Statement of

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Chairman Reed, Ranking Member Allard and members of the Subcommittee, I appreciate this opportunity to discuss how the OCC supervises derivatives activities in national banks and share our views on the risk mitigation efforts underway in the credit derivatives market.

I have spent 24 years at the OCC working as a national bank examiner and have had the opportunity to examine the derivatives and trading activities at many of our largest national banks that function as financial intermediaries in OTC derivatives markets. I currently serve as a Deputy Comptroller in the Credit and Market Risk Division, supporting OCC senior management in identifying supervisory solutions for financial risk management issues in the national bank system.

For over 20 years, OTC derivatives have been an important component of the risk management products and services that national banks offer to their clients. As noted in our first quarter 2008 derivatives report that is attached to my written statement, the five largest national banks, all supervised by the OCC, account for 97 percent of the total U.S. commercial bank derivatives holdings. These same five banks are responsible for nearly all credit derivatives trading among U.S. commercial banks.

We believe that these large national banks, with their access to resources for people, technology, and capital to support trading businesses, are best equipped to shoulder these risks. This doesn't mean they won't make mistakes – these are not risk-free businesses, but it does mean they have the wherewithal to devote the necessary talent and resources to establish risk management systems that meet the expectations and standards set by the OCC.

At these large national banks, the OCC has established resident teams of examiners who serve as the foundation of our supervisory program with their continuous on-site examination of complex areas such as credit derivatives. The dynamic nature of bank trading activities requires the OCC to frequently re-evaluate our risk management expectations, clearly communicate these expectations to our banks, and continually evaluate their compliance with our standards.

From our perspective, there are two significant risks in the credit derivatives market - the first is counterparty credit risk, and the second is operational risk.

The OCC and other regulatory agencies are actively working to address these risks in the credit derivatives market. Given the global nature of derivatives markets, these risks and the issues they raise cut across legal and national boundaries. As a result, our efforts involve both U.S. and key foreign regulators and are aimed at all of the major global financial market participants – both commercial and investment banks. Through collaborative work, we have been successful in focusing industry attention on significantly reducing aged outstanding confirmations in the credit derivatives market, while increasing automation to ensure a stronger financial market going forward. We have also been successful in developing a set of risk metrics that improves transparency among firms and supervisors and have developed a useful forum for identifying and responding to emerging issues in a timely manner. But our work is not done.

At a June 9th meeting between supervisors and industry participants, agreement was reached on an expanded set of future goals. The industry is developing a new commitment letter that will address, among other things, new trade processing goals, a proposed central counterparty clearinghouse, incorporating an auction-based settlement mechanism into standard credit derivatives documentation, and extending these infrastructure improvements to OTC equity, interest rate, foreign exchange, and commodity derivatives.

The clearinghouse proposal, which would create a central counterparty for the clearing of credit derivatives, should reduce counterparty credit and operational risks by providing a mechanism for multilateral netting among the major market participants. A related issue is the question of whether an exchange should be created for credit derivatives. From our perspective, the evaluation of potentially competing alternatives is appropriately being conducted by industry participants who will need to use these mechanisms if risk mitigation objectives are to be achieved. Our role will be to ensure that large national banks who intend to participate in one or more of these alternatives meet our risk management standards and expectations.

While the proposed clearinghouse or exchange based solutions will certainly contribute to our objective of reducing counterparty credit and operational risks in the credit derivatives market, we mustn't lose sight of the fact that the dynamic nature of this market will require ongoing consideration of other initiatives that may also facilitate risk reduction.

I appreciate the Subcommittee's interest in the OCC's supervisory work with respect to credit derivatives, and I look forward to answering any additional questions or comments you may have.