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Comptroller Urges Banks to Improve Risk Management Practices

ORLANDO -- Comptroller of the Currency John D. Hawke, Jr. said today that the banking industry needs better risk management practices to deal with an environment that is more competitive and more challenging than at any time in the last 40 years.

"Loan review and ongoing credit administration are not getting the attention they deserve," he said in a speech to the Bank Administration Institute's Security, Audit and Compliance Conference. "And internal audit functions at some banks are not as strong as they should be to protect banks against the increased risks they face, both as the result of their own business decisions and of forces beyond their control."

In his remarks, Mr. Hawke noted that management practices must keep step with the evolving character of risk, and he suggested a new analytical distinction be drawn between "environmental risk" -- risk associated with long term, macroeconomic change beyond the control of banks and "volitional risk," which is inherent in individual decisions that bankers make every day and often can control.

"While bank regulators must be concerned with the banking system's preparedness to deal with all types of risk, our job requires us to be particularly concerned about volitional risks -- those business decisions that should be subject to some control," he said. "And my special concern is that we see continued evidence of credit standards being relaxed, despite the fact that the OCC and our sister agencies have been sounding off about the secular decline in credit underwriting standards for more than two years now."

"What makes this risk trend particularly worrisome is the absence of proportionality in many banks' ability to manage and control it," Mr. Hawke said. "The effectiveness of banks' internal audit processes has been a matter of concern to the OCC for some time now."

In a recent OCC survey, a large number of larger national banks were found to be understaffed in one or more audit areas. The biggest deficit was reportedly in the Information Technology area--a critical component of every banking activity.

"The growing imbalance between the overall risk profile of the banking system and its internal risk management capacity is the result of a curious mixture of complacency and urgency," said Mr. Hawke.

Some bankers appear to have downplayed internal audit and credit review guidelines out of a mistaken belief that the business cycle has been tamed and even dubious deals will pay off as the economy continues to grow.

However, "bankers are simultaneously under extreme pressure these days to maintain loan volume and earnings at their current lofty levels," Mr. Hawke added. "A sober look at history should demonstrate that realizing a 20 percent return on equity is not a goal that can be sustained -- at least not for very long."

Mr. Hawke added that bankers are primarily in the business of managing, not taking, risk. "To manage risk effectively, they need to be able to identify, quantify, and control risks. To do these things effectively, they need internal audit, loan review, and compliance resources commensurate with the amount of risk they manage. I can think of no practice more penny-wise and pound foolish than to reduce those resources simply because things seem to be going swimmingly right now."

He noted that the OCC on Monday released the latest installment in a series of issuances related to leveraged lending activities, including hedge funds. The letter highlights the unique risks associated with today's leveraged lending activities, outlines OCC's risk management expectations for banks that engage in this business, and aims to resensitize bankers to existing OCC policies and guidance.

Mr. Hawke assured the audience that the OCC will continue to assist bankers in maintaining the safety and soundness of their institutions during these challenging times. "All who have an interest in the continued strength of the American economy are counting on the vitality and integrity of banks' internal control functions as the front line of defense in maintaining the health of our financial system."

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The OCC charters, regulates and examines approximately 2,600 national banks and 66 federal branches of foreign banks in the U.S., accounting for more than 58 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.