Remarks by

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I'm delighted to be with you today. We know that the ABA puts on fine conferences, but I cannot imagine one that's in closer alignment with the OCC's priorities for dealing with the challenges facing the industry today. Operational risk, third-party management, cybersecurity, internal controls--they are all on your program, they are all topics I have addressed in recent months, and they are all topics you will continue to hear me discuss in the months to come.

I would venture to say that if this forum were taking place 10 or 15 years ago, very few of these subjects would have shown up on the agenda. Ironically, that's probably one reason they are showing up so often now.

Unfortunately, in years past, operational issues did not receive the attention they deserved. Perhaps that was because they were not viewed as core functions of the banking business. Few risk management or compliance specialists were promoted into the ranks of senior executives, a fact that surely discouraged top performers from careers in those fields. Yet, as we discovered during the financial crisis and in the years since, the ability to manage these functions is every bit as integral to successful banking—and can just as easily become a bank's Achilles heel—as managing credit risk.

It is well that we are finally giving these functions the attention they deserve. It is also good that we are finally recognizing the individuals responsible for performing those functions.

My intention today is to shed light on a topic—not surprisingly, also on your program—that has been the subject of a fair amount of industry discussion and speculation. That topic is the OCC's "heightened expectations" for risk management and corporate governance. Given the concerns we're hearing from you, I will try to provide some extra clarity on what heightened expectations entail and which institutions would be required to comply with them.

First, some background is in order. As much as any other factor, the financial crisis can be traced back to failures of corporate governance and risk management systems. At some institutions boards of directors and senior managers did not sufficiently comprehend aggregate risk within their firms and lacked a sufficiently robust risk framework—that is, the people, systems, and processes for monitoring a complex set of risks. In some cases, bank compensation programs were structured to share upside benefits but not the downside risks. Inadequate and fragmented technology infrastructures hindered efforts to identify, measure, monitor, and control risk. And some of these institutions' risk cultures lacked effective credible challenge from independent risk managers, audit, and control personnel. While these problems existed to some extent at banks of all sizes, it was in the largest, most complex banking institutions that the problems were most pronounced and where they created the greatest potential threat to the stability of the financial system.

Coming out of the crisis, the OCC resolved to raise standards for corporate governance and risk management systems at those institutions through our program of heightened expectations. The program, which applies exclusively to large, complex banks, sets out roles and responsibilities for front line units, independent risk management, and internal audit—what we commonly refer to as the "three lines of defense" for any bank. Those units have responsibility for establishing an appropriate system to identify, measure, monitor, and control risk taking. Those units must ensure that the board of directors has enough information on the bank's risk profile and risk management practices to ensure operation within the board-approved enterprise risk appetite. If variances arise, boards are then able to offer a credible challenge to management.

By risk appetite, of course, we mean the aggregate level and types of risk the board and management are willing to assume to achieve the bank's strategic objectives and business plan.

Under our heightened expectations, large banks are required to develop a risk appetite statement that defines both quantitative and qualitative parameters for a safe and sound operating environment at their particular bank. That statement should address the question of how the bank will assess and accept risks, articulating behavioral expectations that shape risk culture. In addition, quantitative limits on risk taking should be based on sound stress testing processes and other methods, taking into account the bank's earnings, capital, and liquidity positions.

The second part of our pending guidelines on heightened expectations pertains to standards for boards of directors of large banks. It reminds every board member of his or her duty to exercise sound independent judgment and actively oversee the bank's compliance with safe and sound banking practices. The proposed guidelines stipulate that each covered bank's board have at least two independent members, that banks must establish and maintain an ongoing training program for those directors, and that they conduct an annual self-assessment of the board's effectiveness.

After spending many months revising and refining the heightened expectations framework, this past January the OCC proposed to formalize that framework as enforceable guidelines under Part 30 of the agency's regulations. It is important to understand that in most cases where a bank has failed to meet the guidelines, the bank will be required to develop and implement a plan designed to achieve compliance; a formal enforcement action is only necessary in the event that a bank fails to submit or comply with an acceptable plan.

In any event, the comment period on the proposed guidelines closed last week, and we are now reviewing the responses we received. I expect a number of these responses to raise questions about the scope of our heightened expectations regime. I say this with some confidence because perhaps the single question I am asked most often these days by community bankers is whether the new regime would apply to them, too.

Let me address those concerns directly. As I noted earlier, our heightened expectations are focused only on large and complex institutions. In the proposed guidelines we define these as insured national banks, insured Federal savings associations, and insured Federal branches of a foreign bank, with average total consolidated assets equal to or greater than $50 billion. As I've already mentioned, larger, more complex institutions tend to pose greater systemic risk, which is why heightened expectations are warranted.

What may be fueling community bank concerns is the additional language in the proposed guidelines that would allow the OCC to apply its heightened expectations to a bank with assets under $50 billion—but, as the proposal makes explicit, if and only if we determined that such a bank's operations were highly complex or presented such a heightened risk as to require compliance with the guidelines. This is a high threshold that only will be crossed in extraordinary circumstances.

Some community bankers may be reading that language as a loophole that we will use to impose onerous new requirements on community banks. I want to assure you that this is not the case and not our intent. I can promise that we will consider all the feedback we have received on this and other aspects of our proposal and make any necessary adjustments before the document goes final.

I also can assure you that the OCC will continue to supervise community banks in the manner that these banks have come to expect—as institutions with supervisory needs, both individually and as a group, that generally are very different from institutions many times their size.

Our supervisory structure and policies reflect those specific needs. The OCC tailors its resources and processes to the unique nature of each bank's risk profile, which prominently includes its risk management and governance capabilities. Our supervisory process identifies and evaluates the key risks facing each bank. We devise a supervisory strategy suitable to each bank's strengths and weaknesses. That generally means that OCC examiners will pay special attention to areas where risk might be elevated while spending less time in areas where risk is mitigated and well controlled. In a nutshell, the OCC's approach to community bank supervision is balanced, tailored, and expert.

Similarly, in implementing the regulatory requirements that arose from the Dodd-Frank Act, we have made a serious effort to ensure that the rules did not saddle community banks with new requirements that would prove unnecessary to their condition or irrelevant to their mission.

For example, in formulating our rule on domestic capital, we took an approach that differentiated between large and community banks. Of course, the financial crisis demonstrated the value of more capital and better quality capital for all banks as a backstop against serious economic downturn. But we know that as a group, community banks historically maintained higher capital cushions than many large banks. A primary goal of our recent capital rules has been to strengthen and raise the capital that large banks must maintain. We also listened to the concerns that community bankers raised about how proposed changes on the treatment of residential mortgages and accumulated other comprehensive income, or AOCI, would have on their institutions and adopted a final rule that addressed these concerns.

To help community banks determine to what extent they were subject to the new capital rule, we produced a concise, two-page guide that summarized the requirements applicable to smaller institutions. To further assist community banks, the OCC, along with the Federal Reserve and the FDIC, have provided banks with a Regulatory Capital Estimation Tool.

The OCC has taken a similar approach on stress testing. The same thing that is true for capital standards is also true for stress testing: all banks are well advised to evaluate the adequacy of their financial resources and potential vulnerabilities under various financial scenarios, just as they are well advised to have strong capital. As we plainly noted in our recent guidance on the Dodd-Frank stress-testing requirements, banks with $10 billion or less are exempt from those stress-testing requirements. However, we recognize that stress testing can be a valuable tool and thus in 2012 we provided guidance on stress testing that was tailored to community banks and have provided national banks and Federal savings associations with simple tools to help them analyze their loan portfolios.

This brings me back to our heightened expectations guidelines. The fact is, in the wake of the financial crisis, more is expected of U.S. financial institutions of all sizes in terms of their operational and financial probity. It’s also fair to say that the American people have “heightened expectations” for us as regulators, to do our job in a way that keeps the banking system safe and sound and avoids anything like what the country endured in the last decade.

To that end, we want all banks, including community banks, to maintain strong capital and to take advantage of the analytical tools that can help them prepare for an uncertain future. We also want them to focus on having risk management capabilities commensurate with their size and complexity. And we want to them to do all the things we associate with strong corporate governance, especially in regard to the responsibilities and capabilities of their boards of directors. We will continue to evaluate how well banks are performing these essential aspects of their mission. I do not believe that any responsible banker would want it any other way.

Bank supervision is all about balance—about focusing our efforts where they are needed and avoid imposing undue burden on institutions that pose little or no overall risk to safety and soundness. Finding this balance can be difficult. At the OCC, we are committed to the pursuit.

Thank you.