Comptroller’s Viewpoint

The national banks and federal savings associations that compose the federal banking system are the backbone of a strong national economy, so I am pleased to report that the federal banking system has recovered significantly since the 2008 financial crisis and that it continues to grow stronger by the day. The men and women of the OCC have played an important role in that recovery, and this Annual Report details the steps we have taken to strengthen national banks, ranging from the smallest community banks and thrifts to the multi-trillion dollar institutions that are among the world’s largest financial companies. While these institutions are very different in terms of size, complexity, and business focus, each plays a vital role in our nation’s economic life. It is critical that they all remain safe and sound and able to serve their communities.

When reading this report, I hope you’ll take note of the wide range of activities under way at the OCC that aim to ensure safety and soundness. These activities include work on leveraged lending, derivatives, Bank Secrecy Act compliance, and efforts to contain the risk to banks—and limit the impact on consumers—of home equity lines of credit that are reaching their end-of-draw period.

In this message, I want to focus on four of my top priorities: cybersecurity, our heightened standards for large institutions, the relationship between healthy organizational culture and sound risk management practices, and the work we are doing to implement the recommendations from our international peer review.

Cybersecurity has been much in the news lately, but it has been at the top of my agenda since my early months at the OCC. We have taken a number of steps to improve readiness, not just among the federal institutions we supervise, but also across the industry as a whole.

As chairman of the FFIEC, which brings together all of the bank, thrift, and credit union regulatory agencies, I called for—and the council concurred in—the creation of the Cybersecurity and Critical Infrastructure Working Group. The working group has been quite active and was responsible for issuances alerting banks and the public to the “Heartbleed” vulnerability and attacks on automated teller machines, among other issues. The working group also hosted a widely attended webinar for community bankers on cyber issues. One important initiative was a pilot project to assess the cybersecurity readiness of a sample of institutions supervised by FFIEC member agencies. This pilot will help member agencies make informed decisions about ways to enhance the effectiveness of cybersecurity-related supervisory programs, guidance, and examiner training. It will also help supervisors and bankers identify actions that can strengthen the industry’s overall preparedness and its ability to address the growing level and evolving nature of threats to systems and data.

Each agency has its own programs to address cybersecurity in the institutions it supervises. But
collective action through the FFIEC is of special value in helping all banks and thrifts, and community institutions in particular. Large banks are attractive targets for hackers, and those institutions have sophisticated and well-funded programs in place to address threats. Smaller financial institutions need to take advantage of every option available, including support from the OCC and other regulators, to address cybersecurity threats. We have responded to that need not only as an agency but also through the FFIEC, with informational bulletins, alerts, supervisory support, webinars, and other programs.

It is important to keep in mind, however, just how complex and interconnected the financial system has become. Complexity and interdependence create opportunities for cyber attackers to gain access to the systems of financial institutions and the third-party vendors that provide services to the industry. Not only do financial institutions need to have good controls over their own systems, they also need to monitor carefully the ways in which they connect to third-party vendors, how those vendors manage their systems, and how they connect to still other third parties. Financial institutions need to be aware of ways in which even their own employees may create opportunities to compromise systems, by introducing personal (and possibly corrupted) devices into bank networks. In a highly interconnected environment, it can be very difficult to identify and address all of the potential vulnerabilities a bank might face.

At the OCC, we face many of the same cybersecurity issues as the banks and thrifts we supervise, and we are working every day to address potential vulnerabilities in our own system. Clearly, staying ahead of cyber criminals requires constant vigilance.

While we are working to improve the readiness of all banks in the area of cybersecurity, we are also raising the bar for management and corporate governance in the largest and most systemically important banks and thrifts we supervise. The financial crisis and subsequent events revealed a number of problems at the nation’s largest institutions as well as weaknesses among the bank regulatory agencies. Because the large banks supervised by the OCC have such an outsized effect on the economy, we have focused heavily on implementing new and more robust standards for them. These heightened standards, which we initially termed “heightened expectations,” were translated into formal guidelines during this fiscal year.

Our guidelines are aimed at ensuring that banks have the risk management framework and board oversight needed to address the whole range of risks that banks face, including cyber and other operational risks. The principles in the guidelines will help banks avoid some of the problems that we saw in the years just before and after the financial crisis.

The guidelines require each large institution to define its capacity and appetite for risk and to establish a framework to ensure that risk is being properly controlled within those approved appetite limits. Embedded in the new guidelines is the expectation that the risk management and control functions at the large banks covered by the rules are sufficiently robust for each institution’s size, complexity, and risk profile. Each bank is expected to ensure that its risk profile is easily distinguished and separate from its parent company for risk management and supervisory reporting purposes and that the safety and soundness of the bank is not jeopardized by its parent company’s decisions. A bank’s board of directors is expected to hold management accountable for meeting these standards, and, when necessary, provide a credible challenge to management.

These are significant objectives, and we all recognize that we will not achieve them overnight. We have been pressing these standards, however, for four years. I am pleased that the large banks and thrifts we supervise have made substantial improvements to their governance and risk management practices as a result. Those improvements have made the industry much stronger and better able to withstand financial stress.

Of course, no set of standards can cover every eventuality. Our guidelines are very specific about the standards we expect our largest institutions to meet, but it is impossible for regulators to anticipate and prescribe a remedy for every situation that might eventually pose a problem for a large institution. For that matter, it’s unrealistic to believe that senior management and boards of directors can lay down rules to guide employee action in every situation that might arise. What is possible, though—and,
frankly, more effective—is for senior management to foster a strong and healthy risk culture that promotes responsible business practices, guards against excessive or improper risk taking, and encourages employees to act in the best interests of the whole organization and its customers.

A healthy culture starts at the top. The tone set by the bank’s senior leadership tells employees they are expected to behave responsibly and ethically, to put the long-term interests of the organization above their own, and to treat customers fairly. In that sense, a strong risk culture is really the beacon that guides employees to behave responsibly, knowing that they will have the support and approval of their superiors and their colleagues. When that beacon goes dark, an organization can lose its direction. Without a strong risk culture, a bank might enter new markets or introduce new products without proper due diligence. It might lose sight of the risks of pursuing earnings and growth at any cost. And the absence of a strong risk culture can lead employees to subordinate ethical considerations or the interests of the organization to their own compensation.

The strength of an organization’s risk culture is not easy for regulators to measure. It’s not like credit quality or earnings strength. But it is important, because it has an incredibly powerful influence on risk decisions and behaviors at all levels of an organization. We at the OCC are looking to boards of directors and the senior management of the large banks we supervise—in fact, of all banks—to set the tone at the top that leads to a healthy organizational culture that discourages improper practices and excessive risk taking.

All of that, and more, applies to the OCC. Even as we are asking more of the large banks we supervise, we are also asking more of ourselves. The financial crisis revealed opportunities to strengthen our supervisory processes, so last year we invited a group of regulators from three countries to take a hard look at our supervisory work and offer recommendations for how we might improve. This was not an easy process; being evaluated by one’s peers can be uncomfortable. But in the wake of the financial crisis, which did so much damage to so many households, businesses, and communities, we couldn’t do less.

To be clear, I believe the OCC performed as well and perhaps better than most of our fellow regulators during that difficult time. Of course, that is cold comfort when one considers the extent of the damage caused by the financial crisis. The fact is that we all fell short, and we all have an obligation to do everything we can to improve.

The peer review committee was composed of senior supervisors from Australia, Canada, and Singapore—three countries that proved especially resilient during the financial crisis. It was led by long-time U.S. and international regulator Jonathan Fiechter. The committee found much to like about our approach to supervision. The committee also found areas where it thought we could improve, and it made a number of helpful recommendations. For example, the committee encouraged us to expand our program of lead experts and recommended that we implement a rotation program to limit the time examiners spend at any one bank. It also offered suggestions on enhancing the interagency CAMELS rating system to give banks greater directional guidance and to make the ratings more forward-looking. We set up a working group of senior staff to review these and the other recommendations made in the peer review committee’s report and to oversee the implementation of needed changes. This is an ongoing process, and we have made a strong start.

We also recognized that the ability of the federal banking system to fulfill its role in helping to maintain a strong U.S. economy depends on the dedication and professionalism of every person at the OCC. As we finalize rules developed in response to the crisis and work to implement the supervisory peer review recommendations, we recognize that we must have the foresight, resolve, and capability to identify, understand, and manage the emerging challenges facing the industry and our agency.
Our new strategic plan provides a framework for meeting that need. The plan speaks to core values that harken back to the earliest days of the agency’s existence, among them, integrity, expertise, and independence. One additional core value that has become increasingly important as the banking industry has grown in size and complexity is collaboration, both internal and external. We are more effective working as part of a team than we can be working alone.

The strategic plan sets three broad goals and provides objectives and strategies to implement them. One of our goals highlights our determination to foster a vibrant and diverse system of national banks and federal savings associations that supports a robust U.S. economy. Another speaks to our determination to continue to operate independently and effectively into the future, and a third highlights the importance of “One OCC,” focused on collaboration, innovation, coordination, and process efficiency.

This strategic plan provides the framework for many of our initiatives, including implementation of the peer review recommendations, that will ensure the OCC continues to be ready to meet the needs of an evolving economy and federal banking system. While it is never easy to challenge or change the way an agency or business works, OCC employees embraced the peer review process and are implementing the recommendations enthusiastically. My hope is that senior management at the large banks we supervise will take the same path—not just complying with our heightened standards but also actively embracing them and conveying to employees that they represent management’s expectations as well as those of the OCC.

This report highlights the actions we took over the past year to ensure that banks operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. But neither we nor the banks we supervise can rest on our achievements. It takes continuous effort to strengthen the reputation and resiliency of the banking system and prevent practices and cultures that foster imprudent and excessive risk taking.

The first Comptroller of the Currency, Hugh McCulloch, encouraged bankers to “pursue a straightforward, upright, legitimate banking business,” never being “tempted by the prospect of large returns to do anything but what may be properly done” under the law. This was good advice in 1863, and it is good advice today. Banking is still a business founded on confidence and character. When those qualities are absent, it causes trouble—not just for banks, but for the households, businesses, and communities that depend on a healthy banking system and falter in its absence.

McCulloch’s principles are simple and straightforward, and they provide the basis for every financial institution to develop a strong risk culture. It is my expectation that every national bank and federal savings association will take these principles to heart, so that their employees will engage in responsible business practices and avoid excessive risk taking, for the simple reason that they know that is what management and their colleagues expect of them. McCulloch’s words provide the basis not only for a healthy corporate culture but also for a safe and sound federal banking system that serves the people, the communities, and the economy of the United States.

Thomas J. Curry
Comptroller of the Currency