

Remarks by
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Having been an attendee and participant at quite a few previous ABA conferences, I can report that it's something of an out-of-body experience to be standing here in my new role as the regulator of the national banking system.

But in a more fundamental sense, not much has changed. My wife does not greet me every morning as "Mr. Comptroller." My sixteen year-old doesn't pay any attention to my title when I try to give her driving lessons. Neither does my nine year-old son when it's time to play baseball or soccer. And I'm still the same person who has spent a career supporting banking innovation and competition; who believes safety and soundness, including strong capital, is the bedrock of our banking system; who has helped banks comply with a myriad of rules and regulations, and knows just how important compliance is; and from all of this, is keenly aware of regulatory burden and fatigue, especially for our thousands of community banks. In short, we are the sum of our experiences, and I bring all of this with me to the Office of the Comptroller of the Currency.

Take bank competitiveness and competition. In many ways, these are salad days for your industry. In my past life, I worked hard on the Senate Banking Committee staff, at the Treasury Department, and in private practice to enable banks to compete vigorously to provide consumers with the broad range of financial products and services they demand, wherever they demand it. And although it took a very long time to shed the

outdated laws, rules, and regulations that artificially constrained you, you finally got there. Who would have thought 15 years ago that banks could offer the full range of banking, securities, insurance, credit card, and mutual fund products to customers, in any part of the country? And look at the results: by vigorously competing to provide both new and traditional products and services, banks are stronger than ever – record profits; solid balance sheets; and high levels of capital.

Does that mean there is nothing left to do to modernize our banking laws? Of course not. Markets change; consumer preferences evolve; and banks will always need to adapt and innovate. National banks have very often been at the forefront of that innovation, and the OCC has worked hard to keep the national bank charter strong and vibrant. This is a long, distinguished tradition that I warmly embrace.

But – sadly, there’s always a “but” – let’s not get carried away. If I recall with satisfaction and pleasure the financial modernization that has enhanced the banking charter, I have to say that it’s the pain I remember more from the safety and soundness crisis of the late 1980s and early 1990s, during my last tour in government. As a young staffer on the Senate Banking Committee, the hearings on the savings and loan disaster, begat by a failure of regulation and supervision that cost the taxpayer well over a \$100 billion, are seared in my brain. Likewise, as a Treasury Department official, I witnessed first hand the commercial real estate convulsion that hit the banking industry with such violence, especially in Texas and New England, but in other parts of the country as well.

For those who lived through them, these were formative experiences -- and frightening ones. We saw weak underwriting standards and imprudent asset concentrations wipe out billions of dollars in shareholder equity. We saw too little capital

in the industry to absorb too many losses. And we saw abandoned strip malls, vacant office towers, and what were once bank buildings on the auction block. When it was all over, community banks had failed in record numbers, large blue chip banks in places like Texas had vanished, the bank insurance fund was hanging by a thread, and the country entered the throes of a credit crunch.

To address those concerns, the Treasury Department proposed and Congress enacted a painful law that established the prompt corrective action regulatory scheme that put such a premium on building and maintaining strong capital levels. Those incentives, plus a benign interest rate environment and a remarkably resilient economy, resulted in new bank earnings that were plowed into much higher – and much safer – capital ratios. This capital cushion has proved effective -- not only in absorbing losses, but also in allowing banks to take prudent risks to innovate and grow.

So let me be clear about my perspective from the experiences of the late 1980s and early 1990s: I'm a safety and soundness guy, and I believe in strong capital. The banking system's comeback from those dark days to its present prosperity must be counted as among the more stunning revivals of our lifetime – and I sure don't want to go back.

Those of you who were there for the carnage – and I don't use that metaphor lightly -- can take particular pride and satisfaction in the industry's resurrection. But even as I recognize and applaud the industry's health, I want to make two safety and soundness points. First, we will be watching -- and watching closely -- and we will not hesitate to act. The painful lesson of the past is that bank supervisors have a responsibility to monitor trends constantly and carefully, and let you know in no

uncertain terms if we see risk building to unhealthy levels. I hope it takes no more than a warning to get the industry's attention to arrest dangerous trends before they become full-blown problems. But we cannot shrink from the responsibility to do what it takes to safeguard the safety and soundness of national banks.

For example, the OCC's Underwriting Survey, which we began in 1995, helps us track overall lending trends as well as changing loan terms, giving us a better sense of where follow-up action may be needed. Past surveys revealed slipping underwriting standards – and rising credit risk – in credit card lending. Coupled with our field observations of changes in products and practices, the survey results suggested it was time to encourage the industry to pull back. In January 2003, the OCC issued guidance that has had exactly that effect – as this year's survey plainly shows.

This year's survey also reported a distinct shift toward easing for consumer credit. The effects of this trend have been most noticeable in residential real estate. The easier availability of first mortgages has helped many marginal borrowers obtain loans, and it has helped banks sustain loan volume and profits. But looser underwriting standards and the more widespread penetration of riskier mortgage products have raised questions about how these loans will fare in the event of a rise in interest rates or a softening in house prices. The OCC is currently leading an interagency effort that is looking hard at these practices, and we expect to issue appropriate guidance later this fall.

The other safety and soundness point I want to address, briefly, is the potential change to risk-based capital requirements that we and the other bank regulators are now considering. I am a believer in introducing greater risk sensitivity into our regulatory capital regime. Our current risk-based regime, commonly referred to as "Basel I," simply

does not provide a meaningful measure of the risks faced by large, internationally active banks or the capital they should hold against those risks. Recognizing this reality, the Basel Committee on Banking Supervision has worked with banks over many years to develop a revised capital regime, known as Basel II. The enhancements to risk measurement and risk management systems at the core of Basel II reflect the direction of industry best practice for credit and operational risk management. This has been and continues to be a worthwhile process that I support. But, I want to make a few observations.

If you have been following this issue, then you know that the results of our fourth quantitative impact study – QIS 4, for which the OCC was the principal advocate -- forecasts a significant reduction in capital from Basel II across banks. It also forecasts significant variations in capital levels among banks that appear to have similar exposures to risk. These troubling results have quite rightly caused the regulators to take a “time out” to better understand the QIS-4 submissions. As the OCC has reiterated throughout the process, Basel II implementation efforts must be undertaken in a prudent, reflective manner, consistent with safety and soundness and the continued competitive strength of the U.S. banking system. While we and the other regulators are continuing to discuss the issue, I want to be clear about the basic perspective of the OCC.

First, we must have a clear plan to address the concerns raised by QIS 4 as we move forward with the implementation of Basel II. Certain of these concerns may be more readily understood and resolved through the more rigorous implementation and supervisory process that would come with a more definitive Basel II proposal. But other prudential safeguards may also be necessary to prevent significant reductions in capital.

Second, the QIS-4 results clearly highlight the value of other measures that backstop risk-based capital. This includes the on-site supervisory process and the prompt corrective action regime, particularly its leverage ratio requirement. That will not change under Basel II. QIS-4 confirmed the enormous role that judgment plays in establishing individual bank assessments of credit and operational risk. As a result, examiner scrutiny of those judgments will be a fundamental part of our supervisory process under any Basel II regime, and prompt corrective action must also continue to play a critical role – there is no substitute for the backstop of a simple equity-to-assets leverage ratio.

Third, I believe it is imperative that we have substantial overlapping comment periods with respect to any proposed rule on Basel II, which applies to our largest banks, and a proposed rule regarding so-called “Basel IA,” which is the revised risk-based capital rule that would apply domestically to other banks. Industry participants must be able to compare the two proposals in order to assess competitive effects as they make their comments, because these are concerns that we must take into account before issuing either final rule.

Within the next several weeks, the agencies hope to be in a position both to describe the next step in the process for issuing a Notice of Proposed Rulemaking with respect to Basel II banks, and to publish an Advanced Notice of Proposed Rulemaking with respect to non-Basel II banks. Stay tuned.

Let me now turn from pure safety and soundness issues to compliance – although it really is no longer possible -- if it ever was -- to make such a clear distinction. As I said at the outset, I’ve spent a substantial amount of time in private practice helping banks comply with various aspects of their regulatory regime, from fair lending, to

privacy and security rules, to banks securities activities, just to name a few. It is clear to me that problems in these areas can quickly translate from a pure “consumer protection” issue to one that raises substantial concerns of reputational risk that directly affect safety and soundness. For this reason, I was pleased to learn that the OCC’s basic supervisory philosophy integrates the two functions.

Two compliance issues that are currently pulsing on my radar screen are the new reporting requirements of the Home Mortgage Disclosure Act, or “HMDA,” and anti-money laundering. The purpose of HMDA has remained the same over its roughly 30-year history: to provide information about mortgage loans in order to ferret out and deter illegal discrimination. The recent expansion of the subprime lending market, which offers higher-cost loans to less creditworthy borrowers, prompted Congress to require additional HMDA reporting on high-cost mortgages. The purpose of this new reporting is to help determine whether the higher prices on these mortgage loans reflect legitimately higher costs associated with giving riskier borrowers the chance, probably for the first time, to own their own homes – or, whether they instead reflect illegal discrimination.

Making this determination requires, in the first instance, careful analysis of the new HMDA data. But that data is by no means the whole story, so any final determination of unlawful discrimination can only be made after additional examination, data collection, and analysis. We will continue to implement that process carefully and professionally. That means relying on advanced quantitative modeling, field investigations, and the combined skills of our team of examiners, Ph.D. economists, and attorneys to identify problems and take corrective action. We will continue to pursue each

suspected case of discrimination vigorously and objectively, through the examination process or through legal means, as warranted by the facts – but only by the facts.

Because let's not ever forget that, just as we never encourage lenders to discriminate unlawfully, we need to be very careful not to discourage them from making credit available to anyone who can afford it.

The other compliance issue I want to address is the response by both the industry and your regulators to the challenge posed by those who would use the banking system to launder money and finance terrorist activity. September 11 forced difficult adjustments on all of us – and the adjustment period is not over. Criminals and terrorists can be determined and resourceful. But through equal determination, resourcefulness, and vigilance, we can detect and deter illegal activity – if banks have reasonable anti-money laundering systems in place and the resolve to make them work.

This is an issue that has been a source of confusion and misunderstanding – primarily between banks and supervisors, but also within the supervisory community. As much as possible, we're determined to eliminate that. I believe that the interagency guidance and examination procedures that were released in June represented an important step toward clarifying supervisory expectations. Since then, more than 24,000 people, mostly bankers, have taken advantage of the opportunity to have their questions answered and our supervisory standards explained during nationwide outreach meetings and conference calls.

My goal is to make BSA a strong, consistent part of our overall supervisory program, and to be as balanced as possible in our supervisory judgments. That does not mean “zero tolerance,” and it does not mean eliminating supervisory discretion – but it

does mean more effective communication to you of what we expect. In other words, I want to see our BSA work conducted in the same spirit – and in accordance with the same principles – as all OCC supervision.

The last item on my list of crucial industry issues is a function of all aspects of our regulation. However well intentioned and even necessary a regulation may be, it costs time and money for banks to implement. With an industry as regulated as yours, that means huge amounts of both for every bank in the country. This problem is especially acute for community banks, which operate on thin margins and lack the specialized personnel to handle the mounting volume of paperwork.

It will be one of my priorities to try to alleviate that burden. Sometimes it's possible to take a "two-tier" approach in our regulations – an approach that reflects the relative risks of, and resources available to, community banks. For example, the reporting requirement for community banks is less burdensome than for larger banks. Small, non-problem banks are examined less frequently than larger banks, and banks under \$500 million are exempt from mandatory external auditing requirements. We have also expanded our two-tier approach in the new CRA regulations, which will significantly reduce data collection and reporting requirements for the new class of intermediate small banks. We will look for other areas where that kind of regulatory relief makes sense.

I said at the outset that each of us is the sum of our experiences. In banking, as in life, I believe that experience teaches the importance of moderation and balance. Bankers must innovate and change, but that impulse must be constrained by due respect for the fundamentals of sound banking – by the need for strong capital, liquidity, and risk

management. Likewise, bank supervision must avoid abrupt swings – we cannot leave bankers guessing as to whether the criteria we use to rate credits or compliance will sharply change from one examination to the next. On my watch, we will strive for principled supervision and the communication of clear supervisory expectations – and we will shun accommodation to non-supervisory considerations.

In one area, however, we may be forgiven a tendency toward immoderation. Surely, in a time of great national or local need, caution must give way to action and commitment. We are passing through such a time right now. The last month has been a time of uncommon stress and pain for residents of the Gulf Coast.

But for many bankers, it has brought out their very best. We have seen extraordinary courage and cooperation through the storms. We have seen competitors coming to each other's assistance, sharing office space, teller lines, equipment, and cash. Much has been lost to Katrina and Rita, but you have gained stature in your delivery of critical services to the storms' victims. While much remains to be done, I congratulate you – and I thank you.

And I thank you, too, for your fine hospitality. I look forward to getting to know many more of you during the next five years.