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TESTIMONY OF

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COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

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Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Chairman Shelby, Ranking Member Brown, and members of the Committee, thank you for the opportunity to discuss the Office of the Comptroller of the Currency's (OCC) experience with, and views on, section 165 of the Dodd-Frank Act and the OCC's approach to tailoring our regulatory and supervisory expectations, especially with respect to regional banks, which include banks in the OCC's midsize program and many of those in our large bank program. Because the focus of section 165, as it applies to the banking sector, is on bank holding companies, almost all of the authorities under this section are assigned to the Board of Governors of the Federal Reserve System (Federal Reserve). The OCC's only direct rulemaking authority under section 165 is with respect to the company-run stress test requirements under section 165(i)(2). Otherwise, the OCC's role in section 165 is limited to a consultative one on matters affecting national banks. Nonetheless, the provisions of section 165 are extremely important to the OCC and our supervisory programs as national banks typically comprise a substantial majority of the assets held by bank holding companies with consolidated assets of $50 billion or more. Indeed, the national bank is typically the dominant legal entity within each company. Consequently, the provisions of section 165 have a significant effect on national banks and our supervisory oversight of those institutions.

My testimony today provides a brief overview of the key provisions of section 165 as they apply to bank holding companies. I then describe how the OCC's supervisory and regulatory tools complement and support the objectives of these provisions. As I will discuss, the OCC believes that the supervisory areas addressed in section 165 for which the Federal Reserve is required to develop prudential standards are fundamental to safe and sound banking and are essential elements of our ongoing supervision of national banks and federal savings associations (hereafter, banks). The OCC recognizes that supervisory standards and expectations should reflect the complexity and risk of a bank's activities. This is why the OCC has tailored its supervisory programs into three distinct portfolios – community banks, midsize banks, and large banks. It is also why the OCC seeks to tailor the application of our supervisory standards and expectations to the size and complexity of each individual bank. In some areas, such as capital standards, we do this by setting explicit regulatory minimums that apply to all banks. We then augment these minimums with additional requirements for the largest banks that reflect the complexity and risk of their operations and their interconnections with the broader financial market. In other areas, such as corporate governance, while our approach is more qualitative, we have higher expectations and apply higher standards as the complexity, risk, and scale of banks' operations increase. The OCC believes this flexibility to tailor supervisory and regulatory requirements to reflect our assessment of the risk of individual banks promotes an effective and efficient supervisory regime while minimizing undue burden.

As the Committee considers and evaluates the effectiveness of section 165 and the banks that are affected by its provisions, I would stress two points. First, I believe it is essential for the OCC to retain the ability to tailor and apply our supervisory and regulatory requirements to reflect the complexity and risk of individual banks. We believe our risk-based supervisory approach is consistent with the tailored application that Congress provided for in section 165. While a bank's asset size is often a starting point in our assessment of appropriate standards, it is rarely, if ever, the sole determinant. For this reason, we would be concerned with any proposal that would inhibit our ability to apply specific regulatory or supervisory tools to an individual bank or group of banks. We need access to these tools should we, through our supervision, determine that they are needed to address a bank or a group of banks' risk. Second, although directed towards bank holding companies, the provisions of section 165 are vitally important to the OCC in our role as the primary supervisor of national banks. We would be happy to work with the Committee should the Committee determine that changes are needed to make the application of section 165 more effective and efficient.

II. Overview of Key Section 165 Standards and Requirements for Bank Holding Companies

Section 165(a) of the Dodd-Frank Act authorizes the Federal Reserve on its own or pursuant to recommendations from the Financial Stability Oversight Council (FSOC) to establish certain heightened prudential standards for bank holding companies with total consolidated assets equal to or greater than $50 billion. Standards are required for five areas: 1) leverage and risk-based capital; 2) liquidity; 3) overall risk management; 4) resolution plan and credit exposures; and 5) concentration limits. The Federal Reserve is given discretionary authority to establish standards for: 1) contingent capital; 2) enhanced public disclosures; 3) short-term debt limits; and 4) any other prudential standards that the Federal Reserve, on its own or pursuant to a recommendation by the FSOC, determines are appropriate.

Section 165 directs that the standards should be more stringent than those required for bank holding companies that do not present similar risks to the financial stability of the United States (and thus, are not covered by section 165), and that the standards should increase in stringency, based on various qualitative risk factors. It also permits the standards to be tailored to individual or groups of banking organizations based on their capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors that the Federal Reserve deems appropriate. Finally, section 165 permits the Federal Reserve, pursuant to a recommendation by FSOC, to establish a threshold above $50 billion for the application of standards related to the discretionary standards, listed above, and for the resolution plans and credit exposure reports.

Section 165 has two provisions that use a lower asset threshold than is used for the other prudential standards. These are the stress testing requirements in section 165(i) and the risk committee requirements in section 165(h). Under section 165(i), all banks and other financial companies (not just bank holding companies) with assets above $10 billion are required annually to conduct and publicly report the results of stress tests using scenarios developed by their primary federal financial regulator. Section 165(h) requires publicly traded bank holding companies with assets of $10 billion or more to establish risk committees.

III. The Complementary Nature of Section 165 and the OCC's Supervisory Approach

A key principle underlying section 165 is that the rigor of capital, liquidity, and risk management standards and the intensity of supervisory oversight should increase with, and be reflective of, the risk and complexity of a banking organization's structure and activities. This principle also underlies the OCC's risk-based supervisory approach and programs, and it is one that we fully support.

As noted earlier, we begin the application of this principle by structuring our bank supervisory activities into three distinct portfolios – community banks, midsize banks, and large banks – to reflect the inherent differences in these banks' business models, risk profiles, and complexity. In this respect, while asset size is important and is generally the starting point in determining to which portfolio an individual bank is assigned, it is not the sole determinant. Thus, for example, while most banks in our midsize portfolio fall into the $8 to $50 billion range, this portfolio also includes several banks that exceed $50 billion. These banks have a business model, corporate structure, and risk profile that are distinctly different from the banks in our large bank portfolio, which typically have national or global operations, complex corporate structures, extensive activities and exposures in the wholesale funding and capital markets, or are part of a larger, complex financial conglomerate. This flexible approach, which considers both size and risk profiles, allows us to transition and adjust the intensity of our supervision and our supervisory expectations as a bank's profile changes.

Our midsize bank program is an example of how we tailor and transition our supervisory expectations as a bank's size and complexity increase. As noted above, the banks in this program range in size and, at the low end, may overlap with some banks that are in our community bank portfolio, and at the high end, overlap with banks that are in our large bank portfolio. Banks in our midsize portfolio are generally those that through growth and mergers have acquired a regional or multi-state footprint, yet do not present the same level of complexity and interconnectedness as banks in our large bank program. A major focus of midsize supervision is ensuring that as the scale of each bank's operations and activities increases, so does its risk management and control systems. Banks in this program have a dedicated examiner-in-charge and a team of specialists for each core risk function that provide ongoing monitoring and continuity in our supervision of each bank. The individual examination program for each bank is tailored and may, depending on the complexity and risks of the particular area, draw examiners and blend examination procedures from both our community bank and large bank programs.

As I noted earlier, section 165 requires the development of prudential standards in various areas, including capital, liquidity, risk management, and concentrations. The OCC has, through a combination of regulation and supervisory guidance, established standards in these areas that we expect national banks and federal savings associations to meet. This combination is reflected, for example, in our approach to assessing capital adequacy. Through regulation, we have established explicit, minimum capital requirements that all banks must meet. There are additional, explicit requirements related to market and operational risks that generally apply only to the largest banks that have significant trading activities and complex operations. Our capital rules, however, also allow us to require additional capital based on factors that are not explicitly covered by our quantitative capital rules, including for example, exposures to interest rate risk and credit concentrations. Our supervisory guidance on interest rate risk, concentrations, and capital planning set forth factors that examiners will consider when determining whether additional capital may be needed. The ability to require an individual bank to maintain capital levels above regulatory minimums is especially important when we encounter banks, regardless of size, that may have significant concentrations in certain loan products or market segments.

In the aftermath of the financial crisis, we, along with our U.S. and international supervisory colleagues, have been revising the standards for many of the areas specified in section 165 to strengthen those that apply to the most complex banking organizations and to better align them with risk in the system. With respect to leverage and risk-based capital requirements, the OCC, along with the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC), has implemented a number of enhancements that improve the quality and quantity of capital and impose additional, more stringent leverage ratio requirements for large, internationally active banks, with even higher levels required for the largest, most systemically important banks.[1] With respect to liquidity, in 2010, the OCC and other banking agencies issued an interagency policy statement on funding and liquidity risk management.[2] Consistent with our risk-based approach to supervision, the policy applies to all banks, but specifies that the processes and systems used by banks will vary, based on their size and complexity. In 2013, we, the Federal Reserve, and the FDIC augmented these qualitative expectations with explicit, quantitative liquidity requirements for large, internationally active banks.[3] These requirements, known as the Liquidity Coverage Ratio (LCR), set minimums for the level of high-quality-liquid-assets that a bank must maintain to cover its projected net cash outflows over a 30-day period.[4] The Federal Reserve separately adopted a modified LCR requirement for bank holding companies and savings and loan holding companies without significant insurance or commercial operations that, in each case, have $50 billion or more in total consolidated assets but are not internationally active.

As I discussed in an appearance before this Committee in September,[5] the OCC also has taken action to apply heightened risk management and corporate governance standards to large institutions. These standards address: comprehensive and effective risk management; the need for an engaged board of directors that exercises independent judgment; the need for a robust audit function; the importance of talent development, recruitment, and succession planning; and a compensation structure that does not encourage inappropriate risk taking. We issued the final

[1] See September 9, 2014, testimony of Comptroller of the Currency Thomas J. Curry before the Committee on Banking, Housing, and Urban Affairs available at: http://www.occ.gov/news-issuances/congressional-testimony/2014/pub-test-2014-122-written.pdf for a fuller description of these enhancements.

[2] See OCC Bulletin 2010-13 available at http://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-13.html.

[3] Generally, these are banks with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposure and any consolidated bank or savings association subsidiary of one of these companies that, at the bank level, has total consolidated assets of $10 billion or more.

[4] See OCC Bulletin 2014-51 available at http://www.occ.gov/news-issuances/bulletins/2014/bulletin-2014-51.html.

[5] See September 9, 2014 testimony noted above.

standards as a new appendix to Part 30 of our regulations. Part 30 codifies an enforcement process set out in the Federal Deposit Insurance Act that authorizes the OCC to prescribe operational and managerial standards and is a valuable part of our regulatory toolbox. Under Part 30, if an insured bank fails to satisfy a standard, the OCC may require it to submit a compliance plan detailing how it will correct the deficiencies and how long it will take. Rather than prescribing a "one-size-fits-all" remedy, this approach allows us and the bank to implement actions that are appropriate to the bank's unique circumstances. The approach, however, does not diminish our ability to take more forceful action: we can issue an enforceable order if the bank fails to submit an acceptable compliance plan or fails in any material way to implement an OCC-approved plan.

We believe the expectations for a strong risk management culture, effective lines of defense against excessive or imprudent risk taking, and an engaged board of directors as set forth in our heightened standards are essential for all large banks with significant operations and size. We also recognize, however, that systems and processes that a bank may need to implement, such as culture and risk controls, will vary according to the size and complexity of the bank. Thus, our expectations for how the largest banks implement these standards are substantially more demanding than our expectations for banks with less extensive operations. This difference in expectations is reflected in the phased-in compliance dates we established such that the guidelines were effective immediately for the largest banks but are being phased-in for the other banks covered by our standards with lesser risk profiles. While our heightened standards generally apply to all insured national banks and federal savings associations with consolidated assets equal to or greater than $50 billion, our rule provides us with the flexibility to determine that compliance with the standards is not required if a bank's operations are no longer highly complex or no longer present a heightened risk. Here again, we believe our approach and actions are consistent with and complement the objectives of section 165, and they illustrate how we are able through our supervisory processes to apply, tailor, and adjust our standards to risks inherent in individual banks.

The only provision of section 165 for which the OCC has direct rulemaking authority is section 165(i)(2) with respect to the annual company-run stress testing requirements. As previously noted, this provision mandates that all banks with consolidated assets of more than $10 billion must conduct stress tests using at least three sets of economic conditions. The OCC issued its final rule to implement section 165(i)(2) in October 2012. The rule, which is consistent with and comparable to the stress test rules issued by the other federal banking agencies, establishes methods for conducting stress tests and requires that the tests be based on at least three different economic scenarios (baseline, adverse, and severely adverse). The rule also requires banks to report test results in the manner specified by the OCC and publish a summary of their results.

In drafting the rule to implement this provision of the Dodd-Frank Act, the OCC, FDIC, and Federal Reserve worked to tailor the requirements as appropriate for the smaller, less complex firms. Thus, banks with consolidated assets of between $10 and $50 billion are only required to conduct the stress test once per year (versus the two submissions per year required for bank holding companies with consolidated assets in excess of $50 billion). They also do not have to develop their own stress testing scenarios, nor are they subject to a supervisory stress test. The rule provided a delayed implementation date for banks with between $10 and $50 billion in assets, thereby giving them time to prepare for their first stress test submission. The rule also extended the annual due date for submission of stress test results three months beyond the submission date required for banks with consolidated assets in excess of $50 billion, thereby providing the smaller banks more time in which to conduct their stress tests and report the results. Additionally, we developed a substantially abbreviated data reporting template for these smaller banks, thereby reducing the amount and granularity of data the institutions are required to provide to the agencies. The abbreviated data reporting templates have a further benefit of permitting these banks to publish simpler, less detailed public disclosures relative to the requirements for the $50 billion and over banks. The rule also delayed for a year the initial public disclosure for banks with less than $50 billion in assets. In addition, to reduce burden and avoid duplicative regulatory requirements, the OCC's rule permits disclosure of the summary of the stress test results by the parent bank holding company of a covered institution if the parent holding company satisfactorily complies with the disclosure requirements under the Federal Reserve's company-run stress test rule.

As the OCC noted in its final rule, the annual stress tests required by the Dodd-Frank Act are only one component of the broader stress testing activities that the OCC expects of banks. The OCC's more general and qualitative expectations are set forth in the 2012 interagency guidance on "Stress Testing for Banking Organizations with More Than $10 Billion in Total Consolidated Assets."[6] That guidance emphasizes that stress tests should be an integral part of a bank's risk management and capital planning framework and tailored to a bank's exposures, activities, and risks. It also sets out the broad principles that we expect banks to adhere to when conducting their stress tests. We have tailored separate guidance and tools for community banks

[6] See OCC Bulletin 2012-14, available at: http://www.occ.gov/news-issuances/bulletins/2012/bulletin-2012-14.html.

to use to assess the impact of various stress scenarios on concentrations within their loan portfolios.[7]

IV. Conclusion

The OCC is committed to a supervisory approach that appropriately tailors supervisory expectations and requirements to the scale, complexity, and risks of individual and groups of banks. We have structured our supervisory programs in a manner that allows us to adjust effectively and efficiently the intensity of our supervisory oversight as a bank's risk profile changes. We have used our regulatory tools and authorities to enhance and apply more rigorous capital, liquidity, and risk management requirements to large banks whose size, scope of operations, complexity, and interconnections with other financial institutions pose more risk to financial stability. While the OCC has taken most of these actions outside of Dodd-Frank section 165 authorities, we believe our actions and supervisory approach are consistent with and complement the objectives of section 165. As the primary supervisor of the nation's largest banks, the OCC has a vital interest in ensuring a robust regime of prudential standards for these institutions and retaining the tools we have to effect such a regime.

[7] See OCC Bulletin 2012-33, available at: http://www.occ.gov/news-issuances/bulletins/2012/bulletin-2012-33.html.