bankers Association Annual Convention
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Good morning. Thank you for having me here today to speak at the 107th annual convention of the Louisiana Bankers Association. This is my sixth visit to New Orleans in the last year and a half, and it is still as moving to be here today as it was the first time I saw the devastating effects of Hurricane Katrina. Each time, though, I sense that New Orleans has come back a little more since my last visit. I think we all realize, however, that it is going to take a lot longer than any of us really thought to rebuild and restore New Orleans to some sense of its former self.

I particularly want to thank [insert name] for the invitation to join you this morning. And I also want to congratulate you on the fact that, in addition to 107 years as the Louisiana Bankers Association, you also just celebrated a couple months ago the 50th anniversary of your financial literacy foundation, the Louisiana Bankers Education Foundation. Clearly, the Louisiana Bankers were way ahead of their time on the critical issue of financial literacy.

In my remarks this morning, I want to touch briefly on a few topics. First, I want to talk to you about my continuing concerns with the future of community banking. Most of you are undoubtedly aware of my passion about community banking. You may have already heard me speak, or read of my comments about it. Yet, I feel that I cannot spend too much time on this important topic.

I also want to spend a few minutes on another topic about which I am passionate – the thrift charter. 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. Since joining the OTS in August 2005, I have come to appreciate the unique advantages of the thrift charter.

I also want to provide you with some thoughts on where we are with the current state of the subprime mortgage markets.

Finally, I will conclude today by addressing two very important aspects of the fallout from natural disasters. These issues – affordable housing and the availability of affordable home hazard insurance – are very familiar to Louisiana bankers and residents. Both are defining issues in post-Katrina Louisiana.

The Future of Community Banking

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 real cost to our communities from the loss of this important resource.

But why does community banking matter? Community banking 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 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. I also volunteered my time with the Boy Scouts, on a public hospital board, and at a local YMCA. I was also active in the United Way and coached Little League Baseball.

I know that many of you have very similar credentials. 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.

One of my top priorities as Director of the OTS is to preserve and promote community banking in America. While it has a national and statewide voice in organizations such as the Louisiana Bankers Association, community banking is an industry that is distinctly local.

Much has been written about community banks selling out to larger regional and national banking organizations that have little presence in local communities 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.

Mergers and acquisitions involving community banks are typically motivated by real market pressures, including regulatory burden and unfair competition that is squeezing community banks. Among the issues that we in Washington need to address is unfair competition for deposits and loans in local markets 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. The OTS is sensitive to these issues and is working to reduce unfair competition and regulatory burden on community banks.

Of course, you can do your part to protect and preserve community banking. In your own institution this includes providing 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 is rarely a desirable outcome for the communities and customers you now serve.

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. Since I joined the agency less than two years ago we have increased our overall staff by more than 15 percent. By September 30, 2007, we expect to have a professional staff of almost 1,000 people 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 priorities include 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 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.

Current Issues with Subprime Lending

I am certain that you are all aware of the existing issues with subprime lending in the mortgage markets. Clearly, problems in the subprime and Alt-A markets are considerable. 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 discussions 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 emerged from these discussions is that 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 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 institutions. While federal standards and guidelines may be helpful, we need a way to ensure that the net we cast includes all participants in the mortgage process.

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 cutting off the availability of credit to subprime borrowers.

We also need 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.

As you aware, the federal banking agencies issued proposed guidance on subprime lending. The comment period for that proposal closed a few days ago, on May 7. I hope you had an opportunity 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. If you have not done so, it is still not too late.

An area of particular interest to me is the application of subprime lending standards to state-licensed mortgage brokers and other state-regulated and/or unregulated mortgage bankers and lenders. It is estimated that 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. 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. 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. We are 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.

The Long-term Housing Economy Impact of Natural Disasters

When a hurricane or other natural disaster strikes, more often than not what we see on the news is the devastating impact on our homes. We are all familiar with these aftermath pictures and our heart reaches out to the families impacted by these devastating events. For those who have not lost loved ones, however, you often sense an undertone of “We all survived, it’s just brick and mortar – we can rebuild.” Katrina changed all that. No longer do we have the sense that no matter what Mother Nature sends our way we will somehow come through it if we pull together and rebuild.

Like it or not, some things are bigger than all of us acting together – at least in the context of the post-disaster timeframe that we are accustomed to. Yes, we can and will rebuild, but many are asking “Is it worth it? There are many reasons for this question. I want to talk about two in my remaining time this morning -- affordable housing and the availability of affordable homeowner's insurance.

Just yesterday, I spoke to another state banking group on the issue of homeowner's insurance. I noted that institutions in the Gulf Coast states are currently confronting what most agree is a very difficult insurance market. As a result of the many hurricanes and the significant damage these caused, adjustments in the offering and underwriting of homeowner's insurance have the potential to disrupt the lending business in Louisiana and other Gulf Coast states.

The issue of affordable homeowner's insurance includes a number of problems that manifest themselves in various ways. For instance, homeowners and business owners in coastal areas often cannot find affordable hazard and windstorm insurance. When they find affordable insurance coverage, they often find that the insurance is offered by lesser-rated or unrated companies, and that deductibles are high and coverage is reduced. When disasters hit, they also find that there may be questions as to whether damage was caused by wind or water, and hence whether they are covered or not covered under hazard and windstorm policies.

Financial institutions are concerned about the adequacy of insurance coverage of their residential and commercial loan customers' collateral properties. They also worry whether borrowers can afford heightened escrow payments to cover the cost of insurance, and they worry whether their customers can afford to rebuild given the immediate and potential long-term costs of doing so. Institutions also worry about having to force place insurance coverage for their customers who cannot afford insurance, or who rely on the institution to provide force placed coverage when they cannot find it themselves. Institutions sometimes even have to scramble to find insurance coverage on their own offices.

Coastal state insurance regulators are working hard to have affordable insurance coverage available in their states. State insurance regulators are encouraging well capitalized insurance companies to continue offering insurance in the states, but there are serious issues with exposure to coastal areas. Potential insurance payouts from a direct hit by a significant hurricane are further exacerbated by coastal property values that have mushroomed. Not only have the number of people moving to the coast skyrocketed, but the square footage of residences has ballooned, and the density of waterfront living has jumped due to the prevalence of multi-story condominiums. Reinsurance costs have also exploded since the 2004 and 2005 hurricanes that hit the southeast and gulf states. Some reinsurers stopped offering coverage in the most exposed states.

I know that the Louisiana Bankers Association has devoted a great deal of time and effort to these key insurance issues in the Louisiana legislature. You continue to work for available and affordable insurance for businesses and homeowners, and you stood with other state business leaders to support Governor Blanco last month in proposing a legislative package containing five key insurance proposals.

We are also aware that banking groups in other Gulf Coast states continue to offer advice and counsel to their state legislators and others as they deal with the daunting issues raised by the escalating cost, affordability and/or unavailability of hazard insurance coverage. We are monitoring our affected institutions, and attending meetings with insurance commissioners and other regulators on the subject. While a number of avenues are being explored, and remedies are being put into place or considered, there is still a lot of hope pinned on 2007 being like 2006, which was relatively free of major hurricanes. However, I think we all recognize that this is not a good approach.

While hazard insurance is a monumental issue, addressing the availability of affordable housing in a hurricane-devastated area such as post-Katrina is daunting. We are not talking about finding ways to create additional affordable housing in a hot housing market or one that is squeezing low- and moderate-income families to less desirable neighborhoods. What we are talking about is finding a place to live for people who have lost everything – their home, car, everything but the clothes on their back and, more often than not, their job. These are hard-working people who built a life in New Orleans or some other natural disaster devastated community and, suddenly, have nowhere to go and no job to support them.

Yes, affordable housing has a special significance here is Louisiana, where communities are still striving to figure out even whether to rebuild after the devastation of Katrina. The Louisiana Bankers Association, however, is helping New Orleaners to decide and to come back and rebuild. I would like to commend the Louisiana Bankers for the work you have done to educate your members about Louisiana's Road Home Program, which will disburse about $7 billion in federal community development block grant funds to Louisiana residents whose homes were damaged by Katrina and Hurricane Rita.

It is with this backdrop that I am announcing today that the OTS will be sponsoring our second national housing forum this fall, which will include these very important aspects of the economic housing fallout of natural disasters – future hazard insurance coverage and recovering and restoring affordable housing to disaster affected communities. I hope all of you will be able to attend or listen in to this important event.

Conclusion

Thank you for the opportunity to meet with you this morning. The Louisiana Bankers Association continues to be one of the premier banking advocacy voices in the U.S., at both the state and federal level. It is always a pleasure to be here. I am happy to answer your questions as time permits.