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Administrator of National Banks

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Statement of Douglas Roeder

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before the

Permanent Subcommittee on Investigations

of the

Committee on Governmental Affairs

of the

United States Senate

December 11, 2002

Chairman Levin, Ranking Member Collins, and members of the Subcommittee, thank you for inviting the Office of the Comptroller of the Currency (OCC) to participate in these important hearings. I am Douglas Roeder, Senior Deputy Comptroller for large bank supervision.

Let me begin by commending the Committee for holding these hearings. Enron's failure has been nothing short of a national tragedy, especially for the thousands of Enron employees who lost their jobs and retirement savings. At its height, Enron was a multibillion-dollar corporation whose influence was wide-ranging and far-reaching. Inevitably, some of its business involved national banks, which operate under OCC supervision. In my statement, I'd like to focus on the steps that national banks and the OCC, as their supervisor, are taking to help prevent future Enrons from occurring.

The OCC is responsible for supervising over 2,000 banks, some of which are among the largest in the world. Resident examiners working in these large banks use a risk-based approach to supervision – an approach that takes into account the various sources of risk to a bank. Because credit risk has traditionally posed the greatest threat to safety and soundness of banks, much of our supervisory attention has traditionally focused on credit issues. However, the Enron situation demonstrates just how significant other types of risk can be. As a result, we have asked ourselves how our current approach could be enhanced.

First, we intend to focus more intently on banks' procedures for authorizing new products. Our examiners will evaluate the bank's system to ensure that a comprehensive process exists for senior managers to review and approve new product offerings. Also, we believe it's important that the new product-approval process is sufficiently robust to capture even seemingly small changes that could transform an existing product into one that poses an entirely different degree or type of risk. When in doubt as to whether a product requires vetting through the new product approval process, we encourage bank management to take a conservative approach and to apply the process to the proposed product or activity.

Going forward, we will sample more extensively transactions going through the bank's new products approval process. In particular, we will check to see whether banks are complying with their own processes, and whether proper review and authorization are received prior to engaging in complex structured transactions. In addition, we are in the midst of discussions with the other banking agencies to determine whether interagency guidelines should be revised to more specifically address board and senior management responsibilities for the approval and oversight of new products, such as complex structured products**.**

Second, while a bank's board and senior management may place their stamp of approval on a new product, the bank must also carefully consider the appropriateness of complex structured transactions from the standpoint of the bank's client. This represents a shift in our approach to supervising such transactions. In the past, our focus has been on how well the bank assesses the sophistication of the customer and that customer's ability to perform under the terms of the contract. We will now ask our examiners, in addition, to determine whether bank management understands the customer's disclosure and accounting intent. While it is not realistic for banks to be held responsible for how customers account for transactions on their own financial statements, it <u>is</u> incumbent on bank management to carefully consider the potential impact of their actions on the bank -- and to decline to participate in transactions that do not meet the standards of integrity that the bank has established.

Third, we plan to review large relationships (even if credit risk is low) and "flag" structured products during our credit work for potential further review. We think it is important that bank management establishes controls that encompass the bank's total relationship with its large customers. Competitive pressures are a natural part of any business environment, but care must be taken to assure that line managers eager to retain or expand business with important customers don't cross the line and jeopardize the trust and credibility that forms the foundation of a bank.

It is encouraging to report that banks are studying and learning from the Enron experience, whether or not that experience was first-hand. Banks that offer complex structured transactions have come to realize that they stand to suffer great harm if they are implicated in questionable activities conducted by their customers. As a result, banks have taken steps to improve their internal controls of complex structured transactions and Special Purpose Entities.

Some banks have made changes to management, establishing new oversight committees, developing new policies and procedures, tightening controls, upgrading internal reporting to management and the Board, and improving the quality and quantity of disclosures.

Banks also have strengthened their review and approval processes for complex structured transactions. This includes expanding the definition of products to be approved and enhancing the approval process to provide for a broader range of senior level management review. Also, banks are putting a greater focus on assessing customer motivation and appropriateness, including securing representations from customers regarding disclosures and accounting treatment.

We believe that these are all positive steps toward strengthening internal processes. We are currently evaluating the responses of national banks and will assess these reforms as they are implemented.

I also want to highlight another important facet of the supervisory process – interaction among the federal regulatory agencies. The ability to make and receive referrals ensures that the agency with the appropriate authority and expertise is involved. We are coordinating our reviews of national banks previous involvement with Enron with the Federal Reserve and the SEC. Because this is an open matter, I am unable to comment on institution-specific details that pertain to the current review.

Thank you once again for inviting the OCC to testify at this important hearing.

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in the U.S., accounting for more than 55 percent of the nation's banking assets. Its mission is to ensure a safe and sound and competitive national banking system that supports the citizens, communities and economy of the United States.