

Remarks by
John Walsh
Acting Comptroller of the Currency

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Thank you. It's a pleasure to be here today with so many banks and thrifts whose mission is serving communities across America. With the economy still fragile, and earnings opportunities limited, it's a difficult time for financial institutions to earn a decent return, but it's an especially challenging time for community banks and thrifts that don't have the kind of product and geographic diversification that help large banks weather the ups and the downs of the economic cycle. We at the OCC believe it's vital to our financial system that community institutions not only survive, but that they grow and thrive. I'd like to spend my time today talking about what it will take for that to happen. I'll talk about the lessons we learned from the overwhelming majority of community banks and thrifts – three quarters of federally chartered institutions – that came through the crisis with high ratings, and what distinguished them from those institutions that either didn't make it or are still struggling. I'll also talk about what we, at the OCC, are doing to support you.

There's no doubt that the road ahead will have its share of bumps. While we are starting to see signs of life in the economy, housing markets continue to struggle under an overhang of distressed residential properties, and creditworthy borrowers remain thin on the

ground. Those of you still managing significant volumes of troubled loans know that process both consumes resources and puts pressure on earnings and capital.

Moreover, the long period of short-term interest rates, coupled with a relatively steep yield curve, has encouraged banks to extend asset maturities in the search for higher yields. As a result, many community institutions have significant exposures to interest-rate risk, and we have a good deal of experience with the dangers of making interest-rate bets.

At the same time, you are all dealing with significant changes in the regulatory environment. Banks of all sizes will have to adjust to new laws, new regulations, and new accounting standards, but the process is particularly daunting for community banks that have only limited resources to address the volume of changes coming toward them, even if only to establish that many rules don't apply to them.

What I think is most important going forward is that you carefully balance your efforts to improve earnings in the short run against the need to make strategic investments that will benefit the bank in the long run. Realistically assess the changes underway in the markets you serve. Understand them and leverage them to position your bank for future success.

To the extent you are considering fundamental shifts in your bank's strategy, do your homework to make sure you have a sound business plan, that you fully understand the associated risks, and that you have made the necessary upfront investments to manage them. Those investments include in-house expertise, MIS, and technology to provide the appropriate control environment. Also select third party vendors carefully and make sure that incentives for either the vendor or your own employees are structured to drive the long-term results you are seeking.

I encourage those of you supervised by the OCC to reach out early in the planning stage to your portfolio manager and Assistant Deputy Comptroller and tap into the expertise and experience that our examiners, policy experts, lawyers, accountants, and others have to offer. That is one of the benefits of our combination of local presence and national perspective. Your local exam team understands your local business market, and can readily tap into expertise at the national level on a wide variety of products and services.

And I'd like to offer a particular word of encouragement to the federally chartered thrifts here with us today. I know that you have faced even more regulatory upheaval than the average community bank. In the midst of everything else that's going on, you have had to adjust to new regulatory personnel, processes, and policies. We have worked hard to make that transition go as smoothly as possible and with six months under our belt, I am pleased by the feedback I've received from the thrift executives and directors I've spoken with. As regulators, we don't expect to be loved, but I was pleased to see the CEO of a federally chartered thrift quoted as saying that, for all the uncertainty and anxiety he felt going into the exam, everything went smoothly. I can't promise every bank or thrift that they'll get a 1 rating or that they'll agree with every finding in the exam report. But I will say that you should not find any surprises in our approach to the exam. We stress to both our examiners and our banks the importance of ongoing, two-way communication as the best way to avoid surprises or misunderstandings.

With that thought in mind, I'd like to spend a few minutes discussing the OCC's approach to supervision – both our philosophy and what you might call “the mechanics” of supervision – and what we are doing to assist the efforts of community banks to thrive in both the current environment and the future.

While the OCC is a regulator with national jurisdiction that supervises banks and thrifts of all sizes throughout the country, including the nation's largest financial institutions, most of our resources are devoted to community-focused banks and thrifts. Our examiners live and work in and around the more than 60 cities in which we maintain offices. Each field office is managed by an Assistant Deputy Comptroller who has full decision-making authority for satisfactorily rated institutions.

That's important. It would make little sense to maintain the kind of local presence we have built throughout the country if we were going to make basic supervisory decisions in Washington. In fact, there are a number of states in which we have more offices and examiners than the state banking agency, and we know these towns and markets as well as anyone.

While the local ADC has full authority to make decisions on institutions that are satisfactorily rated, we provide an extra layer of review at the district office level for banks and thrifts where the examiners are proposing a rating of 3 or 4. That ensures consistency and confirmation of the facts and analysis supporting the examination conclusions.

Those banks and thrifts with the most serious problems – about five percent of the total – are overseen by our Special Supervision unit in Washington, which allows us to take advantage of that group's specialized experience. While we don't always succeed, our goal in moving a troubled institution to Special Supervision is to save it – to help the institution work through its problems and get back to the business of serving its community. If that is not possible, the alternate goal is an orderly resolution that minimizes the cost to the Deposit Insurance Fund.

We engage in tailored, ongoing communication between the examiner assigned to monitor the institution and senior management throughout the year. Quarterly offsite financial reviews and phone conversations to follow up on outstanding issues and intervening developments have the effect of making the regular exam less burdensome. It also ensures that community banks and thrifts have ready access to OCC technical resources and consultation whenever the need arises.

Supervisory strategy for each bank or thrift is tailored to the individual characteristics of the institution, such as its size, complexity, market, and risk profile, and focuses on the most significant risks facing the institution.

And let me stress one key principle of OCC supervision – examiner judgment does not replace that of bank or thrift management, provided that the institution follows sound fundamental principles, appropriately manages and controls risks, acts to address problems in a timely way, and cooperates in correcting violations of law or regulation. Our objective is to ensure that the board and senior management are effectively carrying out their fiduciary responsibilities, and operating the institution in a safe and sound manner. But within those parameters, it is up to the institution, and not the OCC, to decide what markets to serve, what products to offer, what prices to charge, and what loans to make.

In addition to the knowledge and experience provided by OCC staff in the local office, their linkage to the OCC's national organization facilitates easy access to a wide range of expertise upon request. For example, each district has highly trained lead experts for commercial credit, retail credit, IT, asset management, compliance, and capital markets that are available to support field offices on complex exams. They also work closely with subject

matter experts in our headquarters and can quickly solicit information through that network when necessary to address a specific issue.

Each district also has a staff of seasoned attorneys led by the District Counsel, as well as accountants, licensing experts, and community affairs officers, all of whom are available not only to support our examiners, but to provide technical assistance to community banks and thrifts upon request.

The OCC invests significant resources in supporting the community bank and thrift population as a whole. This is accomplished in a variety of ways, including outreach programs conducted on the national, regional, and local levels. During 2011, the OCC hosted over 50 outreach sessions throughout the country in which more than 2,500 bankers participated.

We think it's important to provide updates and educational materials on current issues, and we host teleconferences during the year on topics such as credit concentrations, loan loss reserves and, just last month, small business lending. We also host a series of workshops each year for bank and thrift directors, a program that is a direct outgrowth of interaction with the industry. What we heard was that you were looking for ways to assist your directors in understanding the regulatory process and roles of board members, and we responded. Our workshops for directors cover a range of subjects, from risk assessment and compliance, to our newest program for directors, "Mastering the Basics."

We also take advantage of the opportunities afforded to us by the trade associations to meet with bankers at both the national and state levels. This convention is just one example. It's given me and others at the OCC a number of opportunities to interact with community

bankers from around the country in a setting that is particularly conducive to the exchange of information.

Among the other resources we provide to community banks is BankNet, a secure web platform that provides information, communication channels, and important tools such as Comparative Analysis Reporting, or CAR, which allows an institution to compare itself to a peer group, and an easy-to-use stress testing application.

We recognize how difficult it can be for smaller institutions to keep up with the endless wave of guidance and proposed rulemakings – frankly, I can barely keep up with it myself – and so we provide quarterly summaries of recently issued OCC bulletins as a way of staying abreast of these issues. These summaries, which are sent directly to every community bank and thrift CEO, offer an easy way to determine which issuances are relevant for community institutions.

Finally, as we continue work on integrating the former Office of Thrift Supervision into the OCC, we are in the process of establishing two advisory committees, one on minority institutions and the other on mutual savings associations. The goal of these two committees will be to ensure that we stay on top of the unique issues important to these two specialized industry sectors. We are in the process of finalizing the membership of these two committees and plan to hold the first meetings by the end of the summer.

While we are proud of our supervision program and the support we offer to our banks and thrifts, we know that even the best designed programs may not perform as we expected. And if we fail, we want to know about it, and we want to offer a route to remedy. So another program of which we are particularly proud is the OCC's Office of the Ombudsman, which manages our appeals process. Lately, the examination appeals process has been receiving a

significant amount of attention, and Congress is considering legislation to require additional ways for banks and thrifts to appeal exam findings. We created an Ombudsman before it became a legal requirement and have long supported the notion that every bank is entitled to a fair and independent review of supervisory determinations.

Our Ombudsman, Larry Hattix, is a seasoned national bank examiner with over 20 years of experience, and he's supported by a dedicated staff of experienced bank supervision professionals. He is empowered to render an independent judgment, and I can tell you that he "calls 'em as he sees 'em." You'll find a summary on our public web site of every formal appeal that we receive, and the results show that he calls some for the examiners and some for the bank, including some split decisions.

Larry reports directly to me in his appellate capacity, so he's fully independent of the supervisory process. He has direct decision-making authority and is empowered to obtain whatever information he believes is necessary to make a decision. His office is also responsible for identifying and reporting to me on weaknesses in OCC policy, and he makes recommendations for changes in OCC supervisory policy. In short, he is a strong advocate for fairness in the supervisory process, and an advocate for continuous improvement in our approach to supervision.

I can tell you that our examiners respect the role the Ombudsman's office plays in the OCC's supervisory process. They are familiar with the process for filing and reviewing an appeal, and they are trained to share that information with bankers when circumstances warrant. Jennifer Kelly, our Senior Deputy Comptroller for Midsize and Community Bank Supervision, and I have both made it clear to our examiners that we will not tolerate any

action or statement that might discourage the right of appeal or suggest retaliation or retribution toward a bank or thrift that seeks to exercise it.

The only way to know if it works is to try it and, if you have an issue, I encourage you to do so. I can assure you that the agency's senior management stands behind your right to appeal. An additional safeguard in the process is the Ombudsman's contact with each appellant bank or thrift about six months after a decision is rendered to ask whether the institution believes OCC examiners have taken retaliatory action. If the Ombudsman finds evidence that retaliation has occurred, he will refer the complaint for appropriate follow-up – within the OCC, or externally.

In addition to administering the OCC's formal appeals process, the Ombudsman's office also assists the agency by administering an optional, confidential questionnaire that bankers can fill out at the end of each of our examinations. This questionnaire helps us to collect candid feedback on the strengths and weaknesses of our examination processes. Bankers send their responses directly to the Ombudsman's office to ensure their confidentiality. Depending on the response, Larry or someone on his staff might contact the banker to discuss the concern or to gather more information. The Ombudsman's office analyzes and shares aggregate responses internally on a semi-annual basis. This feedback is valuable in identifying areas where we may need to make improvements or determine whether there may be "mixed messages" between headquarters and the field.

Before closing, I want to turn to your side of the safety and soundness equation and consider what individual community institutions are doing to strengthen their ability to deal with financial disruptions. We at the OCC have spent a good deal of time trying to digest the lessons of the financial crisis for smaller institutions. For community banks and thrifts, the

key areas of concern include concentration risk management and capital planning. We are paying close attention, as you would expect, to the institutions that experienced problems during the crisis, and especially to those who failed.

But just as important are the banks that maintained satisfactory composite ratings through the crisis. With so many problems afflicting the industry during the downturn, it's easy to forget that three-quarters of our community bank population maintained a 1 or 2 rating. We've spent a lot of time looking at the strategies those institutions deployed to guard against excessive risk taking, both before and during the downturn.

What we've seen is that successful institutions played to their strengths and focused on their communities. Nobody knows local economic conditions and businesses better than a community banker, and the best community banks and thrifts are the ones that leverage that knowledge most effectively. When a small business needs a quick decision, you can evaluate its proposal quickly because you know them and their local market, and you know the character of the men and women who stand behind the business.

Credit concentrations are always a matter for concern; in fact, concentrations, especially in commercial real estate, were a factor in virtually every failure during the current downturn. Credit concentrations are an almost unavoidable fact of life for community institutions. Yet some banks and thrifts with concentrations prospered during the downturn while others stumbled. What we saw is that those institutions that maintained 1 or 2 ratings through the downturn were the ones that understood and managed the concentrations on their balance sheets. They developed prudent limits and stuck to them, despite tempting returns when times were good. They also engaged in careful underwriting, and they structured loans

appropriately to limit risk to the institution in the event of unexpected declines in the borrowers' performance.

The best community banks and thrifts, the ones that did not lose their bearings during the financial crisis or the downturn that followed, took care of the basics of banking: they recognized problem loans that are inevitable in a downturn, addressed them early, and made sure they did not grow into a threat to the overall financial health of the institution.

That's a skill that your communities can't do without, and that's why we will always have a diverse and vibrant banking system with a broad base of local community institutions. I can assure you that the OCC remains deeply committed to community banks and thrifts, and that the goal of our supervision is to ensure that your institution remains safe and sound, and able to serve your communities.