Remarks of John M. Reich, Director
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Good morning. It is a pleasure to be here in Japan and to speak before such a distinguished audience of bankers, regulators, and others interested in the financial services sector. This is my first visit to Japan and it is wonderful to meet you and see your country.

The theme of this conference is retail finance. That is appropriate, given that we have witnessed in recent years an era of unprecedented consumer lending growth around the world. Financial institutions are constantly seeking out new and innovative ways to attract individual customers and design products that meet their financial needs.

This growth in retail and consumer lending brings with it unparalleled opportunities for individuals to access the capital they need to improve their lives. By its very nature, taking out a consumer loan is an optimistic enterprise. It implies a sense of financial stability on the part of the borrower and a belief that their income levels will continue and enable them to pay off the balance over time. In times of turmoil, or when this confidence in the future falls, individuals are more reluctant to take on more debt and commit a share of their future earnings to paying it off.

But this sense of optimism on the part of lenders and borrowers alike can sometimes get out of sync with the economic cycle – or even out of sync with basic underwriting standards. This can lead to problems for all parties involved – the lenders, the borrowers, and the regulators tasked with looking after the overall health of the system and the protection of the consumer.

This is important to me as director of the Office of Thrift Supervision because our thrift charter is specifically designed to be an efficient and stable platform for retail and consumer lending. Our licensees have the ability to branch nationwide without many of the restrictions placed on other banking licenses in the U.S. It is our responsibility to continually balance promoting the growth of our institutions through responsible lending with the need to ensure the stability of the overall system and protect the customer from abusive practices.

Further, OTS is unique in the U.S. regulatory structure because we also supervise, on a consolidated basis, all those companies that own or control thrift institutions. This supervisory authority was given to us by Congress in statute and extends up to the top-tier holding company in the structure. While most of our thrifts themselves concentrate their lending solely on the domestic U.S. market, a number of our holding company enterprises are truly global in scope and geography – and provide financial services to customers in more than 100 countries around the world. The OTS-supervised holding company population has combined assets of more than $7.6 trillion and includes companies like General Electric, American Express, AIG, Ameriprise Financial, Merrill Lynch, Morgan Stanley and Lehman Brothers. These companies all own thrift institutions and are subject to consolidated supervision by OTS.

Given the global reach of our holding company population, we have found it in our interest to grow our understanding of the retail and consumer finance marketplace outside the United States. Because many OTS-supervised companies offer these products through regulated subsidiaries in local jurisdictions, we have worked hard in recent years to build strong relationships with our supervisory counterparts in key jurisdictions around the world. Gaining insight from these supervisors – and sharing back our consolidated view of the entire enterprise – has helped strengthen our understanding of the companies' overall operations and helped us gain an appreciation for the challenges faced by supervisors as more and more markets open up to these types of lending products.

We have learned that the strong retail lending trend that began in the United States and other developed economies over the past two decades is rapidly expanding to emerging markets the world over – and that many firms supervised by OTS are making important inroads in the effort to serve these new markets.

Let's take a moment and look at some trends for my own country, the United States. In the one-to-four family mortgage market, we've seen total loans outstanding more than double in the last 10 years. Credit card lending has kept pace, growing from $246 billion in outstanding balances in 1996 to $395 billion outstanding in 2005.[1] These figures have been the object of concern from some quarters – particularly as it relates to whether consumers are borrowing too much and not saving enough.

Regardless of where you come down on that particular issue, it remains a fact that this growth represents a corresponding increase in the array of financing choices available to consumers and the extent to which they are taking advantage of these choices.

The financial institutions making these loans benefit as well. We have seen our domestic thrift institutions grow their assets, in the aggregate, by more than half in the past five years from $978 billion in 2001 to more than $1.5 trillion in June of this year. Despite this growth, thrift institutions were able to post strong earnings and profitability, solid loan growth, healthy asset quality and robust capital levels despite concerns about a softening mortgage market in the United States and fears of a consumer spending slowdown.

This is not simply an American phenomenon or a 'developed economy' phenomenon. The developing world is seeing growth rates in the consumer and retail-lending sector that are substantial. What's more, the upside potential is truly staggering.

[1] OTS Research and Mortgage Bankers Association Data

Let's look at China and India, for example, since the emergence of these two countries is rapidly becoming the economic story of the decade.

Overall growth in consumer lending in China, for the period of 2001-2004 was 184%. Non-mortgage consumer lending growth during that same time frame was 259%.[2] Credit cards have done much to fuel this expansion. China has gone from a half-million credit cards outstanding in 1999 to an estimated 20 million outstanding today.[3] These cards account for about 4.6 percent of total consumer expenditure in China, compared to a global average of about 8.6 percent.[4] Given the overall economic growth and population trends in China, it would seem there is tremendous opportunity for further penetration in this market.

India's growth, while not as robust numbers-wise as China, is still astounding by any measure. Overall consumer lending grew by 159% between 2001 and 2004, with non-mortgage consumer lending – primarily automobile lending – growing by 128% during the same time period. Consumer loan growth as a percentage of GDP growth, however, was comparable to China at 453%.[5] Mortgage lending grew at a 40 percent annual rate between 1999 and 2004.[6]

As a basis for comparison, overall consumer lending in the U.S. grew 30% between 2001 and 2004 – reflecting high rates of penetration and a more mature marketplace.

This consumer-lending boom is not simply an India-China phenomenon, either. Other economies in the region are keeping pace, with respectable rates of growth posted in Indonesia, Australia and Thailand.

Predictions for the future are running strong, as well. A recent McKinsey study forecasts 25 percent annual growth between now and 2013 in China alone. This growth trend is significant, and there is clear evidence that foreign banking and financial services firms are anxious to enter these markets and serve this growing customer base. Citibank already has a developing branch network in India and a credit card partnership with Shangai Pudong Development Bank in China. GE Capital has partnered to issue cards with the State Bank of India, announced a $100 million investment in Shenzen Development Bank, and recently signed a credit card partnership with Wal-Mart and SBI in China.

The opportunities presented by this tremendous consumer lending market expansion, and the entry of large foreign financial operations into this space, are obvious. Consumers in these economies will have more choice and better prices for loans that were simply

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[2] Company data and Morgan Stanley Research (*Asia/Pacific Banks,* February 18, 2005)
[3] Euromonitor
[4] CLSA Research (June 2006 *Global Outlook*)
[5] Company data and Morgan Stanley Research (*Asia/Pacific Banks,* February 18, 2005)
[6] Federal Reserve Bank of San Francisco. "Retail Lending in India" October 2005

unavailable to them a decade ago. The firms – both the foreign entrants and their local partners – look forward to the profit potential.

Nonetheless, this development is accompanied by significnat challenges that bear mention along with all the good news about growth.

One such challenge is market access. Clearly supervisors in the emerging markets welcome the growth of a more mature credit culture and a better menu of financial services products for their citizens. But you see evidence of their desire to balance this by ensuring the growth is sustainable and that the local industry can compete with foreign entrants. Access and registration rules in these jurisdictions usually center around allowing foreign companies to partner with local firms up to certain prescribed levels, or to enter on their own through non-deposit taking financial institutions. This has the effect of slowing the market transition and ensuring the local banking market can keep pace with the innovations and capital coming in from abroad.

Another challenge is underwriting. Outside of the mortgage sphere, many of these loans are either unsecured or secured by rapidly depreciating assets like automobiles or motorcycles. To lend in this sphere it is imperative that the lenders have as much information as possible about the borrower's credit history and personal financial profile. These databases are commonplace in the more developed economies, but not so common in some of the emerging markets.

In some instances we've seen the development of rudimentary credit reporting structures, but many of these databases lack sufficient historical data to be effective in evaluating the risk in a given loan. This weakness in centralized reporting systems makes the lenders' own proprietary systems more important. These home-grown databases are usually developed gingerly and over time through a series of small loans to a borrower until the lenders can develop confidence in their credit profile properly assess the risk. Developing a thorough credit infrastructure will be a key challenge for emerging jurisdictions with rapidly growing consumer-lending markets.

A challenge for home country supervisors, like OTS, is ensuring our regulated firms' business in the emerging markets arena is well managed and well executed. We spend a lot of time getting comfortable with the their due diligence procedures on overseas acquisitions, for instance. We study their track record, noting their ability to handle the unique risks posed by entering rapidly growing markets with cultural norms and infrastructure challenges that are much different that their traditional markets in the U.S. and Europe.

While these challenges are significant and should not be minimized, they can be managed through rigorous control structures at the firms themselves – whether they are local institutions or foreign entrants. For supervisors, there is a need for us to better understand how global firms operate on a consolidated basis in order to keep pace with an industry that is deepening and widening its global presence with each passing year.

As our supervised firms have renewed their interest in the global retail marketplace over the past few years, we at OTS have built our own specialized program for supervising financial conglomerates.

Our program is designed to capture, through a thorough risk assessment and continuous examination process, the various risks present in these complex and diverse firms in order to properly form an educated view of the company's financial condition, its control structure, and its ability to execute its strategy. As we conduct our examinations, we follow a written supervisory plan that outlines our specific strategy and priorities for a given conglomerate. Even though we have examiners present in these companies full-time, we still must ensure our work is carefully focused on those areas that give us the best window possible into the company's condition, its executive team, and its risk management and control structure.

During the course of our work we conduct a series of targeted reviews – zeroing in on those areas we've identified as having the greatest risk. Whether it be of a particular business line or a particular business function, we present the findings to senior-level management on a quarterly basis. This allows ample opportunity for formal dialogue and feedback with key decision makers at the top. We coordinate every step of the way with regulators in the various jurisdictions – both domestically and internationally – where our firms do business in order to form a clear picture of the company's consolidated operations. Finally, we assign a rating and present a unified report of examination to the firms on an annual basis.

This program has brought more discipline and rigor to our supervision of companies that pursue complex business strategies that span the globe. It has allowed us to understand how the OTS-licensed banking organization fits into overall corporate operations. And it has provided us an opportunity to grow our understanding of key international markets and regulators.

As the firms we supervise, expand their international activities, the need for regulatory cooperation will grow with them. Supervisors around the world remain engaged in an ongoing dialogue through formal committees like the Basel Committee on Banking Supervision, and in numerous informal discussions related to specific firms and specific supervisory matters. This close cooperation at the regulatory level – combined with responsible and thorough governance at the firms themselves – will preserve profitability, help prevent systemic imbalances and ensure the growth in consumer finance will continue to improve lives and enhance standards of living around the world.

I am grateful for the opportunity to participate in our own international dialogue here today with such a distinguished audience. I appreciate your attention and for the opportunity to be with you.

Thank you.