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TESTIMONY OF

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ACTING COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

July 21, 2011

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.

Chairman Johnson, Ranking Member Shelby, and members of the Committee, today marks the one-year anniversary of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). I appreciate the opportunity to provide the Committee with a progress report about the initiatives the Office of the Comptroller of the Currency (OCC) has undertaken to implement the Dodd-Frank Act.

The Committee's letter of invitation requests that I testify about the impact of the financial crisis on the economy, how the Dodd-Frank Act has improved the financial regulatory framework, and how the legislation will help prevent or mitigate another crisis. During the financial crisis, problems that originated primarily in the residential mortgage sector triggered disruption of the financial system more broadly, leading to severe loss of market liquidity and generating deep losses for investors, financial firms, and others. The global financial crisis was unprecedented in severity and duration, and the depth of the associated recession was the most severe we have experienced in the U.S. since the Great Depression of the 1930s. These financial and economic developments led, quite rightly, to a reconsideration of the ways financial markets and financial firms operate, and gave impetus to efforts to reform the financial system and its oversight.

In response, Congress passed the Dodd-Frank Act to address major gaps and flaws in the regulatory landscape, to tackle the systemic issues that contributed to, or that accentuated and amplified the effects of, the recent financial crisis, and to build a stronger financial system. The Act requires the Federal regulators to put in place new buffers and safeguards to protect against future financial crises and to revise and rewrite many of the rules governing the most complex areas of finance. Additionally, it consolidates authority that had been spread among multiple agencies, and it provides the Federal regulators a number of new tools that should help us avoid problems in the future. For example, the Financial Stability Oversight Council (FSOC or Council) offers a real opportunity to identify key risks across the entire financial system. Ultimately, we hope these reforms will ensure that we will not soon face another crisis of this magnitude.

Much has been written about the causes of the crisis and the efforts to reshape the regulatory landscape through the Dodd-Frank Act. In response to the Committee's invitation letter, I intend to focus my testimony today on the specific actions taken by the OCC to implement the Dodd-Frank Act. My testimony highlights the OCC's work in the following key areas:

- The integration of the staff and functions of the Office of Thrift Supervision (OTS) into the OCC;
- Our efforts to date to support the Bureau of Consumer Financial Protection (CFPB) in standing up its operations;,
- An update on the OCC's contributions to, and participation in, the FSOC;
- OCC efforts underway to implement the Dodd-Frank Act provisions that strengthen risk-based capital, leverage, and liquidity requirements; and
- Our progress in implementing certain key Dodd-Frank Act rulemakings.

I. <u>OTS/OCC Integration</u>

Today is the effective date of the transfer to the OCC of the OTS's responsibilities for supervising federal savings associations. Our goal was to make this transition as smooth as possible, and I am pleased to report our success in this regard. This past

Monday 674 OTS employees reported for duty at the OCC in locations around the country. The official personnel transfers will occur on July 31 to coincide with the beginning of the first full pay period after the official transfer date. In the meantime, these employees are detailed to the OCC under the terms of a blanket Memorandum of Understanding between the two agencies.

When I testified before this Committee in February 2011 and September of last year,[1] I described the steps the OCC was taking to prepare for our expanded supervisory responsibilities and for the integration of OTS staff that is so essential to the success of that effort. This included our close work with the Board of Governors of the Federal Reserve System (FRB) and the Federal Deposit Insurance Corporation (FDIC) to coordinate the transfer of OTS staff, assets, authority and responsibilities; numerous outreach efforts to educate the industry about our new supervisory responsibilities for federal savings associations; and the internal preparations for our expanded supervisory authority. We also noted the designation of a Deputy Comptroller for Thrift Supervision who reports directly to our Senior Deputy Comptroller for Midsize and Community Bank Supervision.

Since then, we have continued our efforts to prepare for an effective integration of the OTS into the OCC. I am very proud of the work done by numerous staff members of the OCC and OTS to accomplish that objective in accordance with the specific requirements of the Dodd-Frank Act. The following section discusses the general

[1] Testimony of John Walsh, Acting Comptroller of the Currency, Before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, February 17, 2011. Testimony of John Walsh, Acting Comptroller of the Currency, Before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, September 30, 2010.

framework for the integration and updates the specific actions the OCC has taken since my last testimony on this topic.

Organizational Realignment to Accommodate Expanded Supervisory Responsibilities

Our work in preparing for effective integration of OTS functions and staff focused on: ensuring that the employee protections afforded by the legislation were fully and equitably implemented; building a sustainable organizational structure to execute effective supervision and regulation of both national banks and federal savings associations on a going forward basis; fostering an environment that will maximize opportunities for staff; and promoting communication with employees and the industry throughout the transition planning process. The OCC's Community Bank Supervision staff will supervise the vast majority of the 648 thrifts for which the OCC is now responsible, while the Midsize and Large Bank Supervision programs will supervise federal savings associations with profiles that align with those units. The Special Supervision portfolio has been expanded to include certain troubled federal savings associations.

The OCC recognizes the importance of leveraging the talent and experience of former OTS staff to help us fulfill our supervisory responsibility for federal savings associations. The transferred OTS staff have been fully integrated into the various policy and field operations units where their skills and experience can best be utilized. All of our examiners will be able to participate in the supervision of both federal savings associations and national banks. Ultimately, the OCC's National Bank Examiner commission will expand to ensure that each commissioned examiner has the skill set and credentials to lead examinations of both national banks and federal savings associations. In the meantime, thrift examinations will continue to be led by accredited Federal Thrift Regulators, while examinations of national banks will be led by commissioned National Bank Examiners. We have completed a thorough evaluation of the OCC and OTS training and certification programs to identify where they coincide and where we need to address gaps. The OCC will work to fill those gaps going forward, but in the near term we are confident we have a sufficient combination of accredited and commissioned examiners to lead examinations of all the institutions we are charged with supervising.

Thrift Industry Outreach

The OCC communicated regularly with the thrift industry during the past year to share information and address concerns. The communication process began with a personal letter that I sent in September to the chief executive officer of each federal savings association. Five additional letters have been sent since that time to provide further information about the integration process. Senior OCC leaders also accepted numerous invitations to participate in industry-sponsored events that provided opportunities to speak directly with management representatives of federal savings associations. Additionally, the OCC developed a day-long program for thrift executives to provide them with information and perspective on the agency's approach to supervision and regulation. The OCC District Deputy Comptrollers and OTS Regional Directors co-hosted 17 of these sessions in locations around the country during the first quarter of 2011. Approximately 1,000 thrift industry representatives attended these sessions. The feedback from the attendees was very positive. They were reassured to learn that the OCC will examine them on the same FDICIA examination cycles as the OTS and that the OTS's historical supervisory information will be maintained and used to ensure continuity and minimize regulatory burden.

The OCC will continue to communicate regularly with thrift industry representatives outside of the supervision process to clarify our expectations, discuss emerging issues, and respond to their concerns. We participate in numerous industry-sponsored events during the year and conduct a variety of outreach activities, including Meet the Comptroller events, chief executive officer roundtables, and teleconferences on topical issues. We also plan to form advisory councils for mutually-owned federal savings associations and minority-owned institutions later this year to replace similar organizations that were sponsored by the OTS.

Review and Continuation of OTS Regulations

As a result of the Dodd-Frank Act's transfer to the OCC of the OTS's supervisory functions relating to federal savings associations, beginning today, the OCC will assume responsibility for the ongoing examination, supervision, and regulation of federal savings associations. The Act also transferred to the OCC rulemaking authority of the OTS relating to all savings associations, both state and federal. Importantly, the Dodd-Frank Act preserves the federal savings association charter going forward, and it retains the Home Owners' Loan Act, the primary statute governing the charter. The OTS's regulations relating to federal savings associations also remain in effect until modified or superseded by the OCC.

The OCC is undertaking a multi-phased review of its regulations, as well as those of the OTS, to determine what changes are needed. We expect first to revise provisions of the OCC's regulations that will be immediately helpful in effecting the transfer of supervisory jurisdiction for federal saving associations to the OCC. This would include the revision of regulations integral to the operations of the agency as well as changes to regulations needed to implement certain Dodd-Frank Act provisions that become effective today. Next, we will republish as OCC regulations the OTS regulations that the OCC will administer going forward to reduce confusion for federal savings associations and to remove duplication. Finally, over the coming months, we will continue to review OCC and OTS regulations, making substantive changes where needed and combining appropriate regulations to further reduce duplication. The following discussion details these efforts.

In addition to transferring to the OCC supervisory responsibility for federal savings associations, Title III of the Dodd-Frank Act transfers all functions of the OTS relating to state savings associations to the FDIC and all functions relating to the supervision of any savings and loan holding company to the FRB. To clarify which agency will be enforcing the OTS rules, the Dodd-Frank Act required the OCC and the FDIC to publish a notice in the Federal Register identifying those regulations of the OTS that the OCC, with respect to federal savings associations, and the FDIC, with respect to state savings associations, will enforce. The OCC published its notice on July 6, 2011.

On May 26, 2011, the OCC also issued a notice of proposed rulemaking (NPRM) revising certain OCC rules that are central to internal agency functions and operations immediately upon the transfer of supervisory jurisdiction for federal savings associations. These proposed changes include clarifying how the public can obtain information from the OCC about federal savings associations under the Freedom of Information Act

(FOIA), the release of non-public OCC information, including information about savings associations, and restrictions on the post-employment activities of senior examiners and assessments of federal savings associations.

The NPRM also contained amendments to the OCC's regulations relating to preemption and visitorial powers to implement the provisions of the Dodd-Frank Act that become effective today, that pertain to national bank and federal savings association preemption and to codify the Supreme Court's decision in the *Cuomo* case. These amendments effect the changes required by the Act, such as the elimination of preemption for both national bank and federal thrift operating subsidiaries. They do not expand federal preemption. The final rule, which appears in today's Federal Register, responds to key issues raised by commenters.

The OCC also has worked closely with OTS staff to prepare an interim final rule, effective shortly, that will republish most OTS regulations in the OCC's chapter of the Code of Federal Regulations and renumber them accordingly as OCC rules, with nomenclature and other technical amendments to reflect the OCC's supervision of federal savings associations. This action consolidates the regulations applicable to national banks and federal savings associations in the regulations of the OCC.

In the next phase of our regulatory review, the OCC will consider more comprehensive substantive amendments to former OTS regulations to reduce duplication and provide consistency with OCC rules. For example, we may propose to repeal or combine provisions in cases where OCC and former OTS rules are substantively identical or substantially overlap. In addition, we may propose to repeal or modify OCC or former OTS rules where differences in regulatory approach are not required by statute or warranted by features unique to either the national bank or federal savings association charter. In all cases we will seek public comment to assist in making these regulations workable and effective for federal savings associations.

II. <u>Transfers of Specified Functions to the CFPB</u>

The OCC also has been working to ensure an orderly transition of certain functions to the CFPB and to assist the CFPB where possible in standing up its operations. Although there are a handful of issues that still need to be resolved, we are striving to ensure that the OCC and CFPB will serve complementary supervisory roles.

On the administrative front, we have contributed staffing expertise by detailing six full time staff members to the CFPB to assist with operational issues. These OCC staff members provided expertise from various areas of the OCC, including the Law Department, the consumer complaints group, bank supervision, information technology, and the OCC's Office of Management. In addition, the OCC has assisted in developing the CFPB's procurement and personnel management processes by providing administration and human resources assistance and by sharing information on salary ranges, position descriptions, and benefits.

Moreover, OCC staff members have participated in numerous informational meetings with CFPB staff to advise them about OCC practices and to assist them in developing their own processes going forward. These meetings have covered a range of topics, including general supervisory matters and enforcement processes, as well as detailed information requests concerning fair lending supervision and analytics, and mortgage and credit card data metrics.

During these discussions, we also considered issues regarding staffing and transfer processes. The OCC and CFPB jointly determined that a voluntary solicitation of interest process would be used for the transfer of OCC employees that perform or support the consumer financial protection functions of the OCC that are transferred to the CFPB. The CFPB solicited interest in a potential transfer to the CFPB from OCC employees working in "transfer-process functions" (*e.g.*, compliance examination functions, enforcement and interpretation of consumer financial law, and consumer education) and made offers to several OCC "transfer-process" employees.

Additionally, we anticipate that we will be providing transitional support for other CFPB functions. One important area in this regard relates to consumer complaints. The OCC will continue to operate our Consumer Assistance Group (CAG) for complaints concerning consumer issues within the jurisdiction of the OCC. In addition, we expect to enter into a Memorandum of Understanding with the CFPB under which, while the CFPB builds its capacity to handle complaints, the OCC/CAG will do intake and processing of complaints on behalf of the CFPB. Under this approach, the CFPB will first begin to handle credit card related complaints involving large banks (those with assets of $10 billion or more) and consumers can contact the Bureau through its Web site, consumerfinance.gov with respect to those matters. It is our expectation that the consumer complaint function for large banks in additional areas will transition as the CFPB builds its capacity.

To inform the development of its supervisory priorities, the CFPB has made substantial requests for non-public supervisory information. In order to better share supervisory information, the OCC, the OTS, and the CFPB entered into a formal MOU.

This allowed the OCC to respond to CFPB information requests by providing: (1) reports of examination, supervisory letters, and other supervisory materials; (2) information on enforcement actions and referrals to other agencies, such as the Department of Justice; and (3) HMDA data analysis, including computer programs that the CFPB could use to recreate OCC analyses.

Finally, to facilitate ongoing communication and the coordination of supervisory matters with the CFPB, the OCC has established the Consumer Issues Steering Committee (CISC). The CISC is chaired by the Deputy Comptroller for Compliance Policy, and its members are representatives from various divisions within the OCC, including Community and Consumer Law, Mid-size Bank Supervision, Large Bank Supervision, and Compliance Policy. The CISC anticipates having regular meetings with CFPB supervision representatives to address examination coordination, information sharing, and consumer compliance issues, as needed.

III. Contributions to the Financial Stability Oversight Council

The OCC actively participates in the FSOC, whose mission is to identify risks to financial stability that could arise from the activities, material financial distress, or failure of large, interconnected financial companies; to recommend standards for implementation by the agencies in specified areas; to promote market discipline; and to respond to emerging threats to the stability of the U.S. financial system. As a means to accomplishing this, the FSOC brings together the views, perspectives, and expertise of Treasury and all of the Council member financial regulatory agencies.

The Council has had seven meetings since its inception with the most recent meeting on July 18. At the July 18 meeting, the Council approved a final rule establishing a framework for designating systemically important "financial market utilities" (FMUs). To process payments and settle transactions between financial institutions safely and efficiently, our financial system relies on certain established protocols and intermediaries, including FMUs that operate multilateral payment, clearing, or settlement systems among financial institutions. Notably, problems at one FMU have the potential to trigger disruptions among the financial institutions they serve. Title VIII of the Dodd-Frank Act directs the FSOC to designate systemically important FMUs for enhanced government oversight if the FSOC determines that the FMU's failure or disruption could create, or increase the risk of, significant liquidity and credit disruptions that would threaten the stability of the U.S. financial system. On July 18, 2011, following the FSOC's previous advance notice of proposed rulemaking (ANPR) and NPRM on this topic, the FSOC approved a final rule setting out the criteria, analytical framework, and process and procedures the FSOC will use in considering whether to designate an FMU as systemically important. The rule includes the statutory factors the FSOC is required to take into consideration and adds subcategories under each of the factors to provide examples of how those factors will be applied. The rule also outlines a two-stage process for evaluating and designating an FMU as systemically important. This process includes opportunities for an FMU to submit materials in support of or opposition to a proposed designation. Consistent with statutory provisions, any designation of an FMU will require approval by a two-thirds vote of sitting FSOC members and the Chairperson. The FSOC also must engage in prior consultation with the FRB and the relevant federal financial agency that has primary jurisdiction over the FMU.

The FSOC also is continuing its work under the provisions of the Dodd-Frank Act that require the designation of nonbank financial firms for enhanced supervision by the FRB. At its first meeting in October 2010, the FSOC approved publication of an ANPR requesting public comment regarding the criteria and analytical framework for designation of nonbank financial firms. Based on a review of comments received and consideration by the members of the FSOC at its January 2011 meeting, the FSOC approved an NPRM. The NPRM set forth the framework the FSOC proposed to use to determine whether a nonbank financial company could pose a threat to the financial stability of the United States. The comment period for this NPRM closed on February 25, 2011.

A number of commenters, as well as some members of this Committee,[2] thought that the NPRM lacked the specificity needed to provide meaningful guidance to potentially designated entities. There is general agreement among the FSOC agencies on the need to provide and seek comment on additional details regarding the standards for assessing systemic risk before issuing a final rule. Staffs are working on a more detailed approach with the goal of proposing revisions for comment in the near term.

Under the Dodd-Frank Act, the FSOC is required to report annually to Congress. This report is in its final approval stages with the FSOC-member agencies, and should be available very shortly. It will include a description of the activities of the FSOC,

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[2] *Oversight of Dodd-Frank Implementation: Monitoring Systemic Risk and Promoting Financial Stability*, Hearing before the Senate Committee on Banking, Housing and Urban Affairs, 112 Cong., May 12, 2011 (Statements of Sens. Patrick J. Toomey, Sherrod Brown and Mark Warner).

significant market and regulatory developments, potential emerging threats to financial stability of the U.S., and recommendations to enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets, promote market discipline, and maintain investor confidence.

IV. Strengthening Capital, Leverage, and Liquidity Requirements

The Committee's invitation also expressed an interest in receiving an update on the Dodd-Frank Act provisions relating to risk-based capital, leverage, and liquidity requirements. Section 165 of the Dodd-Frank Act authorizes the FRB, on its own or pursuant to recommendations from the Council, to establish heightened prudential standards for all designated non-bank financial companies and all bank holding companies with total consolidated assets of $50 billion or greater. These standards must address, among other things, risk-based capital, leverage, and liquidity requirements for those companies.

The Dodd-Frank Act provides a central role for the Council and the prudential regulators, including the OCC, with respect to the standards to be developed by the FRB. For example, under the Act the FSOC is required, as one of its enumerated purposes, to make recommendations to the FRB concerning the establishment of the heightened prudential standards, and the FRB, in prescribing the standards, must "take into account" the Council's recommendations. The FRB also is required to consult with the primary regulator for a depository institution subsidiary of a bank holding company – the OCC in the case of national banks or federal savings associations – before imposing heightened prudential standards on the company that are likely to significantly impact the depository institution subsidiary.

The OCC continues to be active in this consultative capacity both as a member of the Council and as the regulator of national banks and federal savings associations. The Council has established a Heightened Prudential Standards Committee, which the FRB and the OCC co-chair.

The Federal banking agencies also have moved quickly to implement other capital provisions contained in the Dodd-Frank Act. During the financial crisis, all U.S. banking institutions were required to calculate their regulatory risk-based capital requirements using the same generally applicable risk-based capital rules. Although no U.S. banking institutions have been approved to calculate their risk-based capital requirements using the internal modeling methodologies of the advanced approaches risk-based capital rules, there were concerns that large internationally active banking organizations theoretically could operate with lower minimum risk-based capital requirements using the advanced approaches rules than they would be required to hold under the general rules. To address this concern and prevent banking institutions' minimum required capital levels from falling in the wake of the financial crisis, the Dodd-Frank Act provided that the generally applicable risk-based capital rules shall serve as a floor for any other risk-based capital requirements.

Consistent with this requirement, the OCC, FRB, and FDIC published a final rule on June 28, 2011, that amends the advanced approaches risk-based capital regulations to institute a permanent floor. Under the final rule, each national bank subject to the advanced approaches risk-based capital rules must calculate its required minimum risk-based capital under both the general risk-based capital rules, which are applicable to all banks, and the advanced approaches rules, which are only applicable to the largest internationally active banks. Each quarter, an advanced approaches bank will have to calculate its minimum capital requirements under each set of rules, compare the results, and use the more stringent requirements to determine compliance with the minimum risk-based capital standards.

V. <u>Other Rulemakings</u>

As I noted in my February testimony, the OCC is participating in approximately 85 Dodd-Frank Act projects ranging in scope from our extensive efforts that helped to integrate the OTS's staff and supervisory responsibilities to consultation on a variety of rulemakings being undertaken by other agencies. This portion of my testimony highlights the progress we have made thus far in implementing certain key Dodd-Frank Act rules.

Incentive Compensation Rulemaking

Improperly structured compensation arrangements that provided executives and employees with incentives to take imprudent risks were among the many factors cited as contributing to the financial crisis. Consequently, the Dodd-Frank Act required the Federal banking agencies, the NCUA, the SEC, and the FHFA to prohibit incentive-based payment arrangements, or any feature of any such arrangement, at "covered financial institutions" (generally defined to include financial institutions with $1 billion or more in assets) that the agencies determine encourages inappropriate risks by providing excessive compensation or that could lead to material financial loss. Under the Dodd-Frank Act, covered financial institutions also must disclose to their appropriate Federal regulators the structure of their incentive-based compensation arrangements sufficient to determine whether the structure provides ‘‘excessive compensation, fees, or benefits’’ or ‘‘could lead to material financial loss’’ to the institution.

On April 14, 2011, the agencies issued a proposal to implement the incentive-based compensation provisions in Section 956 of the Dodd-Frank Act. The material financial loss provisions of the proposed rule establish general requirements applicable to all covered institutions and additional requirements applicable to larger covered financial institutions. The general requirements provide that an incentive-based compensation arrangement, or any feature of any such arrangement, established or maintained by any covered financial institution for one or more covered persons must balance risk and financial rewards and be compatible with effective controls and risk management and supported by strong corporate governance.

The proposed rule also includes two additional requirements for "larger financial institutions," which for the federal banking agencies, NCUA, and the SEC means those covered financial institutions with total consolidated assets of $50 billion or more. First, a larger financial institution must defer 50 percent of incentive-based compensation for its executive officers for a period of at least three years. Second, the board of directors (or committee thereof) of a larger financial institution also must identify, and approve, the incentive-based compensation arrangements for individuals (other than executive officers) who have the ability to expose the institution to possible losses that are substantial in relation to the institution's size, capital, or overall risk tolerance. These individuals may include, for example, traders with large position limits relative to the institution's overall risk tolerance and other individuals that have the authority to place at risk a substantial part of the capital of the covered financial institution.

The comment period on the proposed rule closed on May 31, 2011, and the agencies collectively received thousands of comments – approximately 9,700 comments were received by the OCC alone. The agencies are carefully considering the comments and diligently working toward jointly issuing the incentive-based compensation final rule.

Credit Risk Retention Rulemaking

Securitization markets are an important source of credit to U.S. households and businesses and state and local governments. When properly structured, securitization provides economic benefits that lower the cost of credit. However, when incentives are not properly aligned and there is a lack of discipline in the origination process, securitization can result in harm to investors, consumers, financial institutions, and the financial system. During the financial crisis, securitization displayed significant vulnerabilities, including informational and incentive problems among various parties involved in the process. To address these concerns, section 941 of the Dodd-Frank Act requires the OCC, together with the other Federal banking agencies, as well as HUD, FHFA, and the SEC to require sponsors of asset-backed securities to retain at least five percent of the credit risk of the assets they securitize. The purpose of this new regulatory regime is to correct adverse market incentive structures by giving securitizers direct financial disincentives against packaging loans that are underwritten poorly.

Pursuant to this requirement, the interagency group issued a joint proposal. In addition to requiring securitization sponsors to retain at least five percent of the credit risk of securitized assets, the proposal would establish a number of exemptions from the risk retention requirement, most notably, an exemption for securitizations backed entirely by "qualified residential mortgages" (QRMs).

Consistent with the statutory provision, the definition of QRM includes underwriting and product features that historical loan performance data indicate result in a low risk of default. Thus, the proposed QRM underwriting criteria are consistent with the premise that a complete exemption from risk retention should be supported by very high quality mortgage loans. That said, we note that this particular aspect of the proposal has been the subject of much comment. The OCC is interested in the feedback on this aspect of the proposal, and we note that if the agencies are persuaded that the proposed underwriting criteria are too restrictive on balance, the preamble to the proposal discussed several possible alternatives.

One alternative would be to permit the use of private mortgage insurance obtained at origination of the mortgage for loans with loan-to-value ratios higher than the 80 percent level specified in the proposed rule. Other alternatives discussed in the proposal include (i) imposing less stringent QRM underwriting criteria, but also imposing more stringent risk retention requirements on non-QRM loan asset-backed securities to provide incentives to originate QRM loans and reflect the relatively greater risk of the non-QRM loan market, and (ii) creating an additional residential mortgage loan asset class along side the QRM exemption with less stringent underwriting standards or private mortgage insurance, subject to a risk retention requirement set somewhere between zero and five percent.

The proposal was published in the Federal Register on April 29, 2011, and comments were due by June 10, 2011. However, the agencies extended the comment period until August 1, 2011, due to the complexity of the rulemaking and to allow parties more time to consider the impact of the proposal.

Margin and Capital Requirements for Covered Swap Entities

During the financial crisis, the lack of transparency in derivatives transactions among dealer banks and between dealer banks and their counterparties created uncertainty about whether market participants were significantly exposed to the risk of a default by a swap counterparty. To address this uncertainty, sections 731 and 764 of the Dodd-Frank Act require the OCC, together with the FRB, FDIC, FHFA, and Farm Credit Administration, to impose minimum margin requirement on non-cleared derivatives. Such requirements should reduce the ability of firms to take on excessive risks through swaps without sufficient financial resources to make good on their contracts. Also, because some financial institutions used derivatives to take on excessive risks, the margin requirements must be based on the risks posed by the non-cleared derivatives and derivatives counterparties. Firms that take significant risks through derivatives should face more stringent margin requirements with respect to non-cleared derivatives, while firms that take lower risks should face less stringent margin requirements.

Under the provisions of the Dodd-Frank Act, the OCC, together with the FRB, FDIC, FHFA, and Farm Credit Administration, published a proposal to establish minimum margin and capital requirements for registered swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants (swap entities) subject to agency supervision. Consistent with the Dodd-Frank Act requirement, the amount of margin that swap entities would be required to collect under the proposed rule would vary based on the relative risk of the counterparty and of the swap or security-based swap. A swap entity would not be required to collect margin from a commercial end user as long as its margin exposure is below an appropriate credit exposure limit established by the swap entity. A swap entity also would not be required to collect margin from low-risk financial end users as long as its margin exposure does not exceed a specific threshold; however, margin would be required to be collected from other financial end users and all swap entities. The proposed margin requirements would apply to new, non-cleared swaps or security-based swaps entered into after the proposed rule's effective date. The proposed rule does not create new capital requirements. Instead, it relies on existing capital standards that address non-cleared swaps and non-cleared security-based swaps to implement the requirement to establish capital requirement for regulated swap entities.

The proposal was published in the Federal Register on May 11, 2011, and comments were due on or before June 24, 2011. However, due to the complexity of the rulemaking, to allow parties more time to consider the impact of the proposed rule, and so that the comment period on the proposed rule would run concurrently with the comment period for similar margin and capital requirements proposed by the Commodity Futures Trading Commission (CFTC), the agencies extended the comment period until July 11, 2011.

Retail Foreign Exchange Transactions

To ensure that retail customers engaged in foreign currency trading fully understand the risks involved in the transactions, as well as to protect those customers from fraud, the Dodd-Frank Act amended the Commodity Exchange Act to provide that national banks (and other institutions) could engage in certain off-exchange transactions in foreign currency with retail customers only pursuant to rules adopted by a Federal regulatory agency, including the institution's appropriate Federal banking agency.

In general, a retail foreign exchange transaction is a transaction in foreign currency between a national bank and a retail customer that is: (i) a future or option on such a future; (ii) an option not traded or executed on a registered national securities exchange; or (iii) a certain leveraged or margined transaction. Last week, the OCC adopted a final rule that authorizes national banks to engage in certain off-exchange transactions in foreign currency with retail customers, subject to a number of requirements pertaining to disclosure, record keeping, capital and margin, reporting, business conduct, and documentation. The requirements are similar to a recently enacted CFTC rule governing retail foreign exchange transactions by CFTC registrants. The OCC decided to model its rule after the CFTC's rule to promote regulatory consistency.

VI. Conclusion

I appreciate the opportunity to update the Committee on the work we have done to date to implement the provisions of the Dodd-Frank Act, and, in particular, the actions we undertook over the course of the year to effect a smooth and workable integration of the OTS into the OCC. I am happy to answer your questions.