Remarks by

Thomas J. Curry
Comptroller of the Currency
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Thank you. It's a pleasure to be here and to have this opportunity, as the head of the nation's oldest federal banking agency – indeed, the nation's oldest federal regulatory agency of any kind – to address the nation's oldest banking association. The Clearing House traces its roots back to 1853, a full decade before President Lincoln signed the National Bank Act and created the OCC.

Of course, the Clearing House is not an association in just some fraternal sense. Its explicit mission at the outset was to facilitate the settlement of checks between banks, but even in those early years its importance went well beyond that. The Clearing House was in a real sense a self-regulator that pooled the resources of its members to prop up those that faced challenges, and in so doing, it helped to maintain public confidence in the financial system.

The Clearing House established standards and best practices that its members had to meet to qualify for support in times of crisis. That was important, because there were a good many banking crises from 1857 through the early 1900s, and the Clearing House was the primary bulwark in preventing things from getting worse. Today much of the burden that once fell to the Clearing House rests with federal agencies like the Fed, the

FDIC, and the OCC, but the Clearing House still shares our collective goal to keep the financial system safe and sound.

With this background in mind, I think this meeting provides an appropriate forum to reflect a bit on the most recent financial crisis and the steps we're taking to address the problems that it brought to light.

The worst days of that crisis seem very far behind us, so much so that I sometimes worry that memories, at least for some in the industry, have begun to fade. I hope that's not the case. If anything, I think we need to step up our efforts to shore up the parts of the system that didn't work as well as they should have, and to make sure that practices at banks and thrifts, particularly at large institutions, don't inadvertently sow the seeds of the next crisis.

That means, first of all, that we must continue to move ahead on implementing the Dodd-Frank Act. While we've accomplished much, there are significant rulemakings still in process that touch upon major issues that were part of the legislative response to the financial crisis. Among them are the Volcker Rule and the risk retention regulation. We are also putting considerable effort into developing a good working relationship with the new agency created by Dodd-Frank, the Consumer Financial Protection Bureau. By working with the CFPB, we can not only minimize the kind of duplicative supervisory efforts by multiple agencies that lead to unnecessary burden for banks and thrifts, but we can provide an important perspective for that agency's consumer rulemakings.

At the same time, we are working very hard on an interagency basis to address new capital requirements, both those mandated for large banks in the Dodd-Frank Act, as well as those that are part of the Basel III capital process. As we continue that work, we are listening very closely to the industry as we review the more than 1,500 comment letters we received. To ensure that we are providing sufficient time for prudent planning and implementation, the agencies do not expect that the proposed rules will take effect on January 1 as we announced last week.

Basel III will likely prove to be one of the most important steps we take to improve the industry's resilience and its ability to stand up to future storms. Since the beginning of the crisis, more than 460 banks have been closed, and in the end, they failed because they didn't have sufficient capital for the level of risk they took on. In addition to the imperative for raising required levels of capital – particularly for large institutions – our proposed rules target two other extremely important goals.

First, the financial crisis made clear that the quality of capital matters as much as the quantity of capital, and our emphasis upon common equity Tier 1 will not only strengthen insured financial institutions, but will provide important reassurances to the market. In addition, the notion of capital buffers – the idea that we should take steps to conserve capital as it gets close to minimum levels – will help ensure that capital is available to absorb losses when financial institutions get into trouble.

But while the new rules stemming from Dodd-Frank and Basel III will go a long way toward shoring up the weak parts of the system, we can only accomplish so much through regulation. What I think is equally, if not more important, is what we do through supervision – through examiner boots on the ground.

While laws and regulations take the long view, and cannot be easily tailored to new developments, our examiners do pay close attention to changes in the environment generally and changes in individual risk profiles specifically. They have the support of our policy experts, and they are able to make decisions about whether the banks and thrifts they supervise are properly accounting for those risks.

The OCC has a supervisory process in place that is extremely effective in ensuring that national banks and federal thrifts are identifying risk and managing it appropriately. We have divided our supervisory program into separate lines of business, a step that recognizes the very significant differences between large banks on the one hand and community institutions on the other, with an important group of midsize banks in the middle.

Most of our resources, including two-thirds of our examiners, are devoted to community and midsize banks, and we locate our examiners in towns and cities across the country, near the institutions they supervise. We develop guidance in Washington, with input from the field, but we empower our examiners to make decisions locally about the banks they supervise. Indeed, we <u>expect</u> them to make those decisions locally.

Large national banks and thrifts are supervised through teams of resident examiners that work on-site, inside the institutions they are responsible for, 52 weeks a year – although I can tell you that during the financial crisis, it was more like 365 days a year. These are highly experienced professionals, and as is the case with our community and midsize exam teams, they have the support of resources from Washington, including PhD economists, lawyers, and an array of specialists in areas such as asset management, securitization, mortgage finance, and consumer compliance.

Although community banks and large banks are very different, what their supervision has in common is the ability of our examiners to tailor individual strategies and solutions, to react quickly to changing circumstances, and to take advantage of the resources that a supervisory agency with a national perspective can bring to bear.

As important as all of that is, the financial crisis made plain that it wasn't enough. I'm not speaking only of our supervisory regime, but also of the standards that were put in place in the years after the thrift and banking crises of the late 1980s and early 1990s, including prompt corrective action, stronger audit requirements, and reforms to the real estate appraisal system. Those were very important reforms, and for a decade and a half, we all took comfort in the fact that the system itself seemed more resilient, that our supervisory structure was more effective, and that banks and thrifts were far more safe and sound than they had been prior to the early 1990s.

So what was missing? How could a crisis of the scale of the 2008 market meltdown have happened?

As I said at the onset of these remarks, there were, in fact, a number of weaknesses in the system that Dodd-Frank took important steps to repair. I personally believe that Dodd-Frank will go a long way toward averting future crises. But in addition to implementing that law, the OCC is very much focused on improving its supervision programs and absorbing the lessons we learned from the financial crisis. We have adopted and are implementing what we refer to as "heightened expectations for corporate governance and oversight." Particularly with respect to our large banks, we have raised the bar for what we expect of senior management and independent directors.

I know that the term "heightened expectations" might sound at first like nothing more than a slogan or platitude that summarizes a thought that is almost too obvious to mention. After all, in the wake of an economic disaster of the magnitude of the financial crisis, it would be hard to imagine that everyone – the public, Congress, the regulators, and even the industry itself– would <u>not</u> have higher expectations, both for the system itself and for individual institutions.

However, we have something very concrete in mind when we talk about heightened expectations, and we have been very specific in our conversations about it with management and independent directors, especially at our large institutions. Achieving excellence in corporate governance is at its core.

At the board level, it's important that independent directors understand the risks that their institutions take on, and that they make sure those risks are well managed. They need to know that their bank or thrift is treating its customers fairly, and that they have programs in place to ensure compliance with a host of federal laws and regulations, from the Bank Secrecy Act to the Fair Lending laws.

We are no longer willing to accept audit and risk management functions that are simply satisfactory. We are looking for excellence. Our expectation now is that large institutions will meet the standard of "strong" for audit and risk management functions, and that the independent directors will take a *strong* hand in ensuring compliance. And finally, we expect directors to be truly independent and to set a clear direction for their institutions, and to be capable of presenting a credible challenge to management, while fulfilling their fiduciary responsibility to preserve the sanctity of the national bank charter.

When I refer to the sanctity of the national bank charter, I have something very specific in mind, and I suspect other supervisory agencies would say much the same thing about the state charter. We want to be sure that national banks and federal thrifts are not just booking entities for the holding company. The charter is a special corporate franchise that provides a gateway to federal deposit insurance and access to the discount window, and the highest fiduciary duty of the Board of Directors is to ensure the safety and soundness of the national bank or federal thrift.

To meet that requirement, independent directors must be able to challenge management in a credible way, and that means there must be effective reporting tools to enable the board to monitor financial metrics and key risks, such as compliance with the Bank Secrecy Act and consumer compliance protection laws. It also means there has to be a record of the board monitoring those key risks. We expect board members to set the tone for enterprise-wide professional standards, corporate values, and integrity for senior management and other employees.

In the area of audit, as I said, satisfactory is no longer good enough. A rating of “strong” is required. And when we say that a strong audit function has to be developed and maintained, we are looking for an internal audit that is highly anticipatory and systemically focused. That audit function, among other things, must be able to identify root causes of issues that come up in audit and effectively implement sustainable change. These are the very specific measures that our examiners will be looking at in our large banks each and every day.

You will hear more from Mike Brosnan, our head of Large Bank Supervision, tomorrow, and he will further detail our program. I’ve only just scratched the surface today. We’ve actually outlined an extensive set of requirements that lay out what we mean when we say heightened expectations. I hope the examples I’ve provided will convey the concepts underpinning this new program and the importance of it to ensuring a safe and sound financial services sector of our economy.

When you get down to it, our expectations amount to a pretty tall set of orders for the boards and management of large financial institutions, and they won't be easy to meet. But we can ask no less of our large banks and thrifts if we are to avoid future financial crises. I think it's important that the supervisory agencies, both here and abroad, continue to discuss the expectations we have for large financial institutions, with an eye toward improving those standards.

Let me close with this thought. The challenges ahead are significant, but it is essential that we meet them. The U.S. economy will not be restored to full prosperity without a strong banking system. An economy as large and diverse as ours needs banks and thrifts of all sizes, from the smallest community institution to the largest multinational bank, to finance it and to meet the needs of our families, communities, and businesses.

What remains is for the banks and federal savings associations that make up the federal system to put the lingering effects of the financial crisis behind them and restore the trust and confidence of the American people. Our goal at the OCC is to make that happen.

Thank you. I'd be happy to answer any questions you have.