

Remarks by
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Thanks, it's a pleasure to be here today, and to have this opportunity to speak before a group that represents so large a share of the nation's financial activity.

I've had the pleasure of working with members of the Roundtable on many occasions over the years, and with Steve Bartlett and Rich Whiting in particular. Steve, I know you plan to leave the Roundtable at the end of the year, and I want to wish you well in whatever you decide to do next.

Let me start by putting in a word about the agency that I now have the privilege of leading, the Office of the Comptroller of the Currency. You may not know this, but next year the OCC will celebrate its 150th anniversary as the nation's original bank regulatory agency. In fact, the OCC is the nation's oldest federal regulatory agency of any kind.

The national banking system, which the OCC supervises, was created to serve both short and long-term goals. President Lincoln was looking for a way to finance the Civil War, and newly-created national banks brought millions of dollars into the U.S. Treasury through requirements that they purchase interest-bearing government bonds.

But at a time in which the nation was being driven apart, Lincoln also envisioned the national banking system as a unifying force.

Now, the financial world has changed a lot since the OCC was created. The national banks we supervise today are larger and more complex than those that the first Comptroller oversaw, and they offer businesses and consumers an array of products and services that could not have been imagined during the Civil War years. More recently, the OCC has assumed responsibility for supervising federal thrifts, which play a vital role in supporting homeownership.

But as a regulator, I am as mindful of what hasn't changed as I am of the industry's evolution. And one thing that hasn't changed is the need for a strong regulatory framework that is supplemented and supported by strong on-site examination.

Neither of these components is static. Even a cursory look at our history shows that both the regulatory and supervisory frameworks must evolve and keep pace with the industry and our financial markets. The financial crisis was a vivid reminder of this, and we are putting in place a number of regulatory reforms that address the shortcomings and abuses that led to the market collapse and the subsequent recession. Each of you has done your share as well, and the industry is much stronger than it was, even in the years prior to 2008. Indeed on any number of measures – including capital, liquidity, asset quality, and the allowance for loan losses – the industry is far healthier and better able to meet the needs of the American economy.

In addition, year-to-year earnings have increased for 12 consecutive quarters. Nonetheless, I worry that too much of the increase in reported profits is being driven by loan loss reserve releases. While the allowance for loan and lease losses is at a high level

industry-wide, quarterly provisions are approaching historical lows and remain below current charge-offs. That has to be a matter of great concern. If provisioning continues at current levels and charge-offs remain constant, the allowance could return to historical lows in just a few years.

I know some would ask why that's a problem. Why shouldn't the industry be allowed to maintain lower reserves if credit losses are low and underwriting has improved, as it clearly has? That's a reasonable question. The answer is that elevated levels of risk at banks and thrifts continue to affect the collectability of loans. Europe is in recession, and growth in Asia has slowed. In the U.S., the housing market is soft and unemployment remains stubbornly high. The economy is taking much longer to emerge from this downturn than from past recessions. With so much uncertainty here and abroad, the industry needs to maintain strong reserves. So we at the OCC are going to remain vigilant on the subject of the loan loss allowance.

Another concern is with the ongoing weaknesses and lapses we've seen in corporate governance and operational risk management, especially at larger, more complex institutions. You can see evidence of these problems almost daily in the newspaper headlines: Bank Secrecy Act violations, concerns about the integrity of LIBOR, the foreclosure processing mess, questions about debt collection practices, and inadequate controls over trading activities, among them.

These operational problems are mounting so quickly, and so soon on the heels of the financial crisis, that some industry observers have begun raising questions about the value of supervision, particularly the on-site supervision that both the OCC and the Federal Reserve employ with respect to large banks. In fact, a columnist at one major

financial news organization recently argued that on-site examination has outlived its usefulness and should be either eliminated or sharply pared back. And this brings me to a third concern that I'd like to address – namely the role and benefit of supervision in what I'll call the post Dodd-Frank world.

The article included one curious quote from an anonymous former regulator: “Name a crisis that was prevented by on-site examiners.” Of course, by definition, the crisis that was prevented has no name or identifying attributes and therefore is impossible to cite. But it seems to me that the quote illustrates, however unintentionally, the real value that prudential supervision brings.

Much of our work is invisible to the world at large. It is the behind-the-scenes tasks of evaluating and questioning risk management practices, ensuring that strong internal controls and audit are in place, and making sure that the banks and thrifts we supervise have appropriate processes, procedures, and contingency plans to address risk.

On a daily basis, prudential supervision is responsible for identifying problems and ensuring that they are corrected. You know that and I know that because we are privy to those decisions. The public at large is not. As regulators, we don't issue press releases every time we require a change in an institution's risk management or its BSA compliance program. Those successes are recorded behind the scenes without public notice. In point of fact, it is generally our failings – and yours – that make their way into the headlines, while the successes go unnoticed, since they involve the problems that were prevented from happening.

And, in case you were wondering, this isn't a new issue or concern for Comptrollers. In 1891, for example, Comptroller Edward S. Lacey wrote in the OCC's annual report that:

It has become a habit on the part of the general public whenever the failure of a national bank occurs to at once challenge the integrity or skill of the examiner charged with its supervision, oblivious of the fact that his energy, his experience, and his devotion to duty may have prevented the failure of a score of more or less embarrassed institutions as to whose mismanagement they are of necessity entirely uninformed.

That was in 1891, more than 120 years ago, and I suspect that 120 years from now, one of my successors will be echoing the same concern – and perhaps citing this speech as evidence of its historical roots.

Returning to the present, there is much interest today in data-driven tools such as stress testing, and there is considerable merit to the arguments in favor of such approaches. During the financial crisis, the stress-tests conducted under the Supervisory Capital Assessment Program, or SCAP, played an important role in the restoration of confidence in the banking system. The tests were rigorous, and the public – from average consumers to financial analysts – put faith in the results. Without question, the SCAP exercise helped us target areas of weakness and vulnerability. But our examiners didn't need to wait for those findings to begin work, nor, for that matter, did the individual institutions being tested.

Our on-site examiners knew where the weaknesses were: where more capital was needed, where liquidity was weak, and where reserves and asset quality needed

strengthening. And based on their findings, we had begun putting capital and liquidity agreements in place in some institutions well before the start of the SCAP testing. We were able to do that precisely because we had teams of examiners working continuously on-site in those institutions.

I don't mean to imply that stress testing isn't important. It's a valuable tool for both bankers and supervisors. It can help distill vast amounts of data into more actionable analysis. The results can illuminate weaknesses and potential correlations on a financial institution's balance sheet. They can tell us where more capital is needed and which institutions are most vulnerable to a jump in unemployment or a spike in interest rates, for example.

But let me be clear. Stress testing is only one tool, albeit an important one, and any suggestion that it might be a substitute for supervisory boots on the ground is simply wrong-headed.

In fact, many of the biggest problems we are dealing with today – and the ones that are proving most damaging to large banks – have nothing to do with credit risk, liquidity, or any of the other areas of risk that are the typical focus of stress testing. Instead, they involve operational risk, from foreclosure processing to BSA violations to debt collection and weaknesses in information technology systems, and the corporate governance structures that oversee such activities.

These are the types of concerns that are best addressed through firm, fair, and sophisticated supervision. Obviously, I'm not going to argue that federal and state regulatory agencies have a perfect track record on this score. But while our track record is not perfect, the system of supervision that we have is very good, and we are working

hard to make it better, even as we work through the process of patching the holes in the regulatory framework that contributed to the financial crisis.

One way in which we are making the system better is by raising our expectations for large banks. These heightened expectations involve standards for boards of directors, talent management and compensation, risk tolerance, audit and risk management, and the sanctity of the bank charter itself.

For example, while regulators operated for years under the premise that oversight functions rated as satisfactory were sufficient, we are now requiring large banks to achieve a rating of “strong” in their audit and risk management functions. We expect members of the bank’s board and its executive management team to ensure that audit and risk management receive visible and substantive support. Our examiners are evaluating the transition from “satisfactory” to “strong” in these two key oversight functions as part of their ongoing supervision. When we find weaknesses, we will require corrective action.

As someone who has been involved in the business of bank supervision for over 25 years, I have learned how important it is that supervision be fair and reasonable. The institutions we supervise play a vital role in supporting economic growth by serving the financial needs of consumers, communities, and businesses, and we don’t want to hamstring those efforts with supervision that is overly burdensome, arbitrary, or unpredictable. But it’s important that everyone, the industry and the public alike, know that supervisors will take strong action when necessary to correct problems, including public enforcement actions and civil money penalties.

It is always regrettable when an enforcement action becomes necessary. But we've learned through hard experience that inaction only makes problems worse. And so I can assure you that the OCC stands ready to take quick and meaningful action when we find significant lapses that threaten safety and soundness or result in violations of laws and regulations.

As bankers you know that not every safety and soundness issue can be boiled down to a set of rules and regulations – that both the business of banking and bank supervision require judgment. At the OCC we are working very hard to strike a balance that elevates standards at the institutions we supervise without taking away the sound discretion they need to run their business – to make reasonable judgments on what loans to make, how much risk is acceptable, and all of the other decisions that are part and parcel of managing a financial institution.

The OCC has been engaged in this process for nearly 150 years now, and while we are not perfect, the examiners and other professionals that do the work of this agency are the finest men and women I have had the privilege to lead in a long career as a regulator. Effective supervision is critical to maintaining a banking system that is capable of supporting a strong economy, and one of my highest priorities as Comptroller of the Currency will be to ensure that the OCC's supervision continues to adjust and improve so that it can continue to meet the challenges of an evolving economy.

Thank you. I'd be happy to take a few questions now.