

Remarks by
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I warmly welcome this opportunity to speak at your annual convention – and not just because it gets me out of icy Washington, D.C., to this warm and beautiful place. While in the past I've been with you via the wonders of modern technology, this is my first opportunity to experience a major ICBA event live and in person. And so far it's been great. I understand that Cam Fine and his ICBA staff bring together at this convention perhaps the most issues-sensitive, passionate assemblage of bankers imaginable. So I would like to take my cue from you and be passionate myself on several topics, most notably the importance of and challenges facing our nation's community banks.

I plan, too, to extend that passion to debunking a few myths about the national banking system. I've been Comptroller of the Currency for about 19 months now, and some of the misconceptions out there amaze me. I don't know if the industry is not listening to our message, or if the OCC has not done a particularly good job of communicating. In any event, I'm working on the latter, and I challenge this group to help me with the former.

For example, this is a perfect venue for me to reaffirm the OCC's commitment to a vibrant community banking sector of the national banking system. Community banking, as I have said to many of the bankers in this room in other meetings, is a linchpin of our national economic infrastructure. And oversight of community banks is a mainstay of the mission of the OCC.

I am, well, passionate on this point, because of one of those myths that I mentioned: the all-too-frequently-expressed view that the OCC is just a “big bank” regulator. Yes, we do indeed supervise most of the largest banks in the country, and we take great pride in that work – which by the way produces a wide variety of safety and soundness benefits that flow beyond those banks to the entire banking system. But let’s put that work in perspective. The OCC’s large bank group totals 22 institutions, and our mid-size group comprises another 21. That leaves over 1,700 community banks – more than 90 percent of all the banks we supervise – 800 of which have less than \$100 million in assets. That’s about 25 percent of all the commercial banks in this country, to which we devote two thirds of our entire examination staff. So let me speak plainly: we never lose sight of the importance of community banks to the mission of the OCC.

Some people seem to have the impression that the OCC emanates solely from Washington – that every Monday morning our examiners board planes bound for banks in the 50 states; that Washington plots each of their movements day-to-day with pins on a big map; and that they fly back to the mother ship in D.C. each Friday for more direction. Well, how many of you know that we have 68 supervisory offices around the country, in communities such as Billings, Montana; Longview, Texas; Salina, Kansas; Iron Mountain, Michigan; and Peoria, Illinois? Or that 95 percent of all supervisory decisions are made at those locations by local staff tied into local communities? The truth is that OCC has almost 1400 examiners out there who live, shop, vote, raise families, and have a personal interest in the economy of their state and region. Statements to the contrary are just plain nonsense.

Okay, I feel better now, so let me go on. Community banks perform a vital role in our financial system. But of course, I’m not telling you anything new. You – community

bankers – support the financial success and prospects, not just of your customers, but also of your communities. You provide the credit and personalized service that bring unique benefits to all the customers you serve. That’s a critical role and one that is central to the OCC view of community banking.

Some have suggested that community banks can’t survive in a world dominated by big financial services conglomerates. With every intention of repeating myself – nonsense. Community banks have survived and prospered, and will continue to do so, because of you – because of your skill and dedication in serving your customers, and because you fill the need for local bankers looking out for local interests. But that is not to say that you don’t face some formidable challenges. This morning I’d also like to share some thoughts on those, and describe some OCC activities that should be of particular interest to you.

It seems almost too obvious to say, but for starters, what’s vital for your continued success is first, to have a playing field that is level, and second, to avoid becoming so shackled by regulation that is unnecessary, that the business of banking becomes a secondary occupation. Indeed, these two challenges often intersect: the disproportionate effect of cumulative regulatory burden on community banks can distort their ability to compete with larger firms that can afford bigger compliance staffs.

So let’s talk first about that elusive level playing field. Competition is certainly one type of challenge, but as I said before, you, community bankers, have shown year in and year out your ability to compete effectively with a variety of firms. Today, however, you face some special challenges, as some of “the other guys” operate under different regulatory regimes that may provide advantages that you don’t have.

So I can understand why you sometimes see a tilt in the playing field. For example, as I talk to community bankers around the country, I often hear about credit unions that have become much larger and are trying to move away from their traditional roles into more bank-like activities such as commercial lending. The question I always get is this: why shouldn't banks and credit unions that engage in the same activities be subject to the same rules in areas like taxation and the Community Reinvestment Act? That's a very good question, and I don't have a very good answer. But of course, it's really a question that only Congress can answer – and I know you haven't been shy about putting the question to them as well.

More recently, a similar issue has been raised regarding industrial loan companies or "ILCs." These are, of course, insured depository institutions just like any other, but ILCs are owned by commercial and other companies that are not subject to the same type of regulation as the parent companies of other banks. That difference in holding company regulation has raised important fairness, supervisory, and public policy concerns. Since we're talking about level playing fields, why shouldn't all companies that own insured depository institutions be subject to similar rules? Again, that's a very good question – and again, it's one that only Congress can answer. It was for this very reason that, as a board member of the Federal Deposit Insurance Corporation, I supported the agency's decision to extend the moratorium on acquisitions of ILCs by commercial companies. In doing so, I strongly endorsed the FDIC's invitation to Congress to revisit the level playing field issue regarding regulation of ILCs and their holding companies.

These complex competitive issues for community bankers make it all the more important that we bank regulators be sensitive to regulatory burden. When we consider new requirements and standards, we need to be especially aware of the relative costs and benefits

for community banks. And we need to look for opportunities to impose a lighter burden on smaller, less complex institutions where that makes sense. As I've said before, the different tests applied under the recently revised CRA regulation to banks of different sizes is a good example of this concept. We need to identify other areas warranting this type of risk-based approach to regulation.

One such area – and one that the OCC is taking a hard look at – is the lending limit as it applies to national community banks. In 2001, we introduced a “pilot” program that increased the single borrower lending limit for well capitalized and well managed national banks in connection with specified types of loans. I am pleased to report that this pilot has been implemented by community bankers without raising significant supervisory concerns.

The pilot program is scheduled to be reviewed this summer. With the generally positive experience we have gained, we will first decide whether the current features of the program should be made permanent. Separately, we will also consider whether enhanced flexibility should be provided for any broader range of types of loans that are both typical of the community banking business and typically conducted without notable supervisory concerns. Obviously, safety and soundness cannot be compromised. But without stepping over that line, is there additional flexibility that should be provided for community national bankers to extend particular types of credit? We certainly want your input if we decide to propose any additional changes.

Regulatory burden also can take the form of unrealistic regulatory expectations, and here, too, the OCC is constantly looking for ways in which we can improve our approach. We are very proud of the quality of supervision that we provide to community banks in the national banking system. We strive to combine our local presence with the deep resources

that are available to us nationally. This is a combination that enables us to add value to individual banks by, in appropriate circumstances, using experts from around the country to tackle especially difficult issues.

In this context, we do not apologize for encouraging strong standards for all banks in the national banking system. But we also recognize the challenges and complexity of running a banking business. Community banks, having fewer resources than larger banks, especially need to be able to engage in a constructive, consultative dialogue with their supervisors. Where possible and appropriate, OCC examiners are encouraged to provide advice that goes beyond the scope of the formal examination for those banks that want it. This is one of the ways that we can, and do, add real value to what you do as community bankers.

That said, we sometimes hear that our examiners' advice on best practices – the things that should be described as “good to do's” – may sometimes be perceived as things we are requiring as “must do's.” That shouldn't happen, and we need to be careful not to mix the two. That is, we need to be clear when we are conveying advice about best practices, which are not mandatory, and when we are communicating supervisory requirements, which are. The last thing we want is for communications that are intended only to be helpful and informative to result instead in additional – and unintended – regulatory burden.

Similarly, I worry that forces may be at work that needlessly discourage organizers of new banks from exploring the national bank charter option. Why do I say that? In part because of comments I hear from bankers at meetings like this one, and in part because of recent statistics that seem to show a disproportionate surge in the chartering of state banks vs. national banks.

Let me give you an example. In the lobby outside of a recent banker convention, a bank consultant who specializes in de novo charters buttonholed me and said this: “I want to hear whether you, as head of the OCC, really support the chartering of new national banks as you say you do – because the word on the street is that the agency is just not interested.”

Surprised and dismayed, I told him what I will now tell you: Wrong! The OCC welcomes new charters. We not only want new banks, we need them in order to maintain our balanced approach to supervision in the future. And we want to preserve the valuable relationship we’ve had with this sector of the industry for more than 140 years. So let me repeat: our door is open. If I’m not being clear enough, I hope you’ll let me know before I fly back to the mainland.

Now let me also be clear that I’m not here to proselytize. There can be perfectly sound business reasons for preferring a state charter to a national charter, such as differences in assessments. In addition, we simply will not compromise our sound supervisory standards to chase charters. So if organizers choose a state charter over national charter for any of these reasons, then so be it. But if prospective community national banks are deterred by a false perception that the OCC is only oriented to big banks, then we need to fix that perception. Or if we are setting unreasonably high hurdles with an overly conservative application review process, or if we simply are not as responsive as our counterparts in the states, then I want to fix that, too.

At my direction, the OCC has recently undertaken a project to identify the considerations most relevant to organizing groups for new community banks. We are also examining both the standards and the processes we apply to those who decide to go the national charter route, asking ourselves these sorts of questions: Are our standards

reasonable and appropriate, clear and consistent, and accurately communicated to prospective bank organizers? And, once the application process has started, are we performing in a way, especially with regard to timeliness, that appropriately recognizes the needs of a new business enterprise?

This is an internal assessment, supplemented by input from a broad cross-section of industry sources. A number of promising ideas already have been identified to improve and streamline the chartering process, to allow additional flexibility in capital-raising for national bank organizers, and to facilitate more pre-filing consultation to flag important requirements and expectations before charter applications are filed. I am committed to this endeavor, and we should have more specifics in the coming months.

Frankly, I think the national bank charter has a lot to offer for community banks, whether they're long established or newly chartered. Our combination of truly local presence supported by national resources and expertise has real meaning. Let me give you a particular example involving the allowance for loan loss reserves.

Beginning a couple of years ago, we began to hear that some outside bank auditors were taking a harder line than they had before in their reviews of bank loan loss policies and practices. It became apparent to us that this new issue had emerged at least in part as the result of actions taken late in 2005 by the Public Company Accounting Oversight Board, or "PCAOB." That new agency, established by the Sarbanes-Oxley Act, began releasing public portions of its auditor inspection reports that were critical of the audit work performed by several public accounting firms in connection with bank loan loss reserves. This criticism seems to have led at least some auditors to take a harder line in their reviews of bank loan loss policies and practices.

That concerned us. Loan loss reserves are a crucial component of solid bank risk management and a foundation of a safe and sound banking system. While we do not tolerate the use of reserves to manipulate earnings or mislead investors, we strongly believe that bankers should not be discouraged from making appropriate provisions – based on both their experience and their judgment – regarding current business and credit cycles. We don't want to see banks lowering their reserves inappropriately, especially with our increased concern that credit risk is rising in the banking system. Now is simply not the time for bankers to be dropping their guard – or their reserves.

Thus, we responded vigorously to this development on several fronts. First, at the local level, we have made clear that we would intervene with an outside auditor in cases where that auditor was inappropriately trying to substitute its judgment for a bank's in determining reserve adequacy. In addition, the larger accounting firms have agreed to ensure that OCC local examination staffs are involved whenever a bank's reserve level is being questioned.

Second, if any of our bankers are encountering this issue, we have told them point blank to alert their OCC supervisory office. We have engaged with local auditors on this point and will continue to do so. And if it is necessary to take the matter up the chain, we have the experts and the resources to do that with accounting firms at the regional and national level when treatment of a local issue is being driven by a national policy that we believe is inappropriate.

Third, at the national level we have held talks with the leadership of the PCAOB and the large CPA firms to make sure that we understand each other's concerns. Recent joint

discussions, led by the OCC, have been most productive. We have similar interactions with FASB and the SEC on an ongoing basis.

Finally, late last year the federal banking agencies issued a revised interagency policy statement on the allowance for loan and lease losses. The policy supports our fundamental concern that reserves be adequately documented; acknowledges the inevitably judgmental nature of determining the appropriate level for the reserve; and recognizes as appropriate prudent and conservative allowances that represent management's best estimate from within a range of estimated losses. We also recognize that it is sometimes difficult to determine the judgmental or qualitative factors of the loan loss reserve, and as a result, we are working with the other banking agencies on a best practices paper to assist banks in supporting these portions of their allowance.

This revised policy, and the PCAOB's endorsement of it, will help address, systemically, the bases for many of the loss allowance challenges that bankers have encountered from their outside auditors. If not, as I said before, national bankers should be in touch with their OCC supervisory office, and we will join in the dialogue with their outside auditor, including at the regional or national level, if necessary.

Now, that's just one example of what we mean when we talk about the combination of our local presence and national perspective, which we believe is uniquely valuable to every community national banker. I could list many other examples, but my time is short. So let me close by emphasizing again the central points of my remarks today: community banking is fundamental to our mission; we appreciate the many challenges community bankers face today; and the resources and the expertise of the OCC are committed to support

you – community bankers – in conducting a safe, and sound, and successful banking business.

Thank you very much.