Remarks by

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Good morning, and thank you for joining today's call regarding our *Semiannual Risk Perspective* for Fall 2015. Since launching the *Risk Perspective* publicly in 2012, the report has become an important part of our supervision of national banks and federal savings associations. The report highlights in a transparent way the risks facing the federal banking system and our priorities as supervisors of national banks and federal savings associations. And it makes us accountable to the public for managing the risks that we've identified.

Strategic, underwriting, cybersecurity, compliance, and interest rate risks remain the OCC's top supervisory concerns. The report talks in more detail about each of these risks, but I wanted to spend some time highlighting a few items for you today. As you may know, I spoke several times this fall about the growing risk posed by weakening credit standards. This report reinforces that concern. As the economic cycle turns, we see banks and thrifts reaching for yield and growth, sometimes extending their reach at the expense of sound underwriting, strong risk management, and adequate loan loss provisioning. OCC examiners will be paying close attention to each of those areas in the coming months. As I've mentioned previously, in the area of credit risk, the warning lights are flashing yellow.

Regulators and bank management need to act now to prevent those risks from becoming reality. We can't afford to wait until the warning lights turn red.

Before turning to your questions, I want to highlight a few things that struck me as I reviewed this report. First, banks must respond responsibly to competitive pressures and the difficult environment in which they operate. At this point in the business cycle, it's getting harder and harder for banks to find creditworthy borrowers who want new loans, and alternative investments are limited in this continuing low-interest rate environment. As a result, we've seen banks and thrifts relax underwriting standards, layer risks in consumer and commercial lending products, and accumulate concentrations, particularly in commercial real estate.

In terms of underwriting, this is the third consecutive year in which we've seen underwriting standards slip. Generally, we are seeing banks continue to make concessions on pricing, weaker or non-existent loan covenants, and maturities lengthening. We have also seen increases in underwriting exceptions and risk layering. All of which combine to introduce risk at origination. Bankers with long memories will remember the worst loans are made in the best of times, and the growing credit risk in their banks should be managed very closely.

I'm sure everyone on the call is paying close attention to oil prices which flirted with $36 per barrel late last week—a price level not seen since 2009. There is no question the energy industry has been hit hard with the decline in oil and gas prices.
As noted in the Shared National Credits Report, problem energy loans have increased. Losses from these loan have been moderate so far, but we are likely to see some increases in the months ahead. The problems will affect regions differently. Texas, North Dakota,

Pennsylvania, Louisiana, Colorado, Wyoming, and Oklahoma have seen the impact of companies reducing drilling activities, canceling significant new projects, and laying off employees in 2015.

Interest rate risk is another area where we are paying very close attention, even as the FOMC prepares its announcement regarding rates this afternoon. Interest rates have remained at historic lows for an extended period, and bank earnings could be affected negatively if short-term interest rates rise relative to long-term rates.

We expect banks to assess their interest rate risk exposure under a variety of scenarios specific to the bank's own risk and complexity. We also expect banks to assess the risk that the large deposit growth that occurred during the recession could potentially change direction quickly as rates rise. Where depositors sought shelter from the storm, they may also seek to take advantage of rising rates. Banks should consider the long-term implications to earnings and capital in strategic planning when assessing their exposure to changes in interest rates.

An area that gets less press, but has our attention, is the dramatic increase in lending to nondepository financial institutions. Over the past three years, these loans have increased by more than 217 percent, with growth totaling $53.8 billion over the previous year.

Generally, these nondepository financial institutions invest in other financial assets, securitizations, direct lending, or other activities that are often similar to activities of a bank. Therefore, the risk from these loans can be highly correlated to the banks' risk and lead to concentrations. That is why we are encouraging bankers to monitor any concentration risk from these loans and ensure they clearly understand the underlying business model of these companies. This also will be a focus of our supervision strategies going forward.

Second, banks of all sizes face strategic risk as they evolve to meet changing consumer needs and the demands of an increasingly competitive environment. They can, and they should, adapt their business models, roll out new products, and venture into new markets. But they must exercise care in doing so.

They need to be sure they understand the new products and markets and perform an appropriate amount of due diligence. Banks and thrifts can remain relevant and thrive in meeting the needs of the customers, communities, and businesses that depend upon them, but they must manage change carefully.

Finally, while managing rising credit risk is crucial, we can’t lose sight of the continued risk associated with cybersecurity and compliance, including anti-money laundering requirements. We can’t allow the federal banking system to be compromised by hackers or used by criminals or terrorists. We saw in the aftermath of the financial crisis that there is a price to be paid for ignoring compliance. The good news for banks is that there’s evidence of progress in this report.

Enforcement actions have declined steadily from their peak in 2009, and matters requiring attention have declined for the third consecutive year. That means fewer issues are rising to the level of being singled out by examiners for bank management or worse requiring correction through enforcement. The areas that continue to make up the most of these issues differ among large and community banks. The top five MRA categories for large banks are credit, capital markets, BSA/AML, consumer compliance, and information technology. For community banks the categories also include enterprise governance but exclude capital markets because of the differences in business models.

With this semiannual risk perspective, our job is to watch closely, articulate the risks we see, and act in timely manner to prevent those risks from endangering the health of our broader financial system.

This report serves to focus our efforts as well as the banks. Because of the risks we identify here, bankers know examiners' priorities for the next six months. As the executive summary of the report states, our priorities for large bank examiners include governance and oversight, credit and underwriting, and in the area of compliance, we'll focus on cyber, BSA/AML, fair access, and operational risk. For community banks, examiner priorities include strategic planning and governance, underwriting, interest rate risk, as well as the compliance issues mentioned for large banks.

With that, I'd like to take a few of your questions.